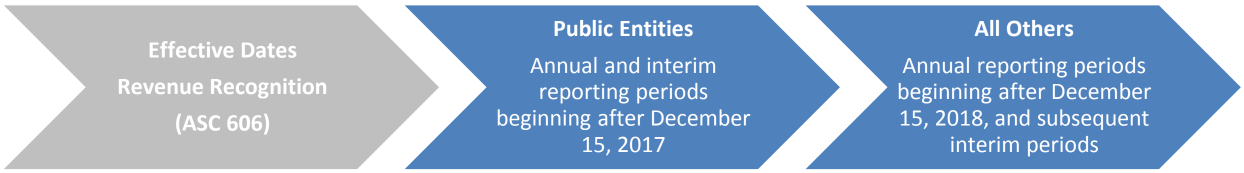
Revenue Changes for Energy Companies

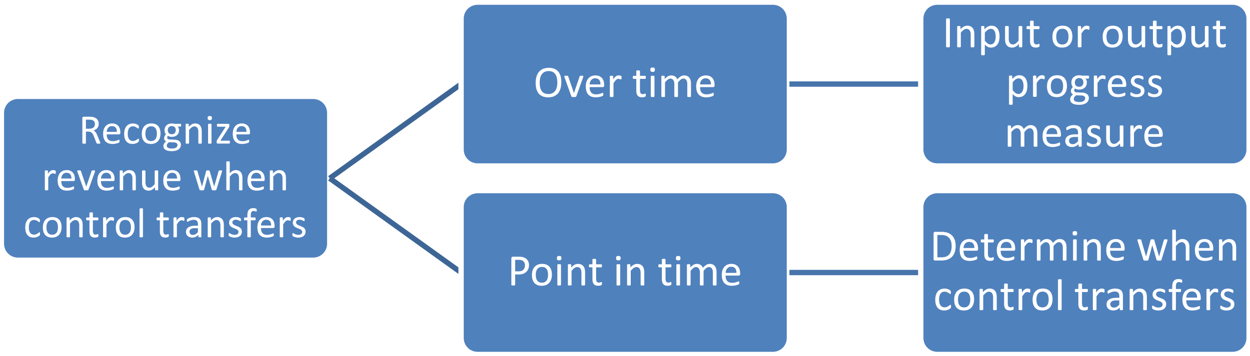
Revenue recognition will change with the adoption of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606), which supersedes most industry-specific guidance and adds significant disclosures. Implementation is a significant undertaking for entities across all industries. Energy companies face additional challenges due to the variety of revenue streams and industry regulations. The effect on each company will vary depending on existing income streams, customer base and current estimation methodologies and accounting elections.



Recent U.S. Securities and Exchange Commission (SEC) filings give us insight into the most significant changes expected for the energy and utility sectors. After lengthy, costly and time-consuming implementation efforts, most large accelerated filers do not expect a material change to the bottom line or to the timing or pattern of revenue recognition for major income streams. This effect belies the efforts to date and ongoing maintenance required, including redrafting accounting policies, updating internal controls and modifying IT systems. This is the first major principles-based standard that will require substantially more management judgment, supporting documentation and disclosure than previous strict criteria-based guidance. In some cases, companies may come to different conclusions on seemingly similar transactions. Below are key themes noted in recent 10-K filings for 2017 year-ends.

Revenue Recognition

Under Accounting Standards Codification (ASC) 606, an entity recognizes revenue when (or as) a performance obligation is satisfied by transferring a promised good or service to a customer. For performance obligations satisfied at a point in time, the associated revenue would be recognized at that point in time. For performance obligations satisfied over time, an entity must choose a recognition method that best depicts the transfer of goods or services. Entities should consider all relevant facts and circumstances in making this assessment—the inherent nature of the commodity, specific contract terms and information about infrastructure or other delivery mechanisms. Deciding the appropriate recognition pattern can be a significant management judgment. Conclusions will depend on a company's unique facts and circumstances and should be properly documented for an auditor's and regulator's review.



Filings of energy companies state:

> *NextEra Energy*
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> *FPL will recognize revenues under the new revenue standard as electricity is delivered and billed to customers, as well as an estimate for electricity delivered and not yet billed. NEER's revenue from contracts with customers is derived primarily from the sale of energy commodities, electric capacity and electric transmission. For these types of sales, NEER will recognize revenues under the new revenue standard as energy commodities are delivered and as electric capacity and electric transmission are made available, consistent with the amounts billed to customers. NEER believes for substantially all of its contracts with customers that the obligation to deliver energy, capacity or transmission is satisfied over time as the customer simultaneously receives and consumes benefits as NEER performs. Revenue recognition under the new revenue standard for both FPL and NEER is substantially consistent with prior practice and as a result the cumulative effect of adopting the new revenue standard on January 1, 2018 was not material to NEE or FPL.*

> *Valero Energy*
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> *The majority of our revenues are generated from the sale of refined petroleum products and ethanol. These revenues are largely based on the current spot (market) prices of the products sold, which represent consideration specifically allocable to the products being sold on a given day, and we recognize those revenues upon delivery and transfer of title to the products to our customers. The time at which delivery and transfer of title occurs is the point when our control of the products is transferred to our customers and when our performance obligation to our customers is fulfilled.*

Entitlement Method Eliminated

The SEC has rescinded existing guidance related to balancing arrangements. Previously, entities could record revenue related to production imbalance arrangements by using either an entitlements method or sales method.

> *EOG Resources*
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> *In May 2016, the FASB issued ASU 2016-11, which rescinds certain SEC guidance in the related ASC, including guidance related to the use of the "entitlements" method of revenue recognition used by EOG.*

Revenue Presentation

Any income streams that are not in ASC 606's scope must be separately identified on the income statement. Income streams outside of ASC's scope include, but are not limited to, collaborative arrangements, certain commodity exchange transactions, derivatives and alternative revenue programs.

> *PS&E*
>
> *Upon adoption of ASU 2014-09, the Utility plans to disclose revenues from contracts with customers separately from regulatory balancing account revenue and disaggregate customer contract revenue by customer class.*

> *Southern Company*
>
> *Some revenue arrangements, such as certain PPAs, energy-related derivatives, and alternative revenue programs, are excluded from the scope of ASC 606 and, therefore, will be accounted for and disclosed or presented separately from revenues under ASC 606 on Southern Company's financial statements. Southern Company has concluded contributions in aid of construction are not in scope for ASC 606 and will continue to be accounted for as an offset to property, plant, and equipment.*

> *Duke Energy*
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> *Some revenue arrangements, such as alternative revenue programs and certain PPAs accounted for as leases, are excluded from the scope of the new revenue recognition guidance and, therefore, will be accounted for and evaluated for separate presentation and disclosure under other relevant accounting guidance.*

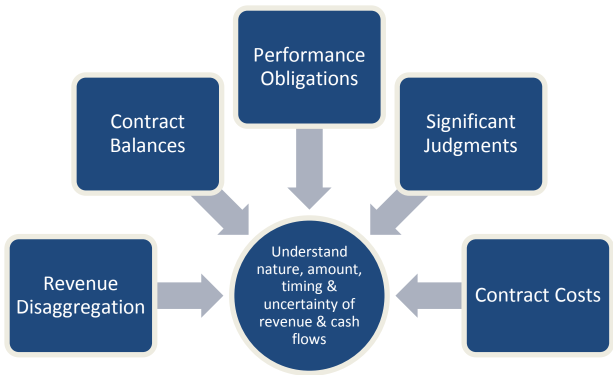
Sales Taxes

As originally issued, ASU 2014-09 required amounts collected on behalf of third parties, *e.g.*, some sales taxes, to be excluded from the transaction price. Entities would have to evaluate taxes collected in multiple jurisdictions to determine if a tax is levied on the entity or customer. The Financial Accounting Standards Board reconsidered, and a subsequent amendment created an accounting policy election to present sales taxes collected from customers on a net basis. An entity not making this accounting policy election would apply the new revenue standard—as originally issued—in determining if those taxes should be included in the transaction price. Most of the large energy companies have indicated they will exclude sales-based taxes collected on behalf of third parties from the transaction price.

> *Exxon*
>
> *"Sales and Other Operating Revenue" on the Consolidated Statement of Income includes sales, excise and value-added taxes on sales transactions. When the Corporation adopts the standard, revenue will exclude sales-based taxes collected on behalf of third parties.*

Disclosures

Companies in all industries that have early adopted the new revenue standard have found this area to be more challenging than initially anticipated. The new revenue standard provides significant relief for nonpublic entities and less focus on quantitative disclosures. In most cases, additional data will need to be collected and additional monitoring and record keeping will be required.



Duke Energy
Duke Energy anticipates additional disclosures around the nature, amount, timing and uncertainty of our revenues and cash flows arising from contracts with customers. Duke Energy continues to evaluate what information will be most useful for users of the financial statements, including information already provided in disclosures outside of the financial statement footnotes. These additional disclosures are expected to include the disaggregation of revenues by customer class.

Pioneer
The Company continues to review its implementation documentation and its evaluation of the new disclosure requirements is ongoing.

Adoption

Entities must adopt the new revenue standard using either a full or modified retrospective approach with multiple practical expedients offered to provide transition relief. Under the full retrospective approach, entities would apply the new revenue standard as if it had been in effect since the inception of all customer contracts. Under the modified approach, the cumulative effect of initial application is recognized in opening retained earnings at the adoption date. Relief is provided so an entity could apply the new revenue standard either to all contracts as of the adoption date or only to uncompleted contracts. Annual 10-K filings revealed that most energy and power and utility companies chose a modified retrospective approach to adoption.

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