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Power Purchase Agreements

Comparison of Alternative model with the IASB's tentative ED proposals

Objective

- 1 The objective of this paper is to provide an overview of the IASB's tentative decisions to be included in the Exposure Draft proposing amendments to the IFRS 9 Financial Instruments in relation to the own-use exception. This agenda paper also compares the Alternative model with the IASB's tentative ED proposals.
- 2 This paper is structured as follows:
 - A. IASB's tentative decisions
 - B. Comparison of the Alternative model and the IASB's tentative ED proposals
 - C. Advantages and disadvantages of the Alternative model
 - D. Questions to the EFRAG FRB

A. IASB's tentative decisions¹

Scope

- 3 The IASB tentatively decided to limit the scope of the PPA Exposure Draft to 'contracts for renewable electricity' that are contracts for which:
 - (a) the source for production of the renewable electricity is nature-dependent so that supply cannot be guaranteed at particular times or in particular volumes. Examples of sources include wind-, solar- and hydroelectricity.
 - (b) the purchaser is exposed to substantially all of the volume risk under the contract through pay-as-produced features. Volume risk is the risk that the volume of

¹ The IASB expects to publish the Exposure Draft in May. Therefore, the EFRAG Secretariat has included the IASB's expected ED proposals based on the IASB's tentative decisions included in the [IASB Update March 2024](#). This paper is not updated on any developments after the IASB Update from March 2024.

Power Purchase Agreements

electricity produced does not coincide with the purchaser's demand at the time of production.

Own-use assessment

4 To apply the own-use requirements in paragraph 2.4 of IFRS 9 to such contracts for renewable electricity, the IASB tentatively decided to propose that, from the contract's inception and throughout its duration, the purchaser under the contract be required 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 entity's expected purchases or usage requirements for the remaining duration of the contract; and
- (b) the reasons for past and expected sales of unused renewable electricity and whether such sales are consistent with the entity's expected purchase or usage requirements. A sale is consistent with the entity's expected purchase or usage requirements if:
 - (i) the sale arises from mismatches between the renewable electricity delivered and the entity's demand at the time of delivery;
 - (ii) the design and operation of the market in which the renewable electricity is traded restricts the entity from having the practical ability to determine the timing or price of such sales; and
 - (iii) the entity expects to repurchase the sold volumes of renewable electricity within a reasonable time after the sale.

Disclosures²

5 The IASB tentatively decided to propose setting specific disclosure objectives that would require an entity to disclose information that enables users of financial statements to assess the effects of contracts for renewable electricity on:

- (a) the entity's financial performance; and
- (b) the amount, timing and uncertainty of the entity's future cash flows.

6 The IASB also tentatively decided to propose that an entity be required to disclose - as items of information for all its contracts for renewable electricity:

² The proposed disclosures for Subsidiaries without public accountability (SWOPA) are very similar to those included in paragraph 6 of this agenda paper.

Power Purchase Agreements

- (a) the terms and conditions of contracts. For example, the contract's duration, type of pricing (including whether they include price adjustment clauses), minimum or maximum quantities, cancellation clauses and whether they include Renewable Energy Credits (RECs).
- (b) the net volume purchased or the total volume for which amounts were net-settled for the reporting period, and an explanation of any significant variances in the volume. These entities are also required to disclose the average market price per unit of electricity for the reporting period.
- (c) either the fair value of the contracts at the reporting date accompanied by the information required by paragraphs 93(g)-93(h) of IFRS 13, or:
 - (i) the volume of renewable electricity the entity expects to sell or purchase over the remaining duration of the contracts. This information could be provided as a range for each of the following periods: not later than one year; later than one year and not later than five years; and later than five years.
 - (ii) the methods and assumptions used in preparing the analysis in (i), including information about changes in those methods and assumptions from the previous period and the reasons for such changes.

B. Comparison of the EFRAG's alternative own-use model and the IASB's ED proposals

Alternative own-use model	IASB's tentative proposals
Scope	
<p>A1. The alternative model applies to all contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument.</p>	<p>B1. The scope of the proposals is limited to contracts of renewable energy that meet two characteristics:</p> <ul style="list-style-type: none"> (d) The source of the production of electricity is nature dependent (see paragraph 3(a) above); and (e) The purchaser is substantially exposed to all the volume risk (see paragraph 3(b) above).
Recognition and measurement	
<p>A.2 The Alternative model splits the contract in different <u>parts</u> and requires the own-use assessment to be made for the different parts of the contract.</p>	<p>B2. The ED proposals do not envisage to change the approach an entity follows to make the own-use assessment. Currently, in accordance with paragraph 2.4 of IFRS 9 an entity assesses the own-use requirements for the <u>whole</u> contract.</p>
<p>A.3 The Alternative model allows that a non-financial item contract is accounted for as an executory contract if it currently meets the own-use requirements but did not meet the own-use requirements at a previous stage of the contract. (i.e. it allows contracts to go from FVTPL to executory contracts and vice versa, depending on whether the contract meet the own-use requirements).</p> <p>The Alternative model includes an accounting policy choice that allows an entity not to reassess whether</p>	<p>B3. The ED proposals do not envisage to modify the current IFRS 9 requirements. Therefore, if a non-financial item contract was at some stage not satisfying the own-use requirements, it would be accounted for at FVTPL and would not be able to be accounted for as an executory contract in the future even if the own-use requirements were subsequently satisfied.</p>

<p>contracts or part of contracts that are accounted for at FVTPL meet the own-use requirements.</p> <p>A.4 The Alternative model is <u>forward looking only</u> in its assessment of own-use.</p> <p>A.5 The Alternative model does not include an automatic overrule of own-use if the conditions in paragraph 2.6(b) or 2.6(c) of IFRS 9 are fulfilled (i.e. it proposes to delete the last section of paragraph 2.6 of IFRS 9).</p> <p>A.6 The Alternative model updates the exception included in paragraph 2.5 of IFRS 9 that allows an entity to irrevocably measure an own-use contract at FVTPL. <u>It removes the requirement to have an accounting mismatch to make use of the exception.</u></p>	<p>B.4 The ED proposals consider that the own-use assessments for the contracts in scope is <u>prospective and retrospective</u>:</p> <ul style="list-style-type: none"> (a) The purpose, design and structure of the contract and expected volumes are to be consistent with the entity’s usage requirements for the remainder of the contract (see paragraph 4(a) above). (b) The reasons for past and expected sales of unused electricity are consistent with the entity’s usage requirements (see paragraph 4(b)4(a) above). <p>B.5 Currently, it is unclear how the ED proposals interact with the last section of paragraph 2.6 of IFRS 9.</p> <p>B.6 The ED proposals do not envisage to modify this exception.</p>
<p>Disclosures</p>	
<p>A.7 The Alternative Model proposes to amend paragraph 5 of IFRS 7: <i>Financial Instruments Disclosures</i> so it applies to all contracts or part of contracts that satisfy the own-use requirements</p>	<p>B.7 The ED proposals include a specific disclosure objective (see paragraph 5 above) and require entities to disclose several items of information to meet the disclosure (see paragraph 6 above) for</p>

Power Purchase Agreements

<p>and are accounted for as executory contracts. Therefore, all non-financial item contracts that are net-settled need to provide FV disclosures</p>	<p>those contracts that are in the scope of the ED proposals. In addition, an entity is not required to disclose the FV of the contracts (i.e. the ED proposals provide alternative disclosures).</p> <p>The ED proposals do not require any disclosure for contracts assessed to be for own-use purposes that are not in the scope of the proposals.</p>
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C. Advantages and disadvantages of EFRAG’s alternative own-use model

Advantages of the Alternative model	Disadvantages of the Alternative model
<p>A8. The Alternative model is a more principles-based model than the ED proposals as it applies to all non-financial item contracts that can be settled net in cash or another financial instrument.</p> <p>A9. The ability of assessing the own-use requirements for each part of the contract will likely provide a more faithful representation of contracts of non-financial item that can be settled net in cash when compared to the current own-use requirements (e.g. a LNG contract for which 75% of the volume is for own-use purposes and 25% is for trading would result in an entity accounting for 25% of the contracts at FVTPL instead of 100%).</p> <p>A10. The Alternative model will likely reduce volatility in the statement of financial performance when compared to current own-use requirements (i.e. only part of the contract would be accounted for at FVTPL).</p> <p>A11. The Alternative model requires entities to disclose the FV of long-term non-financial item contracts that are assessed to be own-use. These contracts pose risk to entities (especially those that are of a very long-term nature) while IFRS Accounting Standards include very limited disclosure requirements for unrecognised contractual commitments.</p>	<p>B.8 The Alternative model would represent a fundamental change to the own-use requirements and would take more time and resources for the IASB to complete the project. Since it applies to all non-financial item contracts that can be settled net in cash a comprehensive outreach would be necessary to identify if unintended consequences arise.</p> <p>B.9 The Alternative model would not likely be fit for the timing solution on PPA contracts that some stakeholders are requesting the IASB to undertake.</p> <p>B10. Splitting a contract in different parts would be more complex and require more resources from companies, especially for entities with large number of contracts and multiple changes in estimates throughout the life of the contract. Therefore, the benefits of the Alternative model might not outweigh the related costs.</p> <p>B11. The Alternative model would likely result in entities disclosing the FV of many non-financial item contracts that are currently accounted for as executory contracts. We have heard that estimating the FV of long-term commodity contracts is challenging. Hence, the benefits of providing this disclosure might not out weight the related costs.</p>

Power Purchase Agreements

A12. The Alternative model will likely increase transparency on which portions of a contract an entity enters into for own-use purposes, and which portion an entity enters for trading purposes when compared to the current own-use requirements.

B12. Unlike the ED tentative proposals, the Alternative model does not provide a mechanism to validate the actual results of an entity's expectations (i.e. the Alternative model is only forward looking in its assessment of own-use). Hence, some entities might take advantage of this to avoid fair valuing a portion of its contract. (it might also imply weak auditing and enforcement processes)

E. Questions for EFRAG FRB

- 7 Do you have any comments or questions on the comparison between the EFRAG's alternative own-use model and the IASB's ED proposals?
- 8 Do you have any comments or questions on the advantages and disadvantages of EFRAG's alternative own-use model?