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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.

Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: July 2006, London

Project: Valuation of electricity derivatives (Agenda paper 10(i))

1. Background

1.1 In March 2005, the Agenda Committee received a presentation by staff of the AASB on derivatives associated with the gold and electricity markets. The Agenda Committee decided to divide the issues arising into two parts. For the first part, it recommended IFRIC to decline to take onto its agenda an issue concerning the meaning of delivery. The IFRIC discussed this recommendation at its June and August 2005 meetings and clarified that 'a synthetic arrangement that results from the linking of a non deliverable contract entered into with a customer to fix the price of a commodity with a transaction to buy or sell the commodity through an intermediary would not satisfy the paragraph 5 exemption' [from IAS 39].(IFRIC Update August 2005)

1.2 For the second part, the Agenda Committee asked the AASB staff to research into (i) whether the lack of notional amounts for certain electricity swap contracts settled as contracts for differences (CfDs) have implications for the application of IAS 39, and (ii) how the valuation of principal-to-principal contracts between market participants is achieved where there is limited market information.

- 1.3 The AASB staff report on that research to the 2 November meeting of the Agenda Committee identified what market participants perceived as significant difficulties in valuing these CfDs for financial reporting purposes, although it admitted that they were valued for risk management and that the risk management valuations were sometimes used also for business combinations. The report stated that the only market transactions of this nature were for periods of 4-5 years, whereas principal to principal CfDs entered into between generators and retailers of electricity were typically of some 10 years duration. Furthermore, the market transactions in CfDs did not relate to the half hour pricing intervals of the electricity market but to averages such as the peak or off peak periods of a day. Accordingly, estimations of the fair values of principal-to-principal CfDs required projections at a detailed level of both future market prices and the amounts of electricity that the retailer would demand in specified pricing periods.
- 1.4 The Agenda Committee discussed whether to recommend that the IAS 39.46(c) exemption from valuation of derivatives (relating to unquoted equity instruments that cannot be reliably measured) provided a suitable analogy for a similar exemption for principal-to-principal CfDs. It decided it could not recommend this course.
- 1.5 The AASB report had cited the guidance in the FASB's DIG 6A that a derivative contract without a notional amount should not be fair valued when a notional amount could not be estimated with sufficient reliability. The Agenda Committee noted that no such guidance existed in IFRSs and decided not to recommend this course.
- 1.6 Since no exemptions from valuation were available, the Agenda Committee considered whether IFRIC should give guidance on techniques of valuation, for example by indicating whether reference should be made to prices observed, for the earlier part of a contract's term, in market transactions in CfDs. It decided that it would be inappropriate to do so, since the issues were too specific. Reference should, however, be made to the general principles under development in the project on measurement of fair values.

1.7 In the light of the above discussions, the staff proposes the following wording for a recommendation that IFRIC should not take this issue onto its agenda. [Deleted.]