

# Clean Energy Forum: Financing and Regulatory Compliance



## Accounting Practitioners Guide For Renewable Energy Projects

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*"The material contained in this presentation is for general information and should not be acted upon without prior professional consultation."*



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## Accounting Needs for Renewable Energy Projects

- Project structuring and reporting generally driven by tax considerations
- Company that raises money to develop and operate projects may have a requirement for GAAP basis financial statements
- Banks lending money to projects may require GAAP basis financial statements



## Unique Accounting Issues Facing Renewable Energy Companies

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- Significant Government Incentives
- Long term contracts for the sale of electricity
- Sale-Leaseback structures
- Obligations to remove plant and equipment at the end of contract



## Significant Government Incentives

- Renewable Energy Projects require government subsidies to compete with fossil fuel generated energy
- Incentives come from both the federal level and state level
  - Federal grants and tax credits
  - State rebates and Renewable Energy Credits
- No authoritative accounting treatment under US GAAP
- AICPA Issues Paper – Accounting For Grants Received From Governments (October 16, 1979) – Superseded with Codification of GAAP but still provides guidance



## Government Incentives

- How should incentives received from the government be characterized in a Company's financial statements?
  - Revenue
  - Reduction to cost basis of project
  - Reduction to Expense
  - Income tax benefit
  
- Varies based on the purpose and nature of the incentive



## Government Incentives

- Issues Paper states:
  - Grants related to revenue should be recognized as revenue in the period of the related events. (Ex. Solar Renewable Energy Credits – relate to the generation of solar renewable energy)
  - Grants related to fixed assets should be taken into income over the depreciable lives of the fixed assets. (Ex. State renewable energy rebates)
  - Grants related to expense items should be treated as reduction to expense as the expenses are incurred (Ex. Federal research and development grants)



# Government Incentives

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- Issues Paper states:
  - Loan guarantees – No benefit should be imputed on grants related to debt
  
  - Income tax benefits (Investment Tax Credit; Production Tax Credit) should be should shown in the income tax line





# Government Incentives

RENEWABLE ENERGY COMPANY  
Consolidated Statements of Operations  
For the Years Ended December 31, 2010

	<u>2009</u>
Revenues:	
Utility revenue	\$ XXX,XXX
Rebate revenue	XXX,XXX
SREC Revenue	<u>XXX,XXX</u>
Total Revenue	XXX,XXX
Operating expenses:	
Cost of operations	XXX,XXX
Depreciation and amortization (net of state rebates of XXX)	XXX,XXX
Selling, general and administrative	XXX,XXX
Research and Development (net of research grants of XXX)	<u>XXX,XXX</u>
Total expenses	XXX,XXX
Net income before income taxes	XXX,XXX
Income tax benefit	<u>XXX,XXX</u>
Net income	<u><u>\$ XXX,XXX</u></u>



## Long Term Contracts for Sale of Electricity

- Generally 15 years plus in duration
- Are these contracts executory contracts or leases?
  - If considered an executory contract, the payments received from the customers are classified as revenue
  - If considered a lease, the payments received are classified as rental income and if the Company is not in the business of renting property, then the payments are not revenue



## Long Term Contracts for Sale of Electricity

- An arrangement contains a lease if all of the following conditions are met:
  - Specific property, plant, or equipment (PP&E) is identified
    - An asset is explicitly identified if the seller (lessor) is contractually obligated to use a specific asset to provide the goods or services requested by the purchaser (lessee).
  - The fulfillment of the arrangement is dependent on the use of the identified PP&E
    - Although PP&E may be explicitly identified in an arrangement, if the fulfillment of the arrangement is not dependent on the use of the specified PP&E, the arrangement is not a lease.



## Long Term Contracts for Sale of Electricity

- The arrangement conveys to the purchaser (lessee) the right to use the identified PP&E
  - Provides that an arrangement conveys the right to use PP&E if the purchaser (lessee) has the right to control the use of the specified PP&E. As provided in the third condition of that paragraph, control over the output of specified PP&E is sufficient to conclude that an arrangement is a lease, even if the party with control over the output does not operate, or direct the operation, of the specified PP&E.



## Sale Lease-back Transactions

- Often developers/ operators of renewable modules will sell the project, once constructed, to a financial buyer and then lease the asset back for operation
- If the transaction qualifies as a sale, then the Company would recognize a gain or loss for any difference between the sale price and the amount paid for constructing the project, which is subject to deferral
- If the lease of the asset qualifies as an operating lease, then the asset and related obligation are not recorded in the Company's financial statements and instead the monthly lease payments are recorded as they come due



## Sale Lease-back Transactions

- A sale-leaseback transaction that does not qualify for sale-leaseback accounting shall be accounted for as a financing.
  - Under this method no gain is recognized, the asset remains recorded in the balance sheet and debt is reflected.
- If the Sale-leaseback criteria are met, then the gain on the sale is generally deferred and recognized over the lease term.



## Sale Lease-back Transactions

- Evaluation of the lease back of the property as an operating or capital lease:
  - Capital lease if any one of the following criteria are met:
    - Present value of lease payments  $>$  than 90% of fair value
    - Lease term is  $>$  75% of economic life
    - Bargain purchase option at conclusion of lease
    - Title transfers at conclusion of lease



## Asset Retirement Obligations

- Asset retirement costs must be capitalized as part of the related property, plant, or equipment when a liability for an asset retirement obligation is initially recognized.
- Changes to the asset retirement obligation resulting from revisions to the timing or the amount of the original estimates shall be recognized as an increase or decrease to (a) the carrying amount of the asset retirement obligation and (b) the related asset retirement cost capitalized as part of the related property, plant, or equipment.
- Only asset retirement obligations that are considered a legal obligation shall be afforded this accounting treatment.





## Asset Retirement Obligations

- Asset retirement costs shall be allocated to depreciation expense using a systematic and rational method.
- Application of a systematic and rational allocation method does not preclude an entity from capitalizing an amount of asset retirement cost and allocating an equal amount to expense in the same accounting period.



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# Questions ?