

Power purchase agreements

Connectivity in practice

26 June 2024

Joint meeting of the Reporting Boards



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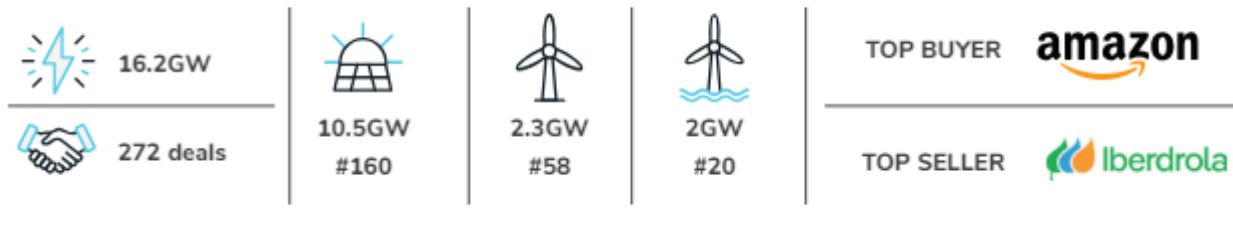
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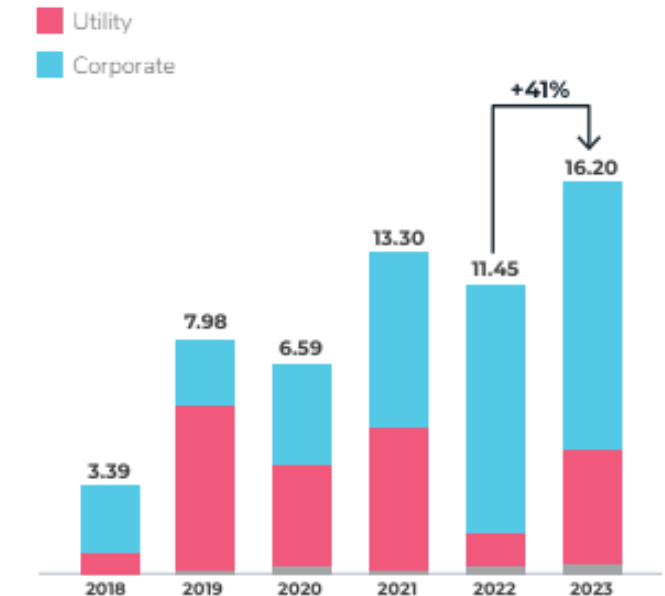
MAIN FEATURES OF POWER PURCHASE AGREEMENTS

- Generally long-term agreements with duration varying between 5 to 20+ years and may be for significant volumes
- Complex contracts often containing Guarantees of Origin (GoOs) or Renewable Energy Certificates (RECs)
- Can be physical (PPAs) or virtual (vPPAs)

EUROPEAN PPA MARKET 2023

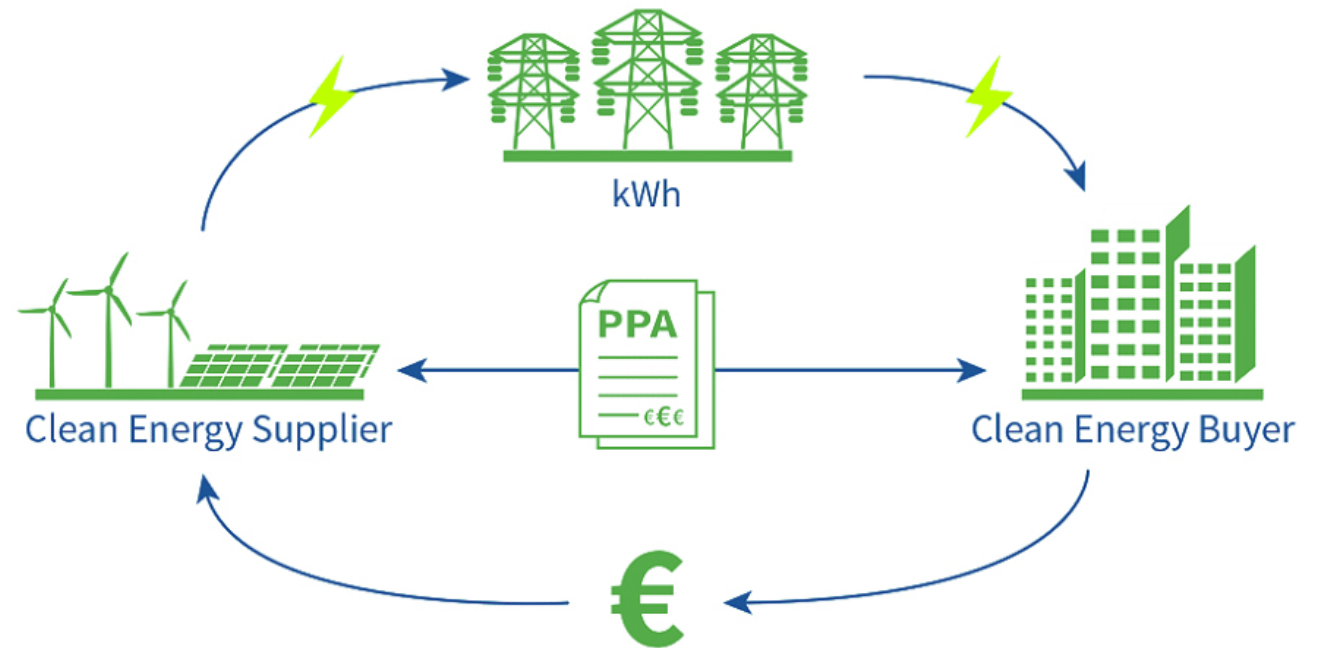


PPA deal flow by disclosed contracted capacity, 2018–2023 (GW)



WHAT IS A PPA?

- Contractual agreement between energy buyers and sellers. High prevalence – resurgence due to its popularity in the field of renewable generation.
- Buyer takes volume risk, i.e. the risk that the timing or volumes of electricity provided is not necessarily aligned with its own demand.



[Source](#)

ASSOCIATED ACCOUNTING ISSUES: PPA's

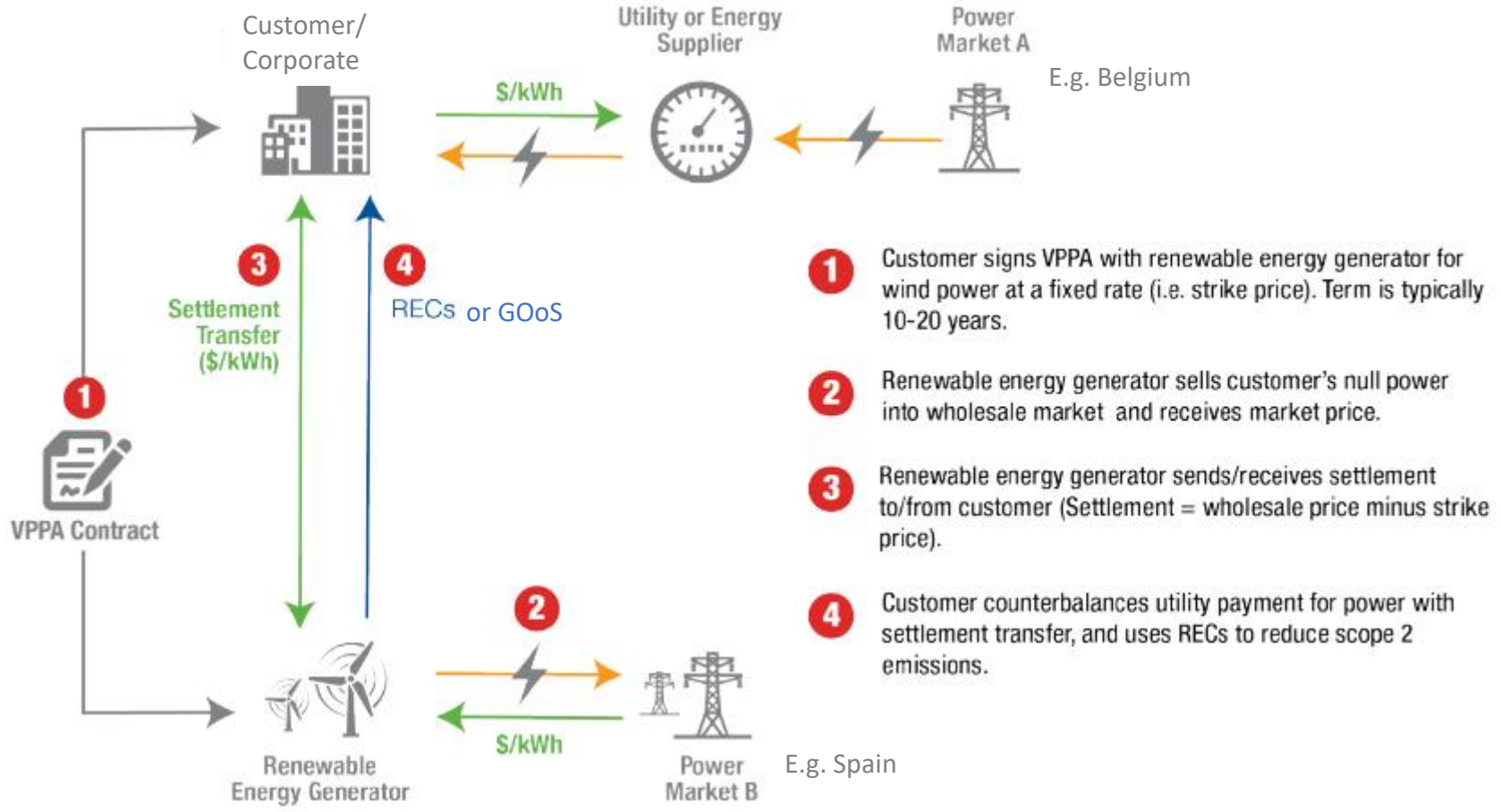
- These contracts are generally classified as derivatives under IFRS Accounting Standards as they do not meet the own-use exception (given that the buyer will often net settle excess volumes)
- Unpredictability of the volume (of electricity) and duration of these contracts (generally longer term) creates valuation issues and volatility in profit and loss
- Hedge accounting problematic given profile mismatches and variable volumes
- Different to US GAAP which in many cases treat these as executory contracts (i.e. no one records anything till delivery or payment)

WHAT IS A VPPA?

- A virtual PPA is a financial contract with loose connection between the renewable asset (like a solar farm) and the energy buyer.
- A VPPA with a fixed price allows the buyer to fix their energy price and pay/receive the difference between the contract price and the market or spot price.
- The generator also provides the Guarantees of Origin (GoOs*) to the buyer. These trace the electricity's origin.
- The parties to the transaction can buy or sell their electricity from the market (so this is a pricing mechanism, similar to an interest rate swap).
- From an IFRS Accounting Standards perspective, these are derivatives, but similar problems arise around the accounting for these as for PPA's. Under US GAAP these are again treated as executory contracts (if it does not have a notional).

*In some territories these are known as REC's

WHAT IS A VPPA?



- 1** Customer signs VPPA with renewable energy generator for wind power at a fixed rate (i.e. strike price). Term is typically 10-20 years.
- 2** Renewable energy generator sells customer's null power into wholesale market and receives market price.
- 3** Renewable energy generator sends/receives settlement to/from customer (Settlement = wholesale price minus strike price).
- 4** Customer counterbalances utility payment for power with settlement transfer, and uses RECs to reduce scope 2 emissions.

Belgian example

In 2020, BayWa r.e. and AB InBev signed a VPPA. This 10-year contract will supply 250 gigawatts of green energy per year to InBev representing 100% renewable electricity for its European brewing operations. The project consists of two solar farms located in Spain.

[Source](#)

[Source](#)

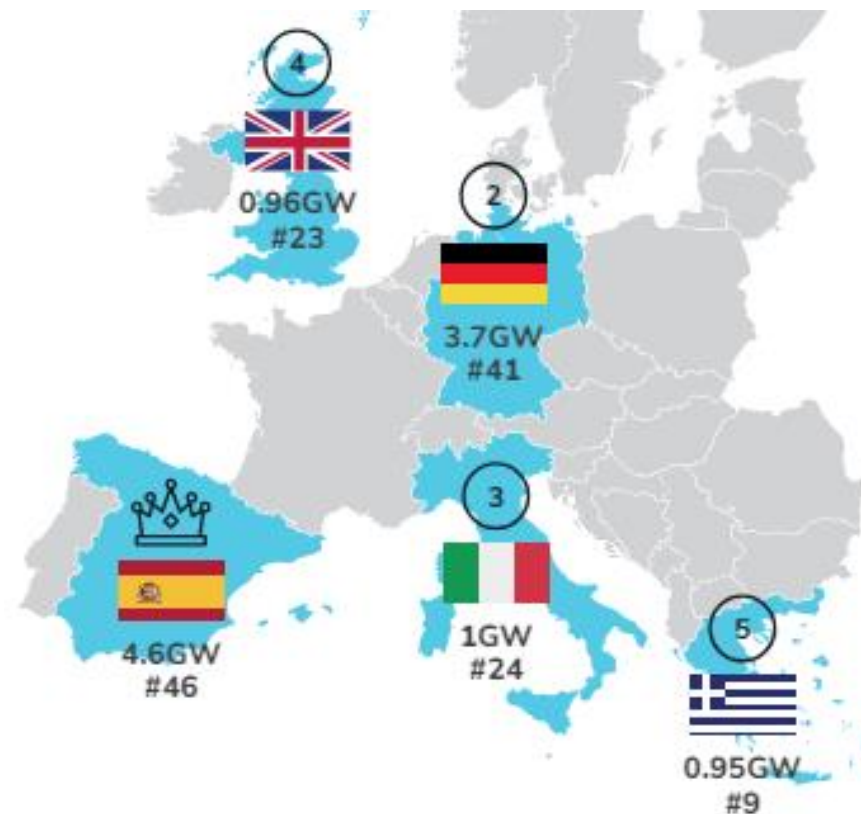
WHY USE VPPA's?

VPPA's are often more flexible and attractive than PPA's for the following reasons:

1. Scalability: Companies can aggregate multiple and smaller energy loads under one single project such as the one described below.
2. Engineering problems and other operational risks sit with the supplier, since there is no physical delivery of energy.

For the renewable energy generator, VPPA's provides stable cash flows that allows bank financing for the building of the asset.

VPPA's dominate the US power market with almost 85% of corporate power purchases in 2022. ([Source](#))



[Source](#)

Financial reporting

IASB ED

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- Narrow-scope standard-setting project: [Exposure Draft](#) issued on 9 May 2024 with 90 days comment period. The project is “fast track”, but the EU endorsement process takes time.
- The IASB proposes to amend IFRS for contracts for renewable electricity (examples are wind-, solar- and hydroelectricity) as follows:
 - (a) Effectively extend the own-use requirements to include contracts to buy and take delivery of renewable electricity for which the source of production of the electricity is nature dependent and the purchaser is exposed to substantially all of the volume risk through ‘pay-as-produced’ features;
 - (b) Simplify the hedge accounting for these types of contracts as the variable volume of the forecast transaction can be designated as the hedged item but using the same volumes as in the hedging instrument for measurement; and
 - (c) Extend the disclosure requirements – see next slides.

An entity shall [**for contracts within the scope of the amendments**] disclose information that enables users to understand how these contracts affect the amount, timing and uncertainty of the entity's future cash flows.

Specifically, an entity shall disclose:

- a) the terms and conditions of the contracts**, e.g. remaining contract duration, the type of pricing etc..
- b) for contracts for renewable electricity that are not measured at fair value through profit or loss, either:**
 - i. the fair value** of the contracts at the reporting date, with sensitivity information etc.; **or**
 - ii. the volume of renewable electricity** a seller under the contracts expects to sell or a purchaser under the contracts expects to purchase over the remaining duration of the contracts, or a range as well as other information.

Seller

Shall disclose the **proportion of renewable electricity covered by the contracts to the total electricity sold** for the reporting period.

Purchaser

Shall disclose for the reporting period:

- a) the proportion of renewable electricity covered by the contracts to the total **net volume of electricity purchased**;
- b) the total net volume of electricity purchased—irrespective of the source of production;
- c) the average market price per unit of electricity in the markets in which the entity purchased electricity; and
- d) if (b) multiplied by (c) differs substantially from the actual total cost incurred by the entity to purchase the volume of electricity in (b), a qualitative explanation of the key reasons for this difference.

In [summary](#):

- EFRAG supports the narrow scope of the ED but believes that other types of contracts (than 'pay-as-produced') should be addressed.
- However, EFRAG foresees application challenges related to some of the requirements specifically related to the time-period considerations.
- EFRAG welcomes the IASB's thorough approach distinguishing the considerations for sellers and purchasers when proposing the hedge accounting requirements for the contracts in scope of the ED.
- On disclosures, EFRAG suggests that proposed disclosure requirements should be limited to only those qualifying for the own-use exception as otherwise covered under IFRS 7.

Comments can be submitted till 15 July 2024 – [Invitation to comment](#)

POSSIBLE DISCUSSION POINTS

Below is the summary of the main topics deemed relevant for the Boards:

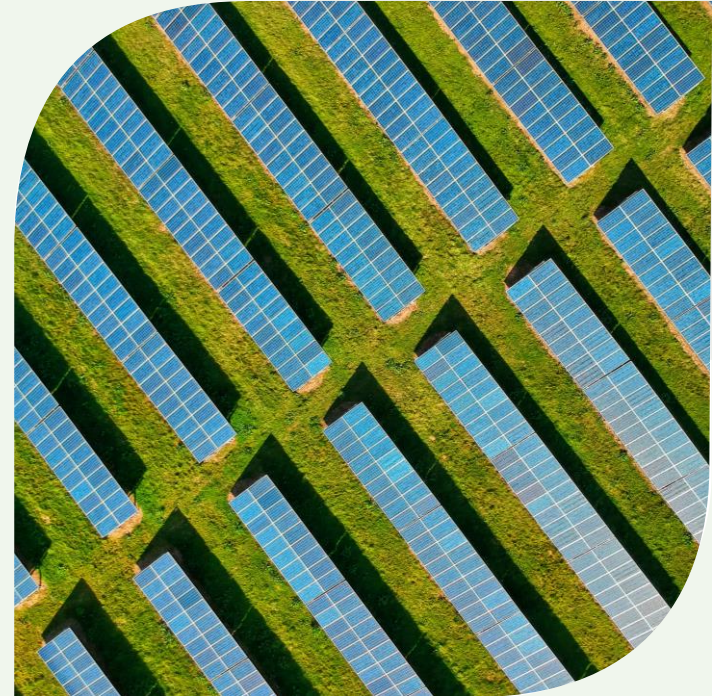
- There is no consensus on the definition of “renewable” electricity. Difference in physical substance of the “renewable electricity” and economic substance (any electricity with the CoO’s/RECs vs these traded separately).
- Proposed disclosures: EFRAG’s DCL suggests to require additional disclosures only when an entity applies own-use requirements of the ED, other situations being covered by current disclosure requirements of IFRS 7.
- Option between disclosing the fair value OR a list of items of information may create comparability issues.
- Proposed disclosures are deemed excessive by the preparers and their usefulness is questioned by the users

Sustainability reporting

QUESTION FROM PLATFORM

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ID 753 Financial materiality in the VC and PPA's

Question asked to EFRAG

- (1) Shall a matter included in the financial statements of the undertaking but being outside of its value chain be reported in the undertaking's financial materiality assessment?
- (2) There is uncertainty whether a PPA would form part of the value chain of the undertaking, for both VPPA's and DPPA's.

ESRS E1 Climate change

44. The undertaking shall disclose in metric tonnes of CO₂eq its (a) gross Scope 1 GHG emissions; (b) gross Scope 2 GHG emissions; (c) gross Scope 3 GHG emissions; and (d) total GHG emissions.

45. The objective of the Disclosure Requirement in paragraph 44 in respect of: (b) gross Scope 2 GHG emissions as required by paragraph 44 (b) is to provide an understanding of the indirect impacts on climate change caused by the undertaking's consumed energy whether externally purchased or acquired. ...The information from this Disclosure Requirement is also needed to understand the undertaking's climate-related transition risks.

49. The disclosure on gross Scope 2 GHG emissions required by paragraph 44 (b) shall include: (a) the gross **location-based** Scope 2 GHG emissions in metric tonnes of CO₂eq; and (b) the gross **market-based** Scope 2 GHG emissions in metric tonnes of CO₂eq.

Definitions:

Scope 1 GHG emissions: Direct GHG emissions from sources that are owned or controlled by the undertaking

Scope 2 GHG emissions: Indirect emissions from the generation of purchased or acquired electricity, steam, heat or cooling consumed by the undertaking.

Scope 3: Indirect emissions occurring in the value chain.

ESRS E1 Climate change:

AR 32 requires a conservative approach when splitting Scope 2 GHG emissions between renewable or non-renewable sources based on GoO's or REC's

GHG Protocol on Scope 2

Methods for scope 2 accounting are “allocation” methods—allocating generator emissions to end-users.

A **location-based** method reflects the average emissions intensity of grids on which energy consumption occurs (using mostly grid-average emission factor data).

A market-based method reflects emissions from electricity that companies have purposefully chosen (or their lack of choice). It derives emission factors from contractual instruments, which include any type of contract between two parties for the sale and purchase of energy bundled with attributes about the energy generation, or for unbundled attribute claims.

Markets differ as to what contractual instruments are commonly available or used by companies to purchase energy or claim specific attributes about it, but they can include energy attribute certificates (RECs, GOs, etc.), direct contracts (for both low-carbon, renewable, or fossil fuel generation), supplier-specific emission rates, and other default emission factors representing the untracked or unclaimed energy and emissions (termed the residual mix) if a company does not have other contractual information that meets the Scope 2 Quality Criteria.

In this way, all companies required to report according to the market-based method will have some type of data option. Not having contractual data for every site will not cause non-compliance with the GHG Protocol Corporate Standard and Scope 2 Guidance. As with scope 3, a range of data may be available. Companies should consult the hierarchy of emission factors for both location-based and market-based methods. Any data on those hierarchies are acceptable

QUESTIONS TO THE JOINT BOARDS

- Do you have comments and/or considerations in relation to the IASB's proposed disclosures, their interaction with the sustainability disclosures and any application questions?
- The EFRAG SR Secretariat will revert to the SRB/ SR TEG with proposed drafting of the solution to the Q&A.



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Thank you