

March 13, 2012

Technical Director
File Reference: 2011-230
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Technical Director:

File Reference: 2011-230 - Revenue Recognition (Topic 605) Revenue from Contracts with Customers

The American Gas Association ("AGA") is pleased to submit our comments on the Financial Accounting Standards Board's (FASB or the Board) Proposed Accounting Standards Update—*Revenue Recognition (Topic 605) Revenue from Contracts with Customers* (the "revised ED" or simply "the ED"). Founded in 1918, AGA represents 199 local energy companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which 91 percent — more than 64 million customers — receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.

AGA appreciates the FASB and International Accounting Standards Board (collectively the Boards) considering our comment letter dated October 22, 2010 on the initial ED, and we note that the revised ED addressed certain important concerns that we initially raised, such as the classification of credit risk and the retention of the guidance for alternative revenue programs currently included in ASC 980 - *Regulated Operations*. We have no further comments on those areas. Therefore, we have limited our comments and responses to questions for which we have specific concerns and items for which we either request clarification, make recommendations, or wish to convey our support.

As with other recent standard setting activities, we share views similar to those expressed within the Edison Electric Institute's (EEI) comment letter on the revised ED. As noted therein, the underlying issues behind our industry's specific questions and concerns will be broadly applicable to many other industries, in particular any industry that continuously delivers the same product over multiple forward delivery periods (i.e., any industry that sells commodities), have

month-to-month services that can be cancelled at any time by the customer, and/or have pricing based on a future market price, including the gas, coal, metals and agriculture industries. We appreciate your consideration of our comments in response to the underlying issues.

Executive Summary

Highlights of our comments are summarized as follows:

- We seek clarification on the identification of a 'distinct' performance obligation, transaction price allocation, measurement of revenue, contract modifications, and contracts with multiple products (i.e., a single contract that incorporates bundled products).
- We support the practical expedient to account for two or more goods or services as a single performance obligation if they have the same pattern of transfer to the customer.
- We disagree with the proposals related to onerous performance obligations.
- We believe the proposed disclosures of the remaining and expected timing of satisfaction of performance obligations could be misleading, misinterpreted by users, and potentially create discrepancies with other financial information provided to investors.

We provide our detailed comments below.

Identification and Satisfaction of Performance Obligations (Question 1 in the ED)

Long term physical gas contracts involve the obligation to continuously deliver a fungible product to customers over multiple forward delivery periods, which may also include reservation charges for related capacity services (storage and/or transportation) either billed separately or as a single/bundled charge. These items can typically be bought and sold separately in most North American markets and are usually provided to the customer simultaneously with the delivery of the commodity (natural gas). Similar to the electricity industry, these delivery periods are commonly defined in terms of months for forward pricing, contractual terms, and billing purposes. Given this background, we believe that the obligation to deliver gas and the related services in each forward delivery period (month) represent separate and distinct performance obligations in accordance with paragraph 28 of the ED. While delivery of gas can be measured as granularly as per mmbtu at the meter, and is priced/sold separately as frequently as daily on a spot basis, the cost and effort of accounting for these products at these levels does not provide any incremental benefit and does not, in our view, change the pattern of revenue recognition. Therefore, we suggest adding practical expedient clarifications to the "sold separately" concepts within sub-parts (a) and (b) of paragraph 28 to indicate that conventional market pricing and billing practices may also be considered in determining the granularity of identified performance obligations on a forward-looking basis.

We also believe that the individual increments of these products and services delivered to the customer meet the criteria in paragraph 37 of the ED for satisfaction of performance obligations as of a point in time (i.e., as each mmbtu delivered is metered, title, physical possession, and the benefits thereof transfer to the customer upon immediate receipt / consumption, and the seller has a present right to payment upon delivery to the customer [independent of any future

deliveries]). Along with the commodity, the benefit of related services such as capacity are also delivered to, and consumed by, the customer as the gas is consumed. Finally, the delivery of these items does not create or enhance an asset over time and each has an alternative use to the seller as they can be sold separately; thus, these items are not delivered "over time". However, as the examples of identification and satisfaction of performance obligations currently in the ED relate primarily to the delivery of different products, we support the EEI's request that the Boards provide an example related to the continuous delivery of the same product(s) over multiple forward delivery periods as representative of multiple distinct performance obligations.

Given our view that energy commodities are transferred at points in time, we strongly support the practical expedient included in paragraph 30 of the ED that permits an entity to account for multiple distinct products together (even if they are not considered a single performance obligation) if they have the same pattern of transfer to the customer (i.e., delivered to the customer over the same period of time (emphasis added)). For sales of energy commodities, revenue is typically accounted for on a monthly basis and we would continue to view this as appropriate in light of the exception in the ED. We believe this exception will help to avoid the undue cost and effort of accounting for individual distinct performance obligations at the most granular level (i.e., price allocation to individual mmbtus, etc.) when accounting for them in combination yields immaterially different reported financial results.

Also, as explained in further detail within the EEI's comment letter on the practical expedient, we believe it can also be used to support the assertion that multiple deliveries of the same product (commodity) over the entire term of contract is consistent with the "same pattern of transfer" / "delivered over the same period of time" concepts, and would thus allow one to treat such individually distinct delivery performance obligations as if they are a single, continuously satisfied performance obligation over the life of the contract. Under such view, a reasonable measure of progress would be chosen (likely the "output method" as indicated in paragraph 41's example of "units produced"). Paragraph 42 goes on to indicate, with a similar example, that "if an entity has a right to invoice a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date...[which the paragraph indicates could be] a fixed amount for each hour of service [or goods] provided [emphasis added], the entity shall recognize revenue in the amount to which the entity has a right to invoice [emphasis added]." This is true for our industry's contracts, given the transfer pattern discussed above and the fact that the customer's desire to contract on a term (forward) basis provides them the value of fixing their per-unit costs.

Transaction Price Allocation

Consistent with the ED's core principle, paragraph 50 of the ED states that the transaction price is the amount of *consideration to which an entity* <u>expects to be entitled</u> in exchange for transferring promised goods or services (i.e., performance obligations) to a customer (emphasis added). Further, paragraph 70 states that an entity shall allocate the transaction price to each separate performance obligation in a similar manner (i.e., in an amount that depicts the amount of *consideration to which the entity* <u>expects to be entitled</u>...for <u>each separate</u> performance obligation, emphasis added). However, paragraphs 71 and 72 state that consideration should be allocated to each performance obligation based on the relative standalone selling price of each

underlying good or service, and that contractually stated prices may, but shall not be presumed to, represent standalone selling prices.

As more fully articulated in the EEI's comment letter on this topic, the issue of transaction price allocation is of primary importance to our industry (being one which is also involved in the sale of fungible, market-observable commodities over time). Without restating all of the specific points raised by the EEI, it is appropriate to say that the general process of price development for gas is similar to that for electricity. Pricing for gas contracts is primarily determined by reference to the "forward curve" (market price) at inception, and the curve itself is influenced by fundamental supply/demand forecasts at the delivery location it relates to, weather projections, etc. Liquidity is generally more prevalent in near-term periods, and decreases further out on the time horizon (along with availability and granularity of price quotes).

Consistent with these views, we believe that for contracts with multiple distinct performance obligations for the same product delivered separately over time (hereinafter referred to as "delivery months"), revenue recognition based on the contract price is consistent with the core principle and the defined transaction price in the ED (also consistent with current GAAP). Allocating a standalone selling price based on something other than the contract price to each such obligation will not represent the amount to which the entity *expects to be entitled* to receive for that specific contract and will be inconsistent with the economic substance of the underlying transaction and is inconsistent with the core principle of the ED. Further, we believe that recognizing revenue based on the forward curve at contract inception will result in substantially negative outcomes, as summarized further below.

Fixed Price Sales

With the exception that natural gas can be stored whereas electricity cannot, all of the broad points raised by the EEI on transaction price allocation are applicable and of significant importance to our industry, particularly as it relates to fixed (strip) priced forward commodity sales. Allocating revenues to each individual forward delivery month will distort our operating margins (given common economic hedging strategies to lock our margins through offsetting fixed price purchases or inventory), which is not consistent with the economics of the arrangements and confusing to our investors. Further, given the similarity in price development for energy commodities mentioned above, this will likely result in reduced comparability amongst market participants in addition to highly burdensome operational requirements. Finally, as it is not uncommon for forward gas sales to meet the definition of a derivative (depending on individual contract terms), the use of alternative accounting elections amongst our members combined with the requirements of the ED will result in yet another potential accounting difference amongst our members (although in this case on an accrual basis of accounting).

Therefore, in order to help assure that the core principle is applied to our contracts in a consistent and representationally faithful fashion, we recommend that the Boards clarify and/or provide an example to indicate that the contract price for a contract with multiple deliveries of the same product over future periods reflects the standalone selling price to be allocated to each of those deliveries.

Variable (Index) Priced Commodity Contracts

For long-term gas sales whose pricing is tied to market (index) rates, the final selling price will (in almost all cases) by definition be equivalent to the standalone selling price at delivery. Accordingly, we request the Boards to modify or clarify in the final standard the following items with respect to the allocation of variable consideration:

- For variable priced contracts where the contract price is equal to market at the time of delivery for all points in time (i.e., market-based contracts), the final standard should not require the estimation and allocation of variable consideration. This process is neither necessary nor relevant for such contracts, and it should be clear from the final standard that it is not required. Further, the same indicators cited in paragraph 82 for use in determining when an entity's experience may not be predictive of the amount of consideration the entity is entitled to collect are also relevant in the case of variable priced contracts (particularly, market volatility, influence of weather conditions, etc.). In other words, we would not be able to reliably estimate the amount of revenue we expect to receive for market priced contracts due to factors outside of the entity's control.
- If such an allocation requirement for market-based contracts is retained in the final standard, an entity should be permitted to update the estimated transaction price at least as frequently as at each reporting date and upon delivery.

Time Value of Money

Another area of similar concern to our industry which is also raised in the EEI's letter on the revised ED relates to the time value of money provisions and their applicability to fixed-price energy commodity contracts. As noted under the Transaction Price Allocation section above, companies in the energy industry frequently enter into contracts to sell gas to customers at a fixed price in small increments (e.g., monthly) for a stated future term. While the fixed contract price is the same for each dekatherm delivered to the customer throughout the entire term, the expected future market price (i.e., evidence of "cash selling price") for each future delivery period will vary from the fixed price that is stated in the contract.

The time value of money provisions in paragraph 58 of the ED indicate that a contract has a financing component "if the promised amount of consideration differs from the *cash selling price* of the promised goods or services" (emphasis added, also further elaborated in paragraph BC144 of the ED's basis for conclusions). Some may interpret fixed price forward contracts of fungible commodities with market underlyings to contain a financing component as, based on our views on price allocation expressed above, the amount of consideration allocated to each performance obligation in the contract (i.e., the fixed strip / contract price) differs from the "cash selling prices" that the supplier would be willing to separately and individually sell the commodity for at each forward delivery period during the term of the contract (i.e., if it were making spot market sales or sales under market-based contracts).

However, we strongly believe that, as long as the total transaction consideration under the contract does not differ substantially from the sum of the cash selling prices throughout the

contract term, such fixed price forward commodity contracts do not inherently contain a financing element because: (1) there is usually no significant time lag between delivery of the product and related cash payments (typical payment terms are 30 days), and (2) the assessment of the transaction consideration for a fixed price contract should be made at the aggregate level for the entire contract and not at the individual performance obligation level. Viewing these fixed price forward contracts as containing a financing component would introduce undue complexity and would produce an outcome that we believe is inconsistent with the intended objectives of the ED. Accordingly, we request the Boards to clarify in the final standard the following item with respect to applying the time value of money provisions:

• For a long term contract with multiple performance obligations arising from delivery of the same product(s) at multiple points over time, if the fixed prices in the contract are based on the future prices at contract inception (e.g., current forward curve) and there is no significant time lag between delivery of each performance obligation and payment for those performance obligations, by definition, that contract would not contain a financing element.

Also, the following would likewise be a clarification which would result in an appropriate accounting conclusion:

• The application of the time lag practical expedient in paragraph 60 of the ED (e.g., assessing the time lag between delivery of the related good / service and cash payment) should be made at the individual performance obligation delivery level rather than for the entire contract as a whole. For example, assume a customer enters into a three year forward commodity contract which is billed monthly based on volumes delivered in the prior month. If the commodity is delivered in September and payment is due in October, this arrangement would not be viewed as containing a financing element since the goods are delivered and cash is collected for the delivered goods within 30 days. In assessing whether or not a financing exists in a contract with multiple performance obligations created by delivery of the same product(s) at multiple points over time, it is not relevant that <u>all</u> goods are not delivered until the end of the three year period. Rather, the assessment would be made based on the delivery of each individual performance obligation as compared to the cash payment for each delivery.

Contract Modifications

We appreciate the Boards' efforts in refining the guidance on accounting for contract modifications by developing specific criteria for distinguishing if a contract modification should be treated as a separate contract or as part of an existing contract. This is not an area that AGA commented on with respect to the original ED, but upon further evaluation and consideration of the comments raised by the EEI, we concur with their request for further clarification as it relates to a common type of modification in both the electric and gas industries (i.e., "blend-and-extends"). Specifically, we believe it would be helpful for the Boards to clarify what is considered to be an 'appropriate adjustment' to an entity's standalone selling price for a good or a service, as discussed in paragraph 21(b) of the revised ED, as different interpretations of this term could result in inconsistent accounting treatment for the same contract modification.

The economics of a typical blend-and-extend are fairly easy to understand, but most importantly is the fact that the "blended" price of the modified portion of the contract relates only to undelivered periods (both the remaining term of the original contract and the extension period). Based upon that view, such contract modifications would be accounted for as a separate new contract and the Seller would account for the effects of the contract modification on a prospective basis. This would faithfully depict the economics of the contract modification as the change in contract price is negotiated after the original contract and it is based upon new facts and circumstances and the future delivery of energy. However, if the adjustment to the standalone selling price of the modified portion of the contract is not considered 'appropriate', the contract modification would not meet the criterion stipulated by paragraph 21 (b) and the Boards propose that we must next consider paragraph 22.

We concur with the EEI's suggestion and respectively request that the Boards provide further clarification on the definition of an 'appropriate adjustment' to standalone selling price and its application to contract modifications together with implementation guidance and an example of how the guidance should be applied to a contract involving multiple future deliveries of the same product in order to clarify this issue and ensure consistent application of the ED.

Identification of a Contract

Paragraph 13 of the ED provides that "contracts can be written, oral, or implied by an entity's customary business practices." As an industry still subject to a significant degree of regulation, we along with the EEI would like clarification of whether the delivery of a good or service without an upfront written contract may result in an "implied" contract at the point of sale. A clarification or example of an implied contract would assist us in determining whether the delivery of our products / services to certain customers in our regulated service territories is within the scope of this ED. In such cases, there is frequently no papered contract with the customer (rather, service is provided on a period-by-period basis under a regulatory approved tariff structure), and he / she decides at the point of sale how much, if any, commodity is needed. Further, in many cases these customers have the right to cancel their "contract", or their relationship with us, without penalty.

If a transaction as described above were deemed to be an implied contact, we would like clarification on the provision in paragraph 15 which states that "a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party." In the case of utility companies that provide electricity or natural gas to residential customers based on a tariff, the customer can terminate the service at any time (e.g., relocation, switch to an alternative provider, etc.). However, typically the utility can cancel only under certain circumstances (e.g., past due bills) due to its legal requirements under a regulated tariff. If it was not the Boards' intention to scope in the delivery of point-of-sale or month-to-month goods or services with no specific future obligations of the supplier or the customer, and for which the customer can cancel at any time, we suggest modifying the provision in paragraph 15 as noted above to clarify that a contract does not exist if any (instead of each) party to the contract has the unilateral enforceable right to terminate the

delivery or consumption of wholly unperformed goods or services under a contract without compensating the other party.

The determination of whether the delivery of energy to residential customers under tariff arrangements is within the scope of this guidance may impact our accounting and disclosures. If the ED applies, considerations may include the allocation of the transaction price based on the standalone selling price (in which case, we would have the same concerns as discussed in the Transaction Price Allocation section above), assessment of the time value of money for payment plans with delinquent customers for past energy consumption, and assessment of the contract modifications guidance for changes in pricing due to billing programs. If the ED is not applicable in this case, we would appreciate clarification regarding the appropriate revenue recognition guidance that would apply.

Disclosures (Question 5 in the ED)

We support the proposed new disclosure requirements, with the exception of the proposal to disclose the aggregate amount of the transaction price allocated to remaining performance obligations and the expected timing of when an entity expects to recognize that amount as revenue as we do not believe that the potential benefits, if any, to financial statement users justify the cost to prepare this disclosure.

We are concerned because the disclosure would not contain reliable or complete amounts of future revenues expected in each period for existing contracts. The disclosed amount of future revenues related to existing performance obligations would be an estimate as preparers may need to make significant judgments about contingent revenue (e.g., estimates in pricing for indexpriced contracts and estimates in volumes that will be required to be provided) and timing of the satisfaction of future performance obligations several years into the future. Therefore, the data presented may change significantly from period to period. In addition, the revenue information disclosed would be incomplete as much of our members' revenue is generated through contracts that are accounted for on a non-accrual basis (i.e., as derivatives and therefore are not included within the scope of this ED). Since the actual amount of revenues earned in a future period would not equal the amount disclosed, we do not believe this disclosure would be meaningful to financial statement users.

Similarly, we are concerned that some users may interpret the amounts disclosed as the total revenues expected in future years, as opposed to expected revenues *for existing contracts*. The amount of expected revenues for contracts that currently exist is often a small piece of the total revenue expected to be earned in a future year (i.e., a contract does not yet exist for most of the projected future revenue); thereby, further supporting our position that this disclosure would not be meaningful to financial statement users. Management develops long-term revenue and earnings forecasts for the company that are based on expected revenues under existing and future contracts, and as such, the forecast information which is often provided to investors will not be based on the same revenues as the disclosure. This difference may lead to confusion among our investors and other financial statement users. Also, this type of forward-looking information would typically be included in Management's Discussion and Analysis as it is expressly covered by the safe harbor rule for projections under Rule 175 of the Securities Act of 1933; therefore,

the inclusion of forward-looking information in the footnotes, which are not covered by the safe harbor rule, will increase potential litigation risk to companies.

Although the ED indicates that this information may be disclosed quantitatively or qualitatively, we are not certain how the aggregate amount of the transaction price allocated to remaining performance obligations and the expected timing of when an entity expects to recognize that amount as revenue could be presented using qualitative information in a way that is useful to investors. Therefore, if this disclosure requirement remains in the final guidance, we request that the Boards provide an example of a qualitative disclosure.

In summary, financial statement preparers may need to gather and maintain a significant amount of data solely to comply with this disclosure requirement, the burden of which we do not believe to be cost-justified. In addition, the resulting information will be easily misunderstood or and unbeneficial to our financial statement users. Therefore, we suggest eliminating the proposed requirement to disclose the transaction price allocated to remaining performance obligations and the expected timing of their recognition as revenue.

Effective Date

The ED indicates that it will not be effective sooner than for annual reporting periods beginning on or after January 1, 2015. If we will be required to allocate the standalone selling price to each performance obligation based on the forward curve (rather than based on the contract price, as discussed in Transaction Price Allocation section above), we are in agreement with the EEI in recommending that the Boards establish an effective date no sooner than January 1, 2016. In order to comply with retrospective application, we anticipate the need to keep two sets of GAAP books, in addition to our books for tax and regulatory reporting purposes. Recognizing revenue based on a forward curve would take a significant amount of time and resources to educate and train impacted functions within our organization; review and analyze a large volume of transactions; design and implement the necessary process and systems changes; reassess and update the relevant financial controls and Sarbanes Oxley documentation; and educate and socialize the changes with external stakeholders. Therefore, it would be challenging to complete these items prior to January 1, 2013 for retrospective application considering that the ED is not yet finalized.

Conclusion

We appreciate your consideration of this topic and our related comments. The proposed changes to revenue recognition will have a significant effect on all industries, and we would be pleased to discuss the impact on our industry with you and to provide any additional information that you may find helpful in addressing these important issues

Very truly yours,

Stephen P. Feltz [s]

Stephen P. Feltz, Treasurer and Controller, NW Natural Chairman of the American Gas Association Accounting Advisory Council