Staff paper

Agenda reference: 2

IFRS Accounting

Emerging Economies Group meeting

Date	**May 2024**
Project	**Power Purchase Agreements**
Topic	**Exposure Draft *Contracts for Renewable Electricity***

Contacts	**Wiesner, Riana**	(rwiesner@ifrs.org)
	Schueler, Matthias	(mschueler@ifrs.org)
	Deysel, Dennis	(ddeysel@ifrs.org)

Purpose of this session

- Provide EEG members with an overview of the Exposure Draft (ED) *Contracts for Renewable Electricity*
- Seek views from EEG members on the proposals in the ED *

Question for EEG members

- See question on slide 5

Information for EEG members:

- Slides 6–9 provide an overview of the project history
- Slides 10–16 provide an overview of the proposals contained in the ED

* The Exposure Draft is expected to be published on 8 May 2024. The ED and supporting material will be available on the project website

Contents

Question for EEG members

Question for EEG members

- What are your preliminary views on whether the proposals in the ED would resolve the application questions with regards to Power Purchase Agreements (PPAs)?

Project Background

Origins of the project (1/2)

- The IFRs Interpretations Committee received a request about how an entity would apply paragraph 2.4 of IFRS 9 *Financial Instruments* to contracts to buy and take delivery of electricity produced from nature-dependent sources, for example PPAs[1].
- The request said entities experience application challenges when applying the requirements in IFRS 9 to these contracts. These challenges arise due to the combination of:

  (a) the characteristics of the sources of renewable electricity production and the design and operation of the market in which the electricity is sold; and

  (b) the ‘pay-as-produced' features of these long-term contracts.

[1]see Appendix 1 for a description of PPAs

Origins of the project (2/2)

- The Committee referred the matter to the International Accounting Standards Board (IASB) for its consideration. Stakeholders told the IASB that:
  - applying the requirements in IFRS 9 to PPAs sometimes provided less useful information to users of financial statements;
  - a timely solution was needed because of an expected increase in the use of PPAs; and
  - any solution proposed would need to consider physical PPAs and virtual PPAs
- Consequently, the IASB decided to add a maintenance project to the work plan to swiftly respond to these concerns.

[1]see Appendix 1 for a description of PPAs

Project timeline: Power Purchase Agreements

Jun 2023

IFRIC meeting

- Initial request received by the IFRS Interpretations Committee

Jul 2023

IASB meeting

- The IASB decided to explore narrow-scope standard setting for PPAs and added a maintenance project to the work plan

H2 2023

Research and outreach

- Outreach and informal consultation phase with over 28 stakeholders globally

Q1 2024

IASB meeting

- Presentation of research and outreach to IASB members
- Development of detailed proposal to amend IFRS 9 *Financial Instruments*

May 2024

IASB meeting

- Publication of the ED *Contracts for Renewable Electricity*

Nov 2024

Final Amendments

- Publication planned for Nov 2024 subject to feedback and redeliberations

Overview of proposals

Overview

The IASB's objectives

The IASB aimed to swiftly respond to stakeholders concerns that:

- applying the requirements in IFRS 9 to contracts for renewable electricity sometimes provided less useful information to users of financial statements; and
- any solution proposed must be timely and consider physical and virtual PPAs

and

- to ensure that any proposed amendments are appropriately ringfenced to avoid unintended consequences

What is the IASB proposing?

The IASB proposes amendments relating to:

- own-use requirements;
- the hedge accounting requirements; and
- the disclosure requirements;

with regard to these contracts.

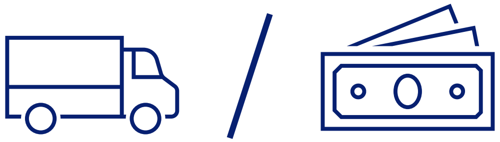
The proposals in the ED:

- have a 90-day comment period—comments are due by 7 August 2024;
- defines the scope to apply to contracts for renewable electricity with specific characteristics; Slide 13
- include considerations for a purchaser under a contract for renewable electricity when applying the own-use requirements in IFRS 9 *Financial Instruments*; Slide 14
- include designation and measurement requirements of the hedged item if an entity uses a contract for renewable electricity as a hedging instrument; Slide 15
- introduce new disclosure requirements for an entity's contacts for renewable electricity; and Slide 16
- provide transition relief and permits early application. Slide 16

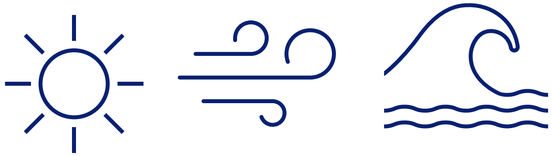
Scope

Contracts for renewable electricity to which the proposals apply:

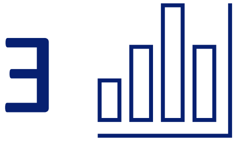
can be gross-settled or net-settled;



are those for which the source of production of the electricity is nature-dependent such that supply cannot be guaranteed; and



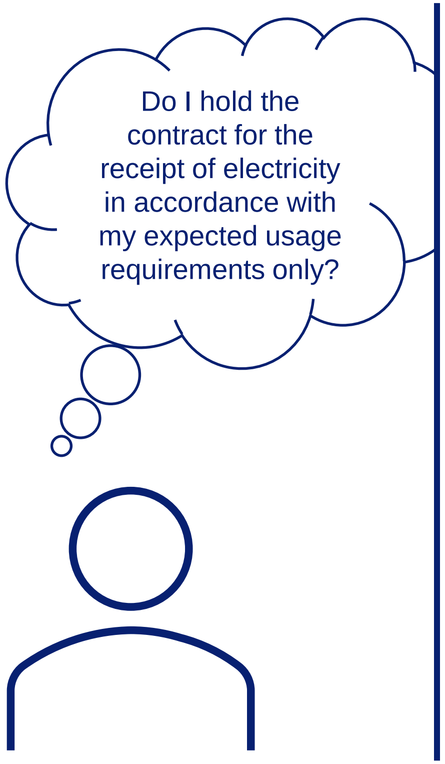
are those for which the purchaser is substantially exposed to all the volume risk through pay-as-produced features.



both conditions must be met

Own use requirements

Applying the own-use requirements, a purchaser under contract to buy and take delivery of renewable electricity considers at inception and at each reporting date:



- the purpose, design and structure of the contract including the volumes of electricity expected to be delivered over the remaining duration of the contract; and
- the reasons of past and expected sales of unused electricity within a short period after delivery—a permissible sale:
  - arises from the entity’s exposure to the volume risk;
  - the design and operation of the market in which the electricity is traded restricts the entity from having the practical ability to determine the timing or price of such a sale; and
  - the entity expects to purchase at least an equivalent volume of electricity within a reasonable time (for example, one month) after the sale.

Hedge accounting requirements

If a contract for renewable electricity meeting the scope requirements in slide 13 is used as a hedging instrument in a cash flow hedging relationship, the proposals permit the :

Designation

as a hedged item

of forecasted sales or purchases with:

a variable nominal volume

if, and only if:

- relates to the variable volume of electricity of the hedging instrument; and
- the forecasted sales or purchases are highly probable.#

forecasted sales are not required to be highly probable if the hedging instrument relates to a proportion of the total future renewable electricity sales from the production facility as referenced in the contract for renewable electricity

Measurement

of the hedged item

- using the volume assumptions as those used for measuring the hedging instrument;
- however, all other assumption shall reflect the nature and characteristics of the hedged item

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Disclosure and transition requirements

The IASB proposes:

1. disclosures for all contracts for renewable electricity in scope of the new amendments. This means for:
   - for gross- and net-settled contracts; and
   - for sellers and purchasers.

2. Transition requirements and that early application be permitted:

Date of initial application

- Own-use requirements: modified retrospective application with cumulative catch-up.
- Hedge-accounting requirements: prospective application but with permission to alter designation of existing cash flow hedging relationships.

Next step

Next step

- The IASB will consider the comments it receives on the Exposure Draft and will decide whether to proceed with the proposed amendments
- The comment letter deadline will be ***07 August 2024***
- The ED and supporting material will be available on the project website

Appendix 1—Contracts for Renewable Electricity: Overview

Overview

Contracts for renewable electricity are often structured as PPAs are grouped as either physical PPAs or virtual PPAs, each with their own accounting implications.

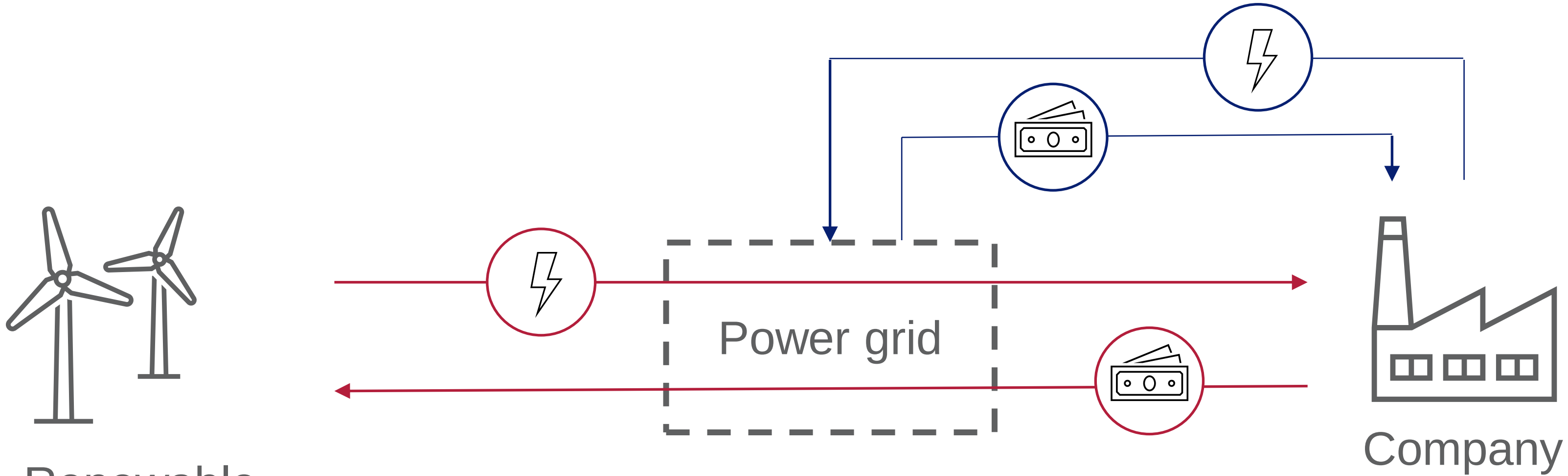
Physical PPAs

Physical PPAs involve a contractual obligation for the buyer to take delivery of and pay for the amount of electricity produced from a referenced production facility. Electricity purchased under a physical PPA must be used within a short period of time or sold back to the market. The issue is whether these contracts qualify for the "own use" exception in IFRS 9, which would allow them to be accounted for as a normal purchase ('executory contract').

Virtual PPAs

Virtual PPAs differ from physical PPAs as they do not contain an obligation for the buyer to take delivery of electricity. Instead, the buyer and the supplier settle the difference between the contractually specified price and the prevailing market price. Virtual PPAs meet the definition of a derivative but the current hedge accounting requirements do not enable an entity to fully reflect the companies' risk management strategies.

Physical power purchase agreements



2

- The company sells any unused power to the grid
- The company receives the spot price for the power sold

1

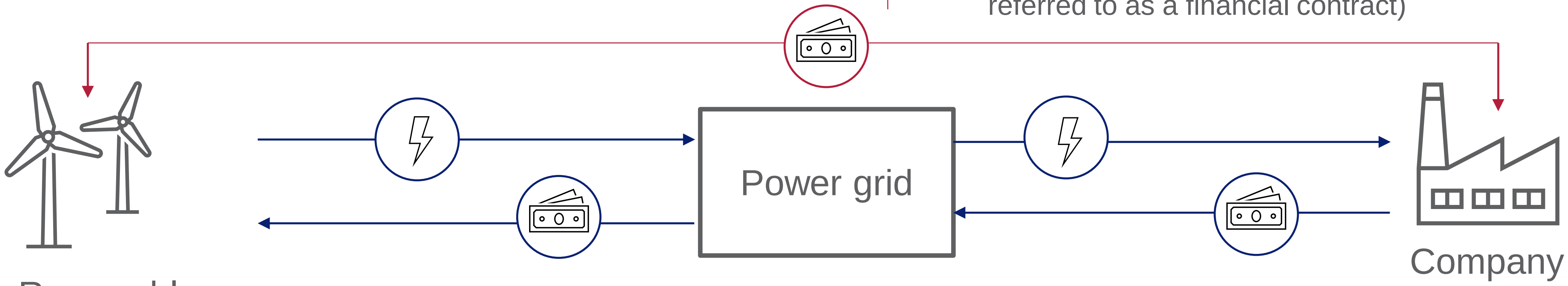
Physical PPA

- The producer delivers power to the company by crediting their account with the grid.
- The company pays a fixed price for the power delivered.

Virtual power purchase agreements

3 **Virtual PPA (contract for differences)**

Net settlement of the difference between the spot and the fixed price of power. (Commonly referred to as a financial contract)



Renewable power producer

1

- The producer delivers power to the grid.
- The producer receives the spot price for the power delivered

2

- The company buys power from the grid.
- The company pays the spot price for the power delivered

Some variations on physical or virtual PPAs

Short-Term PPAs	These PPAs have a shorter duration compared to long-term agreements. They are often used to provide flexibility and manage energy supply or demand fluctuations in the short term.
Sleeved PPAs	A sleeved PPA involves an intermediary. The intermediary facilitates the transaction and ensures the delivery of electricity from the renewable energy generator to the company. Sleeved PPAs can be useful when the company has specific requirements or limitations that prevent a direct agreement with the renewable energy generator.
Offsite PPAs	Agreements in which the renewable energy generator and the company are located in different geographical locations. The electricity generated by the renewable energy generator is fed into the grid, and the company receives financial benefits or RECs (or GOs) based on the agreed-upon terms.

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