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## IASB<sup>®</sup> Meeting

Date **October 2024**

Project **Power Purchase Agreements (PPAs)**

Topic **Feedback on the transition proposals and the effective date**

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## Purpose of this paper

1. In the Exposure Draft *Contracts for Renewable Electricity* (Exposure Draft), the International Accounting Standards Board (IASB) proposed to amend IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* to account for electricity contracts with specified characteristics.
2. This paper provides the analysis of the feedback on questions six and seven of the Exposure Draft and our recommendations with regards to the effective date and transition requirements.

## Summary of staff recommendations and question to the IASB

3. With regards to the effective date of the proposed amendments we recommend the IASB requires an effective of 1 January 2026, with early application permitted from the date of initial application. The date of initial application is the date when an entity first applies the proposed amendments and must be the beginning of a reporting period after the issue of these amendments
4. With regards to the transition requirements:

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- (a) for the own-use amendments we recommend the IASB:
    - (i) continue to require retrospective application without requiring comparative information to be restated (as proposed in the Exposure Draft);
    - (ii) require the assessment under the own use amendments to be made on the basis of the facts and circumstances that exist at the date of initial application.
    - (iii) permit, at the date of initial application, the designation of Nature-dependent electricity (NDE) contracts at fair value through profit or loss in accordance with paragraph 2.5 of IFRS 9.
  - (b) for the hedge accounting amendments, we recommend the IASB:
    - (i) continue to require prospective application of the hedge accounting requirements; and
    - (ii) permit an entity to discontinue an existing hedging relationship on the date of initial application of the amendments and designate a new hedging relationship applying the amendments.

#### Question for the IASB

1. Does the IASB agree with our recommendations included in paragraphs 3–4 of the paper?

## Structure of the paper

5. We structured this paper by grouping the proposals, the feedback and recommendations on:
  - (a) [the effective date of the proposals](#) (paragraphs 6–16);
  - (b) [the transition requirements the proposed own-use amendments](#) (paragraphs 17–24);

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- (c) [the transition requirements for the proposed hedge accounting amendments](#) (paragraphs 25–31); and
  - (d) [other transition requirements](#) (paragraphs 31–37).

## The effective date

### *Proposals*

- 6. The IASB has not proposed an effective date in the Exposure Draft but question seven of the Exposure Draft asked stakeholders if an effective date of annual reporting periods beginning on or after 1 January 2025 would be appropriate and provide sufficient time to apply the proposed amendments.
- 7. The IASB proposed to permit early application of the amendments from the date the amendments are issued, accompanied by disclosure of that fact.

### *Feedback and analysis*

- 8. Some respondents agreed with an effective date of 1 January 2025 and considered the time from expected publication in the fourth quarter of 2024 to first applying the proposed amendments on 1 January 2025, to be sufficient to complete their preparations. These respondents stated that the increasing number of contracts potentially in the scope of the proposed amendments warranted an early effective date to provide users of financial statements with a better understanding and analysis of these types of contracts.
- 9. However, most respondents preferred an effective date of 1 January 2026 with early application permitted. Most of these respondents expressed concerns that an earlier effective date would not leave sufficient time for entities to digest the requirements and, where necessary develop processes to comply with the proposed amendments. In particular, respondents stated that information to comply with the proposed disclosure requirements may not be readily available and the collection of the necessary data

may require some time. Other respondents remarked that entities planning to apply the hedge accounting amendments also may need to change business processes to be able to complete high quality hedge accounting documentation and prospective effectiveness testing given the degree of complexity a designation of a variable nominal amount as the hedged item may involve.

10. Lastly respondents noted that some jurisdictions require endorsement and/or translation processes to enable their constituents to apply the proposed requirements. These stakeholders said that an endorsement before 1 January 2025 would not be achievable and therefore such an effective date may be of little use for these stakeholders.
11. A few respondents commented that early application from the date the amendments are issued, would provide very little benefit to those entities that plan to apply the hedge accounting amendments (due to the prospective application of the proposed hedge accounting requirements), compared to entities that plan to apply the proposed own-use requirements which is applied on a retrospective basis. In their opinion this would further contribute to a non-level playing field between entities with different types of NDE contracts and could be quite confusing and complex when there are different types of NDE contracts within an entity. These respondents suggested the IASB permit early application only from the beginning of an annual accounting period.
12. The staff agree with respondents that an effective date of 1 January 2025 would not be appropriate, for the reasons explained in paragraphs 9 and 10 of this paper. As a result, we recommend the IASB requires an effective date of 1 January 2026. We considered that this will provide more time for jurisdictions to complete the endorsement and/or translation processes where relevant.
13. We also considered that although this could result in users of financial statements being provided with the required disclosures later than an effective date of 1 January 2025, we don't think there would a loss of information as a result. This is because, to the extent that NDE contracts are measured at fair value through profit loss (in

absence of the final amendments), entities will continue to provide other required disclosures.

14. The staff also continue to be of the view that early application of the final amendments would enable entities that need very little time to prepare, to apply the proposed amendments while at the same time allowing other entities sufficient time to implement the final amendments.
15. We acknowledge the comments that entities might not equally benefit from early application when early application is available from the date the amendments are issued. We also acknowledge the questions that arise with regards to the transition adjustment in such a case when applying the own use amendments (see paragraphs 17–24).
16. We therefore agree that early application should be permitted only from the beginning of a reporting period. We think to limit early application to the beginning of an annual reporting period would defeat the purpose of early application in this instance. As a consequence, we recommend that early application is permitted from the beginning of a reporting period, similar to the requirements in paragraph 7.2.2 of IFRS 9. This means that an entity would be able to apply the amendments from the beginning of any reporting period, such as an interim period, that is after the issue of the final amendments.

## Transition requirements for the proposed own-use amendments

### *Proposal*

17. The IASB proposed in paragraph 7.2.50 of the Exposure Draft to apply the additional requirements for the own-use assessment retrospectively in accordance with IAS 8. Entities are not required to restate prior periods to reflect the application of these amendments. Entities are permitted to restate prior periods if, and only if, it is possible to do so without the use of hindsight. If entities do not restate prior periods, any

difference between the previous carrying amount at the beginning of the reporting period in which the entity first applies the amendments, is recognised in the opening retained earnings (or other component of equity, as appropriate) at the beginning of that period.

18. Paragraph 7.2.51 of the Exposure Draft sets out similar requirements for when an entity early applied the amendments from the date of issue, which might have been during a reporting period.

### ***Feedback and analysis***

19. Generally, most respondents agreed with the proposed transition requirements. Most respondents also did not disagree with the suggested modified retrospective approach for the own-use requirements. However, some respondents said it was unclear whether a full retrospective approach, including restating comparatives, would not be permitted and requested clarification on this. A few respondents also asked whether retrospective application is required in cases where electricity costs are capitalised as input in their production processes and therefore form part of their cost of inventory.
20. Some other respondents expressed concerns regarding paragraph 7.2.51 of the Exposure Draft. These respondents said that the requirement does not achieve its intended objective to permit an entity applying the proposed amendment part-way through a reporting period. They were concerned that when applying paragraph 7.2.51 mid-reporting period may lead to instances of the derecognised fair value amount of the derivative exceeding the fair value which had been reported in opening retained earnings for the period for the same instrument and therefore recommended deleting this paragraph.
21. A few respondents asked whether, under the proposed amendments, the own-use assessment is made on the date of initial application or at inception of the contract. A few other respondents asked if a designation under the fair value option for contracts meeting the own-use exception at inception would be permissible under the proposed amendments. These respondents were concerned that the proposed amendments

would require entities to apply the own-use exception to NDE contracts that they already account for at fair value through profit or loss. They said that in some cases, an entity might want to continue accounting for NDE contracts at fair value through profit or loss even if they qualify for the own-use amendments.

22. As discussed in paragraph 16, we recommend permitting early application from the beginning of a reporting period. This change from the original drafting of the amendments would result in paragraph 7.2.51 of the Exposure Draft to no longer be required.
23. Regarding comments made with regard to the fair value option for own-use contracts in paragraph 2.5 of IFRS 9, the staff acknowledge that there might be situations where an entity might prefer to continue accounting for an NDE contract at fair value through profit or loss even if such contract qualify for the own use amendments. We note that when IFRS 9 was first applied, entities were permitted to designate financial assets under the fair value option at the date of initial application. Similar transition requirements applied when IFRS 17 was applied initially. We are of the view that entities should be provided with similar transition requirements upon initial application of the proposed own use amendments. We therefore recommend the IASB permits the designation of NDE contracts at fair value through profit or loss at the date of initial application in accordance with paragraph 2.5 of IFRS 9.
24. We acknowledge the comments made on the capitalisation of inventory cost or the assessment date for determining the ‘own-use’ of the contract but are of the view that there are no further clarification required as we believe proposed paragraph 7.2.50 of IFRS 9 is clear in this regard.

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## Transition requirements for the hedge accounting amendments

### *Proposals*

25. The IASB proposed in paragraph 7.2.52 of the Exposure Draft to require application of the hedge accounting amendments on a prospective basis. However, the Exposure Draft proposed that an entity could change the designation of an existing hedging relationship to apply the proposed amendments as explained in paragraph BC54 of the Basis of Conclusions on the Exposure Draft.

### *Feedback and analysis*

26. Generally, most respondents agreed with the proposed transition requirements on hedge accounting, ie to require prospective application. However, some respondents advocated retrospective application. These respondents cited a number of reasons why retrospective application should be permitted including:
- (a) that in an existing cash flow hedging relationship, the nominal amount originally designated as the hedged item is likely to would have been relatively low. Because the amount designated is static, there would not have been the same level of offset between the hedged item and hedging instrument, compared to the designation that is possible under the proposed amendments. These respondents said that making changes to the hedging relationship retrospectively would result in the statement of financial position and the statement of changes in equity reflecting a hedge relationship being fully effective from the date of designation. In their view, this would be a fair reflection of the economic offset achieved and would increase the usefulness of the information without requiring use of hindsight.
  - (b) potential cash flow hedging relationships that did not meet the qualifying requirements for cash flow hedging in the past may qualify when applying the proposed requirements. Similar to the reasons provided in (a) above,



respondents were of the view that retrospective application would provide more useful information in a such a case; and

- (c) designating a new cash flow hedging relationship under the proposed amendments, when the NDE contract has been entered into at an earlier date, would result in the hedging instrument being off-market at designation. This would result in ineffectiveness throughout the hedging relationship which would not be a true reflection of the economic offset provided and would have not occurred if the amendments had been available from inception of the contract.

27. However, most of the respondents that are in favour of retrospective application acknowledged that such an approach has never been permitted in the context of hedge accounting and that this could have significant unintended consequences.<sup>1</sup>

Nonetheless, they are of the view that due to the long-term nature of the contracts involved:

- (a) the difference in fair value changes between the hedged item calibrated to market and the off-market hedging instrument could be significant; and
- (b) if retrospective application of the proposed amendments were disallowed entities could be ‘trapped’ with an undesirable outcome for a long period, ie being penalised for contracting such types of contracts earlier than other entities.

28. A few respondents stated that permitting entities to continue hedge accounting for existing relationships may be operationally complex and would raise questions how to measure the designated hedged item and the reclassification adjustment from the cash flow hedge reserve going forward.

29. Although we acknowledge the potential effects and consequences identified by respondents in paragraphs 26–27, we continue to be of the view that hedge accounting

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<sup>1</sup> Paragraph 7.2.26 of IFRS 9 only permits limited retrospective application without retrospective designation. See also [Agenda Paper 15](#) of the September 2011 IASB meeting.

can only be applied prospectively for the reason quoted in paragraphs BC53–BC55 of the Basis for Conclusions on the Exposure Draft. This is important because hedge accounting is an exception to the normal recognition and measurement requirements in IFRS (as explained in paragraph BC 6.76 of the Basis for Conclusions on IFRS 9) and the designation of the hedged item and hedging instrument is done on a ‘instrument-by-instrument’ basis. Permitting retrospective application could therefore create opportunities to designate hedging relationships to achieve a particular accounting outcome and may result in carrying profit or loss results from the past to the present and future, which may be akin to earnings management.

30. Although we appreciate the difficulties caused by using off-market hedging instruments particular for these types of contracts as they are very long dated, we note that an off-market designation is not a new or unique problem as a result of NDE contracts but has existed even when applying the hedge accounting requirements in IAS 39. Therefore, we don’t think this is something that can be addressed as part of this narrow-scope project and any potential changes to the requirements in this regard need to be considered in a broader context.
31. On balance we are therefore of the view that retrospective application of hedge accounting would carry a high risk of unintended consequences, with stakeholder potentially asking for further exception in the future. As a consequence, we recommend the IASB continuing to require prospective application of the hedge accounting requirements and not permitting changes to existing hedging relationships as originally suggested in the Exposure Draft.
32. The intention for permitting changes to an existing cash flow hedging relationship was to apply a changed designation on a prospective basis only without changing past periods, ie freezing the cash flow hedge reserve at the point of initial application. However, we acknowledge that this may lead to operational complexities as raised by respondents (see paragraph 28). We think that a simpler way to achieve a similar outcome, would be to discontinue the existing relationship and designate a new relationship applying the amendments. Although it could be argued that the ability to

designate a variable notional amount might result in an entity's risk management objective for a hedging relationship to change, this might not always be the case. We therefore recommend that as part of the transition requirements, an entity is permitted, on the date of initial application, to discontinue an existing hedging relationship and designate a new hedging relationship applying the proposed amendments.

## Other transition requirements

### *Disclosures*

#### *Proposals*

33. The IASB proposed that an entity applies the disclosure requirements when it applies the amendments to IFRS 9. If an entity does not restate comparative information when it first applies the amendments to IFRS 9, the entity is also not required to present comparative information for the proposed disclosures.
34. The IASB exempted an entity from disclosing the quantitative information that would otherwise be required by paragraph 28(f) of IAS 8 *Basis of Preparation of Financial Statements*.

#### *Feedback and analysis*

35. As respondents did not comment on these proposals, we recommend the IASB finalise the transition requirements for disclosures without any change.

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***First time adoption******Proposals***

36. The IASB proposed not to provide additional transition requirements for first-time adopters (as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

***Feedback and analysis***

37. We recommend the IASB finalise the amendments without adding additional transition requirements for first-time adopters.