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**IASB<sup>®</sup> Meeting**

Date	<b>September 2024</b>	
Project	<b>Power Purchase Agreements (PPAs)</b>	
Topic	<b>Scope of the proposed amendments</b>	
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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* to account for electricity contracts with specified characteristics. With its proposals, the IASB aimed to ensure financial statements faithfully represent the effects of these contracts. This paper provides our analysis of the feedback on Question 1 of the Exposure Draft and recommendations on how to proceed with scoping these proposals. We also are asking whether you agree with our recommendations.

**Summary of staff recommendations and question to the IASB**

2. We recommend that the IASB:
  - (a) replaces the term ‘contracts for renewable electricity’ with ‘nature-dependent electricity contracts’—a term that better reflects the specified characteristics of the electricity contracts within the scope of the proposed amendments. (Our recommendations in this and the other agenda papers are worded assuming the IASB agrees with this recommendation.)

- (b) develops no additional requirements for an entity to determine the appropriate unit of account for transactions in complex market designs and for transactions that include RECs or similar attributes.
- (c) proceeds including in the scope of the proposed amendments electricity contracts with specified characteristics.
- (d) clarifies that nature (or natural forces) controls the source from which electricity is produced and whether any electricity can be produced by the referenced facility at a given time.
- (e) clarifies that for an electricity contract to be included in the scope of the proposed amendments, the cash flows under that contract vary based on the contracted volume of electricity produced by the referenced production facility.
- (f) incorporates and clarifies the concept of volume risk as part of the own-use amendments.

#### Question for the IASB

1. Does the IASB agree with our recommendations included in paragraph 2 of the paper?

## Terminology

3. In this paper we use the following terms for ease of reading:

Term	Explanation
NDE contract	a contract that has the specified characteristics we discuss in this paper. NDE stands for 'Nature-Dependent Electricity'.
NDE contract for receipt	an <i>NDE contract</i> for the receipt of electricity that can be settled net—commonly referred to as a physical power purchase agreement.
NDE contract for difference	an <i>NDE contract</i> that require net settlement of the difference between the prevailing market price and the contractually agreed price for the

	contracted volume of electricity without the obligation to deliver the underlying—commonly referred to as a virtual power purchase agreement.
own-use amendments	the proposed amendments for how an entity performs the <i>own-use assessment</i> for an <i>NDE contract for receipt</i> . We discuss the own-use amendments in Agenda Paper 3B for this meeting.
own-use assessment	an entity’s assessment of whether it holds a contract 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.
own-use requirements	the current requirements in paragraph 2.4 of IFRS 9.

## Structure of the paper

4. We structured this paper by grouping feedback on the proposed scope and the proposals more generally. In this paper we analyse the feedback about:
- (a) terminology used in the proposals (paragraphs 5–9);
  - (b) the unit of account (paragraphs 10–21);
  - (c) the extent of the scope (paragraphs 22–29);
  - (d) characteristic one—the nature-dependency of the source of electricity production (paragraphs 30–40); and
  - (e) characteristic two—contractual features (paragraphs 41–53).

## Terminology used in the proposals

### *Proposals*

5. The IASB proposed to refer throughout the Exposure Draft to an *NDE contract* as a ‘contract for renewable electricity’.

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**Feedback and analysis**

6. A few respondents suggested the IASB reconsiders using the term ‘renewable’ electricity because it adds unnecessary complexity to the proposals. In their view, removing the term throughout the proposals will not affect, but rather improve, the clarity and understandability of the proposed requirements.
7. Some other respondents suggested to instead refer to a contract ‘that references’ electricity because an NDE contract for difference is not a contract ‘for’ electricity but it is a contract that references electricity as the underlying on which net settlement is based.
8. We agree that using terms like ‘renewable’ and contracts ‘for’ electricity reduce the clarity of the proposed amendments. We agree with respondents that these terms are not necessary to communicate the principles of the proposed requirements.

**Staff recommendations**

9. We recommend the IASB replaces the term ‘contracts for renewable electricity’ with ‘nature-dependent electricity contracts’—a term that better reflects the specified characteristics of the electricity contracts within the scope of the proposed amendments.

**The unit of account****Proposals**

10. The IASB included in the scope of the proposed amendments NDE contracts to which the requirements of IFRS 9 would apply. Paragraph BC12 of the Basis for Conclusions on the Exposure Draft explained that the IASB was not made aware of any application challenges when accounting for NDE contracts that entities account for applying other IFRS Accounting Standards, for example IFRS 10 *Consolidated*

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*Financial Statements, IFRS 11 Joint Arrangements, IFRS 16 Leases, IAS 28 Investments in Associates and Joint Ventures and IFRIC 12 Service Concession Arrangements.*

11. Paragraph BC11 of the Exposure Draft also explained that an NDE contract is typically accompanied by renewable energy certificates (RECs) (or certificates, schemes or accreditations with similar attributes). Therefore, RECs are an important consideration for entities entering into these types of electricity contracts. The IASB concluded that it can effectively respond to stakeholders' concerns about NDE contracts separately from the accounting questions about RECs and how this interacts with accounting for these contracts.

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

12. Many respondents said that in their jurisdiction, parties to an NDE contract cannot access the electricity market directly but need an intermediary to do so on their behalf. Entities are therefore required to enter into contracts for, what could be seen as, ancillary transmission services. Respondents explained that these ancillary service contracts are entered into and negotiated separately and independently from the NDE contract.
13. Some intermediaries pass through the electricity delivered under the contract to the entity for a fee. Other intermediaries also streamline the intermittent supply from the production facility to a steadier supply profile. Respondents asked how to assess, particularly for an *NDE contract for receipt*, the contractual features of any other agreements between the electricity producer, the entity and any intermediary.
14. We note that one element of the abovementioned feedback deals with whether the accounting outcome is affected by risk mitigation activities (by the entity or others in the electricity market) that changes the entity's exposure to volume risk. We discuss later in this paper why we think the concept of 'substantially all of the volume risk'

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fits better within the own-use amendments. Therefore, we discuss this element of the feedback in more detail in Agenda Paper 3B for this meeting.

15. Another element to the feedback is how an entity determines the unit of account in a market design that includes multiple contracts with different parties. We acknowledge that it may be difficult to determine the unit of account in complex market designs. Unlike other IFRS Accounting Standards like IFRS 15 *Revenue from Contracts with Customers*, IFRS 9 does not include requirements for the combination of contracts. We think developing requirements for determining the unit of account for NDE contracts cannot be done without the IASB considering a variety of financial instruments and other contracts. Therefore, developing additional requirements to address these accounting challenges goes beyond the scope of a narrow-scope project.
16. We also note that in developing these proposals, the IASB accepted that before an entity determines whether the proposed amendments apply to an NDE contract, an entity would need to consider the substance of its rights and obligations. For example, an entity needs to determine whether its rights and obligations represent the substance of a lease, as defined in IFRS 16.
17. We continue to think that an entity needs to assess the substance of its contractual rights and obligations under the NDE contract and any other ancillary service contracts to determine the appropriate accounting. Although an electricity contract in complex market designs is a good example of such a potentially difficult judgement, it is not a unique judgement that applies only to such contracts. We think the IASB is able to address the unique accounting challenges that arise from an NDE contract without also addressing the accounting challenges around determining an appropriate unit of account.
18. Most respondents agreed (or did not disagree) with the IASB's decision to exclude the accounting for RECs from the scope of the proposed amendments. These respondents did however say that it would be helpful if the IASB could provide guidance on determining the unit of account to which the proposed amendments are applied,

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especially because, the own-use amendments (like the existing own-use requirements) refers to a ‘contract’ being held in accordance with an entity’s expected usage requirements. Respondents asked whether the proposed amendments have to be applied to the contract as a whole (including the RECs) or only to the electricity element of the contract, while separately accounting for the RECs.

19. A few respondents acknowledged that the IASB has a pipeline project on its workplan for pollutant pricing mechanisms and asked that this work be done in a timely manner. They, however, suggested that as the IASB is still doing research on whether to start the pollutant pricing mechanisms project, the accounting for RECs be done in the meantime as a separate project.
20. Developing these proposals the IASB was informed that entities account for RECs separately from the NDE contract. We note that entities across different jurisdictions would have determined the appropriate accounting treatment considering their specific facts and circumstances and the relevant (although potentially different) requirements of IFRS Accounting Standards. We think the IASB did not intend with these proposals to change how an entity determined the appropriate accounting treatment for RECs. Once again, we think that for the IASB to develop requirements determining the unit of account for financial instruments and accounting requirements for separately accounted RECs would require the IASB to consider a variety of financial instruments and other contracts. Therefore, developing additional requirements to address these accounting challenges goes beyond the scope of a narrow-scope project.

### ***Staff recommendations***

21. We recommend that the IASB develops no additional requirements for an entity to determine the appropriate unit of account for transactions in complex market designs or for transactions that include RECs or similar attributes.

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## The extent of the scope

### *Proposals*

22. To ensure that users of financial statements are provided with useful information about the effects these contracts have on an entity's financial statements, the IASB proposed to require application of the proposed amendments to an NDE contract that has specific characteristics. We discuss the two characteristics that the IASB specified in the proposals in more detail later in this paper.
23. Paragraphs BC6–BC10 of the Basis for Conclusions on the Exposure Draft explained that the purpose of the proposed scope was:
- (a) to minimise the risk of unintended consequences of the proposed amendments on how an entity accounts for other contracts to buy or sell non-financial items.
  - (b) to address the accounting challenges that arise from NDE contracts as identified by stakeholders. In developing the proposals, the IASB did not receive feedback that other electricity contracts give rise to similar concerns. Therefore, the IASB concluded that it could define the contracts within the scope of the proposed amendments by using specified characteristics of these contracts.
  - (c) to include both NDE contracts for receipt and *NDE contracts for difference*.
  - (d) to prohibit applying by analogy the proposed amendments to other contracts, items or transactions.

### *Feedback and analysis*

24. Most respondents appreciate that the IASB responded speedily to address the accounting challenges with applying IFRS 9 to NDE contracts raised by our stakeholders. Respondents particularly agreed with the inclusion of both NDE contracts for receipt and NDE contracts for difference within the scope of the



proposed amendments. Most respondents also agreed with restricting the scope of the proposed amendments using the characteristics specified in the Exposure Draft and agreed with not permitting entities to analogise to the proposed amendments for other types of transactions. In their view, these are important steps to mitigate the risk of unintended consequences. However, many respondents asked the IASB to clarify the two characteristics and we discuss this feedback in more detail later in this paper.

25. We continue to agree with the approach the IASB has taken in addressing the accounting challenges with regards to NDE contracts and including within the scope of the proposed amendments both NDE contracts for receipt and NDE contracts for difference.
26. A few respondents suggested that the IASB needs to expand the scope of the proposed amendments to also include other types of contracts, including those an entity holds for Environmental, Social, and Governance (ESG) purposes, for which similar application challenges might arise. These respondents considered the proposed amendments to be either too rules-based or appearing to favour contracts for *renewable* or *green* electricity over other types of contracts.
27. We note that the IASB did not add this project to its workplan because entities enter into NDE contracts as part of the entity's ESG strategy. As noted in paragraph 22 of this paper, the IASB's aim with this project was to ensure an entity's financial statements faithfully reflect the effects of these contracts while addressing the application challenges identified by our stakeholders.
28. We also think that feedback has not indicated other problematic fact patterns or circumstances—that are sufficiently similar to those the IASB aims to address in this narrow-scope project—that identifies an immediate need for the IASB to consider other contracts or transactions as part of this project.

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***Staff recommendations***

29. We recommend that the IASB proceeds including in the scope of the proposed amendments electricity contracts with specified characteristics (NDE contracts).

**Characteristic one—the nature-dependency of the source of electricity production*****Proposals***

30. The IASB proposed that for an electricity contract to be in the scope of the proposed amendments, the referenced production facility needs to produce electricity from a source that is nature-dependent so that supply cannot be guaranteed at specified times or for specified volumes. Examples of such sources of production include wind, sun and water.

***Feedback and analysis***

31. Most respondents agreed that an important element of the scoping criteria is the nature-dependency of the source of electricity production. In their view, many of the accounting challenges arise because of the nature-dependency of the source of electricity production because nobody controls whether any electricity is produced or can completely align electricity supply with the entity's demand for electricity.
32. Despite their agreement with the proposed characteristic, many respondents asked for clarification and further explanation as to the meaning of 'renewable electricity' and 'nature-dependent' for the purpose of the proposed amendments. In their view, any renewable electricity is, by definition, dependent on nature-dependent sources (that is, the electricity comes from sources that are naturally replenished and won't run out).
33. Respondents also said that such clarifications would help to make the proposed amendments more principles-based. It would also ensure more consistent application

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of the proposed amendments when entities are assessing whether a particular contract is in the scope of the proposed amendments. This is because paragraph BC9 of the Basis for Conclusions on the Exposure Draft stated that some hydroelectricity contracts are excluded from the scope while water is listed as an example of a nature-dependent resource.

34. In our view, this characteristic intended to require that nature (or natural forces including weather conditions), rather than man, controls the source from which electricity is produced by the referenced facility. In other words, the electricity producer does not control the source for electricity production and therefore cannot control whether any electricity can be produced at a particular time.
35. Some of these respondents asked whether the requirement ‘supply cannot be guaranteed at specified times or for specified volumes’ refers to the nature of the source for electricity production, the inability of the producer to control the timing and quantity of electricity generated, or both.
36. In our view, this phrase intended to say that because nature (or natural forces) controls the source from which electricity is produced by the referenced facility, nature also determines, whether any electricity can be produced at a given time. The phrase was not meant to refer to a particular entity or party to the contract. We considered that man (as opposed to nature) can influence any man-made production process. The effect of that man-made production process on the output of the production facility is therefore not the unique characteristic the IASB aimed to capture.
37. Therefore, in considering the feedback and how the explanations provided above would assist in providing more clarity on the scoping of the proposed amendments, in answering the questions frequently asked by respondents, we note that:
  - (a) ‘nature-dependent’ does not mean ‘renewable’—that is, this characteristic is not intended to refer to all sources of electricity production that are naturally replenished;

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- (b) waterflow as a source for hydro-electricity production would satisfy this characteristic because rainfall patterns or the ocean tides determine the amount of waterflow and whether any electricity can be produced by a hydro-electricity production facility;
  - (c) a water dam as a source for hydro-electricity production would *not* satisfy this characteristic because man determines the amount of water that can be used for electricity production by the referenced facility; and
  - (d) biomass as a source for electricity production would *not* satisfy this characteristic because man determines the amount of biomass that can be used for electricity production by the referenced facility.
38. Some other respondents asked if ‘supply cannot be guaranteed at specified times or for specified volumes’ means that contracts that guarantees a minimum quantity of electricity to be supplied are excluded from the scope even if the source of electricity production is nature-dependent.
39. We think that with ‘nature-dependency’ the IASB did not include an assessment of the contractual features, like minimum guarantees—‘nature-dependency’ focuses on the nature of the source of the electricity production. Feedback about minimum guarantees is most relevant to the own-use amendments. We discuss this element of the feedback in more detail in Agenda Paper 3B for this meeting because it deals with whether an entity is exposed to ‘substantially all’ of the volume risk.

### ***Staff recommendations***

40. We recommend that the IASB clarifies that nature (or natural forces) controls the source from which electricity is produced and whether any electricity can be produced by the referenced facility at a given time.

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## Characteristic two—contractual features

### *Proposals*

41. The IASB proposed that for an electricity contract to be in the scope of the proposed amendments, that contract needs to expose the purchaser to substantially all the volume risk under the contract through ‘pay-as-produced’ contractual features. Volume risk is described as the risk that the volume of electricity produced does not align with the purchaser’s demand for electricity at the time of production.
42. Paragraph BC7 of the Basis for Conclusions on the Exposure Draft explained that ‘pay-as-produced’ features oblige the purchaser to buy electricity produced by a referenced production facility when that electricity is produced. These features expose the purchaser to substantially all of the risk that the volume of electricity produced does not align with the purchaser’s demand for electricity at the time of production.

### *Feedback and analysis*

43. Most respondents agreed with the concept of volume risk as described in paragraph 6.10.1 of the Exposure Draft. In their view, most of the accounting challenges, especially with regards to the own-use amendments, arise because the purchaser, instead of the seller, is exposed to volume risk.
44. However, respondents noted that the contractual features of NDE contracts are not uniform or standardised and that new features are being included as the market continues to develop. They noted that although ‘pay-as-produced’ features were the main features, in some markets, they have ‘pay-as-nominated’ or ‘pay-as-forecast’ features. Although these features might change the time at which the electricity purchase occurs, they expose the purchaser to the same volume risk as ‘pay-as-produced’ features.
45. Respondents therefore asked that volume risk be clarified to make it more principles-based by avoiding referring to the particular ‘labels’ attached to contractual features

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and better explaining the underlying principle. A few respondents suggested the proposed requirements could include the description in paragraph BC20 of the Basis for Conclusions on the Exposure Draft that NDE contracts are designed and structured to give an entity access to a proportion of the total volume of electricity produced by a referenced production facility.

46. Many respondents also asked about the volume of electricity that is relevant to the assessment of volume risk. Although respondents acknowledged that they understood the IASB's intention was to refer to the volume agreed in the contract and not the total, or necessarily a proportion, of volume produced by the referenced production facility, they nonetheless consider this an important clarification to be made.
47. Another question related to whether volume risk as described in the Exposure Draft only consider the risk of intermittent supply (because the source of electricity production is nature-dependent) or also the risk of intermittent demand, for example when an entity's demand for electricity is seasonal or highly variable (for example day/night). Some respondents also asked for clarification about the relevance of other features such as caps and floors on the volume of electricity to be purchased in assessing whether the purchaser is exposed to substantially all the volume risk.
48. We note that many of the comments we received about 'substantially all of the volume risk' were made in context of the own-use amendments for a purchaser. We also acknowledge that the proposed description of volume risk in the Exposure Draft appear to exclude NDE contracts for difference because it refers to 'the purchaser's demand for electricity.' Based on the feedback and questions about volume risk, we think that considering the purchaser's demand (or expected usage requirements) is most relevant for the own-use amendments. Therefore, we recommend that the concept of volume risk is incorporated and clarified as part of the own-use amendments. We therefore analyse feedback about how to clarify this concept in Agenda Paper 3B for this meeting.

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49. Notwithstanding that recommendation, we still agree with the statement in paragraph BC7 of the Basis for Conclusions on the Exposure Draft that the application challenges that led to the development of the proposed amendments, arise because of the combination of the nature-dependency of the source for electricity production and the contractual features of the NDE contract. We therefore believe that the contractual feature characteristic should be reworded so that it captures all NDE contracts while avoiding the use of labels like pay-as-produced.
50. We also agree with respondents that it would be helpful to clarify that the cash flows under the contract vary based on *the contracted volume of* the output of the referenced production facility—for example 20% of the output or up to 100 units of the output.
51. In our view, to determine the scope of contracts to which the proposed amendments could be applied, the relevant contractual feature is the obligation of an entity to pay or receive (gross or net) an amount for the contracted volume of the electricity (produced by the referenced production facility), as and when that electricity is delivered. However, to ensure that this principle can be applied to both types of NDE contracts, we think it would be helpful to instead refer to the cash flows under the contract that vary based on the output of a referenced production facility.

### ***Staff recommendations***

52. We recommend that the IASB clarifies that for an electricity contract to be included in the scope of the proposed amendments, the cash flows under that contract vary based on the contracted volume of electricity produced by the referenced production facility.
53. We also recommend that the IASB incorporates and clarifies the concept of volume risk as part of the own-use amendments.