IFRS Foundation Trustees' Due Process Oversight Committee (DPOC) meeting

Date	**March 2024**
Project	**Power Purchase Agreements**
Topic	**Approval for a shortened comment period for proposed amendments to IFRS 9 and IFRS 7 related to power purchase agreements**
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Purpose

1. In accordance with paragraph 6.7 of the *Due Process Handbook*, the International Accounting Standards Board (IASB) normally allows a minimum period of 120 days for comment on an exposure draft. If the matter is narrow in scope and urgent the IASB may set a comment period of less than 120 days (but no less than 30 days) after consulting and obtaining approval from the Due Process Oversight Committee (DPOC).

2. **The purpose of this paper is to seek the DPOC's approval for a shortened comment period for an exposure draft of proposed narrow-scope amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* related to contracts for renewable electricity (commonly referred to as power purchase agreements or PPAs).**

3. The posting date of this agenda paper is before the IASB's meeting scheduled on 18 March 2024, at which the IASB will discuss the staff recommendation to set a shortened comment period of 90 days (subject to DPOC approval). Therefore, we will provide an oral update on the IASB's discussion and decisions at the DPOC meeting.

Proposed narrow scope-amendments related to contracts for renewable electricity

Background

4. As highlighted at the February 2024 DPOC meeting (Agenda Paper 1B), the IASB added an urgent research project to its work plan, in July 2023, to address the accounting for power purchase agreements (also referred to as contracts for renewable electricity). Given the urgency of this project, the IASB indicated that it might seek a shortened comment period on the exposure draft, subject to DPOC approval at a future meeting.

5. The IASB's decision to add an urgent project to its work plan followed a recommendation made by the IFRS Interpretations Committee for the IASB to address the accounting for physical PPAs. Physical PPAs that do not meet the 'own-use' exception in IFRS 9[1] are accounted for as derivatives, rather than as executory contracts whose costs are recognised when the contract is executed (ie, when the goods/services are provided). Some stakeholders have questioned the usefulness of this accounting.

6. At that meeting, the IASB also decided to include virtual PPAs (contracts for differences between the fixed price in the agreement and the spot price) in the scope of its work. Virtual PPAs are also derivatives and questions arise about the application of hedge accounting requirements to enable entities to better reflect the purpose for which entities are holding these contracts.

7. Virtual PPAs and physical PPAs are entered into for the same purposes and economically provide the same outcomes, but their use depends on the design and operation of the market structure within a particular jurisdiction. Physical PPAs are contracts between an electricity producer and an electricity consumer that requires the consumer to pay fixed price for each unit of electricity produced under the contract. When renewable electricity is produced, the producer credits the consumers' account with the volume delivered and the consumer has an obligation to pay the fixed price for that volume of electricity, regardless of whether the consumer could use the electricity at that time. Any unused electricity must be sold back to the market at the prevailing spot price. Settlement of the obligations under the contract is done on a gross basis.

8. Virtual PPAs are not contracts for the purchase of electricity but are typically structured as a 'contract for difference' between the electricity producer and the consumer. Both parties to agree to net settle the difference between the agreed fixed price and the prevailing spot price in the market (ie net settled swaps) for the volume of electricity produced. A virtual PPA does not give rise to any obligation to purchase a volume of electricity—the consumer could be required to pay under the contract even if no electricity is needed at that time. Also see Appendix C for an illustration of the differences between physical and virtual PPAs.

Prevalence and urgency

9. To determine the most appropriate approach to develop narrow-scope amendments to IFRS 9 and IFRS 7 that would respond to stakeholder concerns raised, the IASB decided to do research to determine whether:

   (a) contracts for renewable electricity are widespread and if so, what the characteristics of the arrangements are;

[1] The own use scope exception is for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements

(b) the effects of such arrangements on entities' financial statements are expected to be material; and

(c) how the scope of any potential amendments could be restricted to limit the disruption to other arrangements to which the requirements in IFRS 9 are already applied and thereby limit the risk of unintended consequences.

10. Although stakeholders were in general agreement that an accounting solution was needed for these types of arrangements, there was no consensus between stakeholders on what the scope of such a project should be or what an appropriate standard-setting solution could comprise and at times the suggested solutions made were contradictory. The staff have done extensive outreach and research between August and November 2023, to obtain information from stakeholders across many jurisdictions about:

(a) what both renewable electricity producers and consumers consider when entering into PPAs;

(b) the unique characteristics of the arrangements that could be used to restrict the scope of any proposed amendments; and

(c) the potential approaches to narrow-scope standard-setting that would achieve the stated objectives.

11. We also consulted with the Accounting Standards Advisory Forum (ASAF), the IFRS Interpretations Committee and the large accounting firms on these matters.

12. PPA-type contracts have long been used by entities to secure long-term supply and pricing of commodities or other non-financial items used in their production or manufacturing processes. However, nearly all stakeholders we spoke to confirmed that the type of PPAs that give rise to operational challenges to the current accounting requirements, are increasingly being used for the long-term supply of power from renewable or green energy sources. This is because electricity producers and consumers are responding to jurisdictional requirements to transform their power consumption to renewable power. This has led to the development of contractual arrangements that are different from other contracts because the production or volume risk is transferred to the consumer—in other words the consumer has to pay for the electricity produced and delivered regardless of whether it has a demand for the electricity at that time.

13. Most PPAs were either entered into fairly recently or are expected to be entered into in the coming years. For this reason, the effects of PPAs were not yet prevalent in entities' 2023 financial statements. However, all stakeholders we consulted said that having an accounting solution in place as soon as possible, that would better reflect the effects of these arrangements in accordance with the purpose of the contracts, is of utmost importance.

14. The IASB considered the findings of the research on the prevalence and urgency of the project at its December 2023 meeting and decided to proceed with narrow-scope standard-setting.

The proposed amendments

15. In developing the proposed amendments to be decided on in the March 2024 IASB meeting, the IASB's objectives were:

    (a) to limit any disruption to current practice beyond the arrangements in question and thereby mitigating the risk of unintended consequences; and

    (b) to balance the need for a timely solution with the robustness of the potential amendments.

16. Throughout the process of developing the proposed amendments, the IASB continued to consult different types of stakeholders across many jurisdictions including preparers, investors and accounting firms to ensure that the proposed amendments achieve the project objectives. Refer to Appendix A for a summary of outreach meetings by stakeholder type and jurisdiction.

17. To limit any disruption to current practice and mitigate the risk of unintended consequences, the IASB tentatively decided to define the scope of the proposed amendments based on a combination of the nature of the underlying item (being renewable electricity) and the nature of the contractual arrangements (volume or production risk being substantially transferred to the consumer). In addition, the proposed amendments will be placed together in separate sections of IFRS 9 and IFRS 7 rather than being placed throughout those Standards.

18. The IASB believes that a timely solution can be achieved only if any potential amendments are limited to only those discrete aspects of the requirements in IFRS 9 that give rise to the application challenges, namely:

    (a) the assessment of whether a contract to buy renewable electricity is entered into and continues to be held in accordance with a purchaser's expected purchase or usage requirements; and

    (b) the designation of forecasted sales or purchases in a cash flow hedging relationship when a contract to buy or sell renewable electricity (ie a power purchase agreement) is designated as the hedging instrument.

    The IASB is not proposing amendments to any other requirements in IFRS 9.

19. In addition, the IASB intends to propose disclosure requirements to be added to IFRS 7 that will enable users of financial statements to understand the effect of contracts for renewable electricity on an entity's financial performance, as well as the timing, amount and uncertainty of future cash flows of the entity.

20. In developing these disclosure proposals, the IASB has carefully assessed the costs and benefits of the proposed disclosure so that these do not require costs and efforts that outweigh the benefits of the additional information to be provided to users of financial statements.

Rationale for comment period recommended to the IASB

21. To achieve its objective of providing a timely solution as asked for by stakeholders and discussed in paragraph 15 of this paper, the IASB expects to publish an exposure draft in May 2024 and is currently aiming to finalise the amendments in 2024 (subject to stakeholder feedback on the Exposure Draft and the IASB's decisions during its redeliberations). Therefore, a shortened comment period on the Exposure Draft will be needed.

22. We acknowledge that these are complex areas of IFRS Accounting Standards and some stakeholders might rightfully be cautious about the IASB making changes to the requirements. This is particularly the case for hedge accounting, that is a specialised area and any amendments to the current requirements will require an element of education as part of the IASB's consultation on the Exposure Draft. Therefore, stakeholders should be given sufficient time to consider and analyse the proposed amendments.

23. However, the proposed changes are narrow-scope amendments (as discussed in paragraphs 18 of this paper) affecting particular requirements in IFRS 9 only. Furthermore, throughout the project to date, we have clearly communicated on the status of the project and the progress made to date. This included having a special ASAF meeting in January 2024.

24. We are also of the view that implementing the proposed amendments would not be burdensome for preparers and therefore they will not need as much time to consider the potential implementation challenges during the consultation period. For contracts for renewable electricity to which the proposed amendments to the own-use requirements are applied, the proposed amendments would in fact reduce the accounting burden on preparers. And although there would be some effort required to apply the proposed amendments to the hedge accounting requirements to those contracts to which the own-use requirements cannot be applied, we think the additional effort is only incremental. This is because those contracts are required to be accounted for as derivatives under IFRS 9 already.

25. We also note that the IASB added the project on power purchase agreements as an urgent project in July 2023, following requests from stakeholders for a timely solution that will better reflect the purpose and effects of these contracts in the financial statements while at the same time increase their use of renewable electricity.

26. In balancing the need for providing stakeholders sufficient time to analyse the proposed amendments, with the need for urgency as asked for by stakeholders, we are of the view that a comment period of 90 days for the Exposure Draft would be appropriate.

Question for the DPOC

27. **Assuming the IASB agrees with the staff's recommended comment period, does the DPOC give its approval for a shortened comment period of 90 days for an exposure draft of proposed narrow-scope amendments to IFRS 9 and IFRS 7?**

Appendix A: Summary of Due Process considerations (extract from paper 3D for the IASB's March 2024 meeting)[2]

Due process step	Actions
International Accounting Standards Board (IASB) and IFRS Interpretations Committee (Committee) meetings held in public, with papers available for observers. All decisions made by the IASB was made in public sessions	The IASB discussed the matter at the following meetings: • July 2023; • December 2023; • January 2024; • February 2024; and • this meeting. The Interpretations Committee provided input to the IASB and discussed the matter at its November 2023 meeting. The project page on the IFRS Foundation website was updated after every meeting. Agenda papers for the IASB and Committee meetings were posted on the website before every meeting on a timely basis and a summary of each meeting was included in IASB *Update* or IFRIC *Update* as appropriate.
Analysis of likely effects of the forthcoming Exposure Draft or major amendment, for example, initial costs or ongoing associated costs	The proposed amendments are narrow-in-scope and were developed in response to a submission to the Committee. The proposed amendments aim to better reflect the effects of Power Purchase Agreements (PPAs) in an entity's financial statements. The proposed amendments therefore comprise: • proposed amendments to the own-use requirements in IFRS 9 that, in our view, enables the purchaser under a physical PPA to appropriately determine whether to account for the PPA as a normal purchase or a derivative; • proposed amendments to the hedge-accounting requirements that enable entities to designate PPAs accounted for as derivatives as a hedging instrument in a cash flow hedge relationship; and • additional disclosure requirements about PPAs that enable users of financial statement to assess the effects of PPAs on an entity's financial performance and future cash flows. Input and feedback have, in general, been supportive of the proposals because the outcome of the amendments provides useful information about PPAs. As explained in the agenda papers for this meeting, we are of the view that the benefits of each of the IASB's proposals outweighs the cost of that individual proposal listed above. We also think the benefits of the package of proposals also outweighs the cost.

[2] This paper was highlighted to the DPOC on 15 March as part of the Foundation's staff regular monthly report to the DPOC

Outreach meetings with stakeholders	During the development of the proposals, we held outreach 38 outreach meetings with stakeholders. *S*ome stakeholders we spoke to more than once and some meetings included participants from different jurisdictions. We summarise our stakeholder representation by type and jurisdiction:
	Stakeholders by type — **Number**
	Auditors — 6
	Investors or investor groups — 5
	Preparers or preparer groups — 15
	Standard-setters, including the Accounting Standards Advisory Forum (ASAF) — 2
	28
	Stakeholders by jurisdiction — **Number**
	Africa — 1
	Asia-Oceania — 1
	Europe — 12
	North America — 6
	South America — 1
	Multiple jurisdictions — 7
	28
Due process steps reviewed by the IASB	This step is being met by this [IASB] agenda paper.
The forthcoming Exposure Draft has an appropriate comment period	This step is being met by this [IASB] agenda paper—see paragraphs 7–15.
Drafting	
Drafting quality assurance steps are adequate	The IASB as well as the IFRS Foundation's translations, editorial and taxonomy teams will review drafts during the balloting process.
Publication	
Exposure Draft published	We plan to make the Exposure Draft available on our website when published.
Press release to announce publication of the Exposure Draft	We plan to publish a press release on our website with the Exposure Draft.

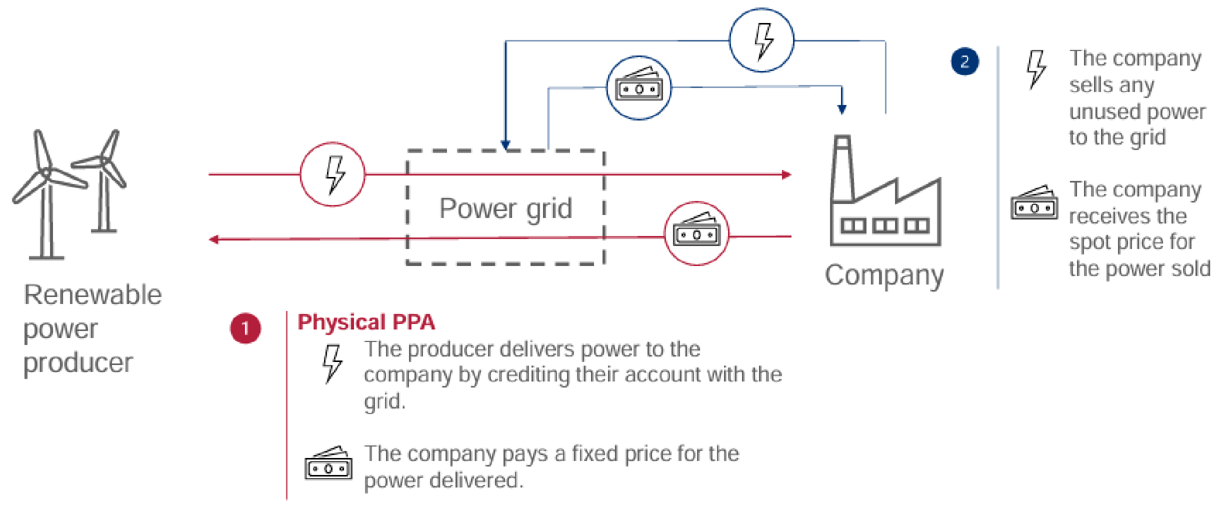
Appendix B: Project timing

28. The project timing can be summarised as follows:

Month	Activities
July 2023	IASB added an urgent project to its work plan to research the prevalence and urgency of potential amendments to IFRS Accounting Standards
August – November 2023	Outreach with different types of stakeholder across many jurisdictions
September 2023	Consultation with ASAF
November 2023	Consultation with the IFRS Interpretations Committee
December 2023	IASB consider research findings and decide to proceed with narrow-scope standard-setting
January 2024	IASB education session on potential characteristics to restrict application of proposed amendments and potential amendments to requirements in IFRS 9 Supplementary ASAF meeting to obtain views on potential amendments discussed at January 2024 IASB education session
January – February 2024	Outreach with different stakeholder types, including investors
February 2024	IASB receives project update
March 2024	IASB to decide on the proposed amendments to include in the Exposure Draft

Appendix C: Illustration of differences between physical and virtual PPAs

Physical power purchase agreements



Virtual power purchase agreements