KPMG

IFRS Today

Our series on the most topical issues in IFRS® Standards and financial reporting

29 June 2021

"In its June meeting, the Committee considered whether a particular contract with a wind farm operator contained a lease."

VIDEO TRANSCRIPT

IFRIC agenda decisions – Economic benefits from use of a wind farm

Brian O'Donovan
KPMG partner and IFRS Interpretations Committee member

Hello – I'm Brian O'Donovan – I'm a partner at KPMG and I'm a member of the IFRS Interpretations Committee – the IFRIC.

In its June meeting, the Committee considered whether a particular contract with a wind farm operator contained a lease. I thought this question was very interesting in itself and as an example of the kind of issues you increasingly face as business practices evolve in response to climate change.

Economic benefits from use of a wind farm

In the fact pattern considered by the Committee, the customer and a wind farm operator enter into a contract relating to all of the electricity to be generated at the wind farm.

But there's a twist. Under local regulations, the wind farm operator cannot supply electricity directly to a customer. Instead, the wind farm supplies the grid: the customer, like all other customers, like all of the people who want electricity, obtain that electricity from the grid. Quite a common arrangement around the world.

What the agreement with the wind farm operator actually says is that the customer will net settle in cash the difference between the spot price for electricity and a fixed unit price as the wind farm operator supplies the grid. In addition, the customer will receive all of the renewable energy credits arising from use of the wind farm.

So at this point your IFRS 16 alarm bells are probably ringing. But is this really a lease?

Well to meet the lease definition the customer must have the right to obtain substantially all of the economic benefits arising from use of the asset. The Committee said that in this fact pattern there are two types of economic benefits to consider: firstly the actual electricity generated by the wind farm; and the renewable energy credits. Well it's clear that the customer does obtain the renewable energy credits, but it does not – it cannot – receive the electricity directly.

And for that reason, the Committee concluded that in this fact pattern the customer does not have the right to obtain substantially all of the economic benefits from use of the wind farm and therefore there can be no lease of the wind farm contained within this agreement.

There's a good chance the agreement actually contains a derivative financial instrument.

Now I've certainly dealt with companies that have entered into contracts of this nature specifically because they want to tell their stakeholders that they obtain all of their power from renewable sources. The conclusion that their contract could contain a derivative financial instrument could be quite a shock.

Next steps

The Committee agreed to issue a tentative agenda decision – it's in the June IFRIC Update, open for comment until mid-August. Take a look – see what you think.

And if – like me – you're passionate about understanding the potential impact of climate change on financial statements, then take a look at KPMG's brand new Climate Change Resource Centre. We've just launched it. It includes resources on this issue and many other financial statement issues as well.

home.kpmg/ifrs

Publication name: *IFRIC agenda decisions – Economic benefits from use of a wind farm*

Publication date: June 2021