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Scope of the proposed amendments – Issues paper

Objective

- 1 The objective of this agenda paper is to:
 - (a) present a summary of the comment letters received by the IASB and the IASB staff considerations and proposals based on this feedback;
 - (b) present an EFRAG Secretariat analysis of the proposals.

Structure of the paper

- 2 This issues papers contains:
 - (a) IASB's tentative decisions;
 - (b) ED proposals
 - (c) Feedback to the ED proposals and IASB staff analysis;
 - (d) EFRAG Secretariat assessment;

IASB's tentative decisions

- 3 In September 2024, the IASB tentatively decided to finalise the proposed scope of the amendments, subject to clarifying that contract within the scope of the proposed amendments:
 - (a) reference nature-dependent electricity generated from sources that depend on natural conditions that cannot be controlled;
 - (b) can be settled net or gross; and
 - (c) expose an entity to cash-flow variability that depends on the contracted amount of nature-dependent electricity.

ED proposals

- 4 The ED [Contracts for Renewable Electricity](#) included the following proposals in relation to the scope of the amendments:
- 5 (6.10.1) 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:
- (a) (6.10.1(a)) the source of production of the renewable electricity is nature-dependent so that supply cannot be guaranteed at specified times or for specified volumes. Examples of such sources of production include wind, sun and water;
 - (b) (6.10.1(b)) that contract exposes the purchaser to substantially all the volume risk under the contract through ‘pay-as-produced’ features. Volume risk is the risk that the volume of electricity produced does not align with the purchaser’s demand for electricity at the time of production.

Feedback to the ED proposals and IASB staff analysis

- 6 Information on this section was prepared based on the IASB staff agenda paper [AP3A Scope of the proposed amendments](#)

Terminology used

Feedback to the ED proposals

- 7 A few respondents suggested the IASB reconsiders using the term ‘renewable’ electricity because it adds unnecessary complexity to the proposals. Some other respondents suggested to instead refer to a contract ‘that references’ electricity because a contract for difference is not a contract ‘for’ electricity but it is a contract that references electricity as the underlying on which net settlement is based.

IASB staff analysis

- 8 The IASB staff agreed that the terms ‘renewable’ and contracts ‘for’ electricity reduce the clarity of the proposed amendments. IASB staff therefore recommended to use the term ‘nature-dependent electricity contracts’ (NDE contract). Further, IASB staff used the terms ‘NDE contract for receipt’ and ‘NDE contract for difference’ to differentiate between the physical delivery contract and a net-settled contract.

The unit of account

Feedback to the ED proposals

- 9 Many respondents commented that in their jurisdiction, parties to an NDE contract cannot access the electricity market directly but need an intermediary to do so on their behalf.

Entities are therefore required to enter into contracts for, what could be seen as, ancillary transmission services. Respondents explained that these ancillary service contracts are entered into and negotiated separately and independently from the NDE contract.

- 10 Respondents asked how to assess, particularly for an NDE contract for receipt, the contractual features of any other agreements between the electricity producer, the entity and any intermediary.
- 11 Further, most respondents agreed (or did not disagree) with the IASB's decision to exclude the accounting for RECs from the scope of the proposed amendments, noting however that it would be helpful if the IASB could provide guidance on determining the unit of account to which the proposed amendments apply. Respondents highlighted that the proposed amendments refer to a contract and asked whether the proposed amendments have to be applied to the contract as a whole (including RECs) or only to the electricity element of the contract while separately accounting for RECs.

IASB staff analysis

- 12 The IASB staff acknowledged that it may be difficult to determine the unit of account in complex market designs, however noted that IFRS 9 does not include requirements for the combination of contracts. Developing requirements for determining the unit of account for NDE contracts cannot be done without the IASB considering a variety of financial instruments and other contracts. Therefore, developing additional requirements to address these accounting challenges would go beyond the scope of this narrow-scope project.
- 13 IASB staff highlighted that before an entity determines whether the proposed amendments apply to an NDE contract, an entity would need to consider the substance of its rights and obligations. Although an electricity contract in complex market designs may be subject to a potentially difficult judgement, it is not a unique judgement that applies only to such contracts. The IASB staff suggested that the IASB should be able to address the unique accounting challenges that arise from an NDE contract without also addressing the accounting challenges around determining an appropriate unit of account
- 14 In relation to the RECs, the IASB staff highlighted that in practice the entities account for RECs separately from the NDE contract and the issue raised to IFRIC was about the electricity part. The IASB staff further noted that entities across different jurisdictions would have determined the appropriate accounting treatment considering their specific facts and circumstances and the relevant (although potentially different) requirements of IFRS Accounting Standards. Therefore, the staff think the IASB did not intend with these

proposals to change how an entity determined the appropriate accounting treatment for RECs.

Extent of the scope

Feedback to the ED proposals

- 15 Most respondents appreciated that the IASB responded speedily to address the accounting challenges with applying IFRS 9 to NDE contracts raised by our stakeholders. Respondents particularly agreed with the inclusion of both NDE contracts for receipt and NDE contracts for difference within the scope of the proposed amendments. Most respondents also agreed with restricting the scope of the proposed amendments using the characteristics specified in the Exposure Draft and agreed with not permitting entities to analogise to the proposed amendments for other types of transactions.
- 16 A few respondents suggested that the IASB needs to expand the scope of the proposed amendments to also include other types of contracts, including those an entity holds for Environmental, Social, and Governance (ESG) purposes, for which similar application challenges might arise. These respondents considered the proposed amendments to be either too rules-based or appearing to favour contracts for renewable or green electricity over other types of contracts.

IASB staff analysis

- 17 The IASB staff highlighted that the IASB did not add this project to its workplan because entities enter into NDE contracts as part of the entity's ESG strategy, but to ensure an entity's financial statements faithfully reflect the effects of these contracts while addressing the application challenges identified by our stakeholders. Further, the IASB staff deemed that the feedback did not indicate other problematic fact patterns or circumstances—that are sufficiently similar to those the IASB aims to address in this narrow-scope project—that identifies an immediate need for the IASB to consider other contracts or transactions as part of this project.

Nature-dependency of the source of production

Feedback to the ED proposals

- 18 Most respondents agreed that an important element of the scoping criteria is the nature-dependency of the source of electricity production. However, many respondents asked for clarification and further explanation as to the meaning of 'renewable electricity' and 'nature-dependent' for the purpose of the proposed amendments. In their view, any renewable electricity is, by definition, dependent on nature-dependent sources. Respondents also said that such clarifications would help to make the proposed

amendments more principles-based and ensure more consistent application. These concerns were raised because paragraph BC9 of the Basis for Conclusions on the Exposure Draft stated that some hydroelectricity contracts are excluded from the scope while water is listed as an example of a nature dependent resource.

- 19 Some of these respondents asked whether the requirement ‘supply cannot be guaranteed at specified times or for specified volumes’ refers to the nature of the source for electricity production, the inability of the producer to control the timing and quantity of electricity generated, or both.
- 20 Some other respondents asked if ‘supply cannot be guaranteed at specified times or for specified volumes’ means that contracts that guarantees a minimum quantity of electricity to be supplied are excluded from the scope even if the source of electricity production is nature-dependent.

IASB staff analysis

- 21 The IASB staff clarified that this characteristic intended to require that nature (or natural forces including weather conditions), rather than man, controls the source from which electricity is produced by the referenced facility. In other words, the electricity producer does not control the source for electricity production and therefore cannot control whether any electricity can be produced at a particular time.
- 22 As such, reference to the supply which cannot be guaranteed at specified times or for specified volumes should be seen from the same perspective - nature (or natural forces) controls the source from which electricity is produced by the referenced facility and nature also determines, whether any electricity can be produced at a given time.
- 23 Regarding the minimum guarantees, IASB Staff noted that the assessment is most relevant for the own-use considerations and suggested to address the feedback in that section.

Contractual features

Feedback to the ED proposals

- 24 Most respondents agreed with the concept of volume risk as described in paragraph 6.10.1 of the Exposure Draft. However, respondents noted that the contractual features of NDE contracts are not uniform or standardised and that new features are being included as the market continues to develop. Respondents therefore asked that volume risk be clarified to make it more principles-based by avoiding referring to the particular ‘labels’ attached to contractual features and better explaining the underlying principle.

- 25 Many respondents asked to clarify which volume is relevant to the assessment of volume risk (i.e. volume agreed in the contract and not all the volume produced by the referenced facility). Similarly, respondents asked whether only the risk of intermittent supply is to be considered or also the risk of intermittent demand. Some respondents further asked about the relevance of other contractual features – for example, caps and floors.

IASB staff analysis

- 26 The IASB staff acknowledged that the proposed description of volume risk in the Exposure Draft appear to exclude NDE contracts for difference because it refers to ‘the purchaser’s demand for electricity.’ Based on the feedback and questions about volume risk, the IASB staff suggested that considering the purchaser’s demand (or expected usage requirements) is most relevant for the own-use amendments. Therefore, the concept of volume risk is incorporated and clarified as part of the own-use amendments.
- 27 Further, the IASB staff suggested that the contractual feature characteristic should be reworded so that it captures all NDE contracts while avoiding the use of labels like pay-as-produced. The staff agreed with respondents that it would be helpful to clarify that the cash flows under the contract vary based on the contracted volume of the output of the referenced production facility—for example 20% of the output or up to 100 units of the output.
- 28 In terms of relevant contract features, in the IASB staff view, to determine the scope of contracts to which the proposed amendments could be applied, the relevant contractual feature is the obligation of an entity to pay or receive (gross or net) an amount for the contracted volume of the electricity (produced by the referenced production facility), as and when that electricity is delivered. However, to ensure that this principle can be applied to both types of NDE contracts, the staff suggests to instead refer to the cash flows under the contract that vary based on the output of a referenced production facility.

EFRAG Secretariat assessment

- 29 The EFRAG Secretariat considers that the IASB tentative decisions address most of the comments raised in question 1 of EFRAG’s Comment Letter and generally improve the proposals included in the ED.
- 30 The EFRAG Secretariat further notes that based on the September 2024 IASB meeting, the reference to the dam when assessing the water-based electricity production will be removed from the final amendments. EFRAG Secretariat agrees with this approach – indeed, example provided by the IASB Staff related to the water dam can be considered by some stakeholders as a general rule (that any electricity production from a water where

there is a dam is excluded from the scope). Rather, EFRAG Secretariat notes that the assessment should be principle-based and evaluated case by case, including the situations where there is a dam.

- 31 EFRAG Secretariat notes a disagreement with the focus on the exposure to cash-flow variability that depends on the contracted amount of nature-dependent electricity. EFRAG Secretariat do not consider the payment structure to be relevant unless it defines the contract as a lease. A prepayment or a fixed payment for a variable volume of nature-dependent electricity should not exclude a contract from the scope of the amendments. The payment structure does not affect the own use assessment. The payment structure may affect the effectiveness of a hedging relationship, but it should not influence the definition of the hedged item in a hedging relationship.
- 32 EFRAG Secretariat further notes that statement ‘for an electricity contract to be included in the scope of the proposed amendments, the cash flows under that contract vary based on the contracted volume of electricity produced by the referenced production facility’ will need to be further clarified to ensure that the related cash flows vary within a certain time interval (by essence, the cash flows for any contract vary based on the volume in the relationship $P \times Q$).
- 33 EFRAG Secretariat notes the IASB’s considerations related to the unit of account, however deems that addressing the application questions raised by the constituents in regard to the auxiliary contracts may be done without fundamental overhaul of IFRS 9 (for example, as part of the illustrative examples).