New revenue standard issued
Potential challenges in the power and utilities industry

The new revenue recognition standard will likely present different levels of complexity for many companies in the power and utilities industry, including challenges in revenue reallocation, transaction pricing, disclosures, and taxes.

Background
The Financial Accounting Standards Board (FASB) issued Accounting Standards Update, Revenue from Contracts with Customers in May 2014. The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers, and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance.
The effective date for public registrants has been deferred to 2018 for calendar year-end (annual reporting periods beginning after December 15, 2017). Early adoption as of the original effective date (2017 for calendar year-end) is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment.

The delayed effective date and transition options are intended to allow companies a reasonable timeframe to comply. However, addressing some areas of the FASB Accounting Standards Codification may require longer lead-time, particularly related to revenue or billing systems where separation and/or allocation changes may be required, so companies should perform a preliminary analysis of the new requirements on a timely basis.

**Considerations and challenges**
The requirements in the standard may become complicated for some power and utilities companies, particularly as it relates to commercial (unregulated) activities and potentially certain regulated customer sales agreements. Examples of some of the challenges are as follows:

**Revenue allocation** — Under the standard, treatment of performance obligations (“POs”) may not be consistent with existing accounting policies or billing practices. To the extent contracts contain more than one “distinct” PO which do not all transfer in the same accounting period, companies may need a systematic solution to allocate pricing to each related PO. An example may be a bundled renewable sale arrangement for delivery of energy and renewable energy credits where registration (title transfer) of the renewable credits does not occur in the same period as energy delivery. Additionally, data to perform the calculations may be in multiple systems and may not currently meet applicable control requirements.

**Transaction price calculations** — Total consideration that the entity expects to be entitled to from the customer over the contract term (i.e., transaction price) may need to be estimated at contract inception and throughout the contract term. Therefore, companies will need to evaluate their existing sale pricing structures and may need to develop policies and methods to calculate or estimate the transaction price when consideration is variable, including variability driven by event-based contingencies (i.e., unit-contingent agreements or sales tied to achieving volumetric targets), cost-based structures (i.e., formula-rate sales), index-priced structures (i.e., index or heat-rate based sales), or fixed priced structures that are otherwise subject to escalation or deceleration. These types of provisions may be common within retail marketing, commercial and off-system sales, and some sales to larger customers in regulated jurisdictions. Companies may also need a process to update these estimates each reporting period, and effectively maintain key data.

**Contract combinations and modifications** — The standard changes the way certain contracts are accounted for and analyzed. Companies may need to address the potential combination of contracts with the same customer (where pricing dependencies exist) and the possible reallocation of revenue across contracts. Adjustments related to contract modifications will also potentially be required. For example, “blend-and-extend” contracts may be at risk for either cumulative revenue adjustments or adjustments to account for the time value of money (financing) given the predominant practice of blending pricing for the pre-modified remaining term with current market pricing over the extension term. These changes might cause some companies to enhance their contract management systems and tools.

**Capitalization of costs to acquire customer contracts** — The standard requires certain contract costs—including costs to acquire a contract with a customer (e.g., sales commissions)—be capitalized and amortized. As a result, companies may need to develop or enhance processes, controls, and systems to identify and account for such capitalized costs. This change may impact competitive retail energy providers.

**Disclosures** — The disclosure requirements under the standard are significant and may require modification to financial and management reporting processes and systems. Additional disclosures include, but are not limited to, disaggregation of revenue, certain information about changes in contract asset and liability balances and contract costs, and information related to the amount of the transaction price allocated to performance obligations not yet satisfied.

**Tax** — Certain tax implications may arise as taxpayers often follow the financial reporting revenue recognition methods in the determination of taxable income and transaction tax obligations. The changes may have cash tax implications, may require federal tax accounting method changes, or give rise to new tax temporary differences that may need to be captured, calculated, and tracked through tax provision processes and systems. Taxpayers who do not follow financial reporting methods for tax may also need to consider the impact of these changes on tax reporting and may need to change their computations and procedures, as well as consider potential tax method changes. Similar implications may arise in foreign jurisdictions that impose tax based upon statutory reporting maintained under either International Financial Reporting Standards or U.S. Generally Accepted Accounting Principles, as this change may impact both standards.

**Other implications**
Organizations may need to consider other project needs, including:

- Implementation of updated or new processes, controls, and systems, where required
- Determination of new monthly closing process steps to accommodate the new requirements
- Steps to estimate the impact of the new standard, to facilitate understanding and planning by other key stakeholders
- Effective training and communication of new requirements
- Effective program and resource management related to this effort

**Getting started**
Some effective first steps to consider as you begin to evaluate the implications of the potential new standard may include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact
- Addressing the longer lead-time areas where new calculation rules or revised allocation processes may be required
How Deloitte Advisory can help
We have an experienced team of professionals, both in the U.S. and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities includes the full breadth of services and competencies needed to help clients address these issues, and would include accounting assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

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