Accounting Hot Topics

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Agenda

Projects Under Development – Combination or acquisition?

Partial Sale of Real Estate – Implications

RECs and RCC – Overview

FASB Simplification Initiative – Recently Finalized Accounting Standards

Projects Under Development – Combination or Acquisition?

Projects Under Development

- Acquisition of projects under development
  - Projects under development (“Project Entity”) refer to renewable generating plants, whose operations are not fully developed, with multiple stakeholders (developer; investor; operator) and ownership structure
  - Ownership in these projects depends whether the acquisition is considered a business (Business Combination under ASC 805) or a group of assets (Asset Acquisition)

Projects Under Development

Key distinctions between acquisition of a business (ASC 805) vs. non-business (asset acquisition):

Business (Under ASC 805)		Non-Business (Under Asset Acquisition Guidance)
Key business processes acquired		No processes acquired (only administrative processes acquired)
Market participants could manage assets to provide a return to its owners		Market participant could not manage assets to provide a returnwithout combining them with other assets
Employees hired		No employees hired
Able to produce outputs at a future date		Not able to create economic benefits
Key elements are missing but can be easily replicated or obtained		Key elements are missing but can not be easily replicated or obtained

Projects Under Development

- Key Considerations for Alternative Energy
  - Will the renewable energy project be built (i.e. feasibility of studies performed, public board approval, permits obtained)?
  - Has the renewable energy project begun construction (stage of construction)?
  - Will the renewable energy project have future revenues (i.e. purchase power agreement)?
  - Does the renewable energy project have financing?

Projects Under Development

- Example # 1
  - Developer acquires a project which has land option contracts, wind feasibility study, permits, ongoing negotiations for financing and a PPA
    - Will the renewable energy project be built? - **Yes**
    - Has the renewable energy project begun construction? - **No**
    - Will the renewable energy project have future revenues? – **Yes**
    - Were key employees hired? - **Yes**
    - Does the renewable energy project have financing? – **Yes**
  - Conclusion: ***Business Combination***

Projects Under Development

- Example # 2
  - Developer acquires a project which has land option contracts and an in-process wind feasibility study
    - Will the renewable energy project be built? - **Maybe**
    - Has the renewable energy project begun construction? - **No**
    - Will the renewable energy project have future revenues? – **Maybe**
    - Were key employees hired? - **No**
    - Does the renewable energy project have financing? – No
  - Conclusion: ***Asset Acquisition***

Projects Under Development

Accounting Item	Business Combination	Asset Acquisition
Measurements of Assets and Liabilities	Fair Value	Cost to the acquiring entity
Transaction Costs	Expensed	Generally included in the recognition of the cost of the asset or group of assets
Goodwill	Recognized as consideration given > FV of assets and liabilities acquired	No goodwill – If the cost exceeds the fair value of the net assets (or fair value exceeds cost), the difference is allocated pro rata on the basis of relative fair values to increase (or decrease) the assets acquired

Projects Under Development

- Alterative Energy Industry Practice
  - Most transactions for alternative energy projects occur in the very early stages of development
  - Assets Acquired: Intangible rights and development costs
    - Land leases
    - PPA
    - Interconnection agreements (SGIA or LGIA)
    - Permits
    - Feasibility and other studies/surveys
  - Liabilities Assumed
    - Not common for liabilities to be assumed

Projects Under Development

- Alterative Energy Industry Practice *(cont.)*
  - There is also diversity in practice for how the fair value of acquired PPAs are determined
    - Fair value is generally determined based on an income approach where revenues at PPA prices are compared with revenues at acquisition date market prices and the difference is discounted to NPV
  - Acquired PPAs are accounted for separately from the corresponding property, plant, and equipment
  - The acquired PPAs are amortized over the life of the PPAs

Projects Under Development

- Alterative Energy Industry Practice *(cont.)*
  - Intangible assets or liabilities should be recognized if land lease terms are favorable or unfavorable to market terms of similar leases
  - Liabilities for guarantees assumed by the acquiring entity should be measured at fair value
    - SEC staff commentary on Day 2 accounting for the guarantee obligation: "…a systematic and rational amortization method would most likely be the appropriate accounting"
  - Indemnifications (e.g. for legal claims, uncertain tax positions) by the seller represent an acquired asset

Partial Sale of Real Estate – Implications

Partial Sale of Real Estate

- Partial Sales
  - Partial sales refer to sales of alternative energy projects and investments in which the seller retains an ownership interest in it.
  - Need to evaluate whether the partial sale of the project constitutes a sale of real-estate business; non-real estate business or non-entity (asset):
    - Real Estate Business – Under ASC 360 and 970 (scope exception to ASC 810)
    - Non-Real Estate Business– Derecognition under ASC 810
    - Non- Entity– Full / partial recognition under ASC 845

Partial Sale of Real Estate

- Real Estate Entities
  - Determining whether a transaction is in substance a sale of real estate follows ASC 360-20-15 (*) and includes the following:
    - Nature of the entire real estate components
      - Integral equipment
    - Includes all in-substance nonfinancial assets that pertain to real estate activities
      - Investments in entities that are in substance real estate
  - (*) ASU 2014-19, effective 12/15/2016, supersedes ASC 360, whereby partial sales of real estate will be derecognized under ASC 810

Partial Sale of Real Estate

- Real Estate Entities *(cont.)*
  - Integral equipment is any physical structure or equipment attached to real estate that cannot be removed and used separately without incurring significant cost (ASC 360-20-15), combined with a decrease in the FV as a result of the removal
  - Significant costs = removal cost and decrease in FV is 10 percent of the FV of equipment

Partial Sale of Real Estate

- Under ASC 360-40-46:
  - Profit (the difference between the sales value and the proportionate cost of the partial interest sold) shall be recognized at the date of ***sale***, if ALL are met:
    - Buyer is independent of the seller
    - Collection of the sales price is reasonably assured
    - Seller will not be required to support the operations of the property or its related obligations to an extent greater than its proportionate interest

Partial Sale of Real Estate

- Partial Sale – Real Estate *(cont.)*
  - Case # 1 – If the seller holds an equity interest in the buyer – Recognize part of the profit proportionate to outside interest at sales date.
  - Case # 2 – If sales price is NOT assured, cost recovery or installment method can apply
    - Cost recovery = Profit deferred until cost of property is recovered through cash payments
    - Installment method = Profit recognized as cash is received

Partial Sale of Real Estate

- Example
  - A contributes land leases and other capitalized development costs to JVNewCo
  - B pays cash for a 50% interest in JVNewCo, representing 50% of the FV of the contributed intangibles (development costs)
  - B pays the cash directly to A, or alternatively contributes the cash to JVNewCo and JVNewCo distributes the cash proceeds to A

Partial Sale of Real Estate

- Example *(cont.)*
  - May A record gain on sale of 50% of JVNewCo?
    - **Maybe**
  - It follows the criteria of ASC 360-20
    - A is independent of B
    - Cash for 50% of intangibles is assured
    - A is only required to support only its remaining interest in JVNewCo
      - In particular A contributed leases, in addition to development costs, and therefore might be required to support the obligations of JVNewCo (after B contributes its 50% share)

RECs and RCC

Renewable Energy Credits (RECs)

- Represent the environmental attributes of the power produced from renewable energy projects and are sold separately from commodity electricity
- Incentivize carbon-neutral renewable energy by providing a production subsidy to electricity generated from renewable sources
- Also known as green tags, renewable electricity certificates, and tradable renewable certificates
- Typically accumulate through some combination of
  - Internal renewable energy
  - Purchase contract with third party renewable energy facilities
  - Transaction in the secondary market

Derivative Considerations

- Although RECs are not considered derivative themselves, contracts to purchase or sell RECs need to be evaluated to determine if they meet the definition of a derivative
- Net settlement criteria (whether the RECs are readily convertible to cash) may require judgement due to the continuously evolving REC market
  - Contracts need to be continually evaluated over their lives
  - Consider “conditional” NPNS designation

Derivative Considerations *(cont.)*

- Readily convertible to cash (RCC) analysis for RECs should consider the following:
  - Type (class) of REC issued along with the location or region
  - Secondary markets for REC exchanges (e.g. the Green Market Exchange)
- Although the REC markets continue to evolve, there remains diversity in practice surrounding RCC conclusions. We recommend focusing on formalizing a policy and being consistent.

FASB Simplification Initiative – Recently Finalized Accounting Standards

Simplification Initiative – Final Standards
Extraordinary and Unusual Items (ASU 2015-01)

Current GAAP versus ASU requirement

Current GAAP

- Item must be unusual *and* infrequent to be considered an extraordinary item
- Entities would be required to present *and* disclose separately

ASU

- Entities would not…
  - Segregate an extraordinary item from the results of ordinary operations
  - Separately present an extraordinary item on its income statement, net of tax
  - Disclose income taxes and earnings- per-share data applicable to extraordinary items

ASU Impact

- Financial statement users continue to be informed
- Reduce complexity and cost in preparing financial statements

Effective date and transition

- Effective for annual periods beginning after December 15, 2015, and interim periods within those annual periods
- Guidance applied prospectively or retrospectively
- Early adoption is permitted

Simplification Initiative – Final Standards

Presentation of Debt Issuance Costs (ASU 2015-03)

Background

- Under current accounting, debt issuance costs are recorded as a deferred charge (i.e., an asset)
- New guidance would alleviate complexity and reduce costs by aligning the presentation of debt discount or premium and issuance cost

Provisions

- Debt issuance costs should be presented in the balance sheet as a direct deduction from the face amount of the note
- Amortization of debt issuance costs would be reported as interest expense
- Does not change the recognition and measurement guidance

Simplification Initiative – Final Standards

Presentation of Debt Issuance Costs (ASU 2015-03) *(cont.)*

Transition Disclosures

- The nature of and reason for the change in accounting principle
- Transition method
- A description of the prior-period information that has been retrospectively adjusted
- The effect of the change on the financial statement line item

Effective date and transition

- ***Public business entities*** – retrospective application for annual periods, and interim periods within those annual periods, beginning after December 15, 2015
- ***Nonpublic entities*** – retrospective application for annual periods beginning after December 15, 2015 and interim periods beginning after December 15, 2016
- Early adoption is permitted

Simplification Initiative – Final Standards

Presentation of Debt Issuance Costs (ASU 2015-03)

Illustrative Example

On January 1, 2015, an entity issues a debt security with a face amount of $10,000,000 to an investor. On the same date, the entity incurs and pays incremental and direct issuance costs of $50,000 to parties other than the investor. The debt security matures in five years (on December 31, 2020).

Before adopting the guidance in the ASU, the entity would record the $50,000 in debt issuance costs on January 1, 2015, as follows:

JOURNAL ENTRY 1	DR	CR	Comment
Cash Debt – long term	$10,000,000	 $10,000,000	To record $10,000,000 note payable on January 1, 2015
JOURNAL ENTRY 2	**DR**	**CR**	**Comment**
Deferred issuance costs (asset) Cash	50,000	 50,000	To record $50,000 debt issuance cost on January 1, 2015

After adopting the guidance in the ASU, the entity would record the $50,000 in debt issuance costs on January 1, 2015, as follows:

JOURNAL ENTRY 1	DR	CR	Comment
Cash Debt – long term	$9,950,000	 $9,950,000	To record $9,950,000* note payable on January 1, 2015

*The $9,950,000 is calculated by netting the $50,000 unamortized debt issuance costs from the note payable amount of $10,000,000.

Simplification Initiative – Final Standards

Presentation of Debt Issuance Costs (ASU 2015-03)

Scope	
Scope	• Guidance applicable to sponsors of defined benefit plans • Employee benefit plan financial statements are *not* within the scope of this standard
Guidance	• Allows entity to measure defined benefit plan assets and obligations on the month-end that is nearest to the employer's fiscal year-end • Would require funded status adjustments for contributions and other significant events occurring between alternative measurement date and fiscal year-end • Employers allowed the use of practical expedient in interim remeasurements as a result of significant events • Entities would be required to disclose use of the practical expedient(s) and the date that the plan assets and obligations were measured

Effective date and transition

- ***Public business entities*** – applied prospectively for annual periods beginning after December 15, 2015, and interim periods within those annual periods
- ***Other entities*** - effective for annual periods beginning after December 15, 2016, and interim periods within annual periods after December 15, 2017
- Guidance to be applied prospectively
- Early adoption is permitted

Simplification Initiative – Final Standards

Accounting for Cloud Computing Costs

(ASU 2015-05)

Objective

- Reduce the uncertainty in accounting for cloud computing arrangements by providing specific accounting guidance from a **customer's** perspective
- ASU provides guidance on whether a cloud computing arrangement contains a software license element (subject to ASC 350-40) or is a service contract

Key Provisions of the ASU

A cloud computing arrangement is in the scope of ASC 350-40 when…

- "The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty."
- "It is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software."

Effective date and transition

- ***Public business entities*** - effective for annual periods beginning after December 15, 2015, and interim periods within those annual periods
- ***Other entities*** - effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016
- Guidance to be applied retrospectively or prospectively
- Early adoption is permitted

Questions?

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