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# 2017 Deloitte Renewable Energy Seminar

Innovating for tomorrow

November 13-15, 2017

Deloitte Center *for* Energy Solutions

# Accounting for PPE impairments and AROs

Kristin Cargin, Managing Director, Deloitte & Touche LLP
Tommy Greco, Senior Manager, Deloitte & Touche LLP
Peter Hannagan, Senior Manager, Deloitte Transactions and Business Analytics LLP

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# Considerations of impairment triggers

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ASC 360 requires that a long-lived asset (asset group) be tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable

- Potential impairment triggers
  - Significant changes in power markets or forward power curves
  - Expiration of Power Purchase Agreement or Energy Hedge
  - Current period operating or cash flow loss combined with a history of operating or cash flow losses
  - Others
- Development phase impairment considerations
- Considerations regarding the asset group

## When to Test a Long-Lived Asset for Recoverability – ASC 360-10-35-21

# Overview of Step 1 and Step 2 impairment analysis

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## Step 1 impairment analysis

An impairment loss shall be recognized only if the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value

Step 1 Test - Recoverability

- Compare undiscounted cash flows expected to result from the use and eventual disposition of the asset to the carrying amount of the asset
- EBITDA considerations and assumptions
  - Revenue
    - Production and Capacity Factors
    - Forward Price Curves
  - Operating expenses
  - Salvage Value

Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group)shall include only the future cash flows (cash inflows less associated cash outflows) that are directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group). Those estimates shall exclude interest charges that will be recognized as an expense when incurred.

# Overview of Step 1 and Step 2 impairment analysis

## Step 1 impairment analysis

Other Cash Flow Considerations

- Length of Period Covered in the Analysis
- Inclusion of Production Tax Credit at project level
- Inclusion of unutilized Investment Tax Credits at project level
- Asset retirement costs and cash flows associated with the asset retirement liability

# Overview of Step 1 and Step 2 impairment analysis

## Step 2 impairment analysis

If Undiscounted Cash Flows < Carrying Value of the asset then proceed to a Step 2 impairment analysis

- Impairment is measured as the amount by which the carrying amount of the asset group exceeds its fair value
- Fair Value approach for long lived assets
- Discounted Cash Flow valuation methodology
  - Simply discounting the cash flow projections used in the recoverability analysis may not be appropriate under ASC 820 because management may use assumptions in the recoverability analysis that are not market-participant assumptions.
  - Discount Rate
  - Tax depreciation benefit
  - Remaining life

### The projected free cash flow to the Facilities were calculated as follows:

- Revenues
- Less: Total expenses
- Less: Depreciation and amortization expenses
- Less: Taxes
- Plus: Depreciation and amortization expenses
- Less: Change in working capital
- Less: Capital expenditures
- Plus: Production tax credits
- Equals: Free cash flow to the Facility

# Overview of Step 1 and Step 2 impairment analysis

## Step 2 impairment analysis

Test for reasonableness – comparisons with:

- Prior valuations of same asset
- Acquisition price
- Market transactions
- Always ask “Does the answer make sense?” and “Can I explain change in value or value relative to market transactions?”

# ARO considerations for renewable energy projects

# ARO considerations for renewable energy projects

Asset Retirement Obligation

ASC 410-20

- Legal obligation associated with the retirement of a tangible long-lived asset
- AROs for renewable generating assets typically result from land lease / easement agreements / permits
  - While requirements are often similar, its important to understand the specific requirements for each respective project
    - Access Roads, O&M Building, Depth of restoration
- Considerations for trigger to record initial Asset Retirement Obligation
- Asset retirement obligations are recognized at fair value in the period in which they are incurred, and when the amount of the liability can be reasonably estimated

# ARO considerations for renewable energy projects

Asset Retirement Obligation

- Settlement Date ASC 410-20-25-11
  - The estimated economic life of the asset might indicate a potential settlement date for the asset retirement obligation. However, the original estimated economic life of the asset may not, in and of itself, establish that date because the entity may intend to make improvements to the asset that could extend the life of the asset or the entity could defer settlement of the obligation beyond the economic life of the asset. In those situations, the entity would look beyond the economic life of the asset in determining the settlement date or range of potential settlement dates to use when estimating the fair value of the asset retirement obligation

# ARO considerations for renewable energy projects

Asset Retirement Obligation

- Subsequent Measurement
  - Changes in Assumptions
    - Timing or Cost Assumptions
  - Upward revisions to the asset retirement obligation should be calculated using the legal entity that owns the renewable facility then-current credit-adjusted risk-free interest rate.
  - Downward revision of the asset retirement obligation, then the undiscounted revised estimate of expected cash flows should be discounted using the credit-adjusted risk-free rate in effect at the date of initial measurement and recognition of the original asset retirement obligation.