



# Energy Accounting, Financial Reporting, and SEC Update

Christine Davine  
Partner  
Deloitte & Touche LLP

James Barker  
Partner  
Deloitte & Touche LLP

George Fackler  
Partner  
Deloitte & Touche LLP



**Deloitte.**

# SEC Environment & Rulemaking

- Political environment
- Strong enforcement program
- Dodd-Frank and JOBS Acts
- Disclosure effectiveness
- Implementation of new revenue recognition standard
- IFRS
- Audit committee report concept release
- PCAOB standard setting agenda
- Cybersecurity

# Enforcement

	FY 2015	FY 2014	FY2013
Number of enforcement actions	807	755	676
Orders for penalties and disgorgements	\$4.2 billion	\$4.2 billion	\$3.4 billion
Whistleblower tips received	3,923	3,620	3,238

## Policy-related initiatives

- Admission of wrong-doing
- “Broken windows” policy

## Financial Reporting and Audit Task Force

- Identify violations related to financial statements, reporting and disclosures, and audit failures
- Monitor restatement activities and analyze industry performance trends
- Use of technology and tools for “data mining” and data analysis

# SEC review process

About 9,000 registrants

Focus on 2,500 registrants that comprise 98% of market cap

All issuers reviewed at least 1 out of every 3 years

Percentage of issuers reviewed:

FY10	FY11	FY12	FY13	FY14	FY15
44%	48%	48%	52%	52%	51%

Staff review is not limited to “four corners of the document” – may listen to analyst/earnings calls, review press releases, websites, etc. and issue comments

Comments are posted to EDGAR 20 days after completion of review

# Disclosure Effectiveness

## What is it?

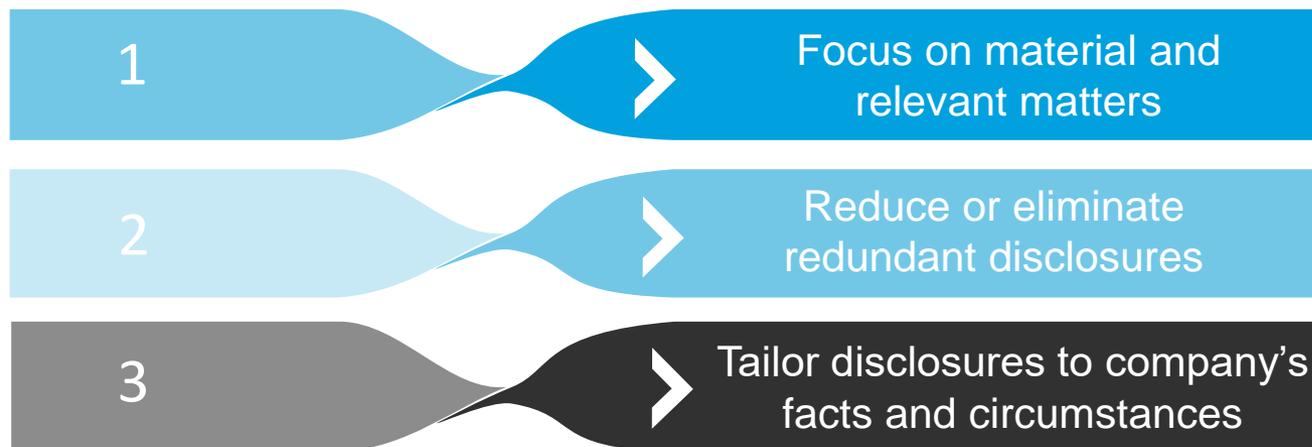
- Providing better information to investors – more understandable, more useful and eliminating excessive disclosure
- Could result in additional disclosure

## What has the SEC staff done lately?

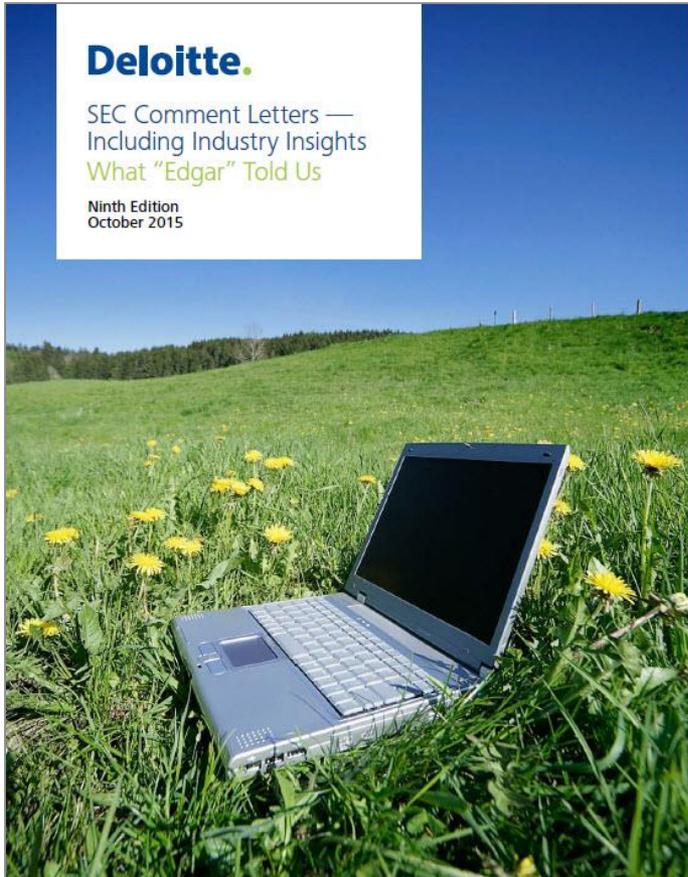
- Request for comment on financial disclosures about entities other than the registrant
- S-K concept release – comments due July 21, 2016

## What's next?

- Staff to make specific recommendations including input from issuers and investors



# SEC Comment Letter Trends



Insights into areas the SEC staff has focused on in recent comment letters including:

- Financial Statement Accounting and Disclosure Topics
- SEC Disclosure Topics
- Disclosure Topics in Initial Public Offerings
- Industry-Specific Topics
  - Consumer & Industrial Products
  - **Energy & Resources**
  - Financial Services
  - Health Sciences
  - Technology & Telecommunications

# SEC Comment Letter Trends: Overall Summary

Topic	12 Months- 7/31/15		12 Months- 7/31/14	
	Rank	Frequency*	Rank	Frequency*
MD&A: <ul style="list-style-type: none"> <li>• Results of operations</li> <li>• Liquidity issues</li> <li>• Critical accounting policies, estimates</li> </ul>	<b>1</b>	23%	<b>1</b>	23%
		11%		15%
		9%		11%
Fair value measurement, estimates	<b>2</b>	22%	<b>2</b>	25%
Revenue recognition	<b>3</b>	15%	<b>4</b>	14%
Non-GAAP measures	<b>4</b>	14%	<b>6</b>	13%
Signatures, exhibits, agreements	<b>5</b>	12%	<b>3</b>	17%
Income taxes	<b>6</b>	11%	<b>5</b>	13%
Segment reporting	<b>7</b>	10%	<b>10</b>	10%
Acquisitions, mergers, business combinations	<b>8</b>	10%	<b>7</b>	12%
Property, plant, and equipment; intangible assets; and goodwill	<b>9</b>	9%	<b>8</b>	11%
Debt, warrants, equity securities	<b>10</b>	8%	<b>11</b>	10%

\* Percentage of all 10-Ks and 10-Q comment letter-yielding reviews that included at least one comment on the respective topic.

# SEC Comment Letter Trends

## Power and Utilities

- Dividend restrictions
  - Footnote disclosures
    - Schedule of parent company financial information
- Accounting for impacts of ratemaking
- Regulatory disallowance of PP&E
- Identification of possible phase-in plans

# Non-GAAP Measures

## Considerations

- Cannot be misleading
  - Nature of adjustments (elimination of normal recurring operating expenses, “cherry picking”, non-GAAP revenue)
  - Liquidity per share amounts
- Not more prominent than GAAP measure
- Appropriately defined, described, labeled and reconciled
- Substantive disclosure about why useful and purpose
- Income tax effects of adjustments
- Consistency between periods and comparable to peers
- Disclosure controls and procedures
- Audit Committee oversight

## Metrics

- Energy: Price and volume detail

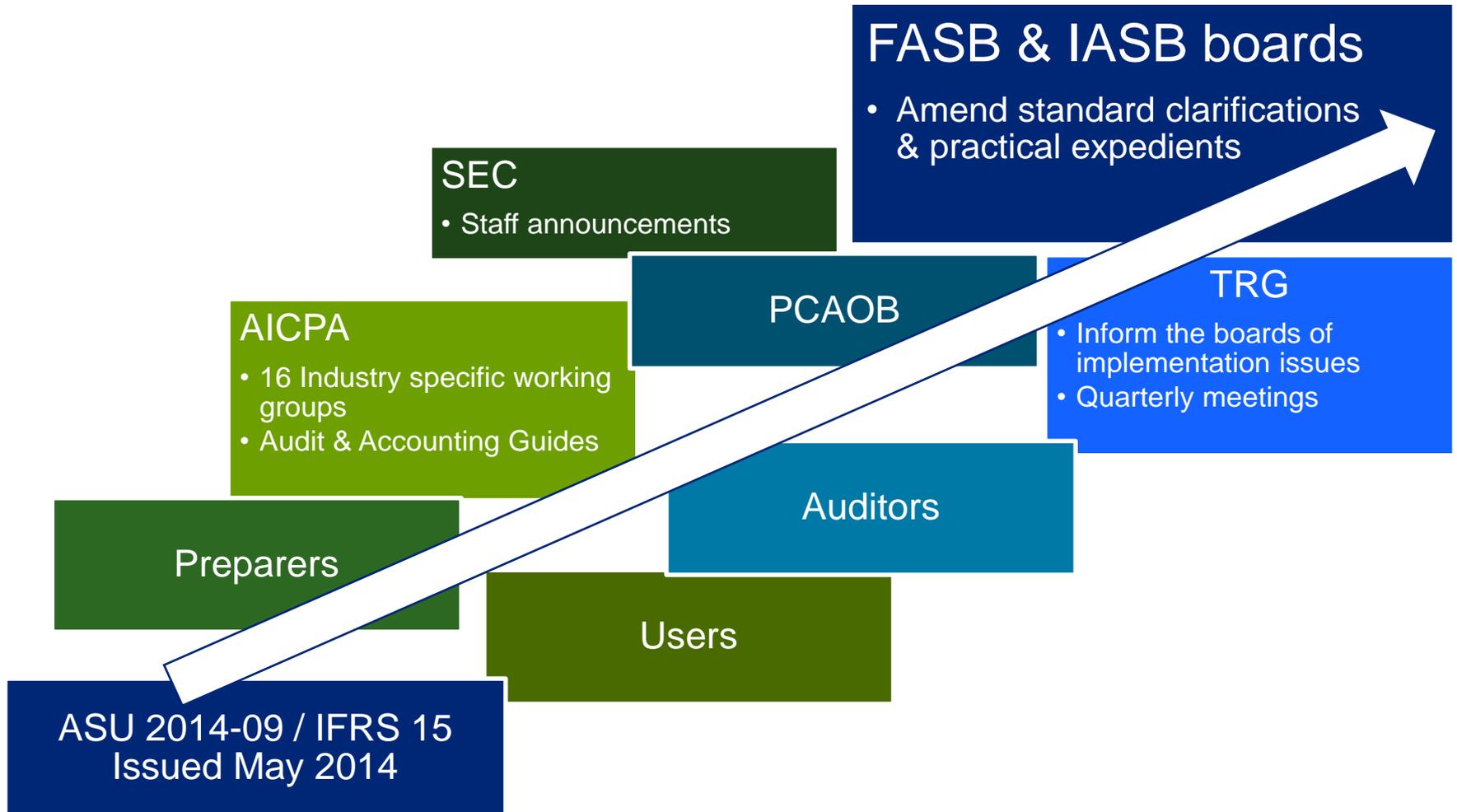


Questions?

# Update on Power and Utility Revenue Recognition Implementation Efforts



# Implementation efforts — Key participants



# New revenue guidance

AICPA working groups

**Purpose — To analyze implementation issues and develop a new Accounting Guide (16 industry teams)**

- [Aerospace and defense](#)
- [Airlines](#)
- [Asset management](#)
- [Broker-dealers](#)
- [Construction contractors](#)
- [Depository institutions](#)
- [Gaming](#)
- [Health care](#)
- [Insurance](#)
- [Not-for-profit](#)
- [Oil and gas](#)
- [Power and utility](#)
- [Software](#)
- [Telecommunications](#)
- [Timeshare](#)
- [Hospitality](#)

# P&U Task Force

## Implementation Update

Industry Task Force Focus Areas	Considerations	Status
Tariff-based sales	<ul style="list-style-type: none"><li>• Scope clarification</li><li>• Carve out of alternative revenue programs</li></ul>	<ul style="list-style-type: none"><li>• Task force consensus that tariff-based sales are in scope</li><li>• RRWG and FinREC agreed with task force consensus</li><li>• Next step is public exposure</li></ul>
Blend-and-extend contract modifications	<ul style="list-style-type: none"><li>• Does a B&amp;E modification represent a new agreement or a separate extension?</li><li>• If a separate extension, is a financing element present?</li></ul>	<ul style="list-style-type: none"><li>• Task force did not reach consensus on B&amp;E treatment</li><li>• Issue was elevated to the FASB staff for a Technical Inquiry</li><li>• FASB staff believes both views can be supported</li></ul>
Step vs. Strip Pricing	<ul style="list-style-type: none"><li>• Can same performance result in different revenue profiles?</li></ul>	<ul style="list-style-type: none"><li>• Task force consensus that different revenue profiles can be supported</li><li>• RRWG agreed – next step FinREC</li></ul>

# P&U Task Force

## Implementation Update

Industry Task Force Focus Areas	Considerations	Status
Variable consideration	<ul style="list-style-type: none"><li>• Dealing with various forms of price and volume variability</li><li>• Application of the constraint guidance</li></ul>	<ul style="list-style-type: none"><li>• General view that many forms of price variability can be linked to discrete delivery of power</li><li>• Task force view that volume variability will often represent optional purchases (e.g. requirements contract)</li></ul>
Partial Terminations	<ul style="list-style-type: none"><li>• Timing of P&amp;L – Immediate or over remaining term?</li></ul>	<ul style="list-style-type: none"><li>• Task force consensus differs from Big 4 feedback</li><li>• Issue to be elevated to RRWG</li></ul>
Bundled arrangements (e.g. PPAs)	<ul style="list-style-type: none"><li>• Identification of separate performance obligations</li><li>• Allocation of transaction price</li><li>• Timing of revenue (customer control)</li></ul>	<ul style="list-style-type: none"><li>• Task force consensus on treatment</li><li>• Focus on items that do not transfer to customer contemporaneously</li><li>• Consideration of level of integration of products/services</li><li>• Separate analysis of RECs and capacity</li></ul>

# P&U Task Force

## Implementation Update

Industry Task Force Focus Areas	Considerations	Status
Sales of RECs	<ul style="list-style-type: none"><li>• Eligible to be accounted for as a series?</li><li>• Transfer of control upon generation of electricity or certification?</li></ul>	<ul style="list-style-type: none"><li>• Consensus reached at March meeting</li><li>• Recognition of revenue upon generation</li><li>• Paper being finalized for RRWG consideration</li></ul>
Sales of Capacity	<ul style="list-style-type: none"><li>• Stand ready = service</li><li>• Application of the series guidance</li><li>• Time-based measure of progress</li></ul>	<ul style="list-style-type: none"><li>• Consensus reached at March meeting</li><li>• Focus on series guidance and ability to apply Invoice PE</li><li>• Paper being finalized for RRWG consideration</li></ul>
Contributions in aid of construction	<ul style="list-style-type: none"><li>• Revenue vs. offset to PP&amp;E</li></ul>	<ul style="list-style-type: none"><li>• Task force reached consensus at March meeting that CIAC is not revenue</li><li>• Paper being finalized for RRWG consideration</li></ul>

# P&U Task Force

## Implementation Update

Industry Task Force Focus Areas	Considerations	Status
SASP for commodities	<ul style="list-style-type: none"><li>• Alternatives to the forward curve?</li><li>• Replaced “series for storable commodities” issue</li></ul>	<ul style="list-style-type: none"><li>• FASB staff completed TI</li><li>• Forward curve not required in many cases</li><li>• Next step – debrief TI with RRWG and FinREC</li></ul>
Collectibility – Sales to low credit quality customers	<ul style="list-style-type: none"><li>• Ability to socialize credit losses through rates</li><li>• Price concession?</li></ul>	<ul style="list-style-type: none"><li>• Added to TF agenda at March meeting</li><li>• Issue paper being developed</li></ul>
Alternative Revenue Programs	<ul style="list-style-type: none"><li>• Presentation of revenue when billed through tariff</li></ul>	<ul style="list-style-type: none"><li>• Added to TF agenda at March meeting</li><li>• Issue paper being developed</li></ul>
Sales of non-financial assets	<ul style="list-style-type: none"><li>• Replacing real estate sale rules</li><li>• Partial sales – unit of account?</li></ul>	<ul style="list-style-type: none"><li>• Active FASB project on asset vs. business</li><li>• Task force may not address</li></ul>

# FASB's New Lease Accounting Standard

Topic 842  
Issued February 2016



# The “Big Picture”

Key takeaways – Refer to Deloitte *Heads Up* for Details

**Most leases on balance sheet for lessees**

*Classification will drive expense profile*

**Lessor model largely unchanged**

*Most changes result from alignment with ASC 606*

**FASB tried to make things easy**

*Classification, reassessment, transition*

**Effective 2019 but don't wait to assess impact**

*Process and systems changes may be required*

*Potential impact on debt covenants*

# Effective date and transition

## Effective date

- Public business entities — effective for calendar periods beginning on January 1, 2019 and interim periods therein
- All other entities — effective for calendar periods beginning on January 1, 2020, and interim periods thereafter
- Early adoption will be permitted

## Transition

- Lessees and lessors are required to use a modified retrospective transition method for all existing leases
- Would apply the new model for the earliest year presented in the financial statements
- Application of approach linked to current lease classification and new lease classification
- An entity can use hindsight when evaluating lease term

### TRANSITION RELIEF PACKAGE

Lessees and lessors are not required to reassess the following upon transition:

- ✓ Whether any expired or existing contracts are leases or contain leases
- ✓ The lease classification for any expired or existing leases
- ✓ Initial direct costs for any existing leases

# New Lease Accounting Standard

What are the likely implications to the industry?

## Definition of a lease

- EITF 01-8 model will be replaced
  - Replaced with focus on who controls “how and for what purpose” an asset is used
  - Dispatch rights will indicate control
  - See Example 9 – Three power plant examples
- Secondary consideration of O&M and involvement in design
  - Approach to design inconsistent with consolidation practice
  - May impact lease decision for renewable PPAs
    - When is an off-taker deemed to have designed the plant?

## Other

- Sale-leaseback rules to change
- Build-to-suit guidance overhauled (for the better)
- No more leveraged leases after effective date – existing leveraged leases grandfathered

# New Lease Accounting Standard

## More potential industry implications

### Lessor Accounting

- Uncertainty regarding impact of variable rents on initial recognition of sales-type lease or direct finance lease
  - Payments are deemed variable if they are contingent on production
  - Even if they are virtually certain (e.g. P95 confidence level)
- To record STL or DFL, lessor derecognizes asset (e.g. plant) and records investment in lease
- Lease guidance will not allow variable rents to be included in the lessor's lease receivable
  - Potential to lead to inception losses
  - Use of negative discount rate?
  - Could impact sellers of renewable energy

# New Lease Accounting Standard

## More potential industry implications

### “Last Mile” Considerations

- Pipeline laterals
- Implications for electric distribution?

### Guaranteed Min Production in Renewable PPA

- Result in fixed lease payments?
- Weather neutral vs. weather adjusted

### Considerations for ISO participants

- Right to bid = control?

### Curtailment Rights

- Convey control to buyer?
- Difference between economic and operational?

# Ratemaking Dilemma and Accounting Implications



# The Math Does Not Lie...

Cost of electricity  
sold (\$)



Cost per kWh sold  
(\$/kWh)

Number of kilowatt  
hours (kWh)  
consumed

# The Math Does Not Lie...

- The numerator is going up and the denominator may well be going down, over time, for the first time in the history of the U.S. electric industry – and this suggests a dilemma

The Math at Work	
<b>The numerator – capital costs</b>	<b>The numerator – operations costs</b>
<b>New generation</b> ↑ – Aging plants – Early retirements	<b>Fuel</b> ↑ – Natural gas at historic lows
<b>New transmission and distribution</b> ↑ – Reliability – Smart grid – Renewable portfolio standards	<b>Emissions retrofits</b> ↑ <b>New technologies</b> ↓
<b>Environmental – Emissions restrictions</b> ↑ – Capital retrofits – Parasitic load	<b>The denominator – kilowatt hours consumed</b>
<b>Interest rates</b> ↑	<b>New sources of demand</b> ↑ <b>Impact of Recession</b> ↔ <b>Efficiency technology advances</b> ↓ <b>Distributed generation</b> ↓

The Dilemma	
$\frac{\text{Increased Costs}}{\text{Decreased kWh Consumed}}$	= Higher Cost Per kWh

# Recent Trends in Ratemaking

- Some actions to keep rates down reduce earnings
  - Lower ROE
  - Assume higher sales growth for test year
  - Disallow or “cap” new plant investment amount
  - Reduce various test year costs (for example by assuming efficiencies or not allowing some elements of costs)

# Recent Trends in Ratemaking

- Other actions to keep rates down potentially do not reduce earnings
  - Reduce depreciation rates prospectively
  - Refund accumulated cost of removal
  - Refund “excess” accumulated depreciation
  - Stepped rate increases for large capital project
  - Permission to defer certain costs until the next rate case
  - “Flow through” ratemaking for certain tax temporary differences
  - Use a policy for timing of including certain costs in rates more slowly than under GAAP

# Overview of Accounting Implications

- Ongoing application of ASC 980
- Some decisions in a rate order require careful consideration, such as:
  - Cost deferrals for major newly completed plant
  - Disallowances for recently completed plant or caps for plants under construction
  - Depreciation adjustments
  - Deferral of various test year costs to a future rate case
  - Full rate of return allowed on cost deferrals

# Phase-In Plan Considerations

- Current efforts of companies and regulators to moderate or nullify rate increases
- Rate programs and strategies designed to minimize rate shock in early years of in-service
- These efforts are coincident with or proximate to the in-service date and rate treatment for major, newly-completed plant—see also “planned” and “accidental”

# Disallowances of Plant Costs

Disallowance examples:

- Direct disallowance
- Cost cap (applied pre-completion)
  - Measure the undiscounted disallowance
  - Discount the disallowance
  - Continue AFUDC until plant is completed
- Explicit, but indirect disallowance
  - Estimate future cash flows disallowed and appropriate discount rate (e.g., allowed cost of capital)

# Plant Abandonments



# Abandonment – When and How

- SFAS 90/ASC 980-360 addresses the accounting for abandonments
- When probable asset will be abandoned, remove from CWIP or plant in service
- Frequent application today – older plants retired early rather than adding pollution control equip
  - Fact that this applies to operating plants and assets is often overlooked

# Abandonment Considerations

- Question Arises— When my company decides that an asset will be retired, is that an abandonment or simply a revised estimate of the original service life? Considerations include:
  - Change in estimated life due to which circumstances
  - How will you recover your unrecovered basis
  - Is something actually probable until your regulatory commission approves it

# Proposed Pension Accounting Standard Update



# Proposed Pension ASU – Overview

- Currently, no specific US GAAP guidance on presenting net benefit cost in the income statement
  - Net benefit cost comprised of several components that reflect different aspects of an employer's financial arrangements and the cost of benefits
- Proposed amendments would require an entity to present
  - **Current service cost component** of net benefit cost with other compensation costs for the related employees
  - **Remaining components** of net benefit cost elsewhere in the income statement
    - Outside of income from operations, if such a subtotal presented
    - Disaggregation of the other components permitted, but not required
- Proposal would limit the portion of net benefit cost eligible for capitalization to **current service cost component**



Questions?



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