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Technical Director
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Financial Accounting Standards Board
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File Reference: 1820-100 - Revenue Recognition, Revenue from Contracts with Customers

The American Gas Association (AGA) is pleased to submit its comments concerning the Financial Accounting Standards Board (FASB or the Board) Proposed Accounting Standards Update - *Revenue Recognition (Topic 605) Revenue from Contracts with Customers (the ED)*. The American Gas Association, founded in 1918, represents 202 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 United States, of which almost 92 percent — more than 65 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 provides almost one-fourth of the United States' energy needs.

The AGA appreciates the FASB seeking to improve accounting for revenue with regard to areas where such improvements would make recorded and disclosed amounts more meaningful. There are some nuances to how revenue is determined and generated at our member organizations, and as a result there are many provisions included in the ED that will significantly affect us. We have limited our responses to questions for which we have concerns, request clarification, make recommendations, or wish to convey our support.

Summary

Highlights of our comments are summarized as follows:

- We believe the guidance currently included in ASC 980, *Regulated Industries*, related to the accounting for alternative revenue programs should not be eliminated as proposed in the ED.
- We disagree with the proposed credit risk model as it will reduce transparency and is inconsistent with other standards, including the recently proposed ASU for financial instruments.
- We believe the proposed disclosures of performance obligations will be misinterpreted by users and will create discrepancies with other information in the financial statements.
- We do not believe the proposed retrospective application of this standard is operational and suggest prospective application.

We provide our comments on selected questions in the ED that are relevant to our member companies below.

General

We have noted that the accounting treatment set forth in Emerging Issues Task Force (EITF) Issue 92-7, *Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs* (EITF 92-7), which is currently codified in ASC 980-605-25, was eliminated in the ED. Alternative revenue programs, such as margin trackers and decoupled rate mechanisms, are programs approved by commissions that were designed to allow utilities to adjust future rates in response to past activities or completed events caused by changes in demand. Unlike unregulated entities, which can more easily react to changing market conditions, the regulatory environment in which a utility operates limits the utility's ability to react to changing conditions outside of rate case proceedings. For instance, if throughput is reduced through conservation efforts, a regulated utility cannot, at will, decide to increase rates to customers to cover costs and the required return as another type of business might be able to do. Nor can a regulated utility decide to cut costs that may limit critical service in reaction to these conditions (e.g., not provide heating in the winter, not provide refrigeration in the summer, not provide the ability of individuals or businesses to prepare food). Thus, these alternative revenue programs are becoming more prominent and more critical to utilities. Without these mechanisms, it would be substantially more difficult for utilities to recover the costs and earn the returns that were authorized.

Addressing alternative revenue programs was deemed important previously and therefore, addressed by the Emerging Issues Task Force in 1992, and they are all the more relevant given existing weather trends, conservation, and economic conditions that have spurred the necessity of more of these mechanisms. EITF 92-7 was necessitated by the fact that when originally drafted, SFAS 71, *Accounting for Certain Types of Regulation*, did not anticipate alternative revenue programs and referenced incurred costs, not the accrual of revenue, in its definition of a regulatory asset. However, we believe that there is no distinction between the two and that the existence of a regulatory asset should continue to be based on a probable future revenue stream established by an order from the utility's regulatory commission, regardless of whether the revenue stream is designed to compensate for a previously incurred cost or a completed alternative revenue program. This EITF confirmed the industry practice of accruing revenue and recording regulatory assets related to under collected revenue requirements associated with these alternative revenue programs, if certain criteria are met. We believe that the revenue recognition project was not intended to change the accounting for regulatory assets by rate-regulated utilities; therefore, the language set forth in EITF 92-7 should be moved to ASC 980-340 rather than being stricken from the ASC altogether.

Responses to Questions in the ED

Question 5: *Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?*

We do not agree with the credit risk model proposed by the exposure draft. In our view, the existing model which includes the recognition of bad debt expense separately from revenue provides the most transparent view of a company's revenue and credit exposure. The requirement to record credit risk as a reduction of revenue makes it difficult for users of the financials to understand a company's collection practices and

changes in the credit quality of its customers. Credit losses have also traditionally been viewed as costs so this would be a departure from well-established and, in our view, well-functioning guidance.

The prices charged to customers are not adjusted to reflect the customers' credit profiles. In the regulated utility industry, the rates charged to customers by the utility are fully mandated by regulators. The rates are recognized as revenue based upon customer usage and are compared with utility expenses to ensure that the utility is earning an authorized return. If that return is not sufficiently earned, the utility requests an increase from the regulators in the rates charged. In addition, the recovery of uncollectible accounts is also mandated by the regulators. As such, the utility industry already has a built-in approach (rate-based model) for addressing credit risk. In addition, under current practices, current expense is a factor of current write-offs, recoveries from customers of amounts previously written off, and expectations of future write-offs based upon historical experience overall. The process is not simplified by mandated notification requirements that vary by ratemaking jurisdiction/commission, meeting special requirements for service turnoff which can vary by customer priority (e.g. hospitals). In addition, there are, in some cases, regulatory accounts established to specifically track components of uncollectible amounts (e.g. deferred treatment of the gas cost components of uncollectible expense). Given these complicated considerations and the fact that utilities can have customer counts in the millions, current practices for both determining uncollectible amounts and the method for recording such amounts work well and provide good transparency with regard to revenue from customers and amounts deemed uncollectible. Additionally, the recognition of the collection of an item previously deemed uncollectible through other income is not appropriate if the initial credit consideration was recorded as a reduction to revenue.

It should also be noted that this proposed provision is not consistent with the credit impairment model in the proposed guidance for financial instruments. As such, we ask that the Boards remove this provision from the final revenue recognition standard.

Question 11: *The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.*

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We do not agree with the proposal to disclose future remaining performance obligations and the expected timing of their satisfaction as we believe that the cost to prepare this information outweighs the potential benefits to financial statement users. Financial statement preparers will potentially need to gather and maintain a significant amount of data to comply with this disclosure requirement. The amount of information that would need to be tracked for the disclosure is both more extensive than what is currently required under US GAAP and more extensive than what investors needed to understand the accounting under the proposed guidance. Also, preparers will potentially need to make judgments about contingent revenue and timing of the satisfaction of future performance obligations several years into the future which may cause significant changes in the data presented from period to period. Therefore, the actual amount of revenues earned in a future period may not be equal to the amount disclosed in the future performance obligations table, which could be misleading to financial statement users. We are concerned that financial statement users may interpret the disclosed amount of future revenues related to existing performance obligations to be the amount of guaranteed future revenues in each period. 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. In addition, 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 will not match the disclosure, which may lead to confusion among our investors and other financial statement users. This type of forward-looking information would typically be included in Management's Discussion and Analysis, and its inclusion in the footnotes will increase potential litigation risk to companies. Therefore, the cost to prepare the information required to comply with this disclosure may be burdensome, and we believe that this information may be confusing and will not provide any direct benefit to financial statement users.

Question 13: *Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?*

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

We support a prospective implementation of this proposed guidance and do not agree that the benefits outweigh the costs and impracticality of applying these changes retrospectively. Companies will need adequate time to prepare for these changes and respond to unforeseen challenges in a variety of industries. This will include substantial information system changes that will be difficult to implement retrospectively. Retrospective application will also cause companies to incur unnecessary costs in revising and auditing previously reported information. Companies would need to maintain two separate revenue recognition systems in tandem during a transition period, and they would have to address internal control and documentation issues under each system which will prove confusing and redundant.

The nature of revenue recognition is that it is based on decisions made on difficult to evaluate criteria such as the achievement of performance obligations and the assessment of collectability at critical times such as a financial statement close. These conditions can be quite difficult to go back and recreate and/or record under dual systems during a transition period. For example, in applying retrospective evaluation, should hindsight be used, or should the estimates utilized at the time be used to recalculate the revenue to be recognized under a new method?

We are also concerned that implementation of a cumulative adjustment will create confusion for the readers of the financial statements and analysts and investors that place such importance in the recognition of revenue. For example, if revenue is effectively recognized in a previous period (through retained earnings) due to a cumulative adjustment, then this revenue would never appear in the income statement. This would impact trend analysis. Our industry has a number of situations where revenue can be deferred over long-term periods and we are concerned about the impact of a cumulative effect on income statement trend analysis.

We feel that a clean start for prospective revenue recognition under the new standard is the preferred approach. If a company has a positive revenue trend under old guidance, it should not prove materially different under new guidance. Re-opening the recognition of revenue which is dependent on judgments made using information available at the time is costly, susceptible to error in application, and we believe will prove confusing to financial statement users. Adequate disclosure should be made available to inform the reader of differences in recognition of revenue between the old and the new guidance and will help the reader better understand the impact of implementing the changes in the recognition of revenue. This will also allow users of the financial statements to effectively analyze any revenue trends without resulting in excess cost to preparers.

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,

Jose Simon [s]

Jose Simon, Vice President and Controller, Piedmont Natural Gas
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