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Power Purchase Agreements

Issues paper

Objective

- 1 This agenda paper provides a summary of the feedback received by the IASB during its January 2024 ASAF meeting on the potential amendments to IFRS 9 and some suggestions from the EFRAG Secretariat on the issues raised at the ASAF meeting. The agenda paper also includes questions for EFRAG FR TEG.
- 2 This paper has been prepared based on IASB Agenda paper [AP1](#) of the January 2024 ASAF meeting.
- 3 This paper is structured as follows:
 - (a) Summary of the ASAF feedback provided to IASB;
 - (b) EFRAG Secretariat analysis

Summary of the ASAF feedback

- 4 In general, ASAF members supported that the IASB encompasses both Power Purchase Arrangements (PPAs) and virtual PPAs (vPPAs) in the envisaged narrow-scope amendments. They highlighted the need of a solution in due process and appropriate timeframe. In this regard, the quick reaction from the IASB was praised.
- 5 Concerns were raised in relation to the unique characteristics geared to ring-fence the proposed amendments. These concerns mainly related to the following:
 - (a) Characteristics of the non-financial items being defined through the legal structure of the market or the market structure. The definition of such structure is not clear and many thought that the characteristics should be geared towards the capacity to store the electricity (or similar) at reasonable cost; and

- (b) Characteristics of non-financial items would benefit from additional clarification / definition of terminology used (weather, location, short-term, control / discretion over the timing or price of resulting sales...). In addition, these characteristics seem to restrict some hybrid contracts where an entity has partial control and leave room for interpretation for other renewable types of energy (hydropower, biomass energy are impacted by weather, but the effect is not immediate).
- 6 Concerns expressed as to the application of the requirements for the own-use are summarised below:
- (a) With regards to b.i. (page 14 in [AP1](#)), the proposal referred to the contracted volumes over the remaining life of a contract when most of the PPAs do not specify quantities since production/volume is weather dependent. Further, it was not clear to the constituents at which granularity the expected usage requirement should be analysed (e.g. large company with multiple locations and multiple PPA contracts, the expected usage requirements can be analysed at contract level, location level, entity level etc.);
 - (b) With regards to b.ii. (page 14 in [AP1](#)), it was noted that if the period is short or there are unexpected circumstances, the requirements might not be fulfilled and therefore an entity will fail own use. The lack of understanding around this requirement was also flagged and additional clarifications related to the periodicity were asked; and
 - (c) With regards to b.iii. (page 14 in [AP1](#)), it was expressed that this requirement may be superfluous and lacking clarification as to the application guidance.
- 7 Concerns raised regarding the disclosure requirements for the own-use included:
- (a) The number of disclosures and nature of some of them raised concerns, especially when it comes to the price agreed in the contract as this is sensitive information. An alternative could be expected future payments based on volume expectations;
 - (b) The fair value requirement seemed to be decoupled from the disclosure objective, which is focused on an entity's future cash flows. Also, it would be costly to calculate (one of the objectives of own use exception was to avoid entities this extra cost). A value range indication could be more feasible than the fair value of the contract. Other view expressed was that the fair value information remains a useful indication and should be disclosed;
 - (c) It would be interesting that entities disclose risk-based information around PPAs like price risk management as well as performance related information;

- (d) For large companies where the number of PPAs can be significant, clarification is needed if the expectation is to provide the contract terms on a contract by contract basis or in aggregate; and
- (e) Disclosure requirements specific to a certain type of contracts seem to be rule-based instead of principle based. Disclosures related to the own-use contracts may be relevant for many other types of contracts and not only for PPAs.

8 As it relates to the hedge accounting proposed application requirements, the summary of the comments provided during the ASAF meeting were as follow:

- (a) On the proposed designation of expected volumes vs highly probable, some members welcomed this approach and some expressed concerns as to the unintended consequences on hedge accounting overall;
- (b) On the assessment of the economic relationship and underlying IASB's staff assumption that the volume is volatile but other assumptions are fixed (for example price), some members expressed concern that the price can also be volatile, depending on the terms of the contract as vPPAs are very complex. Some said that the whole principle seems to contradict the essence of the hedge accounting; and
- (c) There was a concern about contracts already running and the possibility for them to apply hedge accounting in the middle of the contract after the amendment comes out. Similar question was raised on the PPA contracts that failed own-used exception.

EFRAG Secretariat analysis

9 Putting aside the EFRAG Secretariat alternative models suggested for both own-use and hedge accounting and focusing only on the issues raised in the January ASAF meeting, the EFRAG Secretariat understands the view expressed by some that current ring-fencing to specific contracts (PPAs and vPPAs) might lead the proposal towards rule-based amendments.

Physical PPAs

10 Based on the above, in regard to the unique characteristics, the EFRAG Secretariat notes that the majority of the concerns raised relate to the attempts to define the underlying non-financial item through its various aspects to avoid rule-based amendment, however, it may be simpler and clearer to just state that the proposed amendments relate to contracts to buy or sell **electricity** as their main objective.

- 11 In addition, to avoid failure of own use caused by short term volume variations the EFRAG Secretariat considers that an alternative could be to define annual assessment periods specifying that the analysis should **exclude any one-off events** deemed non-recurring. Moreover, an alternative to circumvent the concerns raised by some ASAF members on the retrospective assessment could be to remove the requirement to perform the look-back analysis since the inception of the contract and rather to include **a disclosure requirement to present the actual usage compared to the contracted volumes** for the reporting year and, if the contracted volumes are higher, provide management’s explanation to justify the continued application of the own-use exception.
- 12 In regard to the currently proposed disclosure requirements, the EFRAG Secretariat deems that the suggestions expressed during the ASAF meeting provide a robust basis for the discussion. As it relates to the fair value disclosure, the EFRAG Secretariat considers the fair value information to be useful to both users of the financial statements as well as management itself, though it also acknowledges that it may be costly and complex to obtain. The EFRAG Secretariat agrees with the views expressed during the meeting as to the other disclosure requirements.

Virtual PPAs

- 13 Considering that one of the proposed amendments to the hedge accounting requirements included the removal of the “highly probable” requirement for a hedge item (allowing to designate a proportion up to 100% of an uncertain volume), the EFRAG Secretariat welcomes this direction as this seems to align with EFRAG Secretariat alternative model. We warn against replacing the “highly probable” by the “expected” requirement as this will not resolve the problem for the load-following types of vPPAs.

Question to EFRAG FR TEG members:

- 14 Based on the ASAF meeting feedback, do you agree with the suggested proposals to address the issues raised at the ASAF meeting? Would you like to suggest other potential solutions?