Warren & Selbert

Simple as ABC.

HLBV Accounting

By design, partnership flip structures in renewable energy are disproportionate: the investor and the sponsor receive a cash distribution share that differs from their share of taxable income and their share of initial capital. Furthermore, the shares of cash distribution and taxable income change over time. Unlike a traditional partnership arrangement, capital accounts in partnership flip structures do not maintain a consistent ratio between the partners. This presents a problem for traditional GAAP accounting of these structures.

According to ASC 323-30, investments in partnerships where the investor has significant influence on the entity should use the Equity Method to determine the change in the value of the investment. The increase or decrease in the partner's share of the underlying entity value is then used as a basis for the income earned in each accounting period. This direct application of the Equity Method presumes a single percentage ownership position, which is at odds with the changing distribution and allocation percentages in disproportionate partnership flip structures.

In November 21, 2000, the AICPA released an Exposure Draft Proposed Statement of Position (SOP) that describes the use of the Hypothetical Liquidated Book Value (HLBV) method as an alternative approach to the Equity Method for real estate investments. The Exposure Draft describes HLBV as a means of determining the value of the partner's share in the underlying partnership not simply as an ownership percentage of the total entity, but rather as a function of what the partner would receive if the partnership were to be liquidated at its book valuation. This is referred to as a balance sheet approach because it calculates the value of the entity to each partner by disinvesting the underlying assets and liabilities. Using this approach, HLBV provides a way to address the nature of an investment that has differentiated sharing.

The Exposure Draft was never adopted, and HLBV has never officially been recognized as GAAP. Regardless, HLBV is still often used to account for partnership flip structures because it provides the most meaningful approximation for the value of each partner's investment in the partnership. Because there is no FAS guidance beyond the Proposed SOP, implementation of HLBV can vary among companies.

The most common HLBV calculation involves the sale of the underlying assets at their book value, and an allocation of the proceeds according to a procedure specified in the Limited Liability Corporation (LLC) documents. The procedure, often called the "waterfall," has many negotiated clauses that vary across different renewable energy partnerships. They tend to follow this sequence: 1) resolve minimum gain balances, 2) resolve deficit capital account balances, 3) cover the investment balance of the investor, then 4) allocate the remainder according to the residual sharing percentages documented to occur after the tax flip date. The sum of the amounts allocated to each partner during the waterfall plus the current balance of their capital account equals their HLBV balance. Changes in this balance are used to determine the changes in value of the partner's investment over the accounting period.