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iGAAP in Focus
Financial reporting

IASB finalises amendments on contracts that reference nature-dependent electricity

Contents

This *iGAAP in Focus* outlines the amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* titled *Contracts Referencing Nature-dependent Electricity,* published by the International Accounting Standards Board (IASB) on 18 December 2024.

- The amendments to IFRS 9 are aimed at enabling entities to include information in their financial statements that in the IASB's view more faithfully represents contracts referencing nature-dependent electricity
- These contracts expose the entity to variability in the underlying amount of electricity because the source of electricity generation depends on uncontrollable natural conditions
- The IASB added application guidance to IFRS 9 to address specifically whether a contract to buy electricity generated from a source dependent on natural conditions is held for the entity's own-use expectations
- The amendments also permit an entity to designate a variable nominal amount of electricity as the hedged item when an entity applies the hedge accounting requirements in IFRS 9 and designates a contract referencing nature-dependent electricity with a variable nominal amount as the hedging instrument
- The IASB decided to add complementary disclosure requirements to IFRS 7
- The amendments are effective for annual periods beginning on or after 1 January 2026, with earlier application permitted
- The amendments to the own use exemption are required to be applied retrospectively in accordance with IAS 8 using the facts and circumstances at the date of initial application
- The amendments to the hedge accounting requirements are required to be applied prospectively to new hedging relationships designated on or after the date of initial application.

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Background

Stakeholders noted that entities experience challenges when applying the requirements in IFRS 9 to physical delivery contracts to buy renewable energy. This is because of:

- the characteristics of the sources of renewable electricity production and the design and operation of the market in which the electricity is sold

- the 'pay-as-produced' features, which oblige the purchaser to buy electricity produced from a reference production facility when the electricity is produced (commonly referred to as physical power purchase agreements (PPAs)) and 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.

Stakeholders also asked the IASB to consider how an entity accounts for 'virtual PPAs', i.e. PPAs that require net settlement of the difference between the prevailing market price and the contractually agreed price for the volume of electricity produced from a referenced production facility.

The IASB discussed the matter and, in May 2024, published an exposure draft (ED) titled ***Contracts for Renewable Energy***. After considering the comments received on the ED, the IASB decided to finalise these amendments.

The amendments

Scope

The amendments apply to contracts referencing nature-dependent electricity. These contracts are characterised by contractual features exposing an entity to variability in the underlying amount of electricity because the electricity is generated from a source dependent on uncontrollable natural conditions. This variability is typically associated with renewable electricity sources, such as sun and wind. Contracts referencing nature-dependent electricity include both contracts to buy or sell nature-dependent electricity and financial instruments that reference such electricity.

Observation

The IASB also considered whether to extend the amendments to other types of electricity contracts. However, stakeholders did not raise the same concerns for other types of contracts as they did for contracts that have the characteristics as set out above. Therefore, the IASB decided against expanding the scope of the amendments.

Own use exemption

Some contracts referencing nature-dependent electricity require an entity to buy and take delivery of the electricity when it is generated. These contractual features expose the entity to the risk that it would be required to buy electricity during a delivery interval in which the entity cannot use the electricity. The entity might also have no practical ability to avoid making sales of unused electricity because the design and operation of the electricity market in which the electricity is transacted under the contract require any amounts of unused electricity to be sold within a specified time. The new application guidance states that when an entity applies the own use requirements in IFRS 9:2.4, such sales are not necessarily inconsistent with the contract being held in accordance with the entity's expected usage requirements. An entity entered into and continues to hold such a contract in accordance with its expected electricity usage requirements if the entity has been, and expects to be, a net purchaser of electricity for the contract period. An entity is a net purchaser of electricity if it buys sufficient electricity to offset the sales of any unused electricity in the same market in which it sold the electricity.

Observation

Two IASB members disagreed with this expansion of the own use exemption. In accordance with IFRS 9, an entity is required to measure at fair value derivative contracts to buy or sell non-financial items that can be settled net in cash (or another financial instrument), unless the purpose of the receipt (or delivery) of the non-financial item is in accordance with the entity's expected usage (or purchase or sale) requirements. A practice of net settling all or part of such a contract, including by selling the non-financial item in a readily available market upon its receipt, would not be consistent with the purpose of receipt for the entity's expected usage. In their view, the amendments might produce misleading information because an entity would be exempt from the requirements of IFRS 9 even if the entity knows with reasonable certainty that for some periods it will not use and will instead sell electricity delivered under the contract.

In determining whether an entity is a net purchaser of electricity, the entity is required to consider reasonable and supportable information (that is available without undue cost or effort) about its past, current and expected future electricity transactions over a reasonable amount of time. The entity identifies 'a reasonable amount of time' by considering the variability in the amount of electricity expected to be generated due to the seasonal cycle of the natural conditions and the variability in the entity's demand for electricity due to its operating cycle. In determining whether the entity has been a net purchaser, 'a reasonable amount of time' is not allowed to exceed 12 months.

Observation

The IASB included the 'reasonable amount of time' requirement to ensure that an entity that sells unused electricity purchases in good time at least an equivalent amount of electricity. The IASB intends for a 'reasonable amount of time' to be a short period. In the ED, the IASB gave the example of one month as reasonable time. However, the IASB noted that factors like the seasonal cycle of the natural source of the electricity generation and the cyclicality of an entity's operations might affect the time it takes for an entity to offset sales with purchases. The IASB therefore decided to set a maximum of 12 months, which it sees as a full cycle.

Hedge accounting requirements

Some contracts referencing nature-dependent electricity may be designated as hedging instruments in hedges of forecast electricity transactions. The amendments permit that for such a hedging relationship an entity can designate as the hedged item a variable nominal amount of forecast electricity transactions that is aligned with the variable amount of nature-dependent electricity expected to be delivered by the generation facility as referenced in the hedging instrument. The other hedge accounting requirements in IFRS 9 continue to apply to such a hedging relationship.

If the cash flows of the contract referencing nature-dependent electricity designated as the hedging instrument are conditional on the occurrence of a forecast transaction that is designated as the hedged item in accordance with the amendments, this forecast transaction is presumed to be highly probable.

The amendments also add an example that illustrates one possible way for an entity to designate forecast electricity purchases as the hedged item with a variable nominal amount in a cash flow hedge in accordance with the newly added requirements in IFRS 9.

Observation

The IASB acknowledged that in a hedge of variable electricity sales, hedge ineffectiveness caused by volume uncertainty should not arise because the volume of sales and the volume of electricity covered by the contract referencing nature-dependent electricity are typically fully aligned, which economically does not result in hedging ineffectiveness through volume mismatches. However, the IASB noted that hedge ineffectiveness for forecast electricity transactions could originate from other sources, particularly in the case of purchases of electricity. Therefore, to determine hedge ineffectiveness under the amendments, an entity would include in the measurement of the hedged item and the hedging instrument pricing differences or any other differences that represent actual economic effects.

Observation

One IASB member disagreed with this expansion of the amendments to the hedge accounting requirements. In this IASB member's view, there is no principle-based reason why an entity should be allowed to designate a variable amount of a contract referencing nature-dependent electricity, but be prevented from doing so for other contracts with similar economic characteristics. Accordingly, he believes that, if changes to hedge accounting are required, these should be considered as part of comprehensive amendments to IFRS 9.

Disclosures

Under the amendments, an entity is required to disclose in a single note in its financial statements information about contracts to buy nature-related electricity that meet the own use requirements in IFRS 9. In particular, the entity is required to disclose information that enables users of its financial statements to understand the effects these contracts have on the amount, timing and uncertainty of its future cash flows and on its financial performance. To meet these objectives, an entity is required to disclose:

- information about contractual features that expose the entity to:
  - variability in the underlying amount of electricity
  - the risk that the entity would be required to buy electricity during a delivery interval in which the entity cannot use the electricity
- information about unrecognised commitments arising from such contracts as at the reporting date, including:
  - the estimated future cash flows from buying electricity under these contracts
  - qualitative information about how the entity assesses whether a contract might become onerous, including the assumptions the entity uses in making this assessment

- qualitative and quantitative information about effects on the entity's financial performance for the reporting period, in particular:
  - the costs arising from purchases of electricity made under the contracts, disclosing separately how much of the purchased electricity was unused at the time of delivery
  - the proceeds arising from sales of unused electricity
  - the costs arising from purchases of electricity made to offset sales of unused electricity.

An entity is required to disaggregate, for contracts to buy or sell nature-related electricity that have been designated in a cash flow hedging relationship, the information the entity discloses, by risk category, about the terms and conditions of hedging instruments in accordance with IFRS 7:23A.

If an entity discloses information about other contracts referencing nature-dependent electricity that have been entered into with regards to an entity's electricity purchases (regardless of whether they meet the own use exemption in IFRS 9) in other notes in its financial statements, the entity is required to include cross-references to those notes in the single note mentioned above.

The amendments also include amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures* with minor reductions in disclosure requirements.

Observation
In the ED, the IASB proposed that entities should be required to disclose the terms and conditions of the contracts for renewable electricity and, for contracts for renewable electricity that are not measured at fair value through profit or loss, either the fair value at the reporting date or the volume of renewable electricity a seller under the contracts expects to sell or a purchaser expects to purchase over the remaining duration of the contracts. Stakeholders noted that some of the information might be commercially sensitive and disproportionate to that required for other contracts, events or transactions. In addition, estimating the fair value for these contracts is complex and subject to high levels of measurement uncertainty. The IASB therefore decided to limit the disclosure requirements to those set out above.

Effective date and transition

The amendments are effective for annual periods beginning on or after 1 January 2026, with earlier application permitted.

The amendments to the own use exemption in IFRS 9 are required to be applied retrospectively in accordance with IAS 8 using the facts and circumstances at the date of initial application (the date when an entity first applies the amendments). The date of initial application is the beginning of a reporting period, which might be a reporting period other than an annual reporting period.

An entity is not required to restate prior periods to reflect the application of these amendments, but is permitted to do so if it is possible to do so without the use of hindsight. If the entity does not restate prior periods, it is required to recognise any difference between the previous carrying amount and the carrying amount at the date of initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) at the beginning of that reporting period.

If a contract referencing nature-dependent electricity would be outside the scope of IFRS 9 as a result of applying the amendments to the own use requirements, an entity is permitted, at the date of initial application, to irrevocably designate this contract as measured at fair value through profit or loss in accordance with IFRS 9:2.5.

An entity is required to apply the amendments to the hedge accounting requirements prospectively to new hedging relationships designated on or after the date of initial application. An entity is permitted, at the date of initial application, to discontinue a hedging relationship in which a contract referencing nature-dependent electricity has been designated as the hedging instrument, if the same hedging instrument is designated in a new hedging relationship in accordance with the amendments.

Further information

If you have any questions about the amendments, please speak to your usual Deloitte contact or get in touch with a contact identified in this *iGAAP in Focus*.

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