EFRAG Secretariat: Didrik Thrane-Nielsen,
Aleksandra Sivash, Juan José Gómez

Power Purchase Agreements

Cover Note

Objective

1 The objective of this session is to seek input from the members of the EFRAG FR TEG on the IASB's tentative decisions to be included in the Exposure Draft proposing amendments to IFRS 9 Financial Instruments and IFRS 7 Financial Instruments: Disclosures to address the issues on Power Purchase Agreements (PPAs) and virtual Power Purchase Agreements (vPPAs). The member views will be requested on the following topics:

(a) Proposed narrow-scope amendments to IFRS 9 related to the own-use exception applied to PPAs (IASB staff's AP3A): discussed in the agenda paper 06-02;

(b) Proposed narrow-scope amendments to IFRS 9 related to the hedge accounting requirements applied to PPAs and vPPAs (IASB staff's AP3B): discussed in the agenda paper 06-03;

(c) Proposed disclosure and transition requirements (IASB staff's AP3C): discussed in the agenda paper 06-04;

Project Background

2 At its December 2023 meeting, the IASB tentatively decided to undertake narrow-scope standard-setting project to amend IFRS 9 Financial Instruments to address concerns about the accounting for Power Purchase Agreements, both physical (PPAs) and virtual (vPPAs).

3 The challenges faced by the stakeholders arises because of the unique characteristics of the non-financial item included in PPAs (i.e. power), its inherent variability and unpredictability of the production, the large volumes and duration involved and the complexity of the agreements themselves.

4 PPAs are often considered to be settled net in cash according to paragraph 2.6 of IFRS 9. When the entity is not able to use the power delivered by the producer in accordance with

the PPA within a short period[1], the power has to be sold back to the market at spot price. Power resales, which are normally not for the purpose of generating profit from short-term fluctuations in price, often cause that an entity does not meet the 'own-use' requirements.

5 Virtual PPAs give rise to similar accounting questions related to some of the specific characteristics of the non-financial items and related market structure. To quality for hedge accounting under IFRS 9 the hedging relationship must consist of the qualified hedged item and qualified hedging instrument. There must be a formal designation and documentation of this relationship and the hedging relationship must be effective.

6 For a forecast transaction to qualify as a hedged item, the identified transaction (or a component thereof) must be highly probable (para 6.3.3 of IFRS 9). This requirement will most often not reflect the economic position of an entity after contracting a vPPA because the designated quantity (in the hedged item) needs to be fixed upon inception and remain fixed for the designated period, whereas the actual non-financial item (i.e. power) sold or purchased would vary due to its specific characteristics.

7 Similar analysis is made for the effectiveness considerations, as designated hedging instrument must prospectively achieve an offset with the designated hedged item being the forecasted sales or the forecasted purchases. In presence of variable volumes such economic relationship requirement may not be met (mismatch between the production of power and its consumption).

8 Considering the above, the IASB issued an agenda paper (AP1) for the ASAF January 2024 meeting with its proposed amendments to IFRS 9 for both own-use and hedge accounting application requirements. Based on the feedback collected in the ASAF meeting and through various outreach activities, the IASB Staff issued the recommendations for the proposals to be included in the Exposure Draft to be considered in March 2024 IASB meeting.

9 The IASB met on 18 March to discuss the proposed amendments. A majority of IASB members agreed with the IASB staff's recommendations with limited changes (see specific proposals on the different agenda papers for this session). Two IASB members confirmed that they will provide a dissenting view on the proposals. The IASB expects to publish the ED in May 2024 and a 90-day consultation period was approved.

[1] Time unit set in the relevant market, normally between 5 and 60 minutes.

Next steps

10 The EFRAG Secretariat to gather views on the IASB's tentative decisions in preparation of its draft comment letter. The IASB to publish the ED in May 2024.

Agenda papers

11 In addition to this Cover Note the following agenda paper are presented for this session:

(a) Agenda Paper 06-02 Issues Paper – Own use exception

(b) Agenda Paper 06-03 Issues Paper – Hedge Accounting

(c) Agenda Paper 06-04 Issues Paper – Disclosures and Transition