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Issues Paper - Own-use exception

Objective

- 1 This agenda paper provides a summary 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 and related EFRAG Secretariat analysis. This agenda paper includes references to the IASB Staff Agenda paper 3A 'Scope of the proposed amendments and the proposed amendments to the own-use requirements' for the 18 March 2024 IASB meeting ([Paper 3A](#)).
- 2 This paper is structured as follows:
 - A. IASB's tentative decisions
 - B. EFRAG Secretariat analysis
 - C. Summary of the IASB discussion (session 18 March 2024)
 - D. Questions to the EFRAG FR TEG

IASB's tentative decisions

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

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- 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 purchases 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.

The scope of the proposed amendments

- 5 The IASB staff developed the proposals under the premise that the scope needs to be sufficiently narrow to minimise unintended consequences and the time to finalise the amendments.
- 6 Given the urgency of the project, the fact that the IASB did not identify other contracts with the same challenges as those that apply to PPAs for renewable electricity and the feedback that a timely solution may be achieved by having a less principle-based solution, the IASB staff proposed to limit the scope of the proposed amendments to contracts for renewable electricity. This proposal would meet the objective included in paragraph 5 above.
- 7 In addition to narrowing the scope of the proposed amendments to PPAs for renewable electricity, the IASB staff noted that the IASB could use the location of these proposed requirements within IFRS 9 and IFRS 7 (in separate sections of the standards) to signal that the proposals do not apply to other contracts (similar to the interest rate benchmark reform amendments).

EFRAG Secretariat analysis

8 The EFRAG Secretariat welcomes the swift reaction from the IASB to develop standard setting proposals and the efforts made by the IASB to consider the feedback provided by stakeholders. Likewise, the EFRAG Secretariat acknowledges the premises under which the IASB developed these proposals (i.e. the prevention of unintended consequences, to carry out the project in a timely manner and to leverage as much as possible on the unique characteristics to PPAs).

9 Moreover, the EFRAG Secretariat welcomes the shift in the determination of the scope of the Amendments from referring to non-financial item to identifying the underlying item as “electricity”.

10 However, the EFRAG Secretariat would suggest to further consider the adequacy of using the term “renewable” as there is no consensus on the definition of renewable electricity. In Paper 3A, the IASB Staff notes within the footnote on page 2:

“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”.

11 Moreover, the recent amendments to the [EU Directive](#) (amendments of 18 October 2023), define renewable energy as follows:

(1) “energy from renewable sources” or “renewable energy” means energy from renewable non-fossil sources, namely wind, solar (solar thermal and solar photovoltaic) and geothermal energy, osmotic energy, ambient energy, tide, wave and other ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas, and biogas;

14q) “renewable energy purchase agreement” means a contract under which a natural or legal person agrees to purchase renewable energy directly from a producer, which encompasses, but is not limited to, renewables power purchase agreements and renewables heating and cooling purchase agreements;

12 Renewable electricity may also be any electricity to which Renewable Energy Certificates (RECs) are attached. However, we note that RECs are often separately traded assets and will not to be addressed in this project (i.e. the IASB staff considers that the reserve list project on Pollutant Pricing Mechanisms is better suited to address the issue). Therefore, it is not clear how renewable electricity is defined within the scope of the proposed amendments. If electricity that meet the characteristics in paragraph 3(a) above is deemed to be renewable electricity, we suggest that the IASB refer simply to electricity in the proposed amendments (i.e. instead of renewable electricity).

- 13 Paragraph 3(a) above identifies wind-, solar- and hydroelectricity as examples of electricity being nature-dependent. Paragraph 23(b) of Paper 3A¹ indicates some limitations on some hydro energy contracts. We recommend not to introduce in the ED different requirements for different sources of hydro electricity.
- 14 Further, the scope of the proposed amendments is limited to the contracts where the volume (production) risk is substantially transferred to the purchaser (see paragraph 3(b) above). The IASB staff does not specify when a risk is deemed to be substantially transferred. Considering that the PPAs are generally complex, often include cap or floor features and are structured differently depending on the production technology and the relevant market structure this may result in different interpretations. Therefore, we are of the view that some guidance on this could be helpful.
- 15 Paragraph 4(a) above seems to be referring to two different things (i) whether the purpose, design and structure of the contract is consistent with the entity's usage requirements and (ii) whether the remaining volumes are expected to be consistent with the entity's usage requirements. For clarify sake, it might be helpful to split the sentence into two dedicated subsections.
- 16 Overall, it would be helpful to further elaborate on the periodicity of the assessments. An entity should assess the consistency of the volumes to be delivered under the terms of the PPA with its usage requirements for the remaining life of the contract but, should this assessment be done on a daily, weekly, monthly, yearly or cumulative basis? Our current reading is that the prospective assessment should be done on a cumulative basis but perhaps this is not the IASB 's intention.
- 17 Similarly, an entity will need to assess whether the sales of unused energy are due to mismatches between the renewable electricity delivered and the purchaser's demand requirements at the time of delivery. In some markets, the electricity is delivered and consumed in short intervals (e.g. 15 or 30 minutes). Does it mean that an entity will need to provide evidence for all time intervals that the sales of unused energy are due to supply and demand mismatches? This may be difficult to achieve from a practical perspective. We

¹ Paragraph 23(b) notes that "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 3(b) above".

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are of the view that an illustrative example could be useful to help entities understand how the assessments in paragraphs 4(a) and 4(b) above should be done.

- 18 Moreover, it would be helpful to clarify, from a practical point of view, at what level the assessment needs to be performed to assess the purchaser's expected purchases or usage requirements (paragraph 4(a) above) - at the level of consolidated entity, at the level of subsidiary for which the PPA was entered into or at the level of plant(s) to which the electricity is actually delivered. Perhaps, the level of the assessment depends on the entity's specific circumstances and on the purpose of the PPA (i.e. if the purpose of the PPA is to provide energy to two industrial plants, it makes sense that an entity compares the volumes to be delivered by the PPA with the expected energy requirements of the two plants) but it would be helpful to clarify this aspect.
- 19 In relation to paragraph 4(b)(ii) above, we note that there is no specific market for renewable electricity, only for electricity (and for RECs).
- 20 In addition, illustrative materials would also be useful when featuring situations that may be prevalent such as PPAs with defined caps and or floors on volume or PPAs entered into at consolidated group level for various subsidiaries and locations. Nevertheless, we acknowledge the IASB's limitations to provide illustrative examples or guidance to the various fact-patterns.
- 21 We also consider that it would be helpful to include in the basis for conclusions a linkage with the IFRS IC discussion that triggered having the IASB project as there were some useful discussions/materials (like those related to net pool and gross pool markets).
- 22 In paragraph 53 of Paper 3A² intention is introduced as a underlying principle in the own-use assessment. The EFRAG Secretariat does not recognise this underlying principle in the general own use assessment and highlights the importance of ringfencing this principle if it is to be carried forward to an ED or to the BC.

² Paragraph 53 indicates that "considering the requirements in the diagram (included in paragraph 52 of Paper 3A), 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."

Summary of the IASB discussion (session of 18 March 2024)

- 23 Some IASB members asked for more rigour in defining the own-use requirements as well as thinking about how those requirements may be supported in practice (what evidence). It should be clarified that the requirements need to be reassessed at each reporting date.
- 24 An IASB member suggested to clarify that the sales are permissible because they were expected upon inception and the PPA volumes are ultimately sold for own-use needs and within a relatively short period of time.
- 25 An IASB member suggested that the key feature of the scope of the proposed amendments is not related to the electricity being nature dependent but to the fact the supply cannot be guaranteed at particular times or for particular volumes.
- 26 Further it was noted by some IASB members that the risk transferred to the purchaser seem to be define from the seller point of view, however the own-use analysis is done from the point of view of the purchaser. Therefore, it was suggested that the Staff should focus on the risk beared by the purchaser – the fact that the consumption pattern does not match the supply versus the production risk.
- 27 One IASB member noted that the example given in paragraph 34 of IASB Agenda [Paper 3A](#) may be confusing because a significant percentage of the purchased electricity is sold back. This example may lead to various interpretations and open up a road to unintended consequences and question the overall own-use exception principle currently included in IFRS 9.
- 28 In addition, it was suggested to specify that the mismatch between volume purchased and volume consumed needs to result from nature-related factors and not be linked to management actions.
- 29 One IASB member proposed to specify that if the own-use fails for one PPA it should not impact the rest of the portfolio and that each contract needs to be assessed separately at each reporting period.
- 30 Some IASB members questioned if the own-use exception should be opened up so much. In their view, the current IFRS 9 guidance already provides a thorough basis for analysis and if the own-use exception is not met, the PPAs should be accounted for at fair value. If the IASB considers that the accounting at fair value through P&L does not reflect the economic reality, it could be possible to further explore the solution of accounting for the fair value variances in OCI instead of P&L similar to hedge accounting. In that case, the proposed amendment would only be related to the presentation factor and not impact the

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recognition and measurement criteria. Another member reminded that IFRS 18 standard will be published in April 2024 and will provide the basis for the management performance measures where an entity that deems that the fair value through profit and loss does not reflect the economic substance of the PPA can reflect its own view through management performance measures.

- 31 An IASB member further commented that the analysis included in the Paper 3A is based on the assumption that management is forced to sell back the electricity based on the market structure, however, if the only purpose of management was to get supply of green electricity, it could do it on the spot market without entering into a PPA. Therefore, it is management's choice to enter into a PPA and assume the consequences of potential sales of unused electricity.
- 32 To conclude, a majority of the IASB members supported the IASB's staff proposals.

Questions for EFRAG FR TEG

- 33 Do you have any comments or questions on the IASB's tentative decisions that are included in paragraphs 3 and 4 above?
- 34 What application challenges do you foresee with the proposed amendments?