

Dr Andreas Barckow
Chairman
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[XX August 2024]

Dear Dr Barckow,

Exposure Draft IASB/ED/2024/3 Contracts for Renewable Electricity: Proposed Amendments to IFRS 9 and IFRS 7

1. The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS Accounting Standards for use in the UK and therefore is the UK's National Standard Setter for IFRS Accounting Standards. The UKEB also leads the UK's engagement with the IFRS Foundation on the development of new standards, amendments and interpretations. This letter is intended to contribute to the Foundation's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended international accounting standards undertaken by the UKEB.
2. There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS.¹ In addition, UK law allows unlisted companies the option to use IFRS and approximately 14,000 such companies currently take up this option.²
3. We welcome the opportunity to provide comment on the International Accounting Standards Board (IASB)'s Exposure Draft (ED) *Contracts for Renewable Electricity: Proposed Amendments to IFRS 9 and IFRS 7* (the Amendments). In developing this letter, we have consulted with stakeholders in the UK, including preparers, accounting firms and institutes, and users of accounts.
4. We appreciate the IASB's responsiveness in addressing the challenges faced by entities accounting for contracts for renewable electricity and the demands for

¹ UKEB calculation based on LSEG and Eikon data, May 2024. This calculation includes companies listed on the Main market as well as on the Alternative Investment Market (AIM).

² UKEB estimate based on FAME, Company Watch and other proprietary data.

increased transparency on the use of those contracts. There is a need to provide clarity and minimise the risk of diversity in accounting practice in this increasingly significant area but we believe that this should be achieved whilst respecting the importance of principle-based accounting standards.

5. As explained below, we do not support the IASB's proposed amendments to the 'own-use' requirements. However, we broadly support the proposed amendments to hedge accounting and the proposed disclosure requirements. Facilitating cash flow hedge accounting for relevant contracts, both physical and virtual, and adding disclosure requirements, would mitigate some of the concerns of preparers while also enabling users of accounts to better understand the financial impact of contracts for renewable electricity on an entity's financial position and income statement and the risks to which it is exposed.
6. Our main observations and recommendations are set out in the paragraphs that follow. Responses to the IASB's specific questions about the ED are included in the Appendix to this letter.

'Own-use' requirements

7. The UKEB supports principle-based accounting standards. The IASB's proposed amendments to the IFRS 9 'own-use' requirements are an exception to what is already an exception to financial instruments accounting, and we are concerned that there appears to be no clear conceptual basis for it.
8. In particular, we note that, as set out in the alternative views in the ED, the requirements in IFRS 9 have been accepted as relevant and representationally faithful. Contracts addressed by the ED are typically long term and expose an entity not only to volume risk, but also to price risk. A purchaser is likely to have to sell and subsequently purchase electricity at different market prices, in effect realising the fair value of that portion of the contract. We therefore consider that, for those contracts not meeting the existing 'own-use' requirements in IFRS 9, fair value accounting would better reflect the risks to which the entity is exposed.
9. Finalising the proposed amendments to the 'own-use' requirements may also raise questions about the accounting for other non-financial items and other types of electricity contracts, such as those which promise to deliver fixed volumes of renewable power over specified timeframes³. These types of energy contracts are a growing part of the UK renewable electricity market. While these renewable electricity contracts do not transfer production volume risk to the same extent as in 'pay-as-produced' contracts, they can give rise to short-term supply-demand mismatches, raising similar challenges in meeting the 'own-use' requirements.

³ Stakeholders have referred to these contracts as 'baseload' contracts, though we recognise this term may not be consistently used and may not always serve as an accurate description of their nature.

This gives rise to the apparent anomaly that a contract in which the purchaser has less volume risk may be required to be treated as a derivative, whereas a contract in which the purchaser assumes more volume risk could be assessed as meeting the 'own-use' requirements and accounted for as an executory contract.

10. Overall, therefore, we do not support the proposed amendments on this topic and recommend that the existing 'own-use' requirements in IFRS 9 are left unchanged. We consider that not meeting the 'own-use' requirements may be less of a concern for some preparers if they have the ability to apply cash flow hedge accounting, as that would enable them to reflect their risk management activities in their financial statements.
11. If the IASB nevertheless decides to finalise the proposed amendments relating to 'own-use', we believe that further amendments would be required and have set out our detailed comments on the 'own-use' proposals in paragraphs A7 to A14 of the Appendix.

Hedge accounting requirements

12. We are broadly supportive of the proposed amendments to hedge accounting requirements for contracts within the scope of the Amendments.
13. However, this is a complex area, and we believe that it would be extremely helpful to develop illustrative examples to show users how the proposals are intended to apply in relation to variable volumes of sales and purchases of renewable electricity. This would facilitate consistent application of the amendments.
14. We recognise and support the fact that the IASB has taken a pragmatic approach to addressing the existing challenges with cash flow hedge accounting for renewable energy contracts within the scope of the Amendments. We agree that this approach should limit the risk of unintended consequences. As noted above, the UKEB supports principle-based accounting standards. We therefore encourage the IASB to consider, as part of the IASB's Post-implementation Review of IFRS 9 – Hedge Accounting, whether there is merit for these amendments to be extended to other cash flow hedge relationships.
15. Our detailed comments on hedge accounting are in paragraphs A15 to A19 of the Appendix.

Disclosures

16. Whether a contract to buy or sell a non-financial item, including renewable energy, meets the 'own-use' requirements is a matter of judgement that depends on the specific facts and circumstances, such as the frequency and volume of sales.

17. UK stakeholders, in particular users of accounts, have highlighted a need for increased transparency on an entity's use of contracts for renewable energy, particularly those accounted for as executory contracts.
18. Therefore, irrespective of whether the IASB finalises the amendments to the 'own-use' requirements, we support the proposed disclosure requirements for those contracts for renewable electricity within the scope of the Amendments that meet the 'own-use' requirements.
19. Our detailed comments on disclosures are set out in paragraphs A20 to A25 of the Appendix.

Effective date

20. We think it is likely that an application date of accounting periods beginning on or after 1 January 2025 will be difficult for some preparers, and recommend the proposals are effective for accounting periods beginning on or after 1 January 2026, with early adoption permitted.
21. Our detailed comments on the effective date are in paragraphs A30 to A32 of the Appendix.

Accounting for renewable energy certificates

22. We note that contracts within the scope of these proposals are typically accompanied by renewable energy certificates (RECs), but that the accounting for RECs is not addressed by these proposals. We encourage the IASB to add to its current agenda the project *Pollutant Pricing Mechanisms*, currently in the IASB's reserve list.

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix A: Questions on ED *Contracts for Renewable Electricity— Proposed amendments to IFRS 9 and IFRS 7*

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?

- A1. As noted in our cover letter and in our response to Question 2, the UKEB does not support the IASB's proposed amendments to the 'own-use' requirements in IFRS 9. We do, however, broadly support the IASB's proposals in relation to hedge accounting and the disclosure requirements for contracts for renewable electricity that have the characteristics described in 6.10.1. The IASB's approach in setting a narrow scope for these amendments is pragmatic and should limit the risk of unintended consequences.

Drafting points

- A2. Paragraph 6.10.1 limits the scope of these proposals to 'a contract for renewable electricity' with specified characteristics. The draft text distinguishes between 'normal purchase' contracts and contracts requiring net settlement of the difference between specified prices for the volume of electricity produced from a referenced production facility. While we do not believe there is significant scope for confusion here, it was not clear to us that the latter contracts would meet the requirement to be a contract *for* renewable electricity, as the contract does not involve any delivery of the underlying subject matter.
- A3. We understand the IASB intends these Amendments to apply to virtual PPAs as well as physical PPAs. We recommend the IASB consider defining the term 'contract for renewable electricity' or otherwise making it beyond doubt that the scope includes virtual PPAs.

- A4. We also observe that, in BC3 where the basis for including virtual PPAs within the proposals is discussed, a statement is made that “the objective of both physical PPAs and virtual PPAs is to ensure long-term access to renewable electricity...”. As noted above, our understanding is that a virtual PPA does not involve the delivery of renewable electricity to the customer so may not in itself ensure access to electricity.
- A5. Paragraph 6.10.2 states that paragraphs 6.10.3-6.10.6 “provide exceptions to only the requirements in IFRS 9 specified in the paragraphs 6.10.3-6.10.6.” We are concerned that this reference to “exception”, might be understood to provide a complete exception to the requirements of paragraphs 2.4 or Section 6.3 of IFRS 9. We recommend that paragraph 6.10.2 is reworded to ensure the intended meaning is clearer, for example by using words such as “modify the requirements of IFRS 9 only as specified...”.
- A6. As a further minor drafting point, we note the words in the final sentence of BC20(b) “contracts are timely reclassified as derivatives” would read better as “contracts are reclassified as derivatives on a timely basis...”.

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?

- A7. The UKEB supports principle-based accounting standards. The IASB’s proposed amendments to the IFRS 9 ‘own-use’ requirements are an exception to what is already an exception to financial instruments accounting, and we are concerned that there appears to be no clear conceptual basis for this additional exception.
- A8. In particular, we note that, as set out in the alternative views in the ED, the requirements in IFRS 9 have been accepted as relevant and representationally faithful. Contracts addressed by the ED are typically long term and expose an entity not only to volume risk, but also to price risk. A purchaser is likely to have to sell and subsequently purchase electricity at different market prices, in effect realising the fair value of that portion of the contract. We consider that, for those contracts not meeting the existing ‘own-use’ requirements in IFRS 9, fair value accounting would better reflect the risks to which the entity is exposed.

- A9. We therefore do not support the proposed amendments to the ‘own-use’ requirements and recommend that they are left unchanged.
- A10. If, nevertheless, the IASB decides to finalise the proposed amendments to the ‘own-use’ requirements, we believe that further amendments would be required as set out in the following paragraphs.
- A11. In spite of the clear statement in paragraph 6.10.2 that these requirements shall not be applied by analogy to other contracts, we believe there is a risk that this concession may be interpreted as setting expectations for the actions required by an entity assessing whether the ‘own-use’ requirements are met for contracts that fall outside the scope of these Amendments – i.e. that detailed estimates would be required for periods far in the future. To the extent that this goes beyond existing guidance on the application of IFRS 9 paragraph 2.4, this could lead to changes in practice and cause entities to reach different conclusions on the required accounting for other contracts. While the proposed solution might be seen as a pragmatic approach to contracts within the scope of the Amendments, we caution that this solution is not free of risks of wider repercussions.
- A12. Paragraph 6.10.3(b)(i) includes the criteria that “the sale arises from the entity’s exposure to the volume risk...”. It may be clearer to specify the volume risk that this refers to, for example “the volume risk arising under the contract”.
- A13. Paragraph 6.10.3(b)(iii) refers to purchase of electricity “within a reasonable time” and gives an example of one month. We note that some contracts where supply or demand is significantly affected by seasonal variations, e.g. for the generation of power from solar panels, or where demand drops significantly due to a factory closing for a month in the summer, may not meet the requirement within a month. We recommend the IASB clarify its intention as to whether contracts for renewable electricity for entities where supply or demand is significantly affected by seasonal variations could still be in scope of the proposed Amendments.
- A14. We also note that BC20 (c) explains that ‘reasonable’ depends on an entity’s operations and that a reasonable time “is typically a short time”. We recommend that this guidance be included within the body of the standard.

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?

- A15. In general, we welcome the proposed hedge accounting requirements. In a cash flow hedge relationship in which a contract for renewable electricity that has the characteristics in paragraph 6.10.1 is designated as the hedging instrument, the designation of a variable volume of forecast electricity transactions as the hedged item should allow hedge accounting to more accurately reflect the economic substance of some arrangements involving these contracts.
- A16. We note that the hedge accounting proposals are relatively complex. We believe that users may find it difficult to understand how to apply these new concepts in practice, in particular the precise meaning of paragraph 6.10.4(b). We strongly recommend the development of illustrative examples that show how the requirements of paragraphs 6.10.4 and 6.10.5 are intended to be applied in relation to purchases and sales of renewable electricity. As a more minor drafting point, we consider the text of 6.10.4 (b) should read “does not exceed the volume of future electricity transactions that is highly probable, ...”.
- A17. It is also unclear whether the text of 6.10.4(b) describes a test only at the initial designation of the hedge, or whether there is some component of ongoing assessment of this measure.
- A18. The drafting of paragraph 6.10.5 states “such forecast sales are not required to be highly probable...”. However, our understanding is that it was not the intention of these Amendments to relax the requirement for the forecast transaction, including sales, to be highly probable. We recommend that the drafting of this paragraph is amended to make clear how forecast sales under such a contract meet the ‘highly probable’ criterion. Alternatively, we think consideration could be given to omitting this paragraph completely since, if our understanding is correct, no exception for sales is in fact required – it is just that the assessment against the highly probable requirement should be simple.⁴
- A19. We also consider that the meaning of BC35, which relates to paragraph 6.10.5, is not clear and that the wording of the last sentence in particular should be reconsidered: “The IASB considered that ~~when~~ **if** an entity ~~would~~ proportionately **hedged** all renewable electricity sales, it would be sufficiently clear to the entity that when any renewable electricity sales from the referenced production facility occurred, **the relevant proportion of** those sales would be **highly probable** ~~the hedged item.~~” Finally, we think that BC35 should avoid describing the requirement

⁴ See paragraphs 50-51 of IASB March 2024 agenda paper AP3B.

relating to sales transactions as an 'exception', because as we understand it no exception is required or intended.

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?

- A20. We agree with these proposals. We consider they strike a reasonable balance between providing useful information about the effects and risks associated with these contracts, and concerns about commercial sensitivity.
- A21. We think that users may consider that disclosure of information of this nature would also be useful in relation to similar contractual exposures for contracts for renewable electricity that fall outside the scope of these requirements. However, we note that this may go beyond the scope of these Amendments.

Question 5– Proposed disclosure requirements 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?

- A22. The application of IFRS 19 *Subsidiaries without Public Accountability: Disclosures* in the UK is conditional on the endorsement of the standard by the UKEB. The UKEB has not yet begun its endorsement assessment and the following comments should be viewed in that context.
- A23. We welcome the IASB's identification of consequential amendments to the standard in this ED. We think this is an efficient approach that will ensure disclosure requirements for eligible subsidiaries keep pace with the development of IFRS Accounting Standards for the parent entity's consolidated financial statements. We are broadly supportive of the proposed amendments.
- A24. We believe that it would be helpful if the Basis for Conclusions explained the rationale for the exclusion of IFRS 7 paragraph 42W from IFRS 19.
- A25. We wonder whether the last sentence in IFRS 7 proposed paragraph 44MM was intended to be incorporated in Appendix A in IFRS 19. As a drafting point, we believe the reference in that sentence to paragraph 134(f) of IFRS 19 should refer to 178(f) instead.

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?

- A26. As noted in our cover letter and in our response to Question 2, the UKEB does not support the IASB's proposed amendments to the 'own-use' requirements in IFRS 9. In the event the IASB decides to finalise the proposed amendments to the 'own-use' requirements, we provide some recommendations on transition in the following paragraphs.
- A27. We broadly support the IASB's proposals on transition. However, we are concerned that the requirements in 6.10.3 requiring an entity to assess a contract "at inception of the contract and at each subsequent reporting date", coupled with retrospective application, may be unduly onerous and potentially difficult to apply without the benefit of hindsight.

- A28. If an entity has entered into contracts within the scope of the Amendments several years previously, it may be difficult for them to reassess all the factors indicated in 6.10.3 at each historic reporting date. Because failure to meet the ‘own-use’ requirements is a once and for all assessment, this could make a difference to the outcome - the result of the assessment could be different depending on whether it was carried out at the inception of the contract a number of years ago and at each subsequent reporting date, or only at the date of initial application of the Amendments.
- A29. If the IASB’s intention is that on transition an entity should make the assessment of the factors in 6.10.3 only at the date of initial application of the Amendments, or at the beginning of the reporting period if an entity applies these Amendments in a reporting period during which the Amendments are issued, we recommend this is made explicit in the transition provisions, for example as an optional transition exemption. We note that similar provisions have previously been included in transition provisions such as IFRS 16 paragraph C16, where no reassessment of historic sale and leasebacks was required by lessors.

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?

- A30. We note the urgency of the issue and support the IASB’s efforts to finalise the Amendments on a timely basis. We recognise the importance of these Amendments being available for adoption as soon as possible and support the option to early adopt the Amendments.
- A31. However, given the Amendments are not expected to be finalised until the end of 2024, we consider that preparers may consider an effective date of 1 January 2025 to be challenging. Preparers may face challenges around the data required to assess the factors relating to the ‘own-use’ requirements in 6.10.3, and in preparing the new disclosure requirements in 42V, which may require more lead time.

- A32. We recommend the IASB consider making these Amendments effective for accounting periods beginning on or after 1 January 2026, with early adoption permitted.

DRAFT