www.pwc.com

FECA Finance and Accounting Conference

New FASB accounting projects

September 17, 2015

pwc

With you today from PricewaterhouseCoopers

Gavin Hamilton

Partner

Gavin.s.hamilton@us.pwc.com

410-659-3307

- Over 19 years of experience providing assurance and accounting advisory services to client in the Power and Utilities Sector
- Served as engagement partner for the audits of several public companies within the industry
- Previously led PwC's Power and Utilities technical program

Agenda

- Major FASB technical agenda items
  - Revenue recognition
  - Leases
- Narrow scope projects
  - FASB simplification project overview
  - Cloud computing fees
  - Debt issuance costs
  - Inventory
- Other relevant accounting guidance
  - Environmental & REC accounting

Navigating the new landscape

Revenue from contracts with customers

September 17, 2015
PwC

Revenue recognition overview
Issued May 2014

Impacts

- Standard could significantly change how many entities recognize revenue
- Standard is intended to be principles-based
- Will remove existing industry-specific guidance
- Expanded qualitative and quantitative disclosures (annual and interim)
- Transition Resource Group

Achieve a single, comprehensive revenue recognition model

Core principle is that revenue recognition depicts transfer of control to customer in an amount that reflects consideration to which an entity expects to be entitled

When is it effective

	U.S. GAAP Public	U.S. GAAP Non-public	IFRS
Effective Date	Beginning after December 15, 2017 2018 calendar year	Beginning after December 15, 2018 2019 calendar year	Exposure Draft proposing one-year deferral* 2018 calendar year
Early adoption permitted?	Yes No earlier than the original effective date for public entities 2017 calendar year	Yes No earlier than the original effective date for public entities 2017 calendar year	Yes
Method of adoption	Retrospective (with certain practical expedients allowed) or modified retrospective		

* In July 2015, the IASB voted to confirm the one-year deferral. The formal amendment to IFRS 15, specifying the new effective date, is expected to be issued in 2015.

How does it work

Five Key Steps

1: Identify the contract(s) with a customer

2: Identify the performance obligations in the contract

3: Determine the transaction price

4: Allocate the transaction price to the performance obligations in the contract

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

Comparison to existing guidance – Step #1

1: Identify the contract(s) with a customer

Existing guidance	*New guidance*
Contract is an agreement between parties that creates legally enforceable rights and obligations	Generally consistent with existing practice
Little guidance on accounting for contract modifications	Explicit guidance provided on accounting for contract modifications

Comparison to existing guidance – Step #2

2: Identify the performance obligations in the contract

Existing guidance

Deliverables must have standalone value to be accounted for separately

New guidance

Performance obligations and *distinct* replace *deliverable* and *standalone value* in assessing multiple element arrangements

Comparison to existing guidance – Step #3

3: Determine the transaction price

Existing guidance	***New guidance***
Arrangement's fee must be fixed or determinable for revenue to be recognized	Variable consideration must be estimated subject to a constraint (exception for licenses of intellectual property involving sales- or usage-based royalties)
Discounting of revenues required in limited circumstances	Entities must assess whether a significant financing component exists

Comparison to existing guidance – Step #4

4: Allocate the transaction price to the performance obligations in the contract

Existing guidance

Allocate transaction price to multiple deliverables based on relative selling price

New guidance

Generally consistent with existing practice

Comparison to existing guidance – Step #5

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

Existing guidance	New guidance
Recognition based on transfer of the risks and rewards of ownership	Revenue recognized when or as control of good or service transfers to the customer Criteria identified for assessing whether performance obligation is satisfied at a point in time or over time

Comparison to existing guidance - Other

Other aspects of the standard

Existing guidance	*New guidance*
Diversity in recognition of revenue related to licenses	Guidance provided to assess whether license recognized at a point in time or over time
Required disclosures set forth in ASC 605	More extensive quantitative and qualitative disclosures required
Little guidance on accounting for costs outside of contract accounting	Incremental costs to obtain and fulfill a contract are capitalized if recoverable

Revenue recognition

Key Power and Utilities industry implementation issues:

How to measure progress toward complete satisfaction of a performance obligation that is satisfied over time?

How should revenue earned under alternative revenue programs be presented and disclosed?

How to account for contract modifications?

What is the implication of hardship customers?

Is CIAC within the scope of the new standard?

How to identify performance obligations in a bundled arrangement?

Transition Resource Group

Transition Resource Group (TRG) was created to solicit, analyze and discuss potential implementation issues

Members

- Total of 27 members
- Includes financial statement preparers, users and auditors from various industries and jurisdictions
- Members include those with both U.S. GAAP and IFRS backgrounds

Process

- Implementation issues discussed at TRG meetings originate from various sources
- Raises potential implementation issues to FASB and IASB for further consideration
- TRG does not issue authoritative guidance
- TRG meeting minutes available on FASB website

What companies are doing now

Significant change means preparation is critical

Developing a project plan is key to successfully implement the model An example of such a plan is as follows:

- Establish governance and project management approach
- Catalogue revenue arrangements
- Review current policies and practices
- Identify differences under proposed standard
- Determine adoption approach
- Map policy differences to process and systems impacts
- Consider dual-GAAP approach, including interim solutions
- Establish communication plan
- Educate and communicate within the organization
- Effect process and system changes
- Collect and convert data, perform calculations
- Draft disclosures (both transition and ongoing interim and annual)

On the horizon

Leases

Lease accounting project

What you need to know

- Virtually all leases on balance sheet
- FASB preserves classification model, mostly consistent with current GAAP
- Changes to the definition of a lease will likely impact accounting for power purchase and power sales arrangements
- Transition models proposed

Impacts

- **Balance sheet will be grossed up**
- **Financial metrics and debt covenants may be impacted**
- **Subsequent remeasurement may require additional effort**
- **Elements of a contract may be a lease and will now be on balance sheet**

Looking forward

- **Issuance – Q4 2015**
- **Effective date– to be determined**

How does it work

Lessee

	Balance sheet	Income statement	Cash flow statement
Financing (Type A)	Asset (right of use) Lease liability	Front loaded • Amortization expense • Interest expense	Principal = Financing Interest = Operating Variable = Operating
Straight line (Type B)		Lease expense	Operating

Lessor

	Balance sheet	Income statement	Cash flow statement
Financing (Type A)	Derecognize the underlying asset Recognize net investment in the lease comprising: • Lease receivable (including guaranteed residual value) • Unguaranteed residual value of underlying asset FASB: Deferred selling profit (absent control transfer)	Front loaded • Profit on derecognized asset is deferred when lease does not transfer control to the lessee • Interest income on receivable and residual	Operating
Straight-line (Type B)	Underlying asset remains on balance sheet	Lease income	Operating

Comparison to existing guidance - Lessee

	Existing guidance	*Proposed guidance*
Lessee	Evaluate lease to determine whether on balance sheet (capital lease)	Virtually all leases on balance sheet. Evaluate lease to determine income statement presentation of financing (Type A) or straight line (Type B)
	Evaluation is rules based focused on • Transfer of ownership • Bargain purchase option • Lease term • Minimum lease payments	**FASB** – While all leases (other than short-term leases) will be on balance sheet, lease classification will be similar to existing guidance Generally, today's operating leases will be straight-line and today's capital leases will be a financing **IASB** – All leases will be similar to finance leases today

Comparison to existing guidance - Lessor

	Existing guidance	*Proposed guidance*
Lessor	Evaluate lease to determine whether a net investment is substituted for the leased asset (direct financing/sales type lease)	**FASB** – Derecognize asset and record receivable (includes guaranteed residual) and unguaranteed residual, record profit on derecognized asset only if control transfers and income on receivable and residual (Type A) **IASB** – Record profit on derecognized asset even if control does not transfer (Type A) Asset remains on balance sheet, income is recorded straight-line (Type B)
	Evaluation is rules based following the same criteria as lessee above (plus two additional criteria)	Evaluation will be similar to existing guidance

Standard Setting – Narrow scope projects

September 17, 2015
PwC

FASB simplification overview

Focus on simplification initiative

FASB is focused on simplifying U.S. GAAP by addressing narrow- scope projects that can be completed in a relatively short time period

Issued

- Extraordinary items (January 2015)
- Pension asset measurement date (April 2015)
- Debt issuance cost (April 2015)
- Cloud Computing Fees (April 2015)
- Inventory measurement (July 2015)
- Employee Benefit Plans (July 2015)

Final standard being drafted

- Measurement period adjustments

Redeliberation after ED

- Balance sheet classification of deferred taxes
- Intra-entity asset transfers
- Share – based payment accounting
- Equity method accounting

ED out for comment

- No projects in this stage at this time

Initial deliberations or ED in draft

- Classification of debt

Customer fees in a cloud computing arrangement
Issued April 2015

What you need to know

- Lack of existing U.S. GAAP has created diversity in practice
- Arrangements will be considered multiple element arrangements when:
  - Customer has the contractual right to take possession of the software ***without significant penalty***
  - It is feasible for the customer to either run the software on its own hardware or contract with a third party to host the software
- Arrangements that do not meet both criteria are accounted for as services contracts

Impact

- Symmetry in criteria for customers to apply as vendors when determining whether a hosted arrangement includes a software license

Accounting for internal-use software costs – ASC 350-40

Accounting for cloud computing fees – ASU 2015-05

Scope

- Arrangements are within the scope of ASC 350-40 if (a) customer has right to take possession of software without significant penalty, and (b) it is feasible to run the software with existing hardware.
- If not in scope, the contract is a service contract

Recognition

- Arrangements within the scope of ASU 2015-05 should recognize a license intangible asset. The arrangement will contain a separate hosting service element that will be expensed as incurred.

Measurement

- Allocation of the contract consideration should be allocated between the license intangible and the hosting service based on the relative fair value of each element.

Accounting for internal-use software costs – ASC 350-40

Considerations for rate-regulated entities

- Accounted for in rate base?
- Cost deferral for recovery of cost only as a regulatory asset?
- Disallowance accounting

Debt issuance cost summary

Issued April 2015

What you need to know

- Presented as a direct deduction from the related debt liability
- Aligns presentation of debt issuance costs with that of debt discount or premium
- Recognition and measurement guidance is unchanged
- Guidance does not address revolvers

Impacts

- Cost of issuing debt is no longer recorded as a separate asset
- No effect on income statement—debt issuance costs continue to be amortized using the effective interest method
- Aligns U.S. GAAP presentation with IFRS

Looking forward

- Effective date – periods beginning after Dec. 15, 2015
- Early adoption permitted
- Retrospective application required

Subsequent measurement of inventory
Issued July 2015

What you need to know

- Changes inventory measurement to lower of cost and net realizable value
- Previous guidance requiring lower of cost or market will be removed
- Eliminates the multiple measures of "market" (Ceiling and floor concepts)
- Net realizable value retains its current definition
- LIFO and RIM excluded

Impacts
- Reduce complexity in measurement
- Would more closely align U.S. GAAP and IFRS

Looking forward
- Effective for periods beginning after Dec. 15, 2016
- Early adoption permitted
- Prospective transition

Other accounting topics

September 17, 2015
PwC

The Clean Power Plan

Final ruling August 2015 - Overview

Focus:

- To reduce carbon emissions from existing power plants 32% by 2030 as compared to 2005 levels
- Improving energy efficiency, improving power plant operations, and encouraging reliance on low-carbon energy

Intention:

- The EPA has proposed state-specific emissions targets using a mix of three "building blocks" that make up the best system of emission reductions (BSER)
- States will have the ability to identify their own state plans, which may or may not reflect the EPA proposed federal plan.
- Allows a choice of a emission rate or a mass-based goal (e.g., tons), and the ability to collaborate with other states such as through emissions trading programs.

Industry Impact:

- The EPA estimates annual costs of $8.4 billion in 2030 based on a rate-based approach. It estimates that nation-wide, a mass-based approach would be $5.1 billion.
- Interim targets from 2022 through 2029.
- States to submit their plans by September 2016 or September 2018, if an extension is given
- Based on their modeling of meeting the goals, EPA projects 2030 generation will be 33% gas, 27% coal, 21% renewable, and 19% other.

Source: EPA

The Clean Power Plan

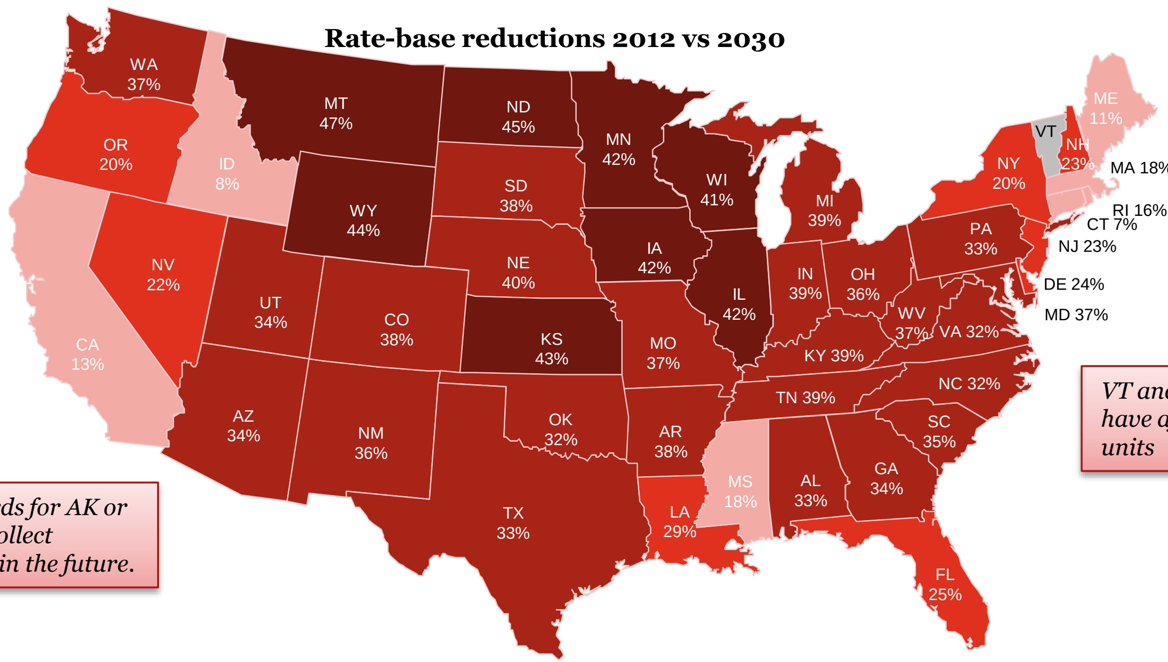
Final ruling August 2015 - Overview

The final rule determined two source specific CO2 emission rates for power plants which were used to determine state emission rate targets based on the state's 2012 generation mix

Rate-base reductions 2012 vs 2030

Reduction:

- <20%
- 20-30%
- 31-40%
- >40%



EPA has not set standards for AK or HI as they continue to collect necessary data to do so in the future.

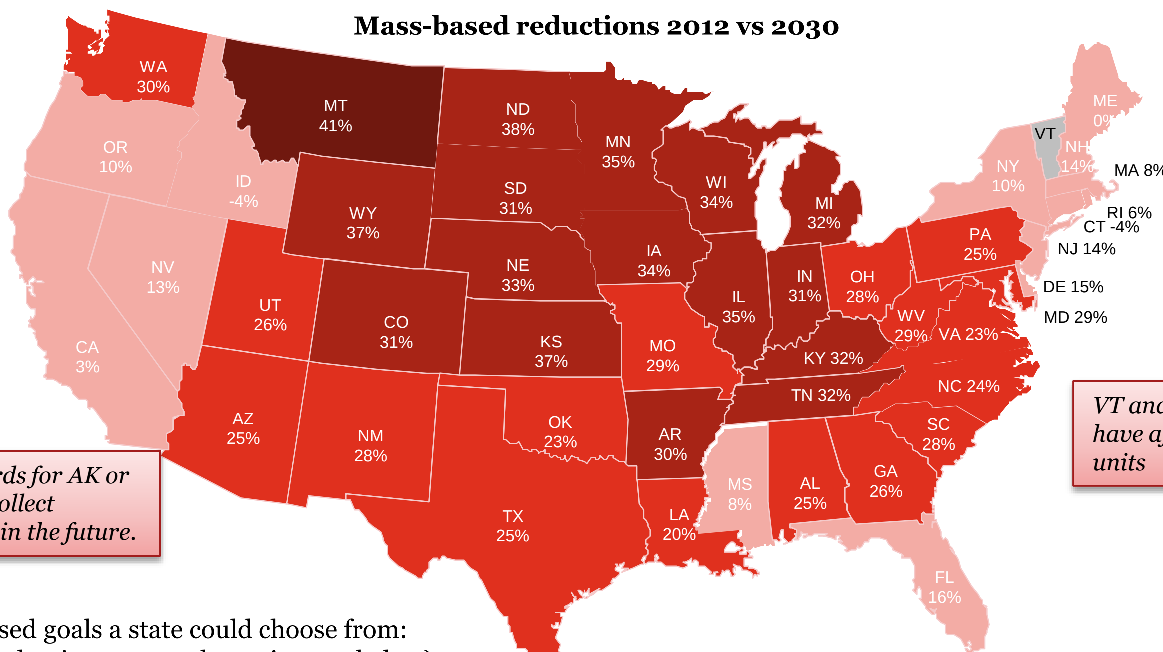
VT and DC do not have affected units

Source: EPA

The Clean Power Plan
Final ruling August 2015 - Overview

The EPA also provided mass-based goals for states who choose to pursue a program based on total CO2 emissions

Reduction:
- <20%
- 20-30%
- 31-40%
- >40%



EPA has not set standards for AK or HI as they continue to collect necessary data to do so in the future.

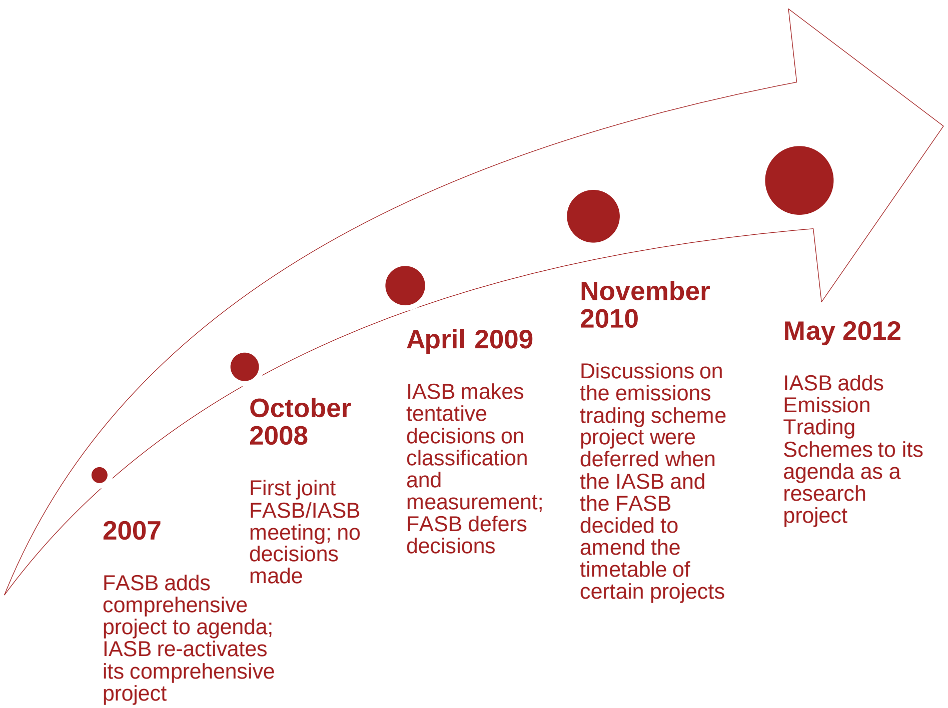
VT and DC do not have affected units

There are two mass-based goals a state could choose from:
1. Mass-based goal (reduction targets shown in map below)
2. Mass-based goal with new source complement: Includes the EPA's estimated new source emissions associated with satisfying incremental demand from 2012.

Source: EPA

Key accounting considerations
FASB and IASB developments

Currently, there is no authoritative guidance on accounting for RECs or emission allowances within U.S. GAAP



IASB

- January 2015 - Began deliberation in Q1 with discussion paper expected to be issued later this year
- June 2015 - Staff recommended taking a fresh approach vs. building on past efforts with the objective of developing an accounting model that will best reflect the economic substance of each type of pricing mechanism

FASB

- January 2014 - Voted to remove the Emissions Trading project from it agenda
- No recent discussion or indication that the project will be resumed

Key accounting considerations

Inventory versus intangible classification

In practice, utilities and power companies typically classify RECs and emission allowances as inventory or intangible assets

Inventory (ASC 330)

Intangible (ASC 350)

PwC believes that both classifications have merit

Key accounting considerations
Inventory versus intangible classification

- Reporting entities should consider the definitions of inventory and intangible assets as prescribed in ASC 330 and ASC 350, respectively
- Classification should consider intended use of the assets (i.e. used for compliance purposes or held for sale)
- Generally, we would not expect RECs generated and held for sale to be classified as intangible assets
- Accounting policy election to be consistently applied

Key accounting considerations

Inventory versus intangible classification

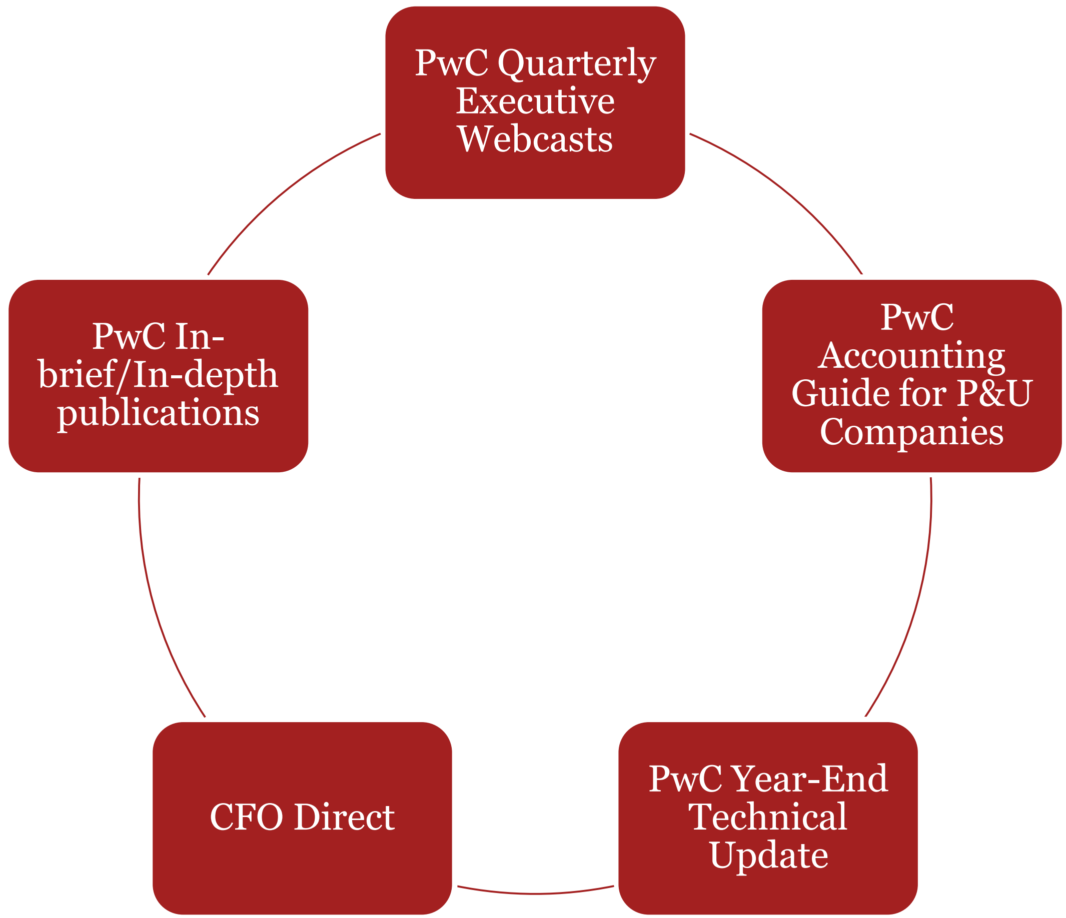
Policy election for classification of RECs and emission allowances will impact how reporting entities consider impairment or decline in value

Inventory	Intangibles
• Lower of cost or market model ("LCM")	• Reviewed for impairment based on guidance prescribed in ASC 360 (Long-lived assets) • Impairment indicators could include: – Significant decline in the price – Significant change in the business or regulatory environment

PwC thought leadership

September 17, 2015
PwC

Where can you go for help?



Thank you