Power Purchase Agreements (IFRS 9)

Update on IFRS Interpretations Committee members' public meeting on 28-29 November 2023

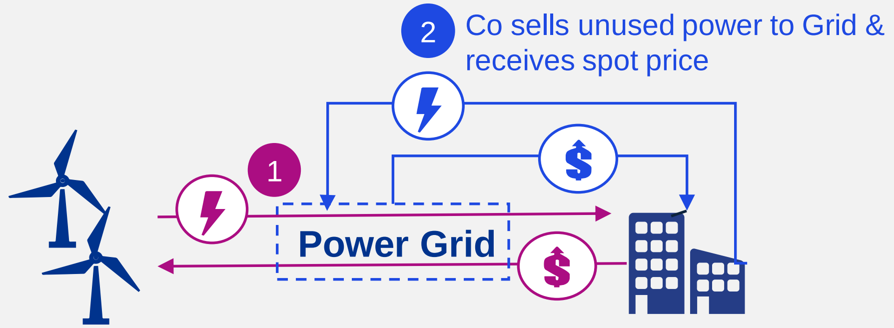
KPMG Ireland

Power purchase agreements (IFRS 9)

In July 2023, the International Accounting Standards Board (IASB) added a project to research whether narrow-scope amendments to IFRS 9 *Financial Instruments* could be made to better reflect how financial statements are affected by Power Purchase Agreements (PPAs) (both physical and virtual).

In its public meeting with the Interpretations Committee (Committee) members' on 29 November 2023, the project team sought inputs into the possible approaches to narrow-scope amendments to IFRS 9. Three potential approaches were proposed by the project team for future IASB consideration:

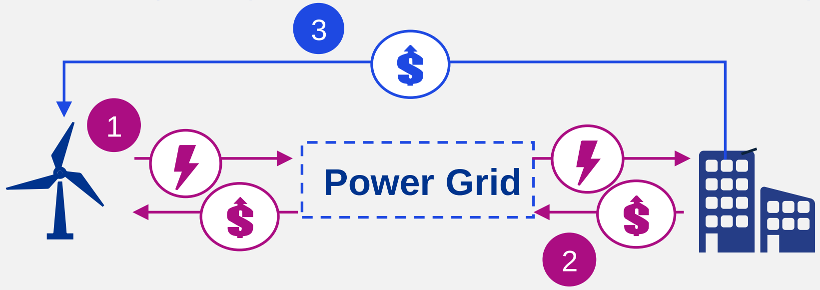
1 Physical PPA



1 Producer 'delivers' power to Co and receives fixed price in contract from Co for predetermined fixed volume

3 Virtual PPA

Net settlement of the difference between the spot & fixed price of power (contract for differences – IFRS 9 derivative)



1 Producer delivers power to Grid & Producer receives spot price

2 Co buys power from Grid & Co pays spot price

Source: [IFRS - IFRS Interpretations Committee]

Power Purchase Agreements (IFRS 9)

01

Amend the guidance on how to assess own-use requirements in IFRS 9

- Include guidance on how to assess own-use requirements in IFRS 9 for non-financial items with special characteristics.
- ***Pros:*** Addresses the accounting concerns for physical PPAs; would maintain the principle nature of own-use requirements; could be done in efficient and effective manner; requires continuous assessment of intention & purpose of PPA.
- ***Cons:*** Physical PPAs will be 'off-balance sheet'; only applies to physical PPAs; does not address concerns with virtual PPAs; and with no disclosures required for executory contracts, investors may not be informed of the risks to the entity.

02

Amend hedge accounting requirements in IFRS 9

- Include guidance on how to assess 'highly probable' for a forecast transaction to enable a virtual PPA to be designated as a hedging instrument.
- ***Pros:*** This would address the accounting concerns for virtual PPAs. PPAs will be 'on-balance sheet' and subject to IFRS 7 Disclosure requirements about risk exposure and risk management; and applying hedge accounting would reflect the economic reality of entity's strategy.
- ***Cons:*** Could disrupt the application of hedge accounting requirements in other hedging relationships, forecast transactions are a long time in the future and could add complexity to hedge accounting

03

Exceptions for PPAs

- An exception for PPAs could be created to exclude them from the definition of derivatives and/or the scope of IFRS 9 entirely.
- ***Pros:*** Project can progress quickly; scope of application can be restricted because the exception would be rules-based and cannot be applied by analogy
- ***Cons:*** Will not reflect the economic substance or purpose of contracts with no transparency when purpose of contracts changes over time, does not provide users with information to understand the effect contracts could have on the financial position, performance or future cash flows.

Various views expressed during the meeting

- The existing guidance was adequate and standard setting was not required. Additional disclosures may be considered.
- A combination of options 1 & 2 along with additional disclosure for own-use could be considered. Scoping out may not be appropriate.
- Trading contracts should not get own-use exemption.
- Ringfence, but not exclude all, contracts from the exceptions in option 3.
- Exclusion from IFRS 9 (with a sunset clause) will allow a temporary resolution that could be implemented quickly, while the standard setters could focus on a principle based accounting solution.
- Evaluate the unit of account, where the contract could be split into smaller units

Members agreed that an early solution was required and that it was challenging to arrive at a quick solution without the risk of unintended consequences for other contracts / transactions or moving away from a principle based approach to standard setting.

Source: IFRS - IFRS Interpretations Committee

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