Working Draft:
Power & Utility Entities Revenue Recognition Implementation Issue

Issue #13-1: Accounting for Tariff Sales to Regulated Customers

Expected Overall Level of Impact to Industry Accounting:
Significant

Wording to be Included in the Revenue Recognition Guide:

Background

1. Utilities that have Regulated Operations (as defined by FASB ASC 980) provide products and services to their regulated customers under rates, charges, terms and conditions of service, and prices determined by the regulator. Collectively, these rates, charges, terms and conditions are included in a "tariff," which governs all aspects of the provision of regulated services by utilities. Tariffs are only permitted to be changed through a rate-setting process involving "an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers." (ASC 980-10-15-2 (a)) Thus, all regulated sales by a utility are conducted subject to the regulator-approved tariff.

2. Tariff sales most commonly involve the current provision of commodity service (e.g., electricity, natural gas, water) to customers for a price that often has a fixed component and a usage-based component. The commodity is sold and/or delivered to and generally consumed by the customer simultaneously, and the provisions of the relevant tariff determine the charges the utility may bill the customer, payment due date, and other pertinent rights and obligations of both parties. Often such sales do not involve a written contract.

3. Some tariffs authorize the regulated utility to increase or decrease its bills to customers for amounts other than compensation for the current provision of utility service. The tariff provisions that authorize such billings are often referred to as alternative revenue programs. The terms and conditions of alternative revenue programs are part of the same overall tariff (legal document) as the terms and conditions for all other aspects of sales of utility service by a utility to its customers.

4. While the terms and conditions for alternative revenue programs are included within the same overall tariff that governs sales by the regulated utility, alternative revenue programs generally relate to the accomplishment of different regulatory objectives, such as reducing the effects of extreme weather on monthly bills, compensating the utility for sales lost due to conservation programs, providing the utility a return on investments in such conservation programs, and for other reasons.

5. The following guidance addresses these aspects of the application of Topic 606 to revenues that arise from regulated utility tariffs (other than amounts from alternative revenue programs), hereafter referred to as revenue from sales of utility service
   a. Whether the contract is with the utility's customers;
   b. Whether revenues from sales of utility service subject to regulated utility tariffs are revenues from a contract ; and,
   c. Whether such revenue is within the scope of Topic 606

Identifying the Customer

6. The FASB Master Glossary defines a customer as:
   A party that has contracted with an entity to obtain goods or services that are output of the entity's ordinary activities in exchange for consideration.

7. FinREC believes that the individuals, businesses, and other entities receiving utility service meet the definition of a customer, as defined in FASB ASC 606, because they obtain goods or services that are the output of the utility's ordinary activities in exchange for consideration. The individual or entity requests, and the utility provides, some or all of its regulated products and services to the customer, including
   a. A service to stand ready to deliver the commodity,
   b. The delivery of the commodity and, in many cases,
   c. The sale of the commodity itself

Identifying the Contract

8. FASB ASC 606-10-25-1 contains the following criteria that must be met in order for an entity to account for a contract with a customer within the scope of FASB ASC 606:
   a. The parties to the contract have approved the contract and are committed to perform their respective obligations,
   b. The entity can identify each party's rights regarding the goods or services to be transferred,
   c. The entity can identify the payment terms for the goods or services to be transferred,
   d. The contract has commercial substance (that is, the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract), and
   e. It is probable that the entity will collect the consideration to which it will be entitled. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see FASB ASC 606-10-32-7)

9. In accordance with ASC 606-10-25-1, FinREC believes that an arrangement between a utility to provide service to customer under a tariff should be accounted for as a contract with a customer that is within the scope of ASC 606 if it possesses the following characteristics:
   a. There is an agreement between the utility and the customer. The agreement may be a formal written contract, or in many cases may take the form of a written application that constitutes affirmation of the contract when the utility delivers service. Under ordinary business practice, this generally occurs when a customer requests utility service orally and implicitly accepts the provisions of the tariff when it takes delivery.
   b. The utility is obligated to provide service to all qualified customers under the terms of the tariff, and when it has done so, the customer is obligated to pay for that service as provided in the tariff. The terms of the tariff are subdivided such that those applicable to each specific utility service, as well as those related to alternative revenue programs, are readily identifiable.
   c. The tariff provides the customer with the standard terms and conditions (rights), including pricing terms, of the contract. It is filed by the utility pursuant to an Order by the utility's regulator and is publicly available. It governs the provision of utility service to customers.
   d. The contract between the utility and individuals, businesses, and other entities that receive utility services and incorporates relevant terms and conditions of the tariff has commercial substance.
   e. The utility is entitled to consideration in exchange for delivering or standing ready to deliver the commodity to the customer class subject to its provisions. The utility determines collectibility of consideration on a customer by customer basis or by groups of customers similarly to non-regulated entities.

      FinREC believes that judgement will be required in determining if it is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for tariff sales. See Power & Utility Issue #13-11: Collectibility, for considerations on assessing collectibility of tariff sales.

10. If any of the criteria FASB ASC 606-10-25-1 are not met, the arrangement would not meet the definition of a contract with a customer under FASB ASC 606, and should be accounted for in accordance with the guidance in FASB ASC 606-10-25-6 through 25-8.

11. FinREC believes that the tariff provisions for sales of utility service (i.e., provisions other than those governing alternative revenue programs) represent terms and conditions incorporated by reference into the contract for utility service with the underlying customer. Although the request for utility service is often oral or written only to the extent of submitting an application for service, when service is provided, it results in a contract that is governed by the relevant tariff provisions. For non-regulated entities, such terms and conditions are generally set by the supplier and are limited by competition, typical business practices, and relevant laws and regulations. The terms and conditions for regulated sales differ only in that more aspects of the transaction price, payment provisions, and other aspects of the goods and services to be provided are specified by a third party regulator since the utility is a regulated entity.

Scope

12. FASB ASC 606 specifically excludes alternative revenue programs from its scope. BC28 of ASU 2014-09 states:

    Revenue from transactions or events that does not arise from a contract with a customer is not within the scope of Topic 606, and, therefore, those transactions or events will continue to be recognized in accordance with other Topics, for example:

    a. Dividends received (although these requirements existed in previous revenue standards in IFRS, the IASB has moved them unchanged, and without changing their effect, into IFRS 9, Financial Instruments).
    b. Nonexhange transactions (for example, donations or contributions received).
    c. For U.S. GAAP, changes in regulatory assets and liabilities arising from alternative revenue programs for rate-regulated entities in the scope of Topic 980 on regulated operations. (The FASB decided that the revenue arising from those assets or liabilities should be presented separately from revenue arising from contracts with customers. Therefore, the FASB made amendments to Subtopic 980-605, Regulated Operations – Revenue Recognition).

13. FinREC believes that revenue from sales of utility service to customers under a tariff is separately identifiable and distinguishable from revenue under alternative revenue programs (even if governed by separate provisions of the same tariff) due to the following:
    a. Tariff provisions governing revenues from the delivery of utility service to customers represent "terms and conditions" incorporated by reference into the contract between the utility and the customer, whereas tariff provisions related to alternative revenue programs represent an agreement between the regulator and the utility specifying criteria which, if met, authorize the utility to bill incremental increases or decreases in those amounts in the future.
    b. As indicated in ASC 980-605-25-3, alternative revenue programs have a common characteristic in which they allow the utility to adjust rates (prices) in the future in response to past activities or completed events. Thus, the revenues for these programs do not represent amounts due to the utility for satisfaction of a current provision of service, but relate to factors in the past for which the regulator has determined that future billings to recipients of utility service must be adjusted. This is evidenced in the description of alternative revenue program revenue as revenue that arises from the creation of, or changes in, regulatory assets/liabilities (not from the provision of utility service).

14. FinREC believes that tariff-based revenue from the provision of regulated utility service to a utility's customers ("utility service") is within the scope of FASB ASC 606 due to the following:
    a. The recipients of utility service meet the definition of a customer.
    b. Revenue from sales of utility service is provided under an arrangement that meets the definition of a contract
    c. Revenue from sales of utility service to customers under a tariff is distinguishable from alternative revenue programs because the tariff contains separate, distinct provisions that govern the specific terms and conditions for each component of a utility's billings to its customers

15. After determining that the contract meets the criteria for contract existence in FASB ASC 606-10-25-1, the entity would apply the other requirements of ASC 606 for such arrangements. Since customers typically have the right to discontinue receiving service at will (e.g. by moving to a different utility jurisdiction), FinREC believes that the term of the contract between the utility and the customer for tariff based services will generally be limited to the services requested and received to date for such arrangements.

Comments should be received by May 1, 2017, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to Kim Kushmerick, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.