KPMG

Contracts for renewable electricity

9 May 2024

Global IFRS Institute | Financial instruments

Mahesh Narayanasami
Partner
KPMG US, DPP New York

"The proposals are a welcome and timely response to common accounting challenges faced by companies entering into renewable electricity contracts. The additional disclosures would provide transparency to users on the effect of PPAs on a company's financial performance and future cash flows."

Mahesh Narayanasami
KPMG global IFRS financial instruments leader

IASB proposals aim to address common accounting challenges and increase disclosures

Highlights

- **What are the proposals for the own use exemption?**
- **What are the proposals for hedge accounting?**
- **What are the proposed new disclosure requirements?**
- **What's next? – Have your say by 7 August 2024**

Companies face challenges in applying IFRS 9 *Financial Instruments* to renewable electricity contracts – sometimes referred to as power purchase agreements (PPAs). The International Accounting Standards Board (IASB) is seeking to address these challenges with proposed **amendments**[1] to:

- the application of the own use exemption for purchasers of PPAs; and
- hedge accounting requirements for purchasers and sellers of PPAs.

The IASB is also proposing to add new disclosure requirements for certain PPAs to IFRS 7 *Financial Instruments: Disclosures* and IFRS 19 *Subsidiaries without Public Accountability: Disclosures.*

What are the proposals for the own use exemption?

It is not always clear under IFRS 9 whether a company that purchases PPAs can apply the own use exemption for accounting purposes. If the own use exemption does not apply, PPAs are accounted for as derivatives measured at fair value through profit or loss (FVTPL). PPAs are often long-term agreements, so measuring them at FVTPL can potentially create significant volatility in the income statement over many reporting periods.

To apply the own use exemption to a PPA, IFRS 9 currently requires companies to assess whether the contract is for receipt of electricity in line with the company's expected purchase or usage requirements – e.g. the purchaser expects to use the quantity it buys, and then actually uses it.

The challenge arises due to the unique characteristics of electricity (including the difficulty to store it) and its market structure – i.e. if a purchasing company is not

1. The proposed amendments would be applicable only to contracts in which "the source for production is nature-dependent (e.g. wind, solar and hydroelectricity) and the purchaser is exposed to substantially all of the volume risk under the contract through pay-as-produced features."

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able to use the electricity within a short period, the electricity has to be sold back to the market. Although these sales occur because of the market structure, and not to profit from short-term price fluctuations, it is unclear if the company can apply the own use exemption under existing requirements.

The proposed amendments would allow a company to apply the own use exemption to certain PPAs depending on:

- their purpose, design, and structure;
- the reasons for past and expected sales of unused electricity; and
- whether such sales are consistent with the company's expected purchases or usage requirements.

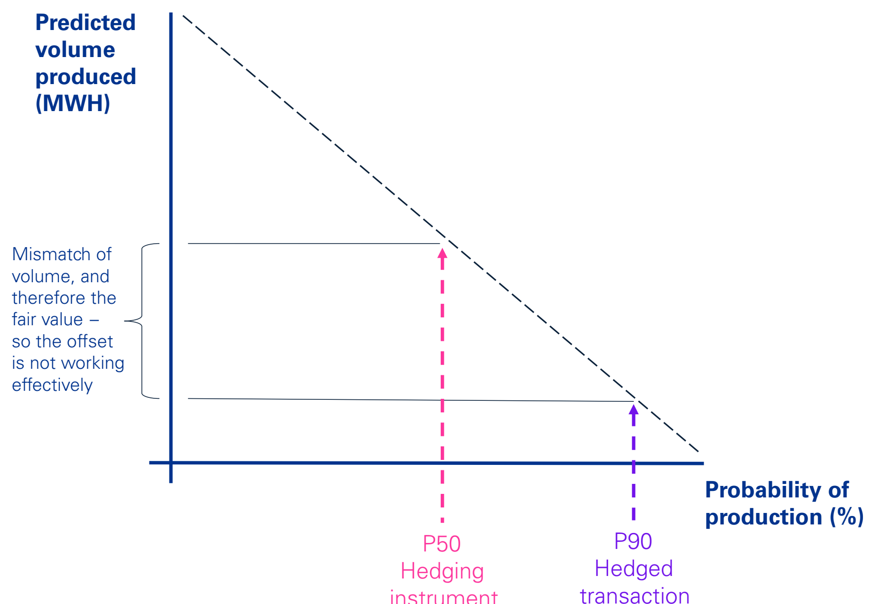
The proposals would require companies to apply the proposed amendments retrospectively (without requiring prior periods to be restated).

What are the proposals for hedge accounting?

Virtual PPAs[2] and PPAs that do not meet the own use exemption are accounted for as derivatives and measured at FVTPL. Applying hedge accounting could help companies to reduce profit or loss volatility by reflecting how these PPAs hedge the price of future electricity purchases or sales.

Under IFRS 9, to apply hedge accounting there needs to be an economic offset between changes in the value of hedging instruments and hedged transactions.

Buyers and sellers of PPAs face challenges when applying cash flow hedge accounting under IFRS 9. This is because the fair value of the hedging instrument (PPA) is based on a P50 estimate[3], while the hedged transaction is required to be based on a P90 estimate[4] due to the requirement for a hedged transaction to be highly probable. This creates a mismatch which could lead to the hedging relationship not qualifying for hedge accounting.



2. A virtual PPA is a contract for difference where the purchaser and the seller net settle periodically in cash for each unit of power generated (on the basis of the difference between the fixed price agreed at contract inception and the current spot market price on each periodic settlement date). If the fixed price exceeds the spot price, then the purchaser pays the difference to the seller and vice versa. Under vPPAs, there are no physical transfers of power and hence the own use exemption will not apply.
3. A P50 estimate indicates the volume of energy production expected to be exceeded with 50 percent probability.
4. A P90 estimate indicates the volume of energy production expected to be exceeded with 90 percent probability. By definition, the P90 volume estimate will be lower than the P50 estimate.

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Subject to certain conditions, the proposals would permit companies to designate a variable nominal volume of forecasted sales or purchases of renewable electricity as the hedged transaction, rather than a fixed volume based on P90 estimates. This would facilitate an economic offset between the hedging instrument and the hedged transaction, enabling companies to apply hedge accounting.

The proposals would apply prospectively but offer the option to re-designate – without discontinuation – existing cash flow hedging relationships during the first annual reporting period in which the proposals are applied.

What are the proposed new disclosure requirements?

The proposed disclosure requirements seek to improve the information that companies provide on PPAs. They would include the terms and conditions of the contract, for example on:

- duration;
- pricing;
- maximum or minimum quantities; and
- whether they include renewable energy certificates.

The disclosures would also include other information such as the net volume purchases, the average market price of electricity, the fair value of the contracts or the expected volume of electricity to be sold or purchased over the remaining duration.

What's next? – Have your say by 7 August 2024

Read the proposals and take the opportunity to provide your comments to the IASB by 7 August 2024.

Speak to your usual KPMG contact to find out more about the proposals and visit **kpmg.com/ifrs** to keep up to date with the latest news and discussion.

Publication name: *Contracts for renewable electricity*

Publication date: May 2024

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