
IFRS Interpretations Committee meeting

Date	November 2023
Project	Power Purchase Agreements (IFRS 9)
Topic	Possible options for a narrow-scope standard-setting solution
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Introduction

Purpose of this session

Context:

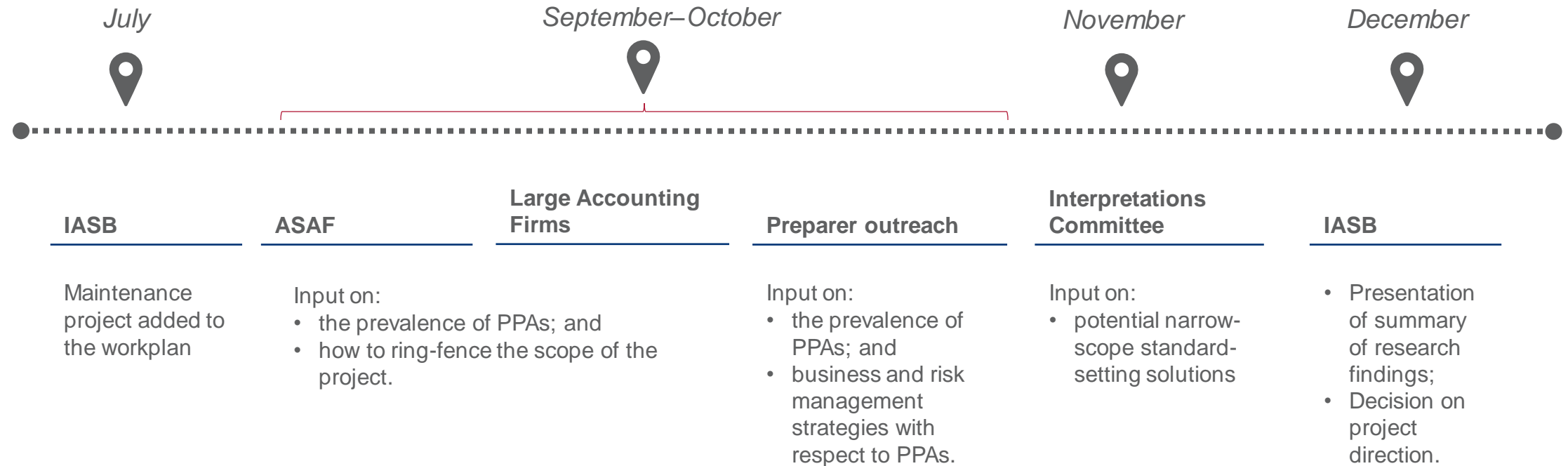
In July 2023, the International Accounting Standards Board (IASB) added a project to its work plan to research whether narrow-scope amendments to IFRS 9 *Financial Instruments* could be made to better reflect how financial statements are affected by Power Purchase Agreements (PPAs) (both physical and virtual). See Appendix A for more information about these agreements.

The IASB asked the project team to do further research and outreach to determine the **prevalence of PPAs** and how to **restrict the scope of any potential standard-setting solution** to limit the risk of unintended consequences for other contracts or transactions to purchase non-financial items.

Purpose of this session:

As part of our research, we are seeking Interpretations Committee (Committee) members' input into potential narrow-scope amendments to IFRS 9 following the additional research the project team has done.

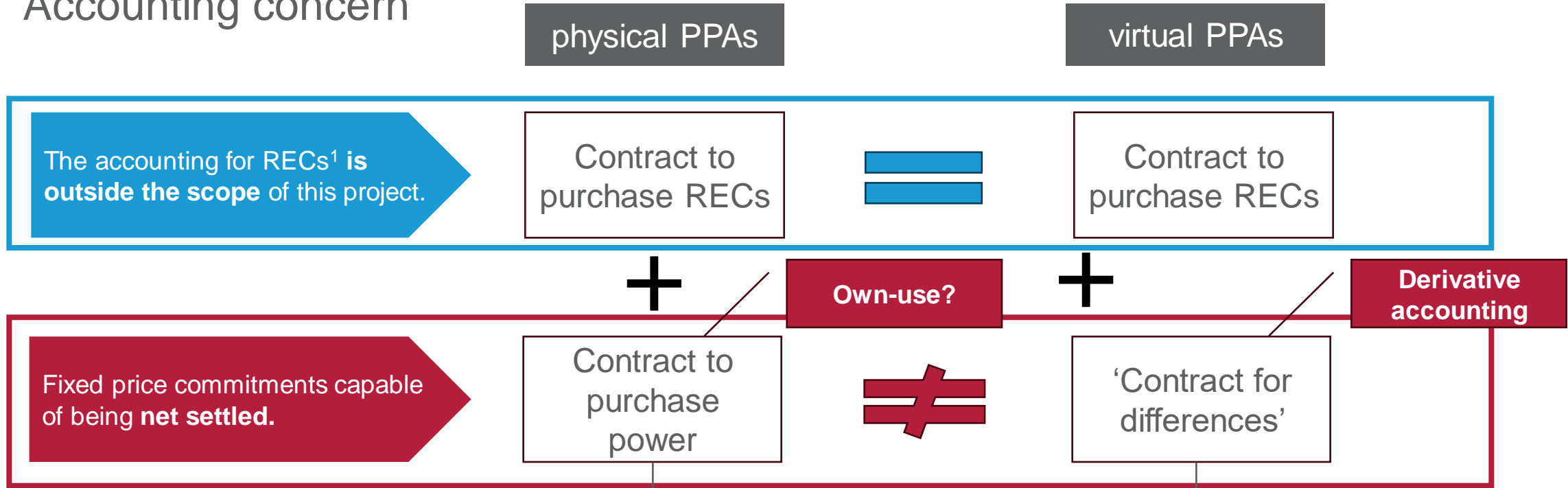
Project timeline



Preparer outreach included discussions with both electricity producers and purchasers (ie consumers) across Europe, South-America, North-America, Australia and South Africa.

Summary of research findings and questions for the Committee

Accounting concern



Quote from preparer: 'Despite practical challenges to measure long-term power purchase agreements at fair value, we share the concern expressed by many others that the implied volatility and the timing of measurement effects in profit or loss do not faithfully depict the economic substance of the transaction and do not allow for an adequate presentation of the operating performance.'

¹Renewable Energy Certificates (RECs) and includes any other equivalent naming convention. RECs may not always be part of PPAs.

Summary of research findings

Prevalence

The use of PPAs is increasing as stakeholders respond to jurisdictional requirements to transform power consumption to renewable power:

- in many industries—that is, PPAs are not isolated to specific industries;
- entities of different sizes; and
- in almost all regions, notably in countries like Australia, Brazil, Canada, Germany, Spain, the United Kingdom and the United States.

The terms and conditions of PPAs vary with regards to:

- contract length—contract length can range from 10 to 30 years;
 - pricing—for many PPAs the price is fixed for the contract period with no adjustments;
 - quantity—can be specified, variable based on the quantity produced, and can include caps or floors;
 - Renewable Energy Certificates (RECs)—most PPAs includes RECs which can subsequently be transacted independently from the electricity.
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Summary of research findings (cont'd)

Business strategies and risk management - Producers

- Power producers enter into long-term PPAs with consumers that include predetermined prices to establish secure revenue streams to fund investments in renewable power plants.
 - The fixed price typically reflects the initial investment required by producer to fund the construction of infrastructure because the variable cost over the life of the power plant will be less significant. Unlike the price of electricity generated from consumption-based commodities (like gas and oil) that fluctuate with the market price of those underlying commodities, the price to generate renewable power is not linked to such commodities.
 - As production of renewable power could be subject to weather conditions, production risk is transferred mainly to consumers.
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Summary of research findings (cont'd)

Business strategies and risk management - Consumers

- The primary business strategy for consumers to enter into PPAs, is to secure their supply of renewable power and reduce their greenhouse gas emissions (supply risk). A secondary factor is to fix the price at which power is purchased (price risk).
 - In other words, if a producer does not produce sufficient power when needed, the consumer need to purchase additional power in the spot market that may not be renewable power or be at a price different than the price in the PPA (in times of high demand the price could be significantly higher).
 - There could be a mismatch between the time *when* power is delivered vs. when it is needed as well as between *where* power is needed vs. where it is produced.
 - Although price is fixed for long period, risk of long-term prices falling below contractually fixed price is seen as an 'opportunity cost'. Cost of electricity included in production costs/cost of sales and not monitored separately to determine if contract became onerous.
-

Summary of research findings (cont'd)

Scope of, and approach to, potential narrow-scope standard-setting

- Some stakeholders, including ASAF members agreed that using characteristics to restrict the scope of standard-setting could achieve a principle-based outcome. However, some questioned whether a list of characteristics may not have unintended consequences for other non-financial items or future market developments.
 - A few suggested to instead base the own-use assessment to reflect management's intention for entering into contract or require a business model test (that is, develop a solution only for physical PPAs).
 - Some said that regardless of the approach the IASB takes, the resulting accounting outcome needs to be the same for physical PPAs and virtual PPAs because the purpose of the contracts are the same and, in most cases, entities do not have a choice in the type of PPA because of the design of the electricity market. In their view, this could only be achieved through an exception—either from the definition of a derivative or from IFRS 9 entirely.
 - However, there was no consensus view among stakeholders about the most appropriate approach for the IASB to take.
-

Questions to the Committee

1. Do you consider the characteristics set out on [slide 14](#) to be appropriate and adequate to restrict the scope of a potential standard-setting project? Are there any other characteristics that you would suggest and why?
2. If the IASB were to undertake any standard-setting, which of the approaches set out on [slides 15–17](#) would in your view, achieve the most appropriate outcome while limiting the risk of unintended consequences, and why? Are there any other options you think we should explore?

Note: in our view, all the options may require additional disclosure requirements to enable investors to assess the effects of these long-term contracts on an entity's financial performance, financial position and cash flows.

Possible approaches for narrow-scope standard- setting

Proposed characteristics of the underlying non-financial items in PPAs

The characteristics of the underlying non-financial item that could be used to define the scope of narrow-scope standard-setting is determined by the nature of the non-financial item and the market structure within which it is transacted and could include:

- neither the seller nor the purchaser controls the timing and volumes of power produced. Production could be sporadic and unpredictable over longer periods;
- the entity's usage or sales expectations can be reliably predicted over a period of time that is shorter than contractual period but not at the discrete points when the energy is delivered; and
- if electricity is produced and purchaser is unable to use the volume supplied, it is forced to sell unused volumes into market at prevailing market rate (no control over timing or price of sales, which could be unfavourable).

Note: in our view the physical or economic feasibility of the storage of renewable energy is not a viable characteristic because of possible future developments. The challenges with storage is, in effect, reflected within the second bullet point above.

1. Amend the ‘own-use’ requirements in IFRS 9

Potential amendment

Include guidance on how to assess ‘own-use’ requirements in paragraph 2.4 of IFRS 9 for non-financial items with characteristics described on [slide 14](#). For example, assessment could consider the purpose and reasons for entering into contract; changes in initial expectations about frequency and volume of transactions with market; evidence of actual vs expected usage (ie whether in a net buyer position); indications of trading intent/profit-driven sales.

Assessment:

<p>Pros:</p>	<ul style="list-style-type: none"> • Addresses the accounting concern for physical PPAs (slide 7); • Consistent with accounting treatment of other executory procurement contracts and requires continuous assessment of intention and purpose; • Maintain principle-nature of own-use requirements; • Could be done in efficient and effective manner.
<p>Cons:</p>	<ul style="list-style-type: none"> • Physical PPAs will be ‘off-balance sheet’ and currently, no disclosures required for executory contracts; • A fixed-price long-term contract exposes an entity to risks that investors may need to know about; • Risk of unintended consequences—could disrupt practice for other contracts that previously failed own use; • Only applies to physical PPAs and would not address concerns with virtual PPAs.

2. Amend hedge accounting requirements in IFRS 9

Potential amendment

Include guidance on how to assess the requirement for a forecast transaction to be ‘highly probable’ for non-financial items with characteristics described on [slide 14](#) that will enable virtual PPA to be designated as hedging instrument. Assessment of highly probable shares mainly similarities with assessment for own use.

Assessment:

Pros:	<ul style="list-style-type: none"> • Applying hedge accounting will be consistent with risk management strategy and ineffectiveness is recognised in P&L, therefore reflect economic reality of entity’s strategy; • Would also address accounting concerns with virtual PPAs; • PPAs will be ‘on-balance sheet’ and subject to disclosure requirements in IFRS 7 <i>Financial Instruments: Disclosures</i>, providing information about the entity’s risk exposure and risk management.
Cons:	<ul style="list-style-type: none"> • Risk of unintended consequences—could disrupt application of hedge accounting requirements in other hedging relationships; • Conceptual challenges around the definition of a highly probable items forecasted to occur a long time in the future; therefore, the requirements may add complexity to hedge accounting requirements; • Entities will still experience some volatility in profit or loss and also volatility within other comprehensive income. • Implementation costs for entities may be high.

3. Exception for PPAs

Potential amendment

An exception for PPAs could be created to exclude them from either the definition of derivatives and/or the scope of IFRS 9 entirely.

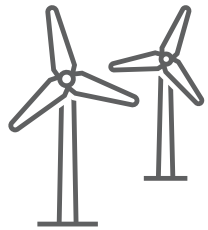
Assessment:

Pros:	<ul style="list-style-type: none"> • Project can progress quickly; • Scope of application can be restricted because an exception would be ‘rules-based’ and cannot be applied by analogy
Cons:	<ul style="list-style-type: none"> • The amendments reduces the principle-based nature of IFRS Accounting Standards, with no conceptual justification for the exception. • Users of financial statements will not be provided with any information to be able to understand the effect these contracts could have on an entity’s financial position, financial performance or future cash flows. • The definition of the type of contracts subject to the exception will need to be precise. • Will not reflect the economic substance or purpose of contracts, with no transparency when purpose of contracts change over time. • Risk of unintended consequences with request for other contracts or non-financial items.

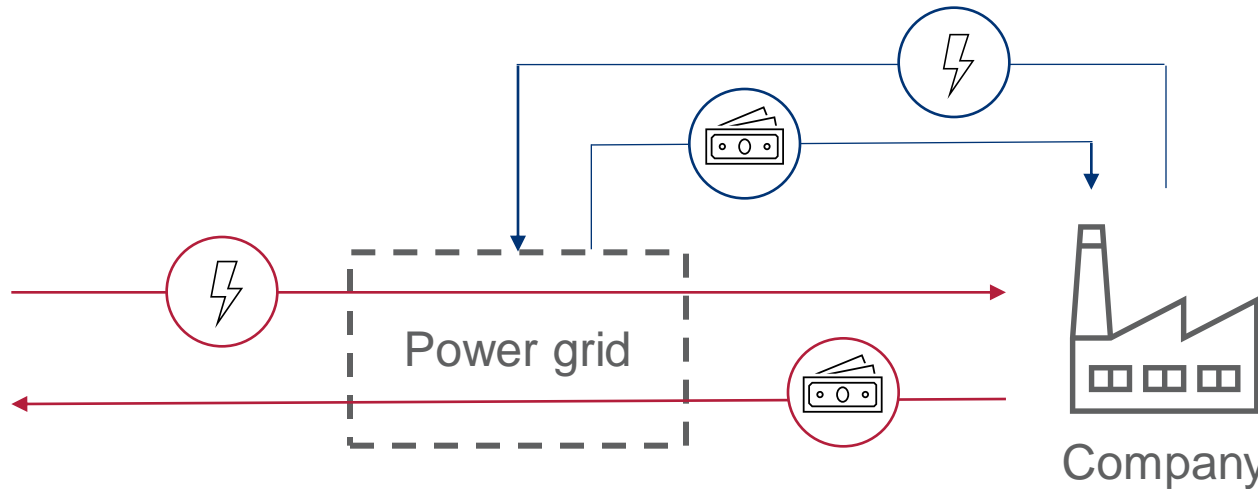
Appendix A—Information about PPAs

Power purchase agreements

physical PPAs



Renewable power producer



1

PPA



The producer delivers power to the company by crediting their account with the grid.



The company pays a fixed price for the power delivered.

2



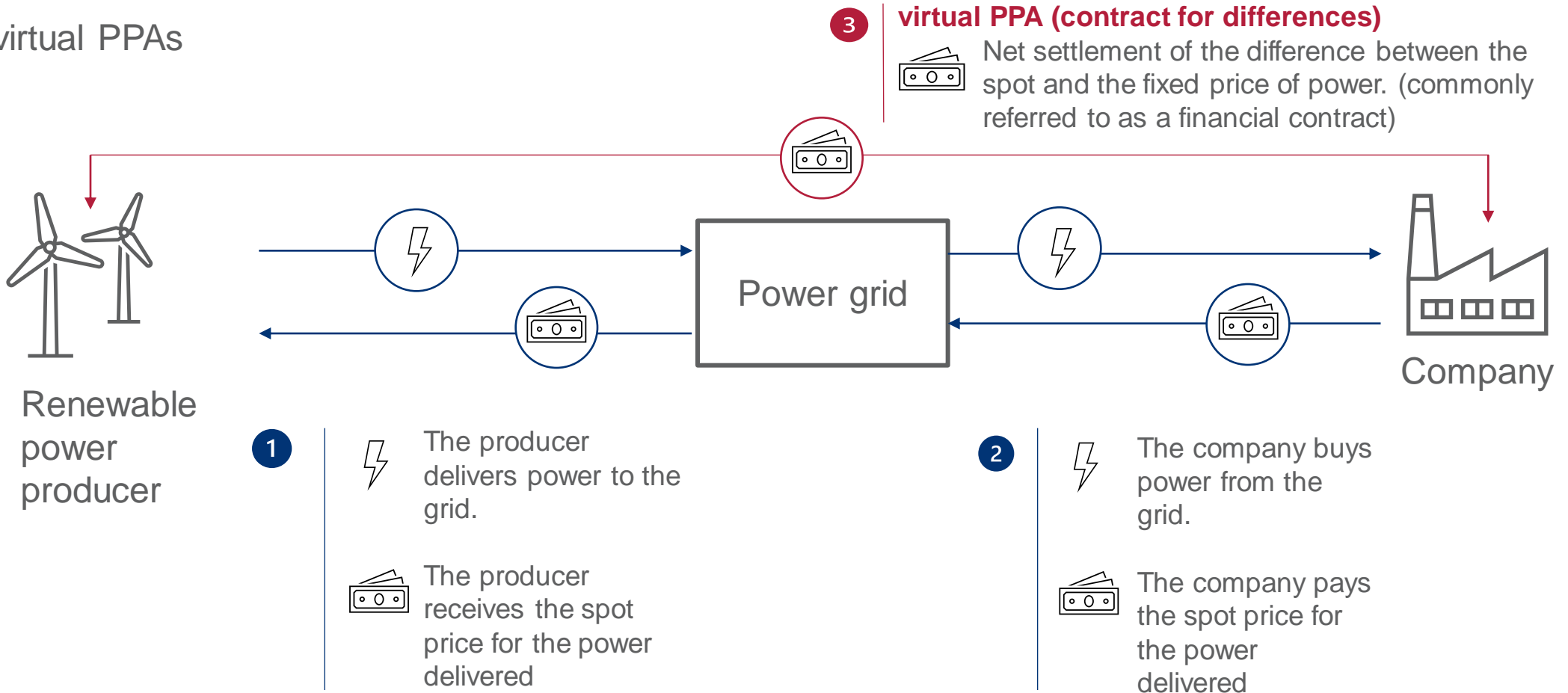
The company sells any unused power to the grid



The company receives the spot price for the power sold

Power purchase agreements (cont'd)

virtual PPAs



Power purchase agreements (cont'd)

Some variations on physical PPAs or virtual PPAs

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

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