No. 2014-30
27 August 2014

Technical Line

FASB — final guidance

The new revenue recognition standard — power and utilities

It is not clear how revenue from tariff sales will be affected by the new standard.

What you need to know

- The new revenue recognition standard is more principles-based than current revenue guidance and will require power and utilities entities to exercise more judgment.
- The key issues for the industry include determining how the standard applies to rate-regulated activities and identifying performance obligations, estimating variable consideration and accounting for contract modifications.
- Power and utilities entities may have to change their processes and information systems to capture information they will need to apply the standard and make required disclosures.
- The standard is effective for public entities for fiscal years beginning after 15 December 2016, including interim periods within those years, and for nonpublic entities in years beginning after 15 December 2017.

Overview

Power and utilities (P&U) entities may need to change certain revenue recognition practices as a result of the new revenue recognition standard jointly issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS. The FASB, however, retained guidance on alternative revenue programs and revenue collected subject to refund that rate-regulated entities use today.

The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements, such

Building a better working world

as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate.

Our Technical Line, *A closer look at the new revenue recognition standard* (SCORE No. BB2771), provides an in-depth discussion of the new revenue standard. This publication summarizes certain key implications for P&U entities.

P&U entities also may want to monitor the discussions of both the Boards' Joint Transition Resource Group for Revenue Recognition (TRG) and a task force formed by the American Institute of Certified Public Accountants (AICPA) to focus on P&U issues. The Boards created the TRG to help them determine whether more implementation guidance or education is needed. The TRG won't make formal recommendations to the Boards or issue guidance. The AICPA's P&U industry task force is one of 16 industry task forces the AICPA has formed to help develop a new Accounting Guide on Revenue Recognition and to aid industry stakeholders in implementing the standard. Any views discussed by the TRG or guidance provided by the AICPA is non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyze the standard and entities begin to interpret it, and our views may evolve during that process. As our understanding of the standard evolves, we will update our guidance.

Key considerations

To apply the new standard, entities will need to change the way they evaluate many of their transactions, even if the amounts they report will not change significantly. P&U entities may need to apply significant judgment when they identify performance obligations, evaluate contracts with fixed and stepped pricing and account for contract modifications.

Further, it is unclear to what extent the standard applies to rates set or approved by a regulator, so rate-regulated entities will need to carefully consider whether their contracts fall within the scope of the new revenue guidance. The new standard will supersede the industry-specific guidance on long-term power sales arrangements currently in Accounting Standards Codification (ASC) 980, *Regulated Operations,* so nonutility power generation entities will apply the new standard to these arrangements.

Rate-regulated activities and alternative revenue programs

The new revenue standard will not apply to rate-regulated entities' alternative revenue programs that follow guidance in ASC 980. P&U entities with regulated operations will have to present revenues from alternative revenue programs separately from revenue they recognize under the new standard.

Alternative revenue programs generally don't result in contracts with customers because of the involvement of regulators in setting or approving rates. It is unclear based on the consequential amendments whether the FASB intended to expand the concept of alternative revenue programs to include all or a portion of tariffed base rates. The AICPA's P&U task force plans to discuss these issues.

Identifying performance obligations

For many P&U arrangements (e.g., take-or-pay contracts, long-term power purchase agreements), entities will have to carefully consider whether the individual units of the good or service delivered are separate performance obligations. For example, a contract may involve a promise to transfer a number of identical units of energy, typically as individual kilowatt-hours (kWh). Under the new standard, a series of distinct goods or services (such as each kWh) that is transferred consecutively is treated as a single performance obligation if the distinct goods or services are substantially the same and would be recognized over time using the same measure of progress. Because electricity generally is simultaneously provided and consumed, an electricity contract will likely meet these criteria. P&U entities will need to carefully consider whether contracts to provide other goods or services meet these criteria.

P&U entities must also evaluate whether there are other distinct goods and services in their contracts. For example, an energy contract may include a promise to make capacity available to the customer on demand, provide transmission services or deliver renewable energy emissions credits. Properly identifying the performance obligations in these contracts may be complex but will be critical because these determinations could drive the pattern of revenue recognition.

Fixed- and stepped-price arrangements

P&U entities will need to apply significant judgment when determining the performance obligations and estimating the standalone selling price for fixed- and stepped-price arrangements. These types of contracts typically include only one type of good or service (e.g., unit of energy, thermal unit of natural gas, waste services) that are sold in multiple units over a period of time. Entities with these types of contracts should carefully consider the contractual terms and evaluate the reasons for the price changes when identifying the performance obligations and determining how to allocate the transaction price to the performance obligations.

In certain cases, the new standard permits an entity to recognize revenue for the amount it has the right to bill.

Unlike contracts to deliver electricity, a contract to deliver some commodities may not meet the criteria to be satisfied over time and therefore may not meet the criteria to be considered a single performance obligation comprised of a series of goods or services. For example, an entity may enter into a natural gas sales contract with an industrial customer that stores the natural gas for later use rather than immediately consuming it. In these situations, entities may identify multiple performance obligations (e.g., each thermal unit). The new standard does not specify how to determine the standalone selling price (e.g., use a calculated value, a current market price or a forward price) for contracts that entities determine have separate performance obligations for each unit of the commodity. As a result, additional developments in this area are likely.

In certain cases, the new standard permits an entity to recognize revenue for the amount it has the right to bill, if that amount corresponds to the value it transfers to the customer. If a P&U entity qualifies for this practical expedient, it could recognize revenue in the same manner it does today (i.e., on an as-billed basis).

Blend and extend modifications

Contract modifications are common in the P&U industry. In many cases, a modification will extend the period of the contract and change the overall pricing. For example, a P&U entity may agree to extend the period of a contract and create a blended price for the remaining units to be delivered over the extended term. Today, P&U entities account for blend and extend modifications on a prospective basis by applying the new, contractual blended rate to all remaining units.

Under the standard, a P&U entity generally will account for a blend and extend modification prospectively because the goods or services provided after the modification are distinct from those previously provided under the contract. A P&U entity will only apply a blended rate to the remaining goods and services if the new goods or services are priced above or below the standalone selling price, which would indicate that an economic relationship exists between the original and modified contract. If a P&U entity determines that the price of the goods or services added in the modification is the standalone selling price, the modification will be treated as a separate contract, and the pattern of revenue recognition will differ from current practice. P&U entities may need to update their processes to analyze blend and extend modifications.

Sales of integral equipment

P&U entities that dispose of assets that today are considered integral equipment or in substance real estate (such as power plants or other utility infrastructure) and that are not considered sales to customers will have to follow the new model for derecognizing nonfinancial assets (including real estate) contained in ASC 610-20, *Other Income — Gains and Losses from Derecognition of Nonfinancial Assets*.

This guidance differs significantly from current real estate sales guidance. As a result, gains on sales of these assets may be recognized sooner than they are today. The amended guidance in ASC 360-10, *Property, Plant, and Equipment — Overall*, also indicates that there may be certain circumstances in which neither ASC 606, *Revenue from Contracts with Customers*, nor ASC 610-20 will be applied when derecognizing a nonfinancial asset. The sale of a subsidiary or group of assets to a noncustomer that meets both of the following requirements will be accounted for in accordance with the derecognition guidance in ASC 810, *Consolidation:*

- It is a business.
- It is also not an in substance nonfinancial asset (because the group of assets or subsidiary also contains significant financial assets).

Refer to our Technical Line that discusses the effect of the new revenue standard on contracts in the real estate industry for more information.

Next steps

- Entities should perform a preliminary assessment on how they will be affected as soon as possible so they can determine how to prepare to implement the new standard. While the effect on entities will vary, entities may face significant changes in revenue recognition. All entities will need to evaluate the requirements of the new standard and make sure they have processes and systems in place to collect the necessary information to implement the standard, even if their accounting results won't change significantly or at all.
- Entities also may want to monitor the discussions of the Boards, the Securities and Exchange Commission (SEC) staff, the TRG and the P&U industry task force formed by the AICPA to discuss interpretations and application of the new standard to common transactions.
- Public entities also should consider how they will communicate the changes with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards discussed in SEC Staff Accounting Bulletin (SAB) Topic 11.M. The SEC staff has indicated it expects an entity's disclosures to evolve in each reporting period as more information about the effects of the new standard becomes available, and the entity should disclose its transition method once it selects it.

SCORE No. BB2818

ey.com/us/accountinglink