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**IASB<sup>®</sup> Meeting**

Date	<b>March 2024</b>	
Project	<b>Power Purchase Agreements (PPAs)</b>	
Topic	<b>Scope of the proposed amendments and the proposed amendments to the own-use requirements</b>	
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**Purpose and context**

1. As Agenda Paper 3 to this meeting explains, this paper includes our analysis and recommendations for the International Accounting Standards Board (IASB) to amend IFRS 9 *Financial Instruments* to address the accounting challenges for Power Purchase Agreements (PPAs). This paper specifically covers the proposed scope of the proposed amendments and the proposed amendments to what we later define as the own-use requirements.

**Structure**

2. This agenda paper includes:
  - (a) a [summary](#) of staff recommendations;
  - (b) our analysis, conclusions and question for the IASB about the [scope](#) of the proposed amendments; and
  - (c) our analysis, conclusions and question for the IASB about the proposed amendments to the [own-use requirements](#).

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3. This agenda paper also includes an appendix that includes a summary of feedback on our preliminary thinking.

## Summary of staff recommendations

4. For the proposed scope of the project, we recommend that the scope of the proposed amendments to IFRS 9 is limited to contracts for renewable electricity<sup>1</sup> for which:
- (a) the source for production of the renewable electricity is nature-dependant such that supply cannot be guaranteed at particular times or in particular volumes. Examples are wind-, solar- and hydroelectricity.
  - (b) volume (ie production) risk is substantially transferred to the purchaser, also referred to as pay-as-produced features. Volume risk is the risk that the timing or volumes of electricity supplied do not necessarily align with the purchaser's demand.
5. For the purposes of applying the requirements in paragraph 2.4 of IFRS 9 (the own-use requirements) to a contract to purchase renewable electricity, we recommend that the IASB requires the purchaser to consider:
- (a) the purpose, design and structure of the contract, and whether the volumes expected to be delivered under the contract continues to be consistent with the purchaser's expected purchases or usage requirements for the remaining life of the contract; and
  - (b) the reasons of past sales of unused renewable electricity and whether such sales are consistent with the purchaser's expected purchases or usage requirements. Sales would be consistent with the purchaser's expected purchase or usage requirements if those sales arise from:

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<sup>1</sup> We note that the [Industry-Based Guidance](#) of IFRS S2 *Climate-related Disclosures* includes in multiple places variations of a definition for renewable energy: (i) 'Renewable energy is defined as energy from sources that are replenished at a rate greater than or equal to their rate of depletion, such as geothermal, wind, solar, hydro and biomass' and (ii) 'Renewable energy is defined as energy from sources that are capable of being replenished quickly through ecological cycles, such as geothermal, wind, solar, hydro and biomass.' We do not propose to make use of these definitions because certain characteristics of renewable electricity under consideration within the scope of this project are narrower.

- (i) mismatches between the renewable electricity delivered and the purchaser's demand requirements at the time of delivery; and
- (ii) the design and operation of the market within which the renewable electricity is transacted in that prevents the purchaser from having the practical ability to determine the timing or price of such sales.

## The scope of the proposed amendments

### *Objective*

6. Most input and feedback to date supported the IASB developing a timely solution for PPAs that also limits the potential for unintended consequences. Consequently, we developed for ourselves this objective for the scope of the proposed amendments within which we developed our recommendations:

The scope of the proposed amendments needs to be sufficiently narrow to minimise: (i) the potential for any unintended consequences; and (ii) the time to finalise the proposed amendments.

### *Themes from input and feedback*

7. We summarised our preliminary thinking, and the input and feedback we have received on our thinking, about the scope of the proposed amendments in the appendix. From that input and feedback, we have identified common themes about the proposed scope of the project:
- (a) whether the IASB should limit the scope to contracts for a specific type of non-financial item;
  - (b) whether the scope can be sufficiently defined;
  - (c) whether the same scope can apply to the proposed amendments to the own-use- and the hedge-accounting requirements; and

- (d) whether the IASB has sufficiently considered alternative scoping suggestions.
8. In the light of the objective in paragraph 6, we considered and analysed these common themes.

***Whether the IASB should limit the scope to contracts for a specific type of non-financial item***

9. It has been suggested that the IASB limit the scope of the proposed amendments to contracts for electricity, green energy or renewable electricity as opposed to referring to a contract for a non-financial item that possess particular characteristics. This feedback suggests that this clarification would reduce the potential for any unintended consequences for other contracts for non-financial items. We also considered such scoping as a potential solution in paragraph 49 of [Agenda Paper 12A](#) of the IASB's July 2023 meeting.
10. We note that the Committee received three fact patterns in its request:
- (a) fact pattern one was about applying the own-use requirements to a physical PPA for renewable electricity from a wind park;
  - (b) fact pattern two was about applying the net-settlement requirements in paragraph 2.6(b) of IFRS 9 to a contract to buy natural gas; and
  - (c) fact pattern three was about applying the own-use requirements to physical PPAs for renewable electricity: wind- and solar electricity.
11. Focusing on fact pattern number one and number three that deal with applying the own-use requirements, we considered that the unique characteristics of the PPAs for renewable electricity, like wind- or solar electricity, would naturally limit the scope to only those contracts for non-financial items that have the same characteristics as contracts for renewable electricity. Using these unique characteristics to scope the proposed amendments would, by implication, then limit the unintended

consequences.<sup>2</sup> If a contract for another non-financial item possessed those same characteristics (however unlikely it may be), in our view there is not a principle-based reason to exclude from the scope of the proposed amendments such other contracts.

12. However, as noted input and feedback have stressed the need for the IASB to move swiftly on this project. Many suggested that a timely solution may be achieved by having a more tailored but less principle-based solution.
13. Additionally, input and feedback have not yet identified other contracts for non-financial items that give rise to the same accounting challenges as those that apply to the PPAs for renewable electricity, like wind- or solar electricity.
14. Consequently, we are of the view that the IASB could propose in an exposure draft to limit the scope of the proposed amendments to contracts for renewable electricity. Limiting the scope of the project in this way responds to the questions about the own-use requirements submitted to Committee and achieve the objective we set ourselves in paragraph 6.

### ***Whether the scope can be sufficiently defined***

15. In January 2024 we reported to the IASB that the accounting challenges in applying the own-use requirements arise because of the unique characteristics of physical PPAs for renewable electricity that were submitted as fact patterns to the Committee. Consequently, we shared with the IASB our preliminary thinking that the scope of the proposed amendments could be based on these unique characteristics, being:
  - (a) the supply/production of the non-financial item is weather (and location) dependant such that the timing and/or volume of the item supplied are not necessarily aligned with the demand for the item;

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<sup>2</sup> In [Agenda Paper 3](#) of the January 2024 meeting of the International Accounting Standards Board (IASB), we noted that, in our view, most of the accounting challenges with physical PPAs can be resolved by explaining how the own-use requirements in paragraph 2.4 of IFRS 9 *Financial Instruments* is applied. This is because potential explanations could be based on the unique characteristics of PPAs that gave rise to the questions. In contrast, application questions about the net-settlement requirements in paragraphs 2.6 of IFRS 9 do not arise from the unique characteristics and therefore any amendments have the risk of unintended consequences to other contracts for non-financial items.

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- (b) the purchaser cannot avoid taking delivery of the non-financial item when produced due to the legal structure of the market the non-financial item is transacted in; and
  - (c) the market structure requires any quantities of the item that an entity is unable to use within a specified short period following delivery, is put back into the market at the prevailing market rate at that point. For this purpose, the timing of any resulting sales is determined by the market structure and the entity has no control/discretion over the timing or price of resulting sales.
16. Considering the input and feedback we have received on our preliminary characteristics (summarised in the appendix), we refined the unique characteristics of physical PPAs for renewable electricity in paragraphs 15(a) and 15(b). (We discuss our preliminary characteristic in paragraph 15(c) in paragraph 20.) Input and feedback consistently confirmed that the unique characteristics of the newer forms of PPAs for renewable electricity are a combination of:
- (a) *the nature of renewable electricity*—the source for production of the electricity is nature-dependant such that supply cannot be guaranteed at particular times or for particular volumes. Examples are wind-, solar- and hydroelectricity.
  - (b) *the contract design*—the pay-as-produced terms of the contract transfers volume risk to the purchaser. Volume risk is the risk that the timing or volumes of electricity produced and delivered do not necessarily align with the purchaser’s demand.
17. We continue to be of the view that the IASB would be able to sufficiently define the contracts within the scope of the proposed amendments by using these unique characteristics because they adequately describe the nature of the contracts that the IASB intends to address.

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***Whether the same scope can apply to the proposed amendments to the own-use- and the hedge-accounting requirements***

18. In January 2024 we shared with the IASB that the proposed amendments to the hedge-accounting requirements (as discussed in Agenda Paper 3B of this meeting) would apply to contracts for non-financial items with the characteristics listed in paragraph 15.
19. Input and feedback suggested that our preliminary characteristic in paragraph 15(c) (the market structure requires any quantities of the item that an entity is unable to use within a specified short period following delivery, is put back into the market at the prevailing market rate at that point) do not properly reflect the contract-for-differences nature of a virtual PPA because it refers to ‘delivery’ and ‘put back’—words signalling a gross-settled contract.
20. Considering this input and feedback, in our view, the IASB could make use of the two characteristics in paragraph 16 to scope the proposed amendments to both the own-use requirements and the hedge-accounting requirements. Our preliminary characteristic in paragraph 15(c) establishes a factor that a purchaser of renewable energy under a physical PPA need to consider when assessing the own-use requirements. We, therefore, moved this characteristic to the proposed amendments to the own-use requirements.
21. Apart from clearly limiting the scope of the proposed amendments to PPAs for renewable electricity, in our view, the IASB could also use the location of the proposed requirements within IFRS 9 and IFRS 7 to communicate that the proposals do not apply to other contracts. The IASB could, therefore, follow the same approach it took when including the requirements for interest rate benchmark reform—that is, create a separate and clearly labelled section within IFRS 9.

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***Whether the IASB has sufficiently considered alternative scoping suggestions******Contracts to buy or sell other forms of electricity***

22. We considered the suggestions of, but decided against, limiting the scope to contracts to buy or sell any form of electricity. Input and feedback confirmed that PPAs for electricity have been prevalent for many years. The IASB has not received input or feedback in the past (including in its recently completed [Third Agenda Consultation](#)) that entities struggle to apply the own-use requirements to such contracts to buy or sell electricity. Because it is the unique characteristics of the newer forms of PPAs for renewable electricity that resulted in the questions to the Committee, in our view, it would be appropriate for the IASB to limit the scope of the proposed amendments to PPAs for renewable electricity.
23. Input and feedback also asked whether contracts for other sources of green energy would be included within the scope. For example, natural gas or biomass energy. Input and feedback noted that:
- (a) although the production of biomass energy is nature dependent (for example because the energy comes from trees), it is not the case that the production of the energy cannot be guaranteed at particular times or for particular volumes. Biomass is the item to fuel the power station, but for example the sun's effect on the biomass does not have the same cause-and-effect on the energy production as when the sun shines to generate energy at a solar farm. Therefore, contracts for biomass energy would fail the characteristic in paragraph 16(a).
  - (b) some contracts for hydro energy do not transfer volume risk to the purchaser because it is possible for the generator to control production by, for example, opening or closing the dam or using other (less expensive) sources of energy to pump water through the generation assets. Therefore, these types of contracts for hydro energy would fail the characteristic in paragraph (b).



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24. We considered, but decided against, broadening the scope of the proposed amendments to contracts for other types of green energy because, to date, we have received no feedback that contracts for other types of green energy result in the same accounting challenges as those for physical PPAs for renewable electricity. Therefore, in our view, it would be appropriate for the IASB to limit the scope of the proposed amendments to PPAs for renewable electricity as described in paragraph 16.

### *Renewable Energy Certificates*

25. There have been a few feedback providers that asked whether the IASB would be able to address the accounting for PPAs for renewable electricity without also considering the accounting for the Renewable Energy Certificates (RECs) that typically accompany these contracts. For example, because RECs are commonly a key reason for entities entering into PPAs, one may consider that the risks and costs created by the unique characteristics of PPAs for renewable electricity form part of acquiring the RECs.
26. As a reminder, RECs (or similar attributes) are market-based instruments certifying that the bearer owns electricity generated from a renewable electricity facility. RECs can typically be traded separately from the renewable electricity 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.
27. At previous meetings, we reported to the IASB that:
- (a) *July 2023* (paragraphs 17 and 46 of [Agenda Paper 12A](#))—stakeholders said that the accounting for RECs is a complex area that also gives rise to many application questions. Although we acknowledge stakeholders' views that there are application questions about the accounting for RECs, we expressed a view that these questions would potentially be more appropriately dealt with as part of the IASB's [pipeline projects](#) on pollutant pricing mechanisms.

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- (b) *December 2023* (paragraphs 22, 51 and 52 of [Agenda Paper 3](#))—almost all purchasers of renewable electricity confirmed that they use the RECs for their own purposes. These RECs are ‘used’ (that is, cancelled or retired) by the entity to offset energy usage from non-renewable sources. All participants confirmed that entities account for the RECs separately from the PPAs (physical and virtual).
28. We continue to be of the view that addressing accounting questions about RECs is best placed within the IASB’s potential project on pollutant pricing mechanisms because the accounting questions go beyond RECs and the own-use requirements. Considering the objective in paragraph 6, we are of the view that the IASB exclude from this project accounting for RECs because including RECs would unnecessarily delay the project.

### **Conclusion**

29. We recommend that the IASB limit the scope of the proposed amendments to IFRS 9 to contracts for renewable electricity for which:
- (a) the source for production of the renewable electricity is nature-dependant such that supply cannot be guaranteed at particular times or in particular volumes. Examples are wind-, solar- and hydroelectricity.
  - (b) volume (ie production) risk is substantially transferred to the purchaser, also referred to as pay-as-produced features. Volume risk is the risk that the timing or volumes of electricity supplied do not necessarily align with the purchaser’s demand.

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**Question for the IASB**

Questions for the IASB

1. Does the IASB agree with our recommendations about the scope of the proposed amendments set out in paragraph 29?

**The proposed amendments to the own-use requirements**

***Objective***

30. Most input and feedback to date supported the IASB developing amendments to the own-use requirements to address accounting challenges with physical PPAs. Input and feedback however identified some concerns about the outcome of the proposals and questioned the wording we used in our preliminary thinking. Consequently, we developed this objective for ourselves to develop our recommendations for the proposed amendments to the own-use requirements:

The proposed amendments need to achieve a ‘level playing field’ between physical PPAs and other contracts for non-financial items that are accounted for as a normal purchase by leveraging as much as possible on the characteristics that are unique to the PPAs.<sup>3</sup>

***Themes from input and feedback***

31. We summarised our preliminary thinking, and the input and feedback we have received on our thinking, about the proposed amendments to the own-use requirements in the appendix. From that input and feedback, we have identified common themes about these proposed amendments:

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<sup>3</sup> We use the term ‘normal purchase’ with the same meaning as it is used in paragraph BCZ2.18 of the Basis for Conclusions on IFRS 9.

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- (a) whether physical and virtual PPAs need to have the same accounting treatment;
  - (b) whether a fair value measurement basis provides better information about all physical PPAs; and
  - (c) whether, and to what extent, actual results need to be considered.
32. In the light of the objective in paragraph 30, we considered and analysed these themes.

***Whether physical and virtual PPAs need to have the same accounting treatment***

33. A few feedback providers questioned whether the IASB needs to amend the own-use requirements.<sup>4</sup> In their view, if a physical PPA fails the own-use requirements as currently written, an entity needs to account for that PPA as a derivative. The IASB then only needs to focus the proposed amendments on ensuring that this entity would be able to apply cash flow hedge accounting—in the same way the entity may want to do for its virtual PPAs. These feedback providers are of the view that physical PPAs and virtual PPAs result in the same economic outcome and, therefore, need to be accounted for in the same way.
34. Assume the following facts for one business day of a purchaser that holds both a physical PPA and a virtual PPA (cash outflows or purchases are positive and cash inflows or sales are negative):

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<sup>4</sup> This is not a new comment. Similar feedback was included in paragraph 39 of the agenda paper for its December 2023 meeting. Paragraph 42 of that paper also reported the feedback from many others that supported the direction to address both own-use and hedge accounting.

Time (3h intervals)	Electricity produced per contract (MWh)	Electricity demand of the purchaser per contract (MWh)	Spot price per MWh (CU)	Fixed price in both PPAs (CU)	Cash flows arising from physical PPA		Cash flows arising from virtual PPA	
					Under contract (CU)	In the spot market (CU)	Under contract (CU)	In the spot market
	A	B	C	D	A x D	(B - A) x C	A x (D - C)	B x C
03:00	1,000	0	43	60	60,000	(43,000)	17,000	0
06:00	800	0	50	60	48,000	(40,000)	8,000	0
09:00	700	1,200	65	60	42,000	32,500	(3,500)	78,000
12:00	350	1,200	80	60	21,000	68,000	(7,000)	96,000
15:00	400	1,300	81	60	24,000	72,900	(8,400)	105,300
18:00	500	1,250	90	60	30,000	67,500	(15,000)	112,500
21:00	600	0	55	60	36,000	(33,000)	3,000	0
00:00	600	0	50	60	36,000	(30,000)	6,000	0
<b>Total:</b>	<b>4,950</b>	<b>4,950</b>			<b>297,000</b>	<b>94,900</b>	<b>100</b>	<b>391,800</b>
<b>Net position:</b>					<b>391,900</b>		<b>391,900</b>	

35. The effective price under both PPAs for the daily period under consideration is CU79.2 per MWh (CU391,900/4,950 MWh) although the targeted price under both PPAs was CU60 per MWh.
36. We acknowledge that both the physical PPA and the virtual PPA, considered together with the purchaser's transactions in the spot electricity market, results in the same **net cash outflow of CU391,900**. Therefore, an entity would be able to achieve the same economic outcome whether it enters into a physical or virtual PPA.
37. However, the economic resources that are exchanged under the two types of PPAs are substantially different over the course of the day:
- (a) *physical PPA*—the entity takes delivery of 4,950 MWh of renewable electricity and pays cash of CU297,000.

- (b) *virtual PPA*—the entity pays cash of CU100.
38. Different accounting treatments for other contracts for non-financial items (fixed-price commitments) already exist applying the own-use requirements. This is consistent with the IASB’s original intension with the own-use requirements. We explain this intension in paragraph 51. Consequently, and in light of the objective in paragraph 30, we are of the view that the IASB needs to consider whether the financial statements of a purchaser would provide useful information if the purchaser accounts for a physical PPA as a normal purchase as opposed to a derivative.

***Whether a fair value measurement basis provides better information about all physical PPAs***

39. In January 2024 we shared with the IASB our preliminary thinking that a contract for a non-financial item with the characteristics listed in paragraph 15 is and continues to be held for the **purchaser’s** expected purchase or usage requirements only if:
- (a) the purpose, design and structure of the contract is to ensure the supply of the non-financial item in quantities that are consistent with an entity’s expected own use requirements over the life of the contract. For example, a contract would fail the own use requirements if the entity contracted for more than its expected purchase requirements.
  - (b) sales of the non-financial item shortly after delivery arising from short-term mismatches between supply and demand are not inconsistent with an entity’s own usage requirements if:
    - (i) the contracted volumes over the remaining life of the contract are still based on the entity’s expected usage requirements;
    - (ii) the entity has used a volume of the non-financial item that is equal to, or more than, the volumes of the non-financial items delivered since inception of the contract; and

- (iii) sales are not made to generate a profit from short-term fluctuations in the market price of the non-financial item.
- 40. Some feedback providers questioned whether it provides useful information if the purchaser under a physical PPAs for renewable electricity could account for the PPA as a normal purchase as opposed to as a derivative.
- 41. Consider the example in paragraph 34:
  - (a) 4,950 MWh of electricity was delivered to the entity under the physical PPA;
  - (b) 3,000 MWh (1,000 + 800 + 600 + 600) of that electricity (61%) was sold shortly after delivery because the entity did not have demand for it when delivered;
  - (c) 3,000 MWh of electricity was bought in the spot electricity market on the same day to supplement the entity's demand not covered by the physical PPA.
- 42. Considering this pattern may continue throughout the duration of the PPA, feedback providers question whether the purchaser should be able to conclude that the physical PPA was entered into and continue to be held for the purpose of the receipt of electricity in accordance with the entity's expected purchase or usage requirements. This is because the purchaser knows when entering into, and while holding, the physical PPA the potential frequency and volume of the electricity sales shortly after delivery.
- 43. Some of these feedback providers acknowledged that reporting entities that are purchasers may view that the volatility in profit or loss when accounting for physical PPAs as derivatives measured at fair value through profit or loss does not reflect the economics of the contract, but in the view of these feedback providers fair value measurement provides useful information to users of financial statements about the effect physical PPAs have on the amounts, timing and uncertainty of purchaser's future cash flows. Therefore, the unique characteristics of physical PPAs for renewable electricity (and the risks they expose the purchaser to) may be best

represented in the financial statements when measured at fair value through profit or loss.

44. We acknowledge these concerns and for this reason we developed our recommendations within the objective in paragraph 30. The proposed amendments need to result in a measurement basis for a purchaser's physical PPAs for renewable electricity that provide useful financial information as opposed to aiming to achieve a particular accounting outcome.

45. Because the concerns involve the appropriate measurement basis of physical PPAs for the purchaser, we considered paragraph 6.2 of the *Conceptual Framework for Financial Reporting*:

Consideration of the qualitative characteristics of useful financial information and of the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

46. Consequently, we considered:

- (a) the fundamental qualitative characteristic: relevance;
- (b) the fundamental qualitative characteristic: faithful representation; and
- (c) the cost constraint.

*The fundamental qualitative characteristic: relevance*

47. Paragraph 2.6 of the *Conceptual Framework for Financial Reporting* says:

Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

48. At previous meetings, we reported to the IASB that:



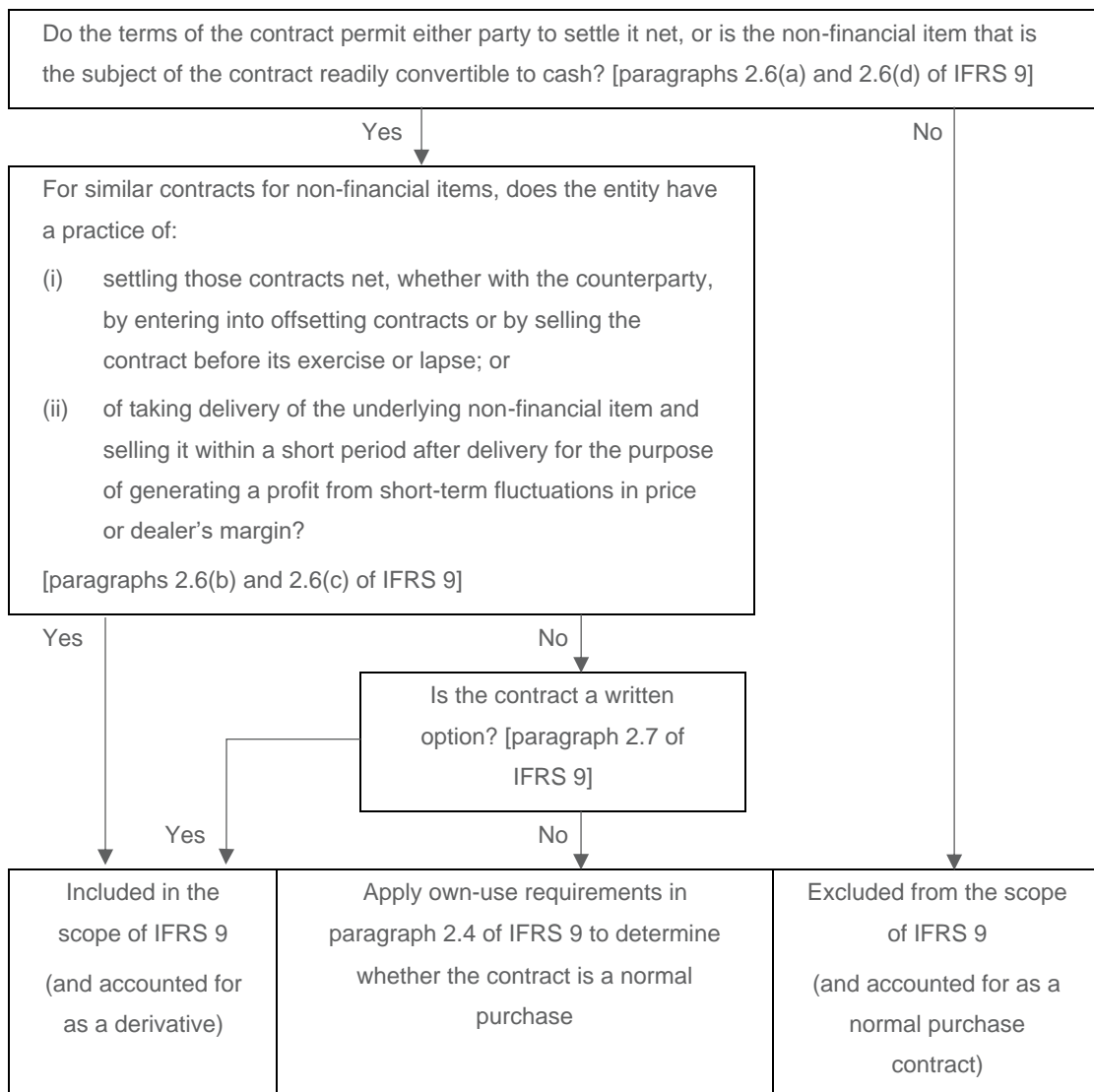
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- (a) *December 2023* (paragraph 27 of [Agenda Paper 3](#))—purchasers explained that their investors assess their performance using for example earnings before interest, taxes, depreciation, and amortisation (EBITDA) and that any inclusion of the 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 was consistent with the limited feedback we received from investors as part of our research on the submission.
- (b) *January 2024* (slides 15–16 of [Agenda Paper 3](#))—in preparation for that meeting we had informal discussions with some members of our Capital Markets Advisory Committee (CMAC) and were able to identify some preliminary items of information users of financial statements would want to know about physical PPAs.
49. Assuming a purchaser entered into the physical PPA to buy renewable electricity for its own use, input and feedback, therefore, suggest that fair value measurement is less relevant compared to accounting for such a typical physical PPAs as a normal purchase (similar to other normal purchase contracts of the entity) with additional information about the fair value disclosed in the notes.

*The fundamental qualitative characteristic: faithful representation*

50. Paragraph 2.12 of the *Conceptual Framework for Financial Reporting* says:

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon (see paragraphs 4.59–4.62).

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51. Evaluating under which circumstances it would be a faithful representation for the purchaser to account for a physical PPA for renewable electricity as a derivative, we considered the IASB's intention within IFRS Accounting Standards to distinguish between contracts for non-financial items that are normal purchases vs. derivatives. Paragraph AG20 of IAS 32 *Financial Instruments: Presentation* explains:
- (a) contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset.
  - (b) therefore, contracts that provide for settlement **only** by the receipt or delivery of a non-financial item are not financial instruments.
  - (c) in addition, the ability to buy or sell a contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the non-financial item do not alter the fundamental character of the contract in a way that creates a financial instrument.
  - (d) **however, some** contracts to buy or sell non-financial items that can be settled net, or in which the non-financial item is readily convertible to cash, are accounted for as if they were financial instruments.
52. This framework in IAS 32 explains the requirements in paragraphs 2.4–2.7 of IFRS 9 (and paragraphs 8–10 of IAS 32). We illustrate these requirements in the following diagram:



53. Considering the requirements in the diagram, the underlying principle that determines whether the substance of a contract for a non-financial item that can be net-settled is a normal purchase or a derivative is the intention with which the purchaser entered into, and continues to hold, the contract. If the purchaser's intention is, for example, 'generating a profit from short-term fluctuations in price or dealer's margin', the substance of the contract is that of a commodity derivative.<sup>5</sup>

<sup>5</sup> We note that paragraphs 3(b) and 5 of IAS 2 *Inventories* also explain that fair value measurement is appropriate in the case of commodity broker-traders because they seek to profit from fluctuations in prices and trade margins.

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54. Applying the requirements in the diagram, a purchaser needs to consider whether the non-financial item is readily convertible to cash, the terms and conditions of the contract and the purchaser's past practices with similar contracts as evidence for its intention. This was reflected within our preliminary thinking in paragraph 39(b)(iii) for when, in our view, it is appropriate to account for a physical PPA as a normal purchase (because sales are not made to generate a profit from short-term fluctuations in the market price of the non-financial item).<sup>6</sup> We acknowledge that this intention may be inherent in the proposed amendments and may not need to be separately identified. In our view, it would improve understandability if the IASB clarifies that the proposed amendments only apply to contracts for non-financial items to which the own-use requirements in paragraph 2.4 of IFRS 9 apply. (That is, contracts within the middle block at the bottom of the diagram in paragraph 52.)
55. As we noted in paragraph 20, the unique characteristic of physical PPAs in paragraph 15(c) (the market structure requires any quantities of the item that an entity is unable to use within a specified short period following delivery, is put back into the market at the prevailing market rate at that point) provides evidence that the sales that occur shortly after delivery—even if frequent or voluminous—were not for the purpose of trading with the energy. But rather, the sales arise from the design or operation of the market. This characteristic includes the fact that an entity may not be able to feasibly store energy so as to determine the timing and price of the sales.
56. In line with the underlining principle in paragraph 52, we continue to be of the view that a purchaser should not be prohibited from accounting for its physical PPAs as normal purchases **solely** because of sales that arise from the design and operation of the market within which the renewable electricity is transacted in. Input and feedback on our preliminary thinking summarised in the appendix confirmed that the design and operation of the market may either force the purchaser to sell unused electricity

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<sup>6</sup> We want to note that the proposed amendments focus on the own-use requirements. Therefore, a physical PPA that can be net-settled because paragraph 2.6(c) of IFRS 9 applies (the purchaser has a past practice of taking delivery of the underlying non-financial item and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) would remain within the scope of IFRS 9.

back into the market shortly after delivery, or if a purchaser does not use the electricity or then sell it back into the market, the market process will ‘repossess’ the electricity and then require the entity to pay a, sometimes punitive, penalty. In our view, accounting for a physical PPA in these circumstances as a normal purchase would faithfully represent the substance of these contracts—that is, accounting for these PPAs as derivatives would, in our view, not faithfully represent the substance.

57. We do, however, acknowledge that proposed amendments for applying the own-use requirements that rely solely on the existence of a particular market design or operation for physical PPAs for renewable electricity may increase the risk for structuring within such a market. In line with our preliminary thinking in paragraph 39(a) and paragraph 39(b)(i), we continue to be of the view that along with the design or operation of the market, a purchaser needs provide evidence of how the volumes expected under the contract is consistent with the purchaser’s expected usage requirements for renewable electricity over the remaining life of the contract.
58. Considering the example in paragraph 34, the purchaser’s demand is 4,950 MWh per day. The purpose, design and structure of the physical PPA need to be consistent with this demand over the life of the contract. For example, if the purchaser entered into, or at some point holds, a contract that the purchaser expects to provide in its expected demand, the physical PPA is accounted for as a normal purchase. If the PPA is expected to deliver renewable energy for a larger volume of energy than the demand because the purchaser wants to sell excess electricity to take advantage of short-term fluctuations in price, the purchaser needs to account for the contract as a derivative. (Input and feedback did raise questions about the reliability of the evidence of a purchaser’s expectations for long-term contracts. We discuss this point as the next theme.)

### *The cost constraint*

59. Paragraph 2.39 of the *Conceptual Framework for Financial Reporting* says:

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. There are several types of costs and benefits to consider.

60. Input and feedback have confirmed that to determine the fair value of PPAs is difficult due to the significant unobservable inputs about volumes of energy and price curves over long contract terms. However, virtual PPAs are required to be measured at fair value through profit or loss because the contract is net-settled. In our view, the cost constraint is not determinative for concluding on an appropriate measurement basis.

*Summary*

61. In summary, to answer the question of whether a fair value measurement basis provides better information about all physical PPAs, we considered and analysed:

Conceptual Framework	Staff analysis
(a) the fundamental qualitative characteristic: relevance	<ul style="list-style-type: none"> <li>input and feedback suggest that fair value measurement is less relevant compared to accounting for a typical physical PPAs for renewable electricity as a normal purchase with additional information about the fair value disclosed in the notes.</li> </ul>
(b) the fundamental qualitative characteristic: faithful representation	<ul style="list-style-type: none"> <li>a purchaser should not be prohibited from accounting for its physical PPAs for renewable electricity as normal purchases solely because of sales that are triggered by the design and operation of the market within which the renewable electricity is transacted in—accounting for these PPAs as a normal</li> </ul>

Conceptual Framework	Staff analysis
	<p>purchase is a faithful representation of their substance.</p> <ul style="list-style-type: none"> <li>as an anti-abuse requirement, a purchaser needs to provide evidence of how the volumes expected under the contract is consistent with its expected usage requirements for renewable electricity over the remaining life of the contract.</li> </ul>
(c) the cost constraint	<ul style="list-style-type: none"> <li>the cost constraint is not determinative to determine the appropriate measurement basis.</li> </ul>

***Whether, and to what extent, actual results need to be considered***

62. As part of our preliminary thinking as outlined in paragraph 39, we included a ‘retrospective validation test’ to introduce rigour and discipline into the proposed requirements. In our view, this was needed because of the characteristics of PPAs for renewable electricity and the long contractual term of a typical physical PPA (typically longer than 15 years). This test in paragraph 39(b)(ii) said: ‘the entity has used a volume of the non-financial item that is equal to, or more than, the volumes of the non-financial items delivered since inception of the contract’.
63. Input and feedback raised various concerns about this aspect of our preliminary thinking. We summarise these concerns in the appendix.
64. Considering the input and feedback, we continue to be of the view that, as part of the evidence outlined in paragraph 57, a purchaser needs to also consider the actual volume of renewable electricity that has been delivered compared to the volume the purchaser had to sell and how this remains consistent with its expected usage requirements. In our view, this addresses the input and feedback that raised concerns

about a purchaser's ability to reliably estimate the volume of electricity that will be delivered and its demand and for a long term. It ensures that future expectations are supported by historic evidence.

65. We acknowledge, and agree with, input and feedback that raised concerns about the 'bright-line' nature of our preliminary 'retrospective validation test'. For all the reasons we received from the feedback providers, we are of the view that the IASB could still include within an exposure draft the requirement for a purchaser to consider actual volumes delivered and sold, but require the purchaser to consider qualitatively the reasons of past sales of unused renewable electricity that has been delivered as opposed to requiring the purchaser to pass a quantitative 'bright-line' threshold. Qualifying reasons would be:

- (a) the sales arise from the mismatches between the renewable energy delivered and the purchaser's demand requirements at the time of delivery; and
- (b) the sales arise from the design and operation of the market within which the renewable electricity is transacted in that prevents the purchaser from having the practical ability to determine the timing or price of such sales.

### **Conclusion**

66. For the purposes of applying the own use requirements in paragraph 2.4 of IFRS 9 to a contract to purchase renewable electricity within the scope of the project, we recommend that the IASB requires the purchaser to consider:
- (a) the purpose, design and structure of the contract, and whether the volumes expected to be delivered under the contract continues to be consistent with the purchaser's expected purchases or usage requirements for the remaining life of the contract; and
  - (b) the reasons of past sales of unused renewable electricity and whether such sales are consistent with the purchaser's expected purchases or usage requirements. Sales would be consistent with the purchaser's expected purchase or usage requirements if those sales arise from:



- 
- (i) mismatches between the renewable electricity delivered and the purchaser's demand requirements at the time of delivery; and
  - (ii) the design and operation of the market within which the renewable electricity is transacted in that prevents the purchaser from having the practical ability to determine the timing or price of such sales.

**Question for the IASB**

## Question for the IASB

2. Does the IASB agree with our recommendations about the proposed amendments to the own-use requirements set out in paragraph 66?

## Appendix—Summary of feedback on our preliminary thinking

A1. The following table summarises the feedback on our preliminary thinking on proposed amendments to IFRS 9 *Financial Instruments*.

	Preliminary thinking: January 2024 <sup>7</sup>	Feedback
The proposed scope of the project—the approach to narrow-scope standard-setting	<p>Most of the accounting challenges with physical PPAs can be resolved by adding application guidance to IFRS 9 that explains how a purchaser applies the requirements in paragraph 2.4 of IFRS 9 (the own-use requirements). The IASB can use the unique characteristics of PPAs to limit the scope of the proposed amendments to only those arrangements that gave rise to the questions about applying the own-use requirements submitted to the IFRS Interpretations Committee.</p> <p>Potential amendments based on applying the own-use requirements to a proportion of a contract is not feasible because the effects of such an approach cannot be limited to particular non-financial items and would most likely give rise to similar questions/application challenges to those that lead to the IASB taking on this project.</p>	<ul style="list-style-type: none"> <li>• Feedback mostly supported amending the own-use requirements and using the unique characteristics of PPAs to ring-fence the proposed amendments. There are questions or concerns about the wording of the characteristics. (See the next line of this table.)</li> <li>• There was some caution that the proposed application guidance may raise similar requests for change from entities that have been applying the (long-standing) own-use requirements. The proposed application guidance could also undermine the importance of accounting for some arrangements as derivatives (and measuring them at fair value through profit or loss). Even though volatility in profit or loss may not always be desirable for reporting entities, accounting for particular arrangements as derivatives provide users of financial statements (investors) with useful information about those contracts. An ASAF member suggested the IASB clearly explains the reason why physical PPAs excluded from the scope of IFRS 9 provide useful information to investors.</li> <li>• One ASAF member expressed concern about the different accounting treatments for physical and virtual PPAs that are economically similar. A hedge accounting solution could apply to both physical PPAs that fail the existing own-use requirements and virtual PPAs.</li> </ul>

<sup>7</sup> [Agenda Paper 3](#) of the IASB meeting in January 2024.

	Preliminary thinking: January 2024 <sup>7</sup>	Feedback
<p>The proposed scope of the project—unique characteristics of PPAs and renewable energy</p>	<p>Proposed application guidance to the own-use requirements could be based on the following unique characteristics:</p> <p>(a) the supply/production of the non-financial item is weather (and location) dependant such that the timing and/or volume of the item supplied are not necessarily aligned with the demand for the item;</p> <p>(b) the purchaser cannot avoid taking delivery of the non-financial item when produced due to the legal structure of the market the non-financial item is transacted in; and</p> <p>(c) the market structure requires any quantities of the item that an entity is unable to use within a specified short period following delivery, is put back into the market at the prevailing market rate at that point. For this purpose, the timing of any resulting sales are determined by the market structure and the entity has no control/discretion over the timing or price of resulting sales.</p>	<ul style="list-style-type: none"> <li>• An ASAF member suggested that the IASB specifies that the non-financial item is electricity.</li> <li>• There were some questions about using ‘weather...dependent’ in (in point (a)) as a characteristic. Not all sources of renewable energy are weather dependent. Nuclear energy may, in the future, also require PPAs and would then not be within the scope of the proposed amendments. One ASAF member suggested we consider referring to volume risk that is ‘nature dependent’ or is ‘outside of the control’ of both parties to the contract—similar to what we had in December 2023.<sup>8</sup> Other ASAF members questioned how an entity would assess ‘control’ because entities may have different levels of control over the production or supply of energy. An ASAF member asked what we mean by ‘and location’ and why it is included in brackets.</li> <li>• An ASAF member suggested that it may be more appropriate to refer to the lack of an entity to store electricity at a reasonable cost.</li> <li>• A few feedback providers said that the market structure doesn’t always ‘require’ you to sell it to market participants, but rather if an entity does not use the electricity or then sell it back into the grid, the market process will ‘repossess’ the electricity and then require the entity to pay a, sometimes punitive, penalty. To avoid the consequences of paying a penalty, the entity sells the electricity.</li> </ul>

<sup>8</sup> In paragraph 37(a) of [Agenda Paper 3](#) of the IASB’s December 2023 meeting we presented a possible characteristic as: ‘neither the seller or the buyer of power (ie off-taker) control the timing and quantity of power supplied’.

	Preliminary thinking: January 2024 <sup>7</sup>	Feedback
<p>The proposed amendments to the own-use requirements</p>	<p>The IASB could require that a contract to buy a non-financial item with the characteristics described in the line above, is and continues to be held for the entity's expected purchase or usage requirements only if:</p> <p>(a) the purpose, design and structure of the contract is to ensure the supply of the non-financial item in quantities that are consistent with an entity's expected own use requirements over the life of the contract. For example, a contract would fail the own use requirements if the entity contracted for more than its expected purchase requirements;</p> <p>(b) sales of the non-financial item shortly after delivery arising from short-term mismatches between supply and demand are not be inconsistent with an entity's own usage requirements if:</p> <p>(i) the contracted volumes over the remaining life of the contract are still based on the entity's expected usage requirements;</p> <p>(ii) the entity has used a volume of the non-financial item that is equal to, or more than, the volumes of the non-financial items delivered since inception of the contract; and</p> <p>(iii) sales are not made to generate a profit from short-term fluctuations in the market price of the non-financial item.</p>	<ul style="list-style-type: none"> <li>Feedback mostly agrees (or do not disagree) that expected sales of some of the quantities of the non-financial item should not be determinative when assessing the own-use requirements. This is because these sales occur because of the market design or process and the inability of an entity to store the energy.</li> <li>There were questions about whether excluding some physical PPAs from IFRS 9 is appropriate if an entity expects when entering into the arrangement that the quantity or frequency of sales will be more than insignificant.</li> <li>There was some caution that requiring an entity to estimate quantities 'over the life of the contract' (item (b)(i)). Suggestions were to require an entity to consider its expected usage over a shorter period. One ASAF member commented entities are able to estimate quantities for intervals (for example, daily intervals) over longer periods of time. An ASAF member suggested the IASB could introduce a concept of 'normal capacity' (see paragraph 13 of IAS 2 <i>Inventories</i>) as the basis for the assessment.</li> <li>Feedback mostly agreed (or did not disagree) with the need for a retrospective validation test (item (b)(ii)). Some questioned the need for a 'bright-line' test of: '...that is equal to, or more than...' Concerns are that: <ul style="list-style-type: none"> <li>(a) an entity may inappropriately fail this test if the assessment is performed at the start of the contract when the entity's usage may still be low or at a point in time in an entity's usage has been low because of the seasonality of its business; or</li> <li>(b) it may inappropriately incentivise entities to contract for less quantities of renewable energy; reducing the progress towards being carbon neutral.</li> </ul> </li> <li>Questions arose about how (b)(iii) interacts with paragraph 2.6(c) of IFRS 9 and whether an entity's decision to actively manage the price risk of the quantities it expects to sell (for example through entering into fixed-price forward sales agreements) would result in that entity failing this requirement.</li> </ul>