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ED/2024/3 Contracts for Renewable Electricity

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (IASB or the Board) Exposure Draft ED/2024/3 'Contracts for Renewable Electricity'. We have considered the exposure draft (ED), as well as the accompanying draft Basis for Conclusions and Alternative Views on the ED.

Our detailed responses to the ED's Invitation to Comment are set out in the Appendix.

Overall we welcome the IASB's efforts and objectives set out in this ED. We believe they will address many stakeholder concerns. However, in our responses to the Invitation to Comment questions we suggest some changes to the ED to make it easier to understand, which in turn should result in more consistent application.

In our response to question 1, we consider the challenges relating to own use on physical contracts and conclude that they are not entirely the same as the hedge accounting challenges. For this reason we consider the scope of the changes being proposed, not to be exactly the same for the two areas. We further note that the challenges relating to hedge accounting (regarding the hedging instrument referencing to variable volumes) are not unique to contractual renewable energy arrangements.

We make some comments in question 2 regarding various aspects of the own use assessment and in responding to question 3 we comment on the hedge accounting criteria. Some uncertainty relating to the application of hedge accounting, including the definition of the hedged item, and how this follows through into areas such as reclassification, still exist. Given this, we would welcome more illustrative guidance.

As explained in our response to question 4, we do not agree with the disclosure requirements relating to cash settled derivatives or contracts in scope of IFRS 9 'Financial Instruments', as we consider the existing requirements in IFRS 13 'Fair Value Measurement' and IFRS 7 'Financial Instruments: Disclosures' to be sufficient. However, in the context of physical contracts meeting the own use, we agree some additional disclosures would provide useful information.

Finally, we have raised some challenges in question 6 relating to transition requirements, and our view on question 7 is that the effective date could be delayed, but still have an option to adopt it early.

If you have any questions on our response, or wish us to amplify our comments, please contact me by email (mark.hucklesby@gti.gt.com).

Yours sincerely,

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Appendix: Responses to the Invitation to Comment questions

Question 1 – Scope of the proposed amendments
Paragraphs 6.10.1–6.10.2 of the proposed amendments to IFRS 9 would limit the application of the proposed amendments to only contracts for renewable electricity with specified characteristics. Do you agree that the proposed scope would appropriately address stakeholders' concerns (as described in paragraph BC2 of the Basis for Conclusions on this Exposure Draft) while limiting unintended consequences for the accounting for other contracts? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 1 – Response

We agree with the overall objectives that the IASB is pursuing. However, from an accounting perspective, the challenges are different for renewable energy physical power purchase agreements (PPAs) in respect of the own use test compared to the hedge accounting challenges faced in respect of virtual power purchase agreements (VPPAs). Given this, our view is the scope of the amendments relating to the own use test should not be entirely the same as those relating to hedge accounting amendments.

Regarding the own use test, the challenges focus on the mismatch in timing between when the purchaser uses electricity compared to when the generator generates it, with this mismatch being more acute due to the nature dependent supply in renewable energy. While we consider in most cases the criteria in paragraph 6.10.1 are appropriate for PPAs, the reference to "volume risk" in paragraph 6.10.1(b) is not clear in the context of some contracts (sometimes referred to as baseload contracts) where the total volume over a period might be fixed (or capped), but where the timing is subject to the same aspects. From the purchaser's perspective, we consider the own use challenges (and the benefits of amendments to the criteria) should also be applied to baseload contracts in the same way. We consider the own use challenges should relate to variation in timing but not total volume.

For VPPAs, we agree that as cash settled derivatives, they should be accounted for in the statement of financial position at fair value. This is consistent with established accounting in IFRS for cash settled derivatives where the underlying is a non-financial commodity. The challenges for VPPAs relate to hedge accounting due to the notional volume being typically variable. We consider the scope relating to the hedge accounting challenges should focus on how variable volume amounts are dealt with. For VPPAs, these are economically effective from the purchaser's perspective providing the purchaser is highly probable to buy at least as much physical electricity. There is not a perfect hedge due to the timing mismatches. The primary issue for VPPAs is the same as for "load following swaps" which are the subject of a March 2019 IFRIC decision. We observe that the load following swap was one where the volume was contractually tied to physical volumes in such a way as to create an apparent perfect hedge from the seller's perspective. In VPPAs, they are not perfect hedges from the purchaser's perspective as there will always be economic ineffectiveness due to timing mismatch. However, in order for a designation to be made in a manner consistent with risk management objectives, as commented on further in our response to question 3 we generally agree with the objectives set out by the IASB. Given this we consider the scope of the hedge accounting proposals for VPPAs should not focus on the renewable energy aspects but rather the hedging instrument having reference to a variable volume.

Question 2 – Proposed 'own-use' requirements
Paragraph 6.10.3 of the proposed amendments to IFRS 9 includes the factors an entity would be required to consider when applying paragraph 2.4 of IFRS 9 to contracts to buy and take delivery of renewable electricity that have specified characteristics. Do you agree with these proposals? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 2 – Response

While we are in general agreement with the proposed amendments, we still have some reservations about what is being proposed and some suggestions for the IASB to consider further.

Paragraph 6.10.3(a) indicates that "...the entity is not required to make a detailed estimate for periods that are far in the future – for such periods an entity may extrapolate projections from reasonable and supportable information available at the reporting date." Paragraph 6.10.2 specifies that what is set out in paragraphs 6.10.3 – 6.10.6 should not be applied to other contracts, items, or transactions by analogy. This wording might imply that when applying the own use exception to those other contracts not covered by this amendment, an entity would need to conduct a detailed analysis for the entire duration of the contract instead of extrapolating based on available information. We observe that in general application of the own use test, IFRS 9.2.6 references "expected" purchase requirements, without expanding on the level of evidence or comfort needed. In most traditional commodity purchases, we anticipate the decisions to contract would be done in conjunction with business plans over a short- or medium-term horizon. The renewable energy contracts have the potential to be for longer periods where business plans may be less developed. While the criteria in paragraph 6.10.3(a) might be helpful in providing more specific guidance in the context renewable electricity contracts, in order to avoid unintended consequences for other contracts, we recommend the Basis for Conclusions acknowledges that IFRS 9 does not have existing requirements on the level of comfort needed in assessing expectations (for other contracts) for the purpose of paragraph 2.6.

Paragraph 6.10.3(b)(ii) outlines one of the conditions to be met for sales to still fall within the entity's expected purchase or usage requirements, being "the design and operation of the market in which the electricity is sold results in the entity not having the practical ability to determine the timing or price of the sale". The wording of this paragraph has exclusively focused on the market in which the entity sells the electricity and has not considered entity-specific criteria. Some entities could (particularly as technology develops) possess battery storage facilities and can time the sale transaction to maximize profits. By concentrating solely on the market structure, the guidance does not address the impact of storage facilities on the assessment. We recommend some additional wording is included to clarify that when an entity has sufficient and practically accessible storage capacity, any sales of storable electricity would be considered as establishing a past practice of net settlement. For instance, if an entity was storing electricity and then selling it onto the market at particular times with the objective of maximising profits, then that would not be consistent with normal own use.

Paragraph 6.10.3(b)(iii) outlines one of the conditions to be met for sales to still fall within the entity's expected purchase or usage requirements, being the entity expecting to purchase at least an equivalent volume of electricity within a reasonable time and then the ED provides a month as an example. While we acknowledge that one month is presented as an example, we are concerned this illustration could lead to unintended consequences. For example, where an entity buys all the electricity generated by a solar farm to meet some of its electricity demand, but it is also obligated to sell the electricity produced over the weekend when the factory is closed, and it subsequently repurchases the electricity that it sold during the week, this situation may be viewed as reasonable. However, if the entity also annually closes for a month due to summer holidays or for some other

foreseeable reason, and subsequently repurchases all electricity sold during that period over a period longer than a month, it becomes unclear whether this would be considered an unreasonable time. The current guidance does not provide clarity on how a reasonable time in this scenario would be determined. We recommend some additional guidance be provided on the principles that an entity would consider when determining a reasonable time in such cases. Besides, the currently proposed one month repurchase horizon could be seen in some jurisdictions as too restrictive for an entity with seasonality effects in their electricity consumption patterns.

Finally, we observe that the proposals deal with a scenario where there is a supplier of electricity and a purchaser. However we are aware that in some jurisdictions, third party aggregators are used in order to balance supply. We ask the IASB to consider how those ancillary services might impact whether the electricity supply qualifies for own use.

Question 3 – Proposed hedge accounting requirements
Paragraphs 6.10.4–6.10.6 of the proposed amendments to IFRS 9 would permit an entity to designate a variable nominal volume of forecast electricity transactions as the hedged item if specified criteria are met and permit the hedged item to be measured using the same volume assumptions as those used for measuring the hedging instrument. Do you agree with these proposals? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 3 – Response

We welcome the proposals which would permit an entity to designate a variable volume of forecast electricity transactions as the hedged item. As mentioned in our response to question 1, we consider the underlying issues in this case are not specific to renewable energy; they also apply when the hedging instrument's contractual terms refer to a variable notional. Where this is the case the criteria in paragraph 6.10.4 is helpful in allowing an entity to designate a hedging relationship which is consistent with its risk management objectives and policies.

With respect to paragraph 6.10.6 (in the context of renewable electricity purchasers' hedges), we are unclear whether the systematic short term timing mismatches would be considered to be volume assumptions or other assumptions. Economically such variations would result in ineffectiveness, although if the intention is to view these as volume assumptions (and therefore not recognising the ineffectiveness) this would provide aid from a cost/ benefit perspective for the preparers. Specifically we note the valuation of renewable energy VPPAs may involve significant unobservable inputs, and valuing an alternative hypothetical derivative with a slightly different timing profile could result in added cost, where the associated benefits may prove unjustified. Some entities, without the requisite skills to model capacity or because of the associated costs, may simply give up hedge accounting if all timing mismatches result in ineffectiveness. In situations like this the proposed amendments, in our view, would be of little benefit for many entities on the hedging side. The resulting volatility in profit or loss (from the revaluation of entire electricity derivative through profit or loss) could be seen by some as not providing any useful information for the users of financial statements where an economic hedge is established.

We observe that with hedge accounting, further challenges could arise in the accounting entries, for example relating to reclassification depending on how the hedged item is defined (for instance whether they are with reference to time buckets and if so the periods thereof). This could depend on how the hedged item is defined. Given this added dimension of complexity we would like to see an illustrative example dealing with this matter.

Question 4 – Proposed disclosure requirements
Paragraphs 42T–42W of the proposed amendments to IFRS 7 would require an entity to disclose information that would enable users of financial statements to understand the effects of contracts for renewable electricity that have specified characteristics on: (a) the entity's financial performance; and (b) the amount, timing and uncertainty of the entity's future cash flows. Do you agree with these proposals? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 4 – Response

Conceptually, we consider that for contracts which are recognised and measured in accordance with IFRS 9, the existing requirements in IFRS 7 and IFRS 13 should apply. They should be the same as for other cash settled commodity derivatives or "own use failing" commodity contracts so we disagree that amendments should be made specifically relating to renewable energy contracts within the scope of IFRS 9.

However, we agree that for physical power purchase agreements which are own use, and are therefore not within the scope of recognition under IFRS 9, additional disclosures should apply. We observe there are no existing disclosures specific to other types of own use commodity contracts, but the long-term nature of own use (and so unrecognised) renewable energy contracts has the potential to give rise to significant exposures, particularly given their long-term nature. We also agree that the proposed disclosures may be useful to a user. That said, we have concerns that some of the requirements in IFRS 7.42V may provide commercially sensitive information in a manner which may go beyond a user's normal needs. Further those disclosures could be more cumbersome and less useful in entities which operate on a global basis, purchasing electricity from various markets. However, we agree that it would be useful information for an entity to disclose the financial impact of the sale of unused volumes.

Further to this, we also question whether IFRS 7 is the appropriate standard to include these disclosure requirements as these contracts are not financial instruments and therefore not in the scope of IFRS 9. We are concerned that a financial instrument disclosure standard is being used to include disclosure requirements for such a transaction that does not involve a financial instrument. Following on from this, when the IASB considers what standard is best suited to set out the disclosure requirements, it would be helpful to also consider whether similar disclosures should be required for other similar long-term own-use contracts, to avoid inconsistent reporting of similar transactions.

Question 5 – Proposed disclosure requirement for subsidiaries without public accountability
Paragraphs 67A–67C of the proposed amendments to the forthcoming IFRS 19 Subsidiaries without Public Accountability: Disclosures would require an eligible subsidiary to disclose information about its contracts for renewable electricity with specified characteristics. Do you agree with these proposals? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 5 – Response

Our response to question 5 is the same as we have provided to question 4.

Question 6 – Transition requirements
The IASB proposes to require an entity to apply: (a) the amendments to the own-use requirements in IFRS 9 using a modified retrospective approach; and (b) the amendments to the hedge accounting requirements prospectively. Early application of the proposed amendments would be permitted from the date the amendments were issued. Do you agree with these proposals? Why or why not? If you disagree, please specify with which aspect of the proposals you disagree. What would you suggest instead and why?

Question 6 – Response

As regards the amendments to the own use requirements, we agree with the modified retrospective approach. However, we are unclear on the dates at which the revised own use requirements should be assessed. Consider if a contract was entered into in 2022, but applies the amendments for the first time in the year to 31 December 2026, with 1 January 2026 being the date of initial application, and the entity chooses not to restate comparatives. Given that the criteria in paragraph 6.10.3 are assessed at inception and at each subsequent reporting date, in such a case, would an entity:

(a) be required to assess the criteria in paragraph 6.10.3 from 2022 onwards and only conclude own use if it met the criteria throughout that period, or

(b) only assess the criteria at date of initial application?

We believe the requirements and interaction with the continuous nature of paragraph 6.10.3 could be made clearer.

Further, we observe that IFRS 9 7.2.51 sets out requirements relating to the opening retained earnings at the beginning of the reporting period which apply if an entity applies paragraph 6.10.3 in a reporting period that “includes the date the amendments are issued”. The requirement specifically refers to the reversal of the “carrying amount at the date when the amendments are issued”. This would mean that if the requirements are applied in the period when the amendments are issued, then the statement of profit or loss would include gains or losses up to the date when the amendments are issued but not thereafter. We observe that understanding this requirement and applying it appropriately may prove challenging so we would like to see the IASB drawing attention to this.

In respect of hedge accounting, paragraph 7.2.52 states the requirements will be prospective, but that an entity is permitted to change an existing designation. We have some concerns with these proposals. We observe that prior to the amendments, due to the variable volume aspects, hedge accounting can be difficult to achieve and any compliant designation might be in a form significantly different to risk management objectives. However, if an entity had made such a designation then the proposals appear to provide a relief to change that designation in a more effective way. Consider if an entity made a previous designation which involved significant ineffectiveness. If an entity were then free to “change” the designation to incorporate the amendments, this could have the effect of bringing into the cash flow hedge reserve previous amounts brought to the statement of profit or loss.

In contrast many other entities would have concluded hedge accounting would not have been feasible under the current requirements, despite being viewed as a strong economic hedge. Those entities could now designate a new relationship, but this would be “non zero starting” involving more complexity.

Under the proposals those who previously sought a form of hedge accounting (albeit with significant ineffectiveness) could be given the advantage with a liberal relief while other entities would not, leading to diversity in application. For this reason, our suggestion would be to either

(a) not provide any transitional relief in order to promote consistency, or

(b) provide relief as described for existing designations, but also provide similar relief for entities with existing contracts which were not previously designated in a hedge relationship.

The benefits of approach (a) are that there is no retrospective transfers to cash flow hedge reserve of gains or losses already recognised in profit or loss, but approach (a) does give rise to more complex non-zero starting relationships. Approach (b) helps negate some complexity but has the negative consequence of retrospectively taking past profits or losses and incorporating these into the cash flow hedge reserve, that some may assess is a form of double counting.

Question 7 – Effective date
Subject to feedback on the proposals in this Exposure Draft, the IASB aims to issue the amendments in the fourth quarter of 2024. The IASB has not proposed an effective date before obtaining input about the time necessary to apply the amendments. In your view, would an effective date of annual reporting periods beginning on or after 1 January 2025 be appropriate and provide enough time to prepare to apply the proposed amendments? Why or why not? If you disagree, what effective date would you suggest instead and why?

Question 7 – Response

We agree these proposals are urgently needed. However, as set out in our response to question 1, we consider the own use issues pose different challenges to the hedge accounting aspects, which means they do not necessarily need to be completed at the same time.

An effective date of 1 January 2025 may be challenging given the adoption processes in various jurisdictions. We would like to see a later mandatory effective date, but with an option to early adopt.