IFRS Accounting

Staff paper

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IASB® meeting

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Project	**Power Purchase Agreements (PPAs)**
Topic	**Summary of research and possible approaches for narrow-scope standard-setting**
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Purpose of this meeting

1. In July 2023 the International Accounting Standards Board (IASB) decided to add a project to the work plan to research whether narrow-scope amendments could be made to IFRS 9 *Financial Instruments* to address concerns from stakeholders about the accounting for Power Purchase Agreements (PPAs).

2. The purpose of this meeting is to:

   (a) provide the IASB with:

      (i) a summary of our research to date;

      (ii) an analysis of possible approaches to narrow-scope standard-setting; and

   (b) ask the IASB whether it agrees with our recommendations about how to take this project forward.

Structure of the paper

3. This paper is structured as follows:

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(a) summary of staff recommendations and questions to the IASB

(b) summary of research

(c) staff analysis of possible approaches for narrow-scope standard-setting ;and

(d) staff conclusions and recommendations.

Summary of staff recommendations and questions for the IASB

4. Based on the findings of the research and other input received from stakeholders we recommend that the IASB to:

   (a) undertake narrow-scope standard-setting to amend IFRS 9 to better reflect power purchase agreements in the financial statements with the next project milestone to be an Exposure Draft; and

   (b) explore an approach to this standard-setting that includes amending the 'own-use' and hedge accounting requirements in IFRS 9.

Question for the IASB

Questions for the IASB
Does the IASB agree with our recommendation in paragraph 4?

Summary of research

5. From the IASB's discussions in July 2023, we identified two questions that we used as the framework for our research. The two questions are:

   (a) *prevalence*—whether the accounting challenges for PPAs are widespread and could, or are expected to, materially affect entities' financial statements?

   (b) *scope*—whether it would be possible to limit any potential standard-setting so that the amendments remain sufficiently narrow in scope and be completed in an efficient and timely manner?

6. For the purpose of our research, we have consulted the Accounting Standards Advisory Forum (ASAF) and the large accounting firms. In addition, we obtained information from stakeholders (31 participants) across multiple jurisdictions that provided insights into what both producers and off-takers of power consider when entering into PPAs.[1] The type and geographical spread of stakeholders are summarised in the below table:

Nature of stakeholders	Geographic representation				
	Africa	Asia-Oceania	Europe	North America	South America
Power producers, including an organisation that represents power producers[2]			✓	✓	
Off-takers of power, including an organisation that represents power consumers	✓	✓	✓	✓	✓

7. So far, we have had limited interaction with users of financial statements (investors) on PPAs.[3] However, based on the input we received, including input from this discussion on potential narrow-scope amendments to further explore standard-setting, we will reach out to investors to understand what information they need about PPAs, or would find useful, for their analysis Their input will enable us to refine the standard-setting solution, including whether to add additional disclosure requirements.

8. In November 2023, we also asked for input from the IFRS Interpretations Committee (the Committee). That discussion focused on approaches to limit any potential standard-setting so that the amendments remain sufficiently narrow in scope and be completed in an efficient and timely manner.

[1] The term 'off-taker' is typically used in project financing. It refers to the party who buys the product being produced by the project or uses the services being sold by the project (for example, electricity, mined copper, or a pipeline).

[2] Many of the power producers we spoke to are also off-takers of power that may enter into PPAs to on-sell power to their customers.

[3] As part of our initial outreach of Agenda Paper 2 for the June 2023 IFRS Interpretations Committee meeting we were able to interview a few investors who shared their views on the information provided in the financial statement regarding PPAs.

9. The summary of our research is structured around the two main questions described in paragraph 5 of this paper and in particular:

   (a) with regards to the prevalence of PPAs:

      (i) the use of PPAs across jurisdictions (paragraphs 10–15);

      (ii) business strategies and risk management (paragraphs 16–32); and

   (b) with regards to the scope of any potential narrow-scope amendments, the characteristics of the underlying non-financial item that could be used to limit the risk of unintended consequences (paragraphs 33–46).

Prevalence

The use of PPAs across jurisdictions

10. PPA-type contracts have long been used by entities to secure long-term supply and pricing of commodities or other non-financial items used in their production or manufacturing processes. However, nearly all stakeholders we spoke to confirmed that the type of PPAs that give rise to operational challenges with regards to the current accounting requirements, are increasingly being used for the long-term supply of power from renewable or green energy sources.[4] This is because power producers and off-takers respond to jurisdictional requirements to transform their power consumption to renewable power. One participant (a large accounting firm) cited an article from Bloomberg NEF that includes statistics about the annual increase in the use of PPAs across different regions.

11. Our research confirmed that PPAs are being used by entities:

   (a) in almost all geographical regions, notably in countries like Australia, Brazil, Canada, Germany, Spain, France, the United Kingdom and the United States.

[4] Green power refers to power generated from a renewable source (like the sun or water) and its production does not produce greenhouse gas emissions or harm the environment. Renewable power may or may not generate greenhouse gas emissions or harm the environment when produced.

(b) across many industries—that is, PPAs are not isolated to specific industries; and

(c) of different sizes and levels of sophistication, which continue to evolve.

12. Stakeholders confirmed that, although there are many variations on the terms and conditions of PPAs between jurisdictions, they can be broadly grouped into:

(a) *physical PPAs*—where the off-taker has a contractual obligation to gross settle the volume of power delivered by the producer. Physical PPAs are common in Europe and South America; and

(b) *virtual PPAs*—a contract for the settlement of the difference between that spot price and the contractually specified fixed price without any obligation to take gross delivery of a volume of power. Virtual PPAs are common in Australia, Europe, Canada and the United States.

13. Many participants said that the type of PPAs an entity enters into depends on the set up or structure of the relevant power market. Virtual PPAs are more common in countries where off-takers cannot obtain delivery of the power from the power producer. This may be because the power producer is situated in a different sub-market or country. For example, in the western part of Australia the grid is organised as a net pool market but in the eastern part of Australia the grid is organised as a gross pool market.[5] Such a market structure often leads to the use of a virtual PPA. Similarly in Malysia, power production, grid access and off-take location may be hard to match and that also leads to the use of virtual PPAs to secure access to renewable energy. Therefore, feedback suggests the more fragmented the market the more likely is the use of virtual PPAs.

14. One participant also suggested that smaller entities may be prone to enter into virtual PPAs because they are more accessible.

[5] For an explanation of gross pool and net pool markets for energy please refer to Agenda Paper 2 of the June 2023 IFRS Interpretations Committee meeting.

15. Our research indicated that the key terms and conditions of PPAs include:

    (a) *contract length*—contracts tend to be more long-term than other supply contracts with contract length ranging from 10 to 30 years. It is also common for contracts to be either non-cancellable, other than in cases of a breach of the contractual terms, or subject to substantial early termination penalties that results in no practical ability to terminate the contract.

    (b) *pricing*—the agreed price for the power is usually fixed, but in some cases could also be adjustable/stepped over the term of the contract, linked to an inflation index or jurisdictional tariff, or a combination.

    (c) *volume*—the agreed volume of power can be a specified volume, proportionate amount the volume produced or could include maximum or minimum quantities. Many participants said that PPAs often require the off-taker to purchase all or a proportion of all the power produced (pay-as-produced).

    (d) *net-settlement clauses*—a few participants noted that some PPAs include net settlement clauses for periods of planned maintenance or shut down of the power generation infrastructure.

    (e) *renewable energy certificates (RECs)*—most PPAs for renewable power include the purchase of RECs. RECs are market-based instruments certifying that the bearer owns electricity generated from a renewable energy facility and can be sold to others separate from the electricity purchased (e.g. sold to other entities as a carbon credit to offset their own emissions). The price for the RECs is not always specified separately in the PPA. Participants from Brazil and Canada said that some of their PPAs do not include RECs.

Business strategies and risk management

Power producers

16. Power producers explained that in order to secure affordable long-term financing for investments in renewable power infrastructure, they need to enter into long-term PPAs with off-takers that include predetermined prices over the whole tenor of the PPA

with no price adjustment features. This includes the transfer of the volume risk to the off-taker through pay-as produced contracts. From a financing perspective, the combination of a contractually fixed price together with secured offtake of the produced power means the producer has a stable and reliable revenue stream which in turn results in more favourable financing terms and rates. If such a structure could not be achieved in a PPA, the cost of capital of such projects would potentially be too high to attract financing.

Power off-takers

17. From a power off-takers's perspective, entities with high power needs, are willing to invest in renewable power generation because it helps to transform their power consumption by building up capacity in renewable energy sources. Although some off-takers are able to construct their own generation infrastructure (like installing solar panels on their production facilities), these sources are generally not sufficient to meet all their power needs.

18. All off-takers we spoke to confirmed that there are a number of key business drivers they consider when deciding to enter into a long-term PPA, the most important being:

    (a) access to supply of renewable power, including RECs, as part of their climate commitments; and

    (b) stable/fixed input prices of power for their products.

Supply of renewable power as part of climate commitments

19. Participants confirmed that the dominant driver in their business decision-making currently is related to their targets to reduce their greenhouse gas emissions. There is a gap between the time when entities need to meet their climate commitments and when supply of power in their market becomes 100 per cent renewable.[6]

[6] Climate commitments refer to an entity's own public commitment to change is method of operation in the future including commitments commonly referred to net zero which refers to an entity or country cutting their greenhouse gas emissions to as close to zero as possible.

20. At present, there are limited alternatives to transacting a long-term PPA and entities need to source renewable power from where that power is available, because there is not necessarily sufficient capacity in their market. Only two off-takers said that their spot market provide sufficient access to renewable power. However, in these markets power production can be unreliable and therefore off-takers also enter into long-term PPAs to secure stable supply and continued access to power to avoid shortages.

21. For most off-takers in other jurisdictions, relying on the spot market does not guarantee access to renewable power. As a result, off-takers may not be able to meet their net zero targets. One off-taker also said that short-term contracts for renewable power are more expensive than long-term contracts.

22. Almost all off-takers of power confirmed that they require, and use, the RECs that are typically included in their PPAs for their own purposes because RECs have a temporary purpose until power markets become 100 per cent renewable.

23. With regards to transactions with the spot market to sell any power that an entity is unable to use within the specified interval, off-takers said that such transactions are never done with a profit objective in mind. This is because they do not have control over the timing, volume or price at which such sales and subsequent purchases are transacted at. On average, off-takers are almost always in a net purchase position (that is, they do not end up selling more power than what they use). Often this net purchaser position (referring to buying and selling of power) results in an overall loss position for the entity for the reasons explained in paragraph 30(a). One off-taker explained that they view the potential net cost that may arise from the PPAs as an opportunity cost that is similar to the 'storage cost' they incur for other resources that they use in their production process.

Fixing the input price

24. For many entities, the price of power is an input into the prices of their goods and services. In general, the spot price for power is based on the price of power generated from all energy sources and is typically determined by the most expensive power

generation source.[7] In addition, the price of power from consumption-based commodities (like gas and oil) fluctuates with the market price of those underlying commodities, often on a hourly basis.

25. In contrast, the price for the production of renewable power is not linked to such commodities and is determined by the cost of constructing and operating the infrastructure generating the power, such as wind parks and solar farms. Therefore, the cost of generating renewable power over the life of the infrastructure are significantly less variable.

26. When entering into long-term PPAs the fixed price is determined mainly by the cost of investment needed by a power producer to deliver a specified volume of power over the contract period. Almost all off-takers explained that they factor into the selling price of their goods any potential input cost that may arise from PPAs. Therefore, fixed price PPAs enable off-takers to have more stable input costs into their goods and services which enable them to manage their input costs and margins much better over time.

27. For this reason, stakeholders believe that the financial impact from supply contracts should be accounted for when transactions occur, as part of their 'cost of sales' or operating expenses. In their view having the full valuation impact over the life of PPA, which is a function of the expected power usages over the contract period and forward projections of spot prices in profit or loss is not providing useful information to users of the financial statements. These off-takers explained that their investors assess their performance using for example earnings before interest, taxes, depreciation, and amortisation (EBITDA) and that any inclusion of the full fair value changes of the PPA (if accounted for as a derivative) would distort that performance metric and would require the use of non-GAAP measures. This is consistent with the limited feedback we received from investors as part of our research on the submission

[7] In effect the power supplied to the grid consists of a percentage of renewable and non-renewable power.

to the Committee–see paragraphs 35–37 of Agenda Paper 12A of the July 2023 IASB meeting.

28. Furthermore, because power prices could be quite volatile due to changes in commodity prices, recognising the fair value changes in profit or loss results in information that neither reflect the effect of PPA on their activities by fixing the cost of power, nor would it reflect the outcome of not having the PPA–in the absence of a PPA, all transactions for the purchase of power in the spot market would be presented as part of cost of sales or operating costs in the period in which the transactions occurred.

29. Off-takers acknowledged that any long-term supply contract exposes the entity to risk, for example, a few participants from the mining industry said that entering into long-term supply contracts that fix the price for a non-financial item is not limited to power. They enter into long-term contracts for other inputs in their production process because the life cycle of their operations are long. However, any risks embedded in supply contracts are identified and assessed when entering into such long-term contracts as part of their normal risk management practices.

30. The key risks associated with PPAs for off-takers are:

    (a) most physical PPAs are structured as ‘pay as produced’ contracts, which means the producer is passing most of the production risk to the off-taker–if the power producer does not deliver sufficient power when the off-taker requires it, the off-taker must purchase additional power in the spot market that may be at a price higher than the price determined in the PPA. This first situation is typically the case because at the time a off-taker requires power will be when most other off-takers also need power and prices are high. If the power producer generates power at a time when the off-taker does not need it—but is required to pay for it—the off-taker will need to sell the surplus power in the spot market (typically through an intermediary) at a price that is lower than the price in the contract. This latter situation is typically the case

because at the time when the off-takers do not need power, power is typically cheaper, for example in the evenings, nights or over weekends.

(b) although a virtual PPA does not require an off-taker to pay gross for the power delivered, it requires the off-taker to settle the difference between the agreed price in the PPA and the spot market price whenever power is delivered (in this case to the spot market of the relevant grid).[8] There could therefore be a timing difference between settling the difference on a volume of power produced and when the entity purchases that same volume of power from the spot market.

31. Off-takers acknowledged that from a risk management perspective PPAs carry significant price risk because the price is fixed for the contract duration. However, as power is an input into the prices of their goods and services, they would not necessarily consider a PPA to become onerous simply because the spot price is below the contracted fixed price. From their perspective, the input cost for power compared to the total product cost, would make it unlikely that even in an unfavourable price risk scenario—such as if the future spot energy price is significantly lower than the contracted fixed price of a PPA—for that effect to not be absorbed via the product pricing (ie they could increase the price of goods and services accordingly or accept a lower margin). As a result, these off-taker also did not think such contracts could likely become onerous in the future.

32. Many power producers are also off-takers in PPAs. They acquire power to sell to their customers. For these types of off-takers, fixing the price of the power purchased is an important strategic objective for entering into long-term PPAs.

[8] Participants to the research have explained that for example a pay-as produced virtual PPA is settled monthly in arrears based on hourly volume deliveries (which are known ex post) at the prevailing spot price on delivery.

Scope

33. At its July 2023, the IASB tentatively decided to research whether narrow-scope amendments could be made to IFRS 9 to better reflect how financial statements are affected by PPAs in which the underlying non-financial item:

    (a) cannot be stored economically; and

    (b) is required to either be consumed or sold within a short time as determined by the market structure in which the item is bought and sold.

34. We asked members of ASAF, the Committee and the large accounting firms:

    (a) whether they agree with making use of the characteristics of the underlying non-financial items to ring-fence the project; and

    (b) if, yes, what characteristics are unique to power that could be used.

Ringfencing based on the characteristics of the underlying

35. Some participants, including most Committee members, agreed that using characteristics could achieve a principle-based outcome, while some others questioned whether a list of characteristics could have unintended consequences with regards to other non-financial items or future developments. One participant also asked whether natural gas may have similar characteristics to power. Another participant suggested bandwidth derivatives may also share some characteristics with PPAs.

36. A few participants suggested that to amend IFRS 9's own-use requirements (that is, develop a solution for physical PPAs) management's intention with entering into the contract or a business model test are better approaches to ring-fence the project. Some of these participants suggested that intention may be evidenced if an entity remains a net purchaser of power over the term of the contract. A suggestion has also been made that management's intention could be used as a basis for applying the own-use requirements in paragraph 2.4 of IFRS 9 to a part/portion of PPA, for example by splitting a contract between a proportion held for 'own use'(for example 80 per cent

of the contract volume) and proportion held as a derivative (the remaining 20 per cent capacity).

Proposed characteristics to limit the scope

37. Some participants suggested that the unique characteristics of power include:

    (a) neither the seller or the buyer of power (ie off-taker) control the timing and quantity of power supplied;

    (b) when the buyer is unable to use the volume supplied, it is forced to sell unused volumes into market at prevailing market spot price; and

    (c) a buyer can reliably match its consumption to the delivery of power over a period of time, but not at the discrete points when the seller delivers the power.

38. A few participants said that the physical or economic feasibility of the storage of power is not a viable characteristic because of possible future developments.

Additional considerations

39. Some participants (across all those we interviewed) commented that, in their view, any potential standard-setting solution needs to result in the same accounting treatment for physical PPAs and virtual PPAs. This is because in their view, both types of PPAs are used for the same purposes and are economically very similar. Furthermore, as noted in paragraph 12 above, the types of PPAs an off-taker enters into often depends on the structure of the power market and as a result entities typically do not have much choice in the type of PPA they enter into. Under both types of PPAs an off-taker wants to primarily secure access to power and RECs.

Potential approaches to narrow-scope standard-setting

Provide application guidance to the 'own' use requirements

40. Participants to our research and the Committee members did not disagree that amendments to the own-use requirements in IFRS 9 can be made to clarify how an entity assesses *expected usage*. Participants considered the outcome of such an amendment—accounting for physical PPAs as executory contracts—as an important factor because it provides useful information about physical PPAs considering the business strategies for entering into these contracts.

41. As noted, some Committee members were concerned that the IASB may need to consider a broad range of commodity contracts before it can conclude that these characteristics will not result in unintended consequences.

Amend hedge accounting requirements in IFRS 9

42. Most participants in our research and many Committee members supported the IASB to consider standard-setting solutions for both physical PPAs and virtual PPAs. These respondents therefore suggest a project includes the requirements for both own use and hedge accounting as part of the standard-setting solution.

43. A few Committee members raised concerns that ring-fencing amendments to hedge accounting may be harder to achieve on a principle-based approach than amendments to the own-use criteria.

44. A few other Committee members suggested the IASB could treat accounting for physical PPAs and virtual PPAs as separate projects, as opposed to treating them together in one project, so that if more work needs to be done on, for example the hedge accounting requirements, a standard-setting solution for the own use requirements can move ahead.

Provide an exception from the scope of IFRS 9

45. A few other stakeholders, including some Committee members were concerned that a principle-based approach to narrow-scope standard-setting could have unintended consequences that the IASB would only be able to resolve through research that covers a broad range of commodity contracts. A few Committee members commented that the IASB may need to consider whether a principles-based solution or a timely response is its highest priority. Even though these members are in favour of principle-based solutions, they note that a timely response may require the IASB to consider a more rules-based approach such as a temporary exception from the scope of IFRS 9 for all PPAs.

46. Many Committee members suggested the IASB could respond timeously to current concerns by making use of an exception and address the broader conceptual questions of how to apply the own-use requirements and hedge accounting requirements to non-financial items that lack physicality. A few Committee members suggested that if a short-term rules-based exception is developed, the IASB can consider adding additional disclosure requirements.

Staff analysis of possible approaches for narrow-scope standard-setting

47. Considering the IASB's discussion in July 2023 and our research findings, we developed preliminary views about two aspects of a possible standard-setting solution:

    (a) defining the scope of any proposed narrow-scope amendments; and

    (b) possible approaches for narrow-scope standard-setting.

48. We also presented our preliminary views to the Committee in November 2023 (see Agenda Paper 7 of that meeting). Our responses to the feedback from participants in our research and the Committee are incorporated in our views below.

Other accounting considerations

49. We acknowledge that there are accounting considerations, particularly with regards to physical PPAs, other than the IFRS 9 considerations. However, the IASB's project on PPAs focusses solely focusses on potential amendment to IFRS 9. However, an entity first need to assess whether another IFRS Accounting Standard applies to that contract, for example whether:

    (a) the producer needs to be consolidated applying IFRS 10 *Consolidated Financial Statements*;

    (b) the PPA constitutes a lease to which IFRS 16 *Leases* is applied; or

    (c) the PPA constitutes a service concession arrangement applying IFRIC 12 *Service Concession Arrangements*.

50. Only when a PPA is not accounted for applying another IFRS Accounting Standard, the requirements in IFRS 9 apply.

51. We are also aware that in a typical PPA for renewable power, the fixed contract price also includes delivery of a quantity of RECs.[9] These RECs are 'used' by (that is, cancelled or retired) by the entity to offset energy usage from non-renewable sources.

52. All participants confirmed that entities account for the RECs separately from the PPAs (physical and virtual). The IASB has on its reserve list a project on polluting pricing mechanisms. The possible narrow-scope standard-setting project on PPAs will not include accounting requirements for RECs. Therefore, we do not provide more detail about how entities account for RECs.

Determining the scope of any potential narrow-scope amendments

53. In our view, the scope of any potential narrow-scope amendments could be determined using the unique characteristics of some PPAs. These characteristics are

[9] Feedback suggest that the price can be an 'all-in-one price' for the energy and the RECs or separately identifiable. This depends on the contractual terms of each PPA.

determined by the nature of the non-financial item (power) and the market structure (power market) within which the item is transacted and could include:

(a) neither the seller nor the purchaser fully controls the timing and volumes of the production or delivery of the non-financial item, resulting in short-term mismatches between supply and demand. Production, and therefore delivery, could be sporadic and unpredictable (ie it is weather dependent), especially for each discrete interval at which power could be needed or used.

(b) the entity's usage or sales expectations can be predicted to a high degree of certainty over a period of time that might be shorter than contractual period.

(c) if the non-financial item is delivered and the purchaser is unable to use the volume supplied, the market structure requires any unused power to be put back into the market at the prevailing market rate (ie the entity has no control over timing or price of sales).

54. If the nature of the non-financial item and the market structure have the characteristics listed in paragraph 53, potential narrow-scope amendments could include:

(a) requirements for how an entity needs to assess *expected usage* in paragraph 2.4 of IFRS 9 (see paragraphs 56–63 below); and/or

(b) requirements for how an entity assesses whether a forecast transaction to buy or sell the non-financial item is 'highly probable' in accordance with paragraph 6.3.3 of IFRS 9 (see paragraphs 64–72).

55. However, in the absence of using the characteristics of the non-financial item and the market structure to determine the scope of potential narrow-scope amendments, an alternative approach could be to create an exception from the scope of IFRS 9 for PPAs (see paragraphs 73–75).

Approach 1—Amend the 'own-use' requirements in IFRS 9

56. This approach focusses on a potential amendment to the 'own use' requirements in paragraph 2.4 of IFRS 9. The staff continues to be of the opinion that there is a lack of

adequate application guidance in IFRS 9 *how* to assess an entity's expected usage requirements in markets where the underlying non-financial items display the characteristics as described in paragraph 53. In particular, when taking into account such a specific market structure, we think it is currently not clear:

(a) over which period an entity's expected usage requirements needs to be evaluated; and

(b) to what extent transactions in the spot market subsequent to delivery indicate that a PPA is or is not held for the purpose of an entity's own usage requirement.

57. Potential standard-setting could include application guidance to clarify the requirements for these particular non-financial items. For example, the application guidance could consider clarifying that for the purposes of the 'own use' assessment entity considers:

(a) the purpose and reasons for entering into the contract (for example the structure and design of the contract meets an entity's expected usage requirements over the contract term);

(b) the frequency and volume of transactions with the market other than those needed as a result of short-term mismatches between supply and demand (for example whether estimates about supply or consumption volumes are forecasted based on average or cumulative usage);

(c) evidence of actual vs. expected usage (for example if a purchasing entity is in a net buyer position) since inception of the contract; and

(d) indications of trading intent (for example profit-driven sales).

58. In our view, the unique characteristics outlined in paragraph 53 justifies an approach that considers the additional factors listed in paragraph 57 when assessing the own-use requirements, compared to supply contracts for other non-financial items to which the own use requirements are applied. In other words, a physical PPA should not automatically fail to be considered held for own-use simply because of its unique

characteristics. We, therefore, do not agree with those stakeholders that said the IASB would need to consider a broad range of commodity contracts to develop an approach focussing on the own use requirements. Furthermore, if there are other non-financial items, apart from power, that have these unique characteristics–particularly the requirement to sale unused volumes at the prevailing market rates–in our view, an entity should also consider the factors listed in paragraph 57 when assessing the own-use requirements for those non-financial items.

59. We have considered, but do not recommend, an approach based on applying the own use requirements to a portion of a PPA for the following reasons:

(a) Such an assessment would split the unit of account of the contract, something the IASB has rejected in the past in the context of own use. Such an approach would not only represent a fundamental change to the current requirements in IFRS 9, but also carry a significant risk of unintended consequences. This is because using only a portion of a contract as held for own use and a portion for trading, is not unique to PPAs and could equally be applied to other contracts that failed own use because they were not held solely for the purposes of an entity's own use requirements.

(b) Such an approach would require detailed requirements (similar to when a portion of a hedged item is designed in a hedging relationship) on what would qualify as a portion and how an entity need to apply the own use requirements. This would include requirements for ongoing assessment of the own use portion and whether subsequent changes to that portion could be made.

(c) It could give rise to questions about transactions with the market similar to those that lead to the submission to the Committee. For example, if at inception of a PPA 80 per cent of a contract is designated for own use but subsequent sales of unused power amounts to more than 20 per cent, it would be difficult to reconcile the initial intention of the entity to the actual actions the entity took in the market; and

(d) Frequent changes in accounting outcomes based on management's intention with regards to the portion held for own use, are not likely to provide useful information to users of financial statements and could lead to very complex accounting questions, for example, how to account for the fair value of the derivative portion when changing the portion held for own use. Equally, not allowing subsequent changes to the own use portion could result in many derivatives being designated as held for own use at inception and accounted for an executory contract even when those derivatives are subsequently held for trading.

60. In our view, such an approach would represent a fundamental change to the own use requirements and take a considerable time and resources to complete as it would not involve narrow-scope standard-setting nor would it be a timely solution for stakeholders.

Advantages

61. Following an approach as described in paragraph 56–58 would not be a fundamental change to the current own use requirements and be a narrow-scope amendment that could be finalised in an efficient manner. It would maintain the current discipline of the own use requirements as it would require the continuous assessment of the purpose of the PPA. It would also achieve an accounting outcome that is consistent with other executory contracts for which the underlying are also non-financial items which are delivered gross, without a significant risk of unintended consequences or disruption to current practices with regards to own use.

Disadvantages

62. As noted in paragraph 15 of this paper, physical PPAs are typically contracts for 15 plus years. Such contracts inherently expose an entity to risk (for example price risk). However, currently, there are no specific disclosure requirements for any contracts to which the own use requirements are applied although IFRS 7 requires disclosure of the risks arising from an entity's financial instruments. Therefore, given the unique

characteristics of PPAs, investors might require additional information to be disclosed that will enable them to understand the timing, amount and uncertainty of future cash flows arising from these contracts.

63. Amending the 'own use' requirements would only resolve the practical concerns for physical PPAs but not for virtual PPAs leaving many stakeholders which cannot contract a physical PPA without an accounting solution for their contracts.

Approach 2—Amend the hedge accounting requirements in IFRS 9

64. This approach focuses on the hedge accounting requirements in IFRS 9 for a forecast transaction and could include, among other potential clarifications, additional requirements on how to assess the requirement for a forecast transaction to be 'highly probable' for contracts where the underlying non-financial item have the characteristics as described in paragraph 53.

65. For example, permitting the designation of a variable or unspecified nominal amount as the hedged item–in other words, the hedged item is a forecast transaction where the entire output volume is designated but unknown at the time of designation and may enable a producer to more easily achieve hedge accounting when using a virtual PPA as the hedging instrument.

66. In addition, further amendments that could alleviate some of the constraints on power off-takers, include the current requirements on 'highly probable' with respect to the time horizon of the forecasted volume estimates. This could for example require forecasted power purchases to be highly probable over the short- and medium term, while forecasted purchases (or sales) over the longer-term are expected/probable to occur when the non-financial underlying items have the characteristics described in paragraph 53 of this paper.

67. Such an approach might enable virtual PPAs to be designated as a hedging instrument in a cash flow hedging relationship with the assessment of the 'highly probable'

requirement sharing many of the considerations as suggested in paragraph 53, thereby using similar principles for a 'own-use' assessment and hedge accounting.

68. We acknowledge that developing potential amendments to the hedge accounting requirements would be complex and does not guarantee to a standard-setting solution could be found. We also acknowledge stakeholders' suggestion that any amendments to the hedge accounting requirements be developed separate from any amendments to the own use requirements to not delay a solution addressing physical PPAs. However, in our view, separating a potential standard-setting solution into two projects may not be feasible because both approaches rely on the same underlying characteristics. Therefore, feedback and input on either approach, may affect the other.

Advantages

69. The ability to utilise hedge accounting for virtual PPAs would be consistent with an entity's risk management strategy with respect to such contracts. For example, an entity whose objective it is to fix the price of the underlying non-financial item for the term of the virtual PPA would be able to reflect this in its financial statements by applying cash flow hedge accounting. This would mean that not all of the fair value changes of the virtual PPA would be recognised in profit and loss in the period the changes occur, but the effective portion would be recognised in other comprehensive income. However, any ineffectiveness, which may be caused by for example, timing or basis differences between the spot purchase of power and the net settlement of the virtual PPA, would be recognised in profit or loss thus reflecting the economic reality of the virtual PPA not fully hedging the variability in cash flows–in other words, the amounts recognised in profit or loss would be a true reflection of the economic substance of the hedging relationship.

70. Applying hedge accounting would also mean that the virtual PPA would continue to be recognised in the statement of financial position and remain subject to the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* for hedging relationships. This would therefore provide useful information to users of the financial statements about the entity's strategy to hedge the variability in cash flows arising

from forecasted purchases or sales of power while at the same time addressing the accounting challenge stakeholders have reported to the IASB.

Disadvantages

71. Any amendments to the requirements for a forecast transaction, designated as a hedged item in a cash flow hedging relationship, to be 'highly probable' could carry a high risk of unintended consequences. The hedge accounting requirements set a deliberately high hurdle for forecast transactions as it results in a measurement exception for designated derivatives. Therefore, to be able to solve this challenge, the hedge accounting requirements may become even more complex.

72. Furthermore, applying hedge accounting is voluntary and for entities not currently applying hedge accounting, the implementation costs may be high.

Approach 3—Exception from the scope of IFRS 9 for PPAs

73. This approach would create an exception from the scope of IFRS 9 for PPAs, either by excluding them from the definition of derivatives and/or adding a scope exclusion to paragraph 2.1 of IFRS 9. Such an exception:

    (a) would require a definition for PPAs to be develop;

    (b) may include a 'sunset clause' (that is an end-date for the exception).

    (c) may include additional disclosure requirements.

    Many of those that suggested this approach, did so on the basis that it could provide a temporary exception from derivative accounting, while the IASB continue to develop a longer-term solution as part of its project on PPAs.

Advantages

74. The general advantage of creating an exception to the general requirements is that any project can progress relatively quickly depending on the justification used for excluding PPAs from the scope of IFRS 9. This is because any exception is 'rules-based' rather than relying on defining principles and therefore the scope of its

application can be restricted to a distinct population of qualifying contracts for the purchase or sale of particular non-financial items.

Disadvantages

75. Although we agree that a timely standard-setting solution is preferrable and that such an approach would achieve a similar accounting outcome for both physical and virtual PPAs, we do not however, consider a rules-based temporary exception to be an appropriate measure because:

(a) it does not remove the risk for unintended consequences or necessarily lead to a timelier solution. Any scope exclusion will require precise and careful wording, while being sufficiently narrow to avoid the risk of abuse of the exception. For example, depending on the wording of the exception, PPAs may be structured to have very little to do with the purchase or sale of power while including other underlying items (non-financial or financial) just to achieve a particular accounting outcome. Therefore, it is likely that developing sufficiently robust criteria for such an exception could also take a considerable time to complete.

(b) Once an instrument is excluded from the scope of IFRS 9 there would typically be no requirement to assess the purpose of the instrument on an ongoing basis. Therefore, if the purpose of the instrument changes subsequently, there might be reassessment required or any information provided to users of the financial statements about such an instrument.

(c) There is no conceptual basis to exclude virtual PPAs from the scope of IFRS 9 and this would create inconsistency with the accounting for other contracts for the settlement of differences (for example interest rate swaps) or other derivatives that do not have a specified nominal amount.

(d) PPAs are typically long-term contracts. Feedback also identified that entities are expected to increase their PPAs within the next few years as they work towards their net zero targets. An exception to the scope of IFRS 9 might apply to many PPAs by the time a more general project on the own use or

hedge accounting requirements have been completed. Should such a future project require PPAs to be recognised in the statement of financial position, it will place a lot of pressure on any potential transition requirements at that time to balance practicality of implementation and the usefulness of information to users of financial statements.

(e) The IASB just recently completed its *Third Agenda Consultation*. Adding larger standard-setting projects to the IASB's workplan may only be feasible during its next agenda consultation. This may delay bigger projects to change own-use or hedge accounting requirements for quite some time.

Staff conclusions and recommendations

Prevalence

76. Based on our findings of the research regarding prevalence of PPAs as detailed in paragraphs 10–32 of this paper and other input we received from stakeholders we are of the opinion that PPAs are prevalent in multiple jurisdiction. Although often not visible in the financial statements stakeholders have also reported diversity in practice in applying the existing requirements in IFRS 9 as well as operational accounting challenges for both physical and virtual PPAs.

77. Therefore, we recommend the IASB to undertake narrow-scope standard-setting to amend IFRS 9 to better reflect the PPAs in the financial statements with the next project milestone to be an Exposure Draft.

Scope and preferred approach standard-setting

78. Having considered the findings of our research and the advantages and disadvantages of the three potential approaches discussed in this paper, we are on balance, of the opinion that the IASB should not pursue an approach based on an exception from the scope of IFRS 9 (ie approach three) further. This is because we think the

disadvantages, in particular the significant risk of unintended consequences, outweighs the benefits. In our view, it risks undermining the principle-based nature of IFRS Accounting Standards which is not justified in this case.

79. The other two approaches (approaches one and two) are not mutually exclusive and can be further explored in combination. This is because the characteristics described in paragraph 53 of this paper, can be used, to a large extent, for both approaches. We think that these characteristics would enable us to ringfence any potential amendments not only for the own-use assessment but also for hedge accounting. At the same time, we would be able to address accounting challenges raised for both physical and virtual PPAs.

80. We therefore recommend that the IASB further explore an approach to narrow-scope standard-setting that includes amending the own-use and hedge accounting requirements at the same time.