The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.
Beyond the Bottom Line

This Power & Utilities Spotlight discusses the new revenue model and highlights key accounting issues and potential challenges for P&U entities that recognize revenue under U.S. GAAP or IFRSs. For additional information about the new standard, see Deloitte’s May 28, 2014, Heads Up.

Background

The goals of the ASU are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRSs while (1) streamlining, and removing inconsistencies from, revenue recognition requirements; (2) providing “a more robust framework for addressing revenue issues”; (3) making revenue recognition practices more comparable; and (4) increasing the usefulness of disclosures. The ASU states that the core principle for revenue recognition is that an “entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.”

The ASU indicates that an entity should perform the following five steps in recognizing revenue:

• “Identify the contract(s) 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 the performance obligations in the contract” (step 4).
• “Recognize revenue when (or as) the entity satisfies a performance obligation” (step 5).

Entities will be required to reassess several aspects of their current revenue accounting and determine whether changes are necessary. In addition, the ASU requires significantly expanded disclosures about revenue recognition, including both quantitative and qualitative information about (1) the amount, timing, and uncertainty of revenue (and related cash flows) from contracts with customers; (2) the judgment, and changes in judgment, exercised in applying the revenue model; and (3) the assets recognized from costs to obtain or fulfill a contract with a customer.

Key Accounting Issues

Although the ASU may not significantly change how P&U entities typically recognize revenue, a few of the ASU’s requirements may be inconsistent with current practice. Discussed below are some key provisions of the ASU that may affect P&U entities.

Thinking It Through

To help P&U entities implement the ASU, the FASB and IASB have created a joint transition resource group (TRG) and the AICPA has assembled a P&U industry task force. In addition, the AICPA is currently developing an accounting guide on revenue recognition. See Deloitte’s July 2014 TRG Snapshot for information about the topics discussed at the inaugural joint TRG meeting.
Tariff Sales of a Regulated Utility

While ASU 2014-09 supersedes much of the industry-specific revenue guidance in current U.S. GAAP, it retains the guidance in ASC 980-605 on rate-regulated operations that have alternative revenue programs. P&U entities within the scope of ASC 980-605-15 will continue to recognize additional revenues allowable for Type A and Type B alternative revenue programs if those programs meet the criteria in ASC 980-605-25-4. However, in the statement of comprehensive income, revenues arising from such programs will be presented separately from revenues arising from contracts with customers that are within the scope of the ASU.

One of the issues that we expect the P&U industry task force to review is whether sales to tariff-based customers are within the scope of the ASU. If such sales are deemed to be within the ASU’s scope, it will be necessary to determine the term of the contractual relationship between the utility and each customer as well as any rights or obligations either party has under the contract.

ASU 2014-09 also does not amend the guidance in ASC 980 on recognizing regulatory assets and liabilities (formerly FASB Statement 71).

Blend-and-Extend Contract Modifications

Contract Modifications

P&U entities should consider how they are affected by the ASU’s guidance on accounting for “approved” modifications to contracts with customers. The approval of a contract modification can be in writing, by oral agreement, or implied by customary business practices, and a contract modification is considered approved when it creates new, or changes existing, enforceable rights or obligations. A contract modification must be accounted for as a separate contract when (1) it results in a change in contract scope because of additional promised “distinct” goods or services (see Distinct Performance Obligations below) and (2) the additional consideration reflects the entity’s stand-alone selling price for those additional promised goods or services (including any appropriate adjustments to reflect the circumstances of the contract). That is, the entity would continue to account for the existing contract as if it was not modified and account for the additional goods or services provided in the modification as a “new” contract.

If a contract modification is not considered a separate contract (i.e., it does not meet the criteria above), an entity should evaluate the remaining goods and services in the modified contract and determine whether to account for the modification prospectively (if the remaining goods and services are distinct from those already transferred) or retrospectively in accordance with the ASU. If the remaining goods and services are distinct from those already transferred, the modification is accounted for prospectively, the transaction price is updated (i.e., it now includes both the remaining consideration from the original contract and the additional consideration in the modification), and the updated transaction price is allocated to the remaining goods and services to be transferred. In contrast, if the goods or services are not distinct and are part of a single performance obligation, the modification is treated retrospectively and the amount of revenue recognized is adjusted to reflect the new modified contract (e.g., the measure of progress is adjusted to account for the new expectation of performance completed), resulting in a cumulative-effect catch-up adjustment.

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5 For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”

6 FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation.
Blend-and-Extend Contract Modifications

B&E contract modifications are common in the P&U industry. In a typical B&E modification, the supplier and customer may renegotiate the contract to allow the customer to take advantage of lower commodity pricing while the supplier increases its future delivery portfolio. Under such circumstances, the customer and supplier agree to “blend” the remaining, original, higher contract rate with the lower, extension-period rate for the remainder of the original contract term plus an extended term. The supplier therefore defers the cash realization of some of the contract fair value that it would have received under the original contract terms until the extension period, at which time it will receive an amount that is greater than the current market price for those periods as of the date of the modification.

Potential Impact of New Revenue Model

P&U entities should carefully evaluate the facts and circumstances related to a B&E contract modification to determine whether it should be accounted for as a new contract (which may include a significant financing component) or as a prospective contract modification. A B&E contract modification is treated as a new contract when distinct goods or services are added to the contract and the additional consideration reflects the stand-alone selling price of those additional goods or services. In such cases, the payment terms may need to be reevaluated because the payment of consideration may create a significant financing component in which some of the consideration for the future goods or services is paid early as a result of the “blended” price agreed to by the parties. In contrast, when the additional distinct goods are not included at the stand-alone selling price in the contract modification, the modification will be treated prospectively (since the remaining and additional deliveries would be distinct from the goods delivered as of the modification date) and the new blended price will be allocated to the remaining goods to be provided to the customer (including the undelivered goods in the original contract and the newly added goods).

Example

Company A enters into a four-year arrangement to sell power to Company B at a fixed price of $35/MWh. By the end of year 2, the price of power has dropped significantly and Company B wishes to renegotiate the contract to take advantage of lower market prices at $25/MWh. Company A and Company B agree to extend the terms of the existing contract by two years (i.e., there are four years remaining after modification); the new contract has a fixed-price structure of $30/MWh.

Thus, Company A will now be receiving $30/MWh ($5/MWh less than originally contracted) during years 3 and 4. In contrast, during years 5 and 6 (i.e., the extension period), Company A will be receiving $5/MWh more than the market price of $25/MWh.

Potential Alternatives

If the modified price is determined to be the stand-alone selling price for the additional power provided in years 5 and 6 (e.g., the volume is expected to be consistent in years 3 to 6 and the $25/MWh is determined to be the stand-alone selling price of the additional power in years 5 and 6), the contract modification should be treated as a new contract. However, the payment terms are not in line with the entity’s performance under this “new” contract, since payments will be received in years 5 and 6 at the blended rate of $30/MWh. Company A should therefore consider whether a significant financing component has been created in the new contract, since the payments made in years 5 and 6 under the new contract are higher than the stand-alone selling price (Company B is paying Company A back for its financing in years 3 and 4) while the payments in years 3 and 4 are lower than those under the original contract because of the blended rate that Company A and Company B agreed to as part of the contract modification.
P&U entities should be aware that while gas processing and other tolling arrangements may be structured similarly to commodity exchange arrangements, the applicability of the ASU to the two types of arrangements may differ.

**Example (continued)**

If the modified price for the additional power in years 5 and 6 is not determined to be the stand-alone selling price and the power in years 3 to 6 (i.e., the remaining undelivered goods as of the contract modification) is assessed and determined to be “distinct” from the power provided in years 1 and 2, the contract modification is not treated as a new contract but as a prospective modification and the blended rate of $30/MWh is recognized for power delivered throughout the remaining contract (years 3 to 6). In such circumstances, an entity would generally conclude that no financing is present.

**Commodity Exchange Arrangements**

**Scope Considerations**

Commodity exchange arrangements are common in the P&U industry. In these arrangements, an entity agrees to sell a certain quantity and grade of a commodity to a counterparty at a specified location and simultaneously agrees to buy a specific quantity and grade of a similar commodity from that same counterparty at another location. In effect, specified inventories of the two parties are exchanged (e.g., in-ground natural gas inventories are exchanged at different storage hubs). Entities usually enter into such arrangements to avoid ancillary costs (e.g., transportation costs).

Companies may need to determine whether these types of arrangements are outside the scope of the new revenue recognition model and are instead accounted for under ASC 845. Generally, the purpose of exchange arrangements is to allow the parties to meet the needs of the market; therefore, the parties in such arrangements are not considered to be the end-user purchasers of the product if they are in the same line of business. Although a counterparty in a commodity exchange arrangement may meet the ASU’s definition of a “customer,” nonmonetary exchanges between two parties in the “same line of business” are outside the new standard’s scope. Therefore, the new revenue model is not expected to have a significant impact on commodity exchange arrangements.

**Thinking It Through**

In certain arrangements, a marketer or other P&U entity may agree to sell wet gas to a gas processor and simultaneously buy back, as separate products, dry gas, condensates, natural gas liquids, etc. Such agreements are considered tolling arrangements, and P&U entities should carefully assess these arrangements to determine whether they are within the scope of the new revenue guidance or constitute a lease or receipt of a processing service that is accounted for under other U.S. GAAP. Similar considerations would also apply to gas-to-power tolls. P&U entities should be aware that while gas processing and other tolling arrangements may be structured similarly to commodity exchange arrangements, the applicability of the ASU to the two types of arrangements may differ.

**Distinct Performance Obligations**

**Identifying the Performance Obligation in the Contract**

The ASU provides guidance on evaluating the promised “goods or services”7 in a contract to determine each performance obligation (i.e., the unit of account). A performance obligation is each promise to transfer either of the following to a customer:

- “A good or service (or a bundle of goods or services) that is distinct.”
- “A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.”

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7 Although the ASU does not define goods or services, it includes several examples, such as goods produced (purchased) for sale (resale), granting a license, and performing contractually agreed-upon tasks.
The ASU requires entities to perform a qualitative assessment that takes into account the likelihood and magnitude of a potential revenue reversal and provides factors that could indicate that an estimate of variable consideration is subject to significant reversal.

Under the ASU, a series of distinct goods or services has the same pattern of transfer if both of the following criteria are met: (1) each distinct good or service in the series meets the criteria for recognition over time and (2) the same measure of progress is used to depict performance in the contract. Therefore, a simple forward sale of electricity, natural gas, etc., for which delivery of the same product is required over time would generally be treated as a single performance obligation satisfied continuously throughout the contract. In this case, a P&U entity would determine an appropriate method for measuring progress toward complete satisfaction of the single performance obligation and would recognize the transaction price as revenue as progress is made.

Variable Pricing

**Determining the Transaction Price**

The use of variable consideration (e.g., index or formula-based pricing), as well as uncertainty regarding delivery quantity, may present challenges related to estimating and allocating the transaction price and applying the ASU’s constraint guidance. For example, a P&U entity may have a multイヤ年 contract to sell a fixed quantity of electricity each hour by using a price derived from a formula. When the transaction price includes a variable amount, an entity must estimate the variable consideration by using either an “expected value” (probability-weighted) approach or a “most likely amount” approach, whichever is more predictive of the amount to which the entity will be entitled.

An estimate of variable consideration is only included in the transaction price to the extent that it is probable that subsequent changes in the estimate would not result in a “significant reversal” of revenue. This concept is commonly referred to as the “constraint.” The ASU requires entities to perform a qualitative assessment that takes into account the likelihood and magnitude of a potential revenue reversal and provides factors that could indicate that an estimate of variable consideration is subject to significant reversal (e.g., susceptibility to factors outside the entity’s influence, long period before uncertainty is resolved, limited experience with similar types of contracts, practices of providing concessions, or a broad range of possible consideration amounts). This estimate would be updated in each reporting period to reflect changes in facts and circumstances.

**Thinking It Through**

A contract may include various types of consideration. In some cases, an entity may need to use significant judgment in estimating certain variable amounts (e.g., amounts based on wind generation). In other instances, amounts may vary but are more easily estimated, such as potential minimum fees or charges that are in-substance fixed (e.g., a capacity charge). When evaluating the constraint in such cases, an entity would determine the significance of the potential reversal of revenue by comparing the potential reversal with the total consideration (including both fixed and variable consideration). The larger the fixed consideration (e.g., guaranteed minimum or capacity charges) is in proportion to the total consideration, the greater the chance that amounts of variable consideration would not create the potential for a “significant” reversal (i.e., the estimate would not be “constrained” and would therefore be included in the transaction price).

**Power Purchase Agreements**

PPAs typically give the power purchaser the right, over the term of the contract, to buy from the independent power producer an amount of energy in exchange for a fixed price, a variable price, or a combination of fixed and variable pricing.

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8 “Probable” in this context has the same meaning as in ASC 450-20: “the event or events are likely to occur.” In IFRS 15, the IASB uses the term “highly probable,” which has the same meaning as the FASB’s “probable.”
Identify the Contract With a Customer

Two P&U entities will often collaborate to develop a new generator, plant, or asset; in such contracts, one of the two parties will agree to off-take part or all of the power produced. For example, an industrial manufacturer or utility that wants to obtain power and green attributes may collaborate with a supplier (that will construct, own, and retain tax benefits from the generating asset) to design and develop a solar or wind farm. The parties in such collaborative arrangements will need to consider all facts and circumstances to determine whether a supplier/customer relationship exists.

Identifying the Performance Obligation(s) in the Contract

A PPA is a good example of an arrangement in which a series of distinct goods is accounted for as a single performance obligation. That is, when PPAs do not qualify as leases or derivatives, P&U entities may conclude under the ASU that a PPA represents a single performance obligation satisfied over time because:

- The product is substantially the same and will be transferred consecutively in the series (see ASC 606-10-25-14(b)) — for example, in consecutive hourly deliveries of electricity over multiple years.
- The customer will simultaneously receive and consume the benefits of each distinct delivery of electricity (i.e., the delivery of electricity meets the criterion in ASC 606-10-25-27(a) and, as a result, the series meets the criterion in ASC 606-10-25-15(a)).
- The same measure of progress for each distinct delivery of electricity (e.g., a unit-based measure) would be used, thereby satisfying the criterion in ASC 606-10-25-15(b).

Determining the Transaction Price

The amount and timing of contract pricing in a PPA can vary as a result of a number of commercial terms and contract provisions. PPAs, including those related to renewable energy sources such as wind, often contain explicit variable pricing provisions. Such PPAs might also include payment amounts related to a minimum availability requirement — for example, to ensure that the supplier’s investment in the generation asset is recovered. This minimum availability payment may be relatively large compared with variable payments. Although the minimum availability payment may depend on the entity’s ability to make available the renewable energy source throughout the PPA, such availability may be entirely within the entity’s control.

The ASU states that when determining the transaction price, an entity should “assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed, or modified.” Because the entity can anticipate its own performance when determining the transaction price, the evaluation of the constraint (i.e., whether a significant revenue reversal may occur) may be eased as the magnitude of any potential subsequent reversal is mitigated by the fixed consideration (i.e., the minimum availability payment). See the Variable Pricing section for additional discussion.

Recognizing Revenue When (or as) Performance Obligations Are Satisfied

A supplier recognizes revenue in a PPA that is determined to be a performance obligation satisfied over time by measuring progress toward satisfying the performance obligation in a manner that best depicts the transfer of goods or services to the customer.
contracts will be recognized at the contract price (i.e., will not give rise to embedded financing elements). P&U entities will need to consider this approach when assessing contracts with other pricing conventions (e.g., step-price arrangements).

**Thinking It Through**

PPAs commonly include a combination of fixed, variable, and stepped pricing or provide for volume variability based on contingent factors. When implementing the ASU, P&U entities should carefully consider existing and future PPAs to determine whether they contain such complex terms, which may make it more difficult for them to apply the new revenue model to determine the transaction price and measure progress toward satisfying relevant performance obligations.

**Take-or-Pay Arrangements**

In a take-or-pay arrangement, a customer pays a specified price to a supplier for a minimum volume of product or level of services. Such an arrangement is referred to as “take-or-pay” because the customer must pay for the product or services regardless of whether it actually takes delivery. Power, natural gas, and other energy commodity off-take contracts, as well as certain service arrangements (e.g., those related to natural gas storage or transportation), may be structured as take-or-pay.

**Identifying the Performance Obligations in the Contract**

As in a PPA, in a take-or-pay arrangement, the supplier would generally conclude under the ASU that it has entered into a contract with a customer to deliver a series of distinct, but substantially the same, goods delivered consecutively over time (see discussion above in Distinct Performance Obligations). The supplier should account for that series of distinct goods as a single performance obligation — and as a single unit of account — because:

- The customer simultaneously receives and consumes the benefits of each distinct delivery of electricity or other commodity (i.e., the delivery of electricity meets the criterion in ASC 606-10-25-27(a) and, as a result, the series meets the criterion in ASC 606-10-25-15(a)).
- The same measure of progress for each distinct delivery of electricity or other commodity (e.g., a unit-based measure) would be used, thereby satisfying the criterion in ASC 606-10-25-15(b).

**Recognizing Revenue When (or as) Performance Obligations Are Satisfied**

Because the performance obligation in a take-or-pay arrangement is satisfied over time, the supplier recognizes revenue by measuring progress toward satisfying the performance obligation in a manner that best depicts the transfer of goods or services to the customer. The best depiction of the supplier’s performance in transferring control of the goods and satisfying its performance obligation may differ depending on the terms of the take-or-pay arrangement:

- Consider a vanilla take-or-pay arrangement for monthly deliveries of natural gas whereby the customer pays irrespective of whether it takes delivery and does not have the ability to make up deliveries not taken. In this case, it may be appropriate to use an output measure of progress based on time to recognize revenue because the supplier could be satisfying its performance obligation as each month passes.
- In a take-or-pay arrangement for monthly deliveries of natural gas whereby the customer can make up deliveries not taken later in the contract tenor, an output measure of progress based on units delivered may be appropriate. In this case, the supplier should recognize revenue for volumes of natural gas actually delivered to the customer each month and recognize a contract liability for volumes not taken, since the supplier’s performance obligation associated with those volumes is unsatisfied despite receipt of customer payment.

As in a PPA, in a take-or-pay arrangement, the supplier would generally conclude under the ASU that it has entered into a contract with a customer to deliver a series of distinct, but substantially the same, goods delivered consecutively over time.
Bundled Arrangements

Electricity is often sold in conjunction with other energy-related products and services, including capacity, various ancillary services such as voltage control, and renewable energy certificates (RECs). Companies regularly enter into transactions involving such items as energy, RECs, and capacity in a single contract, often with one transaction price.

Scope Considerations

ASU 2014-09 explicitly states that if other Codification topics address how to separate and account for the different products and services in a contract with a customer, entities should look to those topics first. Specifically, ASC 606-10-15-4 states:

A contract with a customer may be partially within the scope of this Topic and partially within the scope of other Topics. . . .

a. If the other Topics specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement guidance in those Topics . . . .

b. If the other Topics do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply the guidance in this Topic to separate and/or initially measure the part (or parts) of the contract.

P&U entities should carefully consider their contracts with customers for multiple products and services and assess whether (1) products or services separated in accordance with the guidance in other Codification topics should be accounted for under ASU 2014-09 and (2) an entity should apply ASU 2014-09’s guidance on distinct performance obligations when separating multiple products and services in contracts with customers.

Identifying the Performance Obligation in the Contract

As discussed above, P&U entities that sell, for example, RECs together with the related energy may need to assess whether the promise to deliver RECs represents a performance obligation that is “distinct” from the promise to deliver electricity (see discussion above in Distinct Performance Obligations). Under the ASU, a performance obligation is distinct if it meets both of the following criteria in ASC 606-10-25-19:

• The good or service in the performance obligation is capable of being distinct (i.e., the customer can benefit from the good or service on its own or with readily available resources).

• The good or service is distinct in the context of the contract (i.e., it is separately identifiable from other goods or services in the contract).

If an entity concludes that the promise to deliver the RECs, for example, meets both criteria, that promise will be considered a distinct performance obligation. The transaction consideration will be proportionally allocated to each performance obligation (e.g., to the electricity and RECs).

Recognizing Revenue When (or as) Performance Obligations Are Satisfied

After determining which goods or services in the bundled arrangement result in distinct performance obligations, a P&U entity must assess when control of the good or service within each performance obligation is transferred (i.e., over time or at a point in time) to determine when revenue will be recognized.

Control of a good or service (and therefore satisfaction of the related performance obligation) is transferred over time when at least one of the following criteria is met:

• “The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.”

• “The entity’s performance creates or enhances an asset . . . . that the customer controls as the asset is created or enhanced.”

• “The entity’s performance does not create an asset with an alternative use to the entity . . . . and the entity has an enforceable right to payment for performance completed to date.”
If a performance obligation is not satisfied over time, it is deemed satisfied at a point in time. Under the ASU, entities would consider the following indicators in evaluating the point at which control of an asset has been transferred to a customer:

- "The entity has a present right to payment for the asset."
- "The customer has legal title to the asset."
- "The entity has transferred physical possession of the asset."
- "The customer has the significant risks and rewards of ownership of the asset."
- "The customer has accepted the asset."

The recognition of revenue is determined separately for each distinct performance obligation within a bundled arrangement. Therefore, there may be delays in the recognition of revenue attributable to other products and services that are sold with the related energy.

In the REC example above (in which the RECs are a distinct performance obligation), for instance, the P&U entity would need to appropriately consider the manner that best depicts the transfer of the RECs to the off-taker as it determines when it has satisfied the distinct performance obligation to deliver the certificates. If the title of the certificate is not transferred when the energy is sold (e.g., as a result of certification lag), control of the certificates may not have been transferred to the off-taker. Thus, revenue from the RECs may not be recognized at the same time as it is for the energy.

**Thinking It Through**

Some entities have historically concluded that, while the transfer of the title to RECs may lag behind the selling of the energy, certification is perfunctory after generation of the energy is complete and the patterns of revenue recognition for RECs should therefore match those for the energy. Entities may need to revisit this practice when adopting the ASU.

**Sales of Power-Generating Property, Plant, and Equipment**

P&U entities often enter into arrangements that include the full or partial sale of power-generating property, plant, and equipment (e.g., transactions involving the sale of all or a part of power plants, solar farms, and wind farms). Under current GAAP, depending on the nature of the transaction, an entity might conclude that the transaction is the sale of a business and account for it under ASC 810-10 or, alternatively, conclude that it is the sale of real estate and account for it under ASC 360-20.

**In-Substance Nonfinancial Assets**

Currently, entities account for the sale of real estate in the form of a financial asset by applying both the real estate sales guidance in ASC 360 and the guidance in ASC 810 (rather than only the deconsolidation guidance in ASC 810) if the sale involves an investment that is considered in-substance real estate (e.g., an equity interest in an entity whose sole asset is a single property). In addition, entities evaluate the disposal of equipment attached to real estate assets in accordance with ASC 360 if the equipment is considered integral equipment.

The ASU expands the concept of in-substance real estate to include all in-substance nonfinancial assets. Accordingly, an entity applies only the deconsolidation guidance in ASC 810 when the transfer or sale of a subsidiary or business is not considered the sale of in-substance nonfinancial assets. While the ASU does not define in-substance nonfinancial assets, a transaction that historically has been outside the scope of ASC 360 may be accounted for under the ASU’s guidance (rather than only ASC 810) if the entity substantially comprises nonfinancial assets (including real estate).
Thinking It Through

The ASU’s consequential amendments eliminate the guidance in ASC 360-20 on sales of real estate. Entities will therefore need to apply the new guidance in ASC 606 on sales or transfers of nonfinancial assets (including real estate). See Deloitte’s July 2, 2014, Heads Up for additional information, including considerations related to evaluating various forms of continuing involvement.

Accounting for Partial Sales

Under ASC 360, a sale is considered a partial sale if the seller retains an equity interest in the property (or the buyer). Profit (the difference between the sales price and the proportionate cost of the partial interest sold) is recognized only for the portion sold if the buyer is independent of the seller (i.e., not a consolidated subsidiary of the seller) and if certain other requirements are met. The ASU does not carry forward the current guidance in ASC 360 on partial sales and does not provide guidance on the appropriate unit of account for performing this evaluation. Specifically, the ASU does not indicate whether the evaluation should focus on the transfer of control of the interest in the entity (as it would for the sale of an undivided interest) or on the transfer of control of the underlying asset held by the entity. The focus of the evaluation could significantly affect an entity’s determination of whether control has been transferred.

The FASB is currently evaluating its guidance on partial sales or transfers of nonfinancial assets as part of its project to clarify the definition of a business. However, if the FASB does not complete this project by the time the ASU becomes effective, diversity in practice may evolve since entities may apply different approaches to determine how to account for partial sales of nonfinancial assets in accordance with the ASU.

Disclosures

The ASU requires significantly more disclosures, including additional quantitative and qualitative information that enables “users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.” The ASU’s disclosure requirements include:

- Presentation or disclosure of revenue and any impairment losses recognized separately from other sources of revenue or impairment losses from other contracts.
- A disaggregation of revenue to “depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors” (the ASU also provides implementation guidance).
- Information about contract assets and liabilities (including changes in those balances) and the amount of revenue recognized in the current period that was previously recognized as a contract liability and amount of revenue recognized in the current period that is related to performance obligations satisfied in prior periods.
- Information about performance obligations (e.g., types of goods or services, significant payment terms, typical timing of satisfying obligations, and other provisions).
- Information about an entity’s transaction price allocated to the remaining performance obligations, including (in certain circumstances) the “aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied)” and when the entity expects to recognize that amount as revenue.

With certain exceptions for nonpublic entities (see Appendix C of Deloitte’s May 28, 2014, Heads Up for a summary of these exceptions).
• A description of the significant judgments, and changes in those judgments, that affect the amount and timing of revenue recognition (including information about the timing of satisfaction of performance obligations, the determination of the transaction price, and the allocation of the transaction price to performance obligations).

• Information about an entity’s accounting for costs to obtain or fulfill a contract (including account balances and amortization methods).

• Information about the policy decisions (i.e., whether the entity used the practical expedients for significant financing components and contract costs allowed by the ASU).

The ASU requires entities, on an interim basis, to disclose information required under ASC 270 as well as to provide annual disclosures (described above) about (1) the disaggregation of revenue, (2) contract asset and liability balances and significant changes in those balances since the previous period-end, and (3) information about the remaining performance obligations.

### Effective Date and Transition

The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, for public entities. Early application is not permitted (however, early adoption is optional for entities reporting under IFRSs).

The effective date for nonpublic entities is annual reporting periods beginning after December 15, 2017, and interim reporting periods within annual reporting periods beginning after December 15, 2018. Nonpublic entities may also elect to apply the ASU as of any of the following:

- The same effective date as that for public entities (annual reporting periods beginning after December 15, 2016, including interim periods).
- Annual periods beginning after December 15, 2016 (excluding interim reporting periods).
- Annual periods beginning after December 15, 2017 (including interim reporting periods).

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU.

- **Full retrospective application** — Retrospective application would take into account the requirements in ASC 250 (with certain practical expedients).
- **Modified retrospective application** — Under the modified approach, an entity recognizes “the cumulative effect of initially applying [the ASU] as an adjustment to the opening balance of retained earnings . . . of the annual reporting period that includes the date of initial application” (revenue in periods presented in the financial statements before that date is reported under guidance in effect before the change). Under the modified approach, the guidance in the ASU is only applied to existing contracts (those for which the entity has remaining performance obligations) as of, and new contracts after, the date of initial application. The ASU is not applied to contracts that were completed before the effective date (i.e., for which an entity has no remaining performance obligations to fulfill). Entities that elect the modified approach must disclose an explanation of the impact of adopting the ASU, including the financial statement line items.

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10 The FASB has offered nonpublic entities some practical expedients that they can use to avoid providing certain of the disclosures required by the ASU. For additional information about this disclosure relief, see Appendix C of Deloitte’s May 28, 2014, Heads Up.
and respective amounts directly affected by the standard’s application. The following chart illustrates the application of the ASU and legacy GAAP under the modified approach:

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial Application Year</strong></td>
<td><strong>Current Year</strong></td>
<td><strong>Prior Year 1</strong></td>
<td><strong>Prior Year 2</strong></td>
</tr>
<tr>
<td>New contracts</td>
<td>New ASU</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing contracts</td>
<td>New ASU + cumulative catch-up</td>
<td>Legacy GAAP</td>
<td>Legacy GAAP</td>
</tr>
<tr>
<td>Completed contracts</td>
<td></td>
<td>Legacy GAAP</td>
<td>Legacy GAAP</td>
</tr>
</tbody>
</table>

**Thinking It Through**

The modified transition approach offers entities relief from having to restate and present comparable prior-year financial statement information. However, entities will still need to evaluate existing contracts as of the date of initial adoption under the ASU to determine whether a cumulative adjustment is necessary. Therefore, entities may want to begin considering the typical nature and duration of their contracts to understand the impact of applying the ASU and determine the transition approach that is practical to apply and most beneficial to financial statement users.

**Implementation Challenges**

**Increased Use of Judgment**

Management will need to exercise significant judgment in applying certain aspects of the ASU’s requirements, including those related to the identification of performance obligations, determination of the transaction price, and allocation of revenue to each performance obligation. It is important for entities to consider how the ASU specifically applies to them so that they can prepare for any changes in revenue recognition patterns.

**Retrospective Application**

The ASU requires retrospective application (whether full or modified), with certain optional practical expedients available to entities at their discretion. This aspect of the ASU may require P&U entities to gather data and assess contracts that commenced several years before the ASU’s effective date (e.g., long-term power sales agreements). P&U entities also will most likely be required to perform dual tracking of revenue balances during this retrospective period, given the potential difficulty associated with retroactively recalculating revenue balances at the time the new ASU becomes effective.

**Systems, Processes, and Controls**

The ASU requires several new practices and disclosure requirements under which P&U entities will have to gather and track information that they may not have previously monitored. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems.

P&U entities with large volumes of sales contracts may find it operationally challenging to assess each sales contract to categorize and account for customer incentives in accordance with the ASU. Such entities may need to make substantial system modifications to facilitate this process.

P&U entities may also recognize an asset for certain costs of obtaining or fulfilling a contract (unless the amortization period is one year or less and entities choose to recognize those costs as expenses immediately). P&U entities may need to modify their current accounting practices and make appropriate system modifications to track data on contract duration, contract costs, and periodic amortization and impairment testing of capitalized costs.
Further, to ensure the effectiveness of internal controls over financial reporting, management will need to assess whether additional controls need to be implemented. P&U entities may also need to begin aggregating essential data from new and existing contracts since many of these contracts will most likely be subject to the ASU.

**Thinking It Through**

Note that the above are only a few examples of possible changes P&U entities may need to make to their systems, processes, and controls. P&U entities should evaluate all aspects of the ASU’s requirements to determine whether any other modifications may be necessary.

**Income Taxes**

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include advance payments for goods and services). These rules are often consistent with the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer applies the revenue recognition method it uses in maintaining its books and records (e.g., cash basis, U.S. GAAP, IFRSs). Although the Internal Revenue Code does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on a Schedule M) to properly account for income taxes. The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income because companies are often permitted to use the same methods for tax purposes as they use for financial accounting purposes. Thus, it will be important for tax professionals to understand the detailed financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

If a change in a tax accounting method is advantageous or expedient (including circumstances in which the book method has historically been used), the taxpayer will most likely be required to obtain approval from the relevant tax authorities to use the method. Similar implications may arise in foreign jurisdictions that maintain statutory accounting records under U.S. GAAP or IFRSs.

**Thinking Ahead**

Although the ASU is not effective until annual periods beginning after December 15, 2016 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), P&U entities should start carefully examining the ASU and assessing the impact it may have on their current accounting policies, procedures, systems, and processes.

Deloitte has an experienced team of professionals, both in the United States and globally throughout the member firms of Deloitte Touche Tohmatsu Limited, who can assist in implementing the new revenue recognition standard. In addition to our role as assurance providers, our capabilities include the full breadth of services and competencies needed to help clients address these issues, such as 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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