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Setting new sights

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Accounting for the new revenue recognition standard

Allison Taylor, Senior Manager, Deloitte & Touche LLP
Teresa Thomas, Partner, Deloitte & Touche LLP

Agenda

Overview of ASC 606

Goals of the new standard

Convergence of revenue recognition principles under U.S. GAAP and IFRS

Improve revenue recognition requirements and disclosures

- Remove inconsistencies
- Provide a more robust framework
- Improve comparability
- Provide more useful information
- Eliminates industry-specific guidance

Effective date

Update
Deferral of effective date

- In August 2015, the Financial Accounting Standards Board (FASB) issued an ASU that defers the effective date of Accounting Standards Codification (ASC) 606 by one year.
  - Annual reporting periods beginning after December 15, 2017 (public)
  - Annual reporting periods beginning after December 15, 2018 (nonpublic)
- Additionally, the ASU allows entities to early adopt ASC 606 as of the original effective date (annual reporting periods beginning after 12/15/16, FY2017).

- In September 2015, the International Accounting Standards Board (IASB) issued an amendment to International Financial Reporting Standard (IFRS) 15 in order to defer the effective date by one year.
  - Annual reporting periods beginning on or after January 1, 2018
- The IASB continues to allow entities to early adopt IFRS 15.

Transition methods

Update
Practical expedient for contract modifications (FASB & IASB)

- Full retrospective approach
  - Restate prior periods in compliance with ASC 250
  - Optional practical expedients
- Modified retrospective approach
  - Apply revenue standard to contracts not completed as of effective date and record cumulative catch-up
  - Required disclosures:
    - Amount of each F/S line item affected in current period
    - Explanation of significant changes

cumulative catch-up

January 1, 2018 Initial application year	2018 Current year	2017 Prior year 1	2016 Prior year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch-up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

Transition methods

The following provides key observations and challenges for each approach:

	Full retrospective	Modified retrospective
Dual reporting requirements	• First two years will have to be restated	• Dual record-keeping required in the year of adoption
Comparability	• Present historical periods as applicable • Cumulative catch-up adjustment will be January 1, 2016	• No comparison for new standard • Cumulative catch-up adjustment will be January 1, 2018
System considerations	• Retrospective will require information be prepared and validated prior to January 2018. Such procedures "trial runs" will provide opportunity to fix potential unforeseen/unplanned challenges	• More time to develop a one-time transition plan with more runway to fix data and system challenges ahead of "go-live" on January 2018 • Trial runs likely will still be required but may not be as in-depth as with full retrospective
Transition relief requirements	• Provides relief for contracts with calendar-year terms • Provides relief for the "remaining performance obligations" disclosure requirement for contract longer than one year (*i.e.,* multiyear maintenance) • Contract modifications	• Disclose the amount by which each financial statement line item is affected by the new guidance for 2018 as compared to the prior/legacy guidance • Provide an explanation of the significant changes between applying the new guidance and prior/legacy guidance • Contract modifications

Transition considerations
SEC perspective

Five-year table

At the September 2014 Financial Accounting Standards Advisory Council (FASAC) meeting, the SEC staff clarified its views on how registrants would reflect their implementation of ASC 606 in the five-year table required under SEC Regulation S-K, Item 301

- The staff indicated that it would not object if a registrant reflected its adoption of the new revenue standard in the five-year table on a basis that is consistent with the adoption in its financial statements (i.e., reflected in less than each of the five years in the table)
- A registrant could present in the five-year table:
  - Only the most recent three years if the registrant uses the full retrospective method to adopt the new revenue standard
  - Only the most recent fiscal year if it uses the modified transition basis

Regardless of the transition method adopted, registrants would be expected to disclose the method they used to reflect the information (e.g., how the periods are affected) and that the periods are not comparable

But also…

- SAB Topic 11.M transition disclosures
- Requirement for revised financial statements in a registration statement (i.e., a “fourth year”)
- ASU 2016-11 rescinds ASC 932-10-S99-5 on balancing arrangements
- ICFR implications

New revenue guidance
The five-step model

Core principle: Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services

Identify the contract with a customer
(Step 1)

Identify the performance obligations in the contract
(Step 2)

Determine the transaction price
(Step 3)

Allocate the transaction price to performance obligations
(Step 4)

Recognize revenue when (or as) the entity satisfies a performance obligation
(Step 5)

This revenue recognition model is based on a control approach, which differs from the risks and rewards approach applied under current U.S. GAAP

High-level ASC 606 five step approach

Step 1: Identify the contract	A contract is an agreement between two or more parties that creates enforceable rights and obligations. • A contract should meet the following criteria: – (a) approval & commitment; (b) identification of rights; (c) identify payment terms; (d) contract has commercial substance; and (e) collection is probable
Step 2: Identify the performance obligation (PO)	A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. If an entity promises in a contract to transfer more than one good or service to the customer, the entity should account for each promised good or service as a performance obligation only if it is (1) distinct or (2) a series of distinct goods or services that are substantially the same and have the same pattern of transfer.
Step 3: Determine the transaction price	The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. • Consider the effects of: – (a) variable consideration; (b) constraining estimates, (c) existence of significant financing component; (d) non-cash consideration; and (e) consideration payable to the customer
Step 4: Allocate the transaction price to the POs	When more than one performance obligation exists allocate the transaction price to each PO. To allocate an appropriate amount of consideration to each PO, an entity must determine the standalone selling price at contract inception of the distinct goods or services underlying each PO and would typically allocate the transaction price on a relative standalone selling price basis.
Step 5: Recognize revenue	Recognize revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. For each PO, determine whether the entity satisfies the PO over time by transferring control of a good or service over time. If an entity does not satisfy a PO over time, the PO is satisfied at a point in time.

Disclosures (ASC 606 & IFRS 15) Overview

Disclosures about contracts with customers

- Disaggregation of revenue
- Information about contract balances
- Information about performance obligations
- Remaining performance obligations

Disclosures about significant judgments and estimates

- Description of significant judgments
- Transaction price, allocation methods and assumptions

Other required disclosures

- Practical expedients
- Contract costs

Interim only disclosures

- ASC 270, *Interim Reporting*
- IAS 34, *Interim Financial Reporting**

* IAS 34 was only amended to require disaggregated revenue information; none of the other annual disclosures will be required in interim financial statements for IFRS preparers. Refer to the following slides for information regarding FASB requirements for interim revenue disclosures

Industry task force Implementation update

Industry task force implementation update

Industry task force focus areas	Considerations	Status
Tariff-based sales	• Scope clarification • Carve out of alternative revenue programs	• Task force consensus that tariff-based sales are in scope • RRWG and FinREC agreed with task force consensus • Next step is public exposure
Blend-and-extend contract modifications	• Does a B&E modification represent a new agreement or a separate extension? • If a separate extension, is a financing element present?	• Task force did not reach consensus on B&E treatment • Issue was elevated to the FASB staff for a Technical Inquiry • FASB staff believes both views can be supported
Step vs. strip pricing	• Can same performance result in different revenue profiles?	• Task force consensus that different revenue profiles can be supported • RRWG agreed–next step FinREC

Industry task force implementation update

Industry task force focus areas	Considerations	Status
Variable consideration	• Dealing with various forms of price and volume variability • Application of the constraint guidance	• General view that many forms of price variability can be linked to discrete delivery of power • Task force view that volume variability will often represent optional purchases (e.g., requirements contract)
Partial terminations	• Timing of P&L–Immediate or over remaining term?	• Task force consensus differs from Big 4 feedback • Issue to be elevated to RRWG
Bundled arrangements (e.g., PPAs)	• Identification of separate performance obligations • Allocation of transaction price • Timing of revenue (customer control)	• Task force consensus on treatment • Focus on items that do not transfer to customer contemporaneously • Consideration of level of integration of products/services • Separate analysis of RECs and capacity

Industry task force implementation update

Industry task force focus areas	Considerations	Status
Sales of RECs	• Eligible to be accounted for as a series? • Transfer of control upon generation of electricity or certification?	• Consensus reached at March meeting • Recognition of revenue upon generation • Paper being finalized for RRWG consideration
Sales of capacity	• Stand ready = service • Application of the series guidance • Time-based measure of progress	• Consensus reached at March meeting • Focus on series guidance and ability to apply Invoice PE • Paper being finalized for RRWG consideration
Contributions in aid of construction	• Revenue vs. offset to PP&E	• Task force reached consensus at March meeting that CIAC is not revenue • Discussions with the RRWG on-going

Industry task force
Implementation update

Industry task force focus areas	Considerations	Status
SASP for commodities	• Alternatives to the forward curve? • Replaced “series for storable commodities” issue	• FASB staff completed TI • Forward curve not required in many cases • Next step–debrief TI with RRWG and FinREC
Collectability–Sales to low credit quality customers	• Ability to socialize credit losses through rates • Price concession?	• Added to TF agenda at March meeting • Issue paper being developed
Alternative Revenue Programs	• Presentation of revenue when billed through tariff	• Added to TF agenda at March meeting • Issue paper being developed
Sales of non-financial assets	• Replacing real estate sale rules • Partial sales–unit of account?	• FASB issued proposed ASU in June which addresses partial sales of non-financial assets • Task force may not address

Implementation overview

Revenue recognition—Preparing for the changes

The following summarizes some important near-term actions and decisions that companies will likely need to undertake, given the timeline:

Near-term actions

- Analyze impact of standards on business units and revenue streams
- Develop project plan and roadmap
- Analyze pro forma effect on financial statements
- Determine and resolve specific accounting and tax issues
- Design system solutions, where needed
- Evaluate impact on periodic financial processes

Important decisions

- Transition method
- Contract vs. portfolio approach
- System solutions
- Accounting policy choices

Common implementation steps
Companies implementing new revenue standard focusing on:

Step	Description
Assessment	• Identify and pinpoint key issues to business groups/units • Assessment of process and system implications • Development of project roadmap and business group/unit analysis efforts
Scenario development	• Analysis of key contract types, in areas where revenue accounting will likely change • Analyze the impact for originating transactions and modifications
Business requirements development	• Presentation and documentation of key requirements for any system changes required • Identification of affected billing or ledger systems, and data requirements
Functional requirements development	• Development of granular accounting calculation rules (where required) • Development of precise data field definitions
Design, development and testing of needed systems adjustments	• Focused design and coding development, to automate any key calculation differences required by the new revenue rules • Acceptance testing to help support consistency with accounting requirements • Design of a process to identify and analyze new sales offerings/contract types for consideration under the new revenue accounting rules

Implementation activities by workstreams
New standard requires broad project plans which may include the following:

	Activity	
Technical accounting	• Assessment ("sprint") effort • Scenario documentation • Business requirements • Accounting policy documentation • Finalize transition plan	• Auditor concurrence on accounting policies and scenarios • User acceptance testing • Prepare draft disclosures • Draft financial statements
Data and systems development	• Systems design and architecture • Systems solution development • Systems testing	• Development and stabilization • Post-implementation review
Process/close and report	• Reporting controls/reconciliation • Monthly close process	• Controls implementation review • Draft reporting process development
Readiness and training	• Design and develop training program	• Roll out training
Tax	• Evaluate tax reporting requirements • Tax reporting implementation	• Tax planning/reporting process enhancements
Program management	• Form implementation team • Communicate to audit committee	• Update stakeholders/audit committee

Potential implementation challenges and pitfalls

Overview of potential key system challenges

The following provides several potential system related issues in implementation of the revenue recognition standard for companies.

Issue	Description
1. Disparate systems/multiple source data systems	• Many entities perform revenue allocation in disparate systems with inconsistent data; as a result of the implementation of the standard, data stress levels will rise and companies may want to consider an automated tool or customization as part of the implementation solution
2. Significant use of spreadsheets in process	• Many entities, especially if acquisitive, rely on use of spreadsheets to manage revenue; the requirements of the standard may add complexities to those manual processes • Entities may want to consider a bolt-on revenue recognition tool or customizing current system
3. Performance obligations	• Recording and tracking revenue for each performance obligation or contract in the sales or billing cycle may not be available in current systems • System requirements may need to include the ability to reallocate revenue to completed performance obligations when changes in estimate of a variable transaction price occur
4. Disclosures	• Most changes for disclosure will require changes to the structure and data elements needed for the month-end reports

Overview of potential key data and process impacts

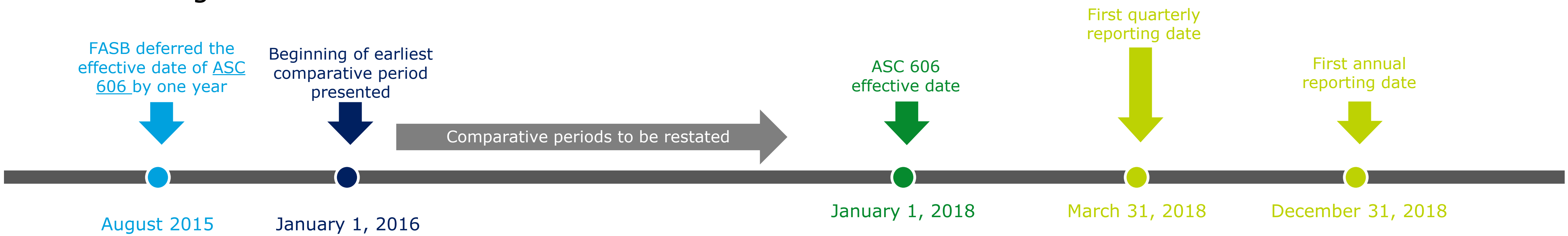
The following provides several potential data and process impacts related to implementation of the revenue recognition standard for companies.

Issue	Description
1. Recognition: distinct criteria	• Significant judgment may be needed when determining whether the goods or services are distinct within the context of the standard; as a result, policies and processes may need to be revised and/or developed
2. Recognition: performance obligations	• The guidance may increase the number of performance obligations within the contract or arrangements and may result in an increase to the number of data elements required to be captured
3. Initial measurement: time value of money	• Given that when determining the transaction price, an entity should adjust the amount of promised consideration for the effects of the time value of money (if the contract has a significant finance component), processes may need to be developed and data elements captured to satisfy the requirement
4. Allocation	• An entity will likely be less constrained by the new allocation requirements for revenue recognition but may need to use more judgment around estimating the stand alone selling price for allocation; as a result, policies and process may need to be revised and/or developed to meet the new requirements

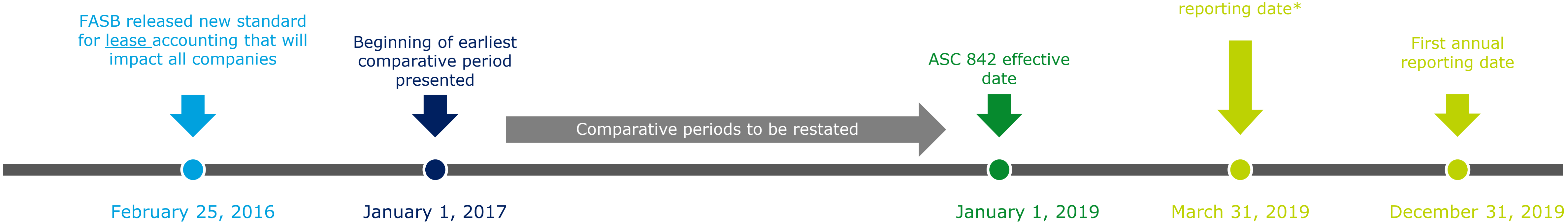
Interaction between ASC 842 and ASC 606

Comparing transition timelines

Revenue recognition



Lease



**Assuming early adoption is not elected*

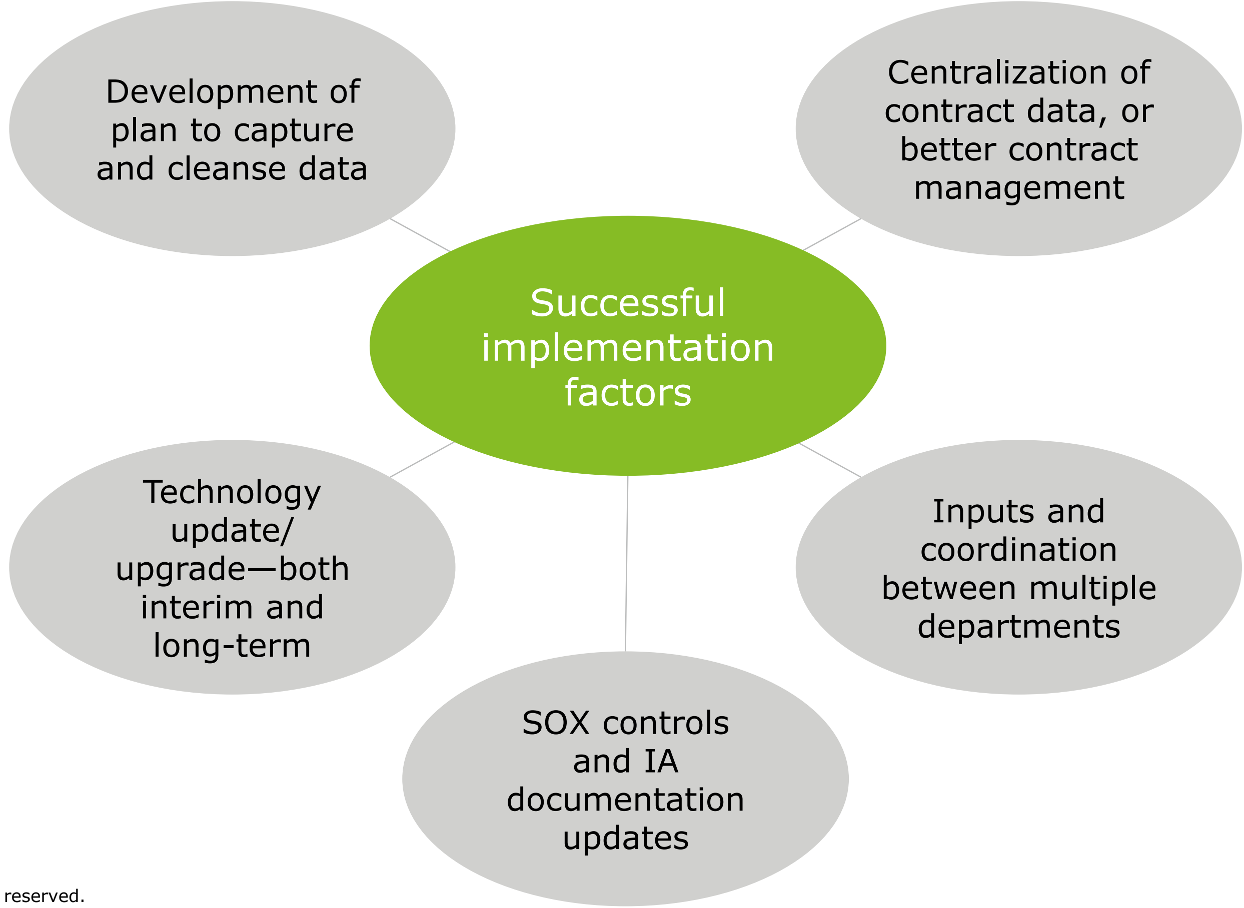
Interaction between ASC 842 and ASC 606
Lessor accounting and revenue accounting

New lessor guidance aligned with the FASB's new revenue standard in many respects

- Sale treatment linked to lessee control of underlying asset
- Lease modifications accounted for in a manner similar to the modification guidance in ASC 606
- Sale recognition depends on whether collectibility of the lease payments plus the residual value guarantee is probable
- Determination of initial direct costs linked to incremental costs of obtaining a contract in ASC 606
- Must consider guidance in ASC 606 when determining how to allocate payments between lease and non-lease components

Interaction between ASC 842 and ASC 606
Operational considerations

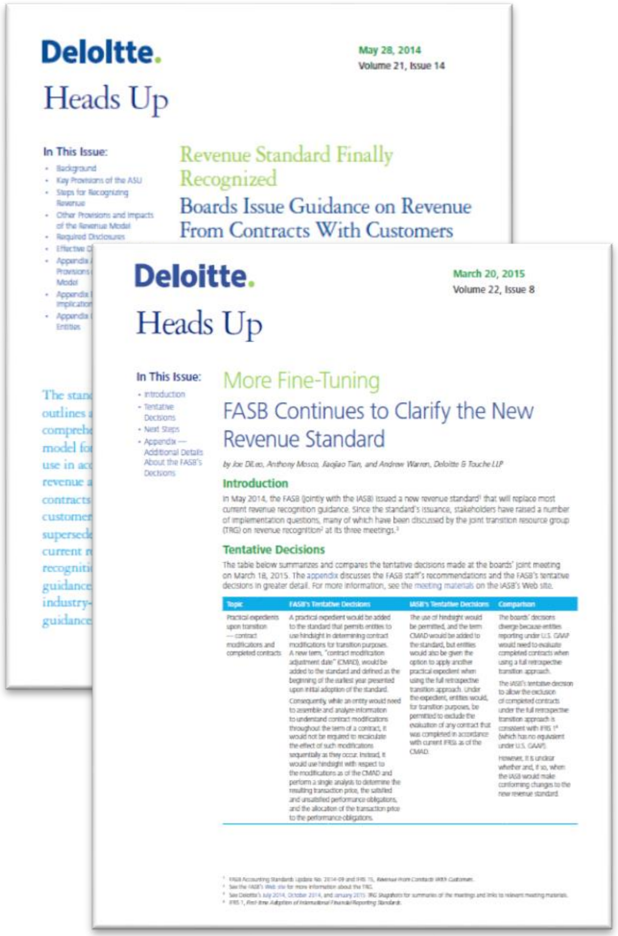
Successful implementation of ASC 606 and ASC 842 requires similar operational consideration, especially around data capture and process flow. There are synergies between the two implementation projects.



Resources

Resources

- Heads Up—Boards Issue Guidance on Revenue From Contracts With Customers
- Heads Up—Real Estate Sales Under the New ASU
- TRG Snapshot
- Industry Spotlight Series
- Revenue From Contracts With Customers: A Roadmap to Applying the Guidance in ASU 2014-09
- Heads Up—FASB Issues Proposed ASU on Licensing and Identifying Performance Obligations
- Heads Up—FASB Confirms Decision to Defer Effective Date of New Revenue Standard by One Year
- Framework for Adoption of ASU 2014-09 – Practice Aid
- Refer to the New Revenue Recognition Standard Resource Center for a comprehensive summary of internal resources and contacts:
- https://audit.deloitteresources.com/revrec/Pages/Home.aspx



Contact

Allison Taylor
Deloitte & Touche LLP
alltaylor@deloitte.com

Teresa Thomas
Deloitte & Touche LLP
tethomas@deloitte.com