

5 August 2024

Dr Andreas Barckow
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Submitted to: www.ifrs.org

Dear Dr Barckow

IASB ED/2024/3 *Contracts for Renewable Electricity*

Thank you for the opportunity to comment on IASB ED/2024/3 *Contracts for Renewable Electricity*. We appreciate the IASB's efforts to address the urgent need for clarity in accounting for Power Purchase Agreements ('PPAs') and other contracts for renewable electricity.

We support the IASB's quick response to a pressing need in the market. During our outreach, we heard similar concerns to those identified by the IASB, reinforcing the need to address this current issue. In particular, we have heard that there is a similar need in our jurisdiction for more consistency in the treatment of Power Purchase Agreements (PPAs) to aid in better financial decision-making. The complexity of these arrangements, arising from both financial and technical aspects related to energy generation and consumption patterns, justifies targeted action.

We broadly agree with the IASB's proposals as a temporary solution to address stakeholder concerns. However, we have some reservations and recommendations for improvement:

- Need for Comprehensive Review:** While the proposals are intended to focus only on particular types of contracts, feedback from our stakeholders highlighted the need for a comprehensive, principles-based review of the hedge accounting requirements in IFRS 9 *Financial Instruments* that can accommodate the complexities of modern risk management practices in the energy sector. We suggest that the IASB should treat the amendments as a temporary solution to address an immediate concern and reconsider whether they remain necessary after a comprehensive review is completed.
- Disclosure Requirements:** We have concerns about the proposed disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*, particularly regarding commercial sensitivity in smaller markets and the potential for misinterpretation of information. We recommend providing more detailed guidance on applying the aggregation principles IFRS 7 effectively and ensuring clear labelling of disclosures related to the proportion of electricity contracts covered by the proposed disclosure requirements to avoid misinterpretation by users and preparers.

Our detailed responses to the specific questions are enclosed in the appendix to this letter. If you have any questions or require clarification of any matters in this letter, please contact Jamie Cattell (Jamie.cattell@xrb.gov.nz) or me.

Yours sincerely



Carolyn Cordery
Chair – New Zealand Accounting Standards Board

Appendix

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?

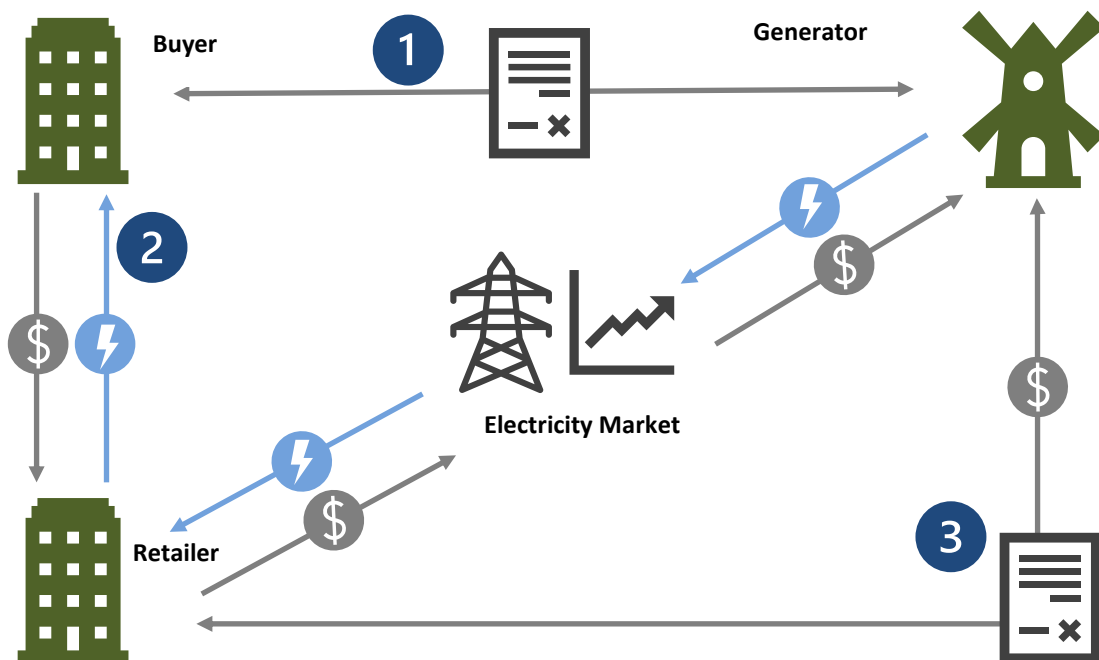
1. We broadly agree that the proposed scope in paragraphs 6.10.1–6.10.2 of the amendments to IFRS 9 would appropriately address stakeholders' concerns while limiting unintended consequences for the accounting for other contracts. However, we have some reservations and a suggestion for improvement.
2. Our most significant concern is about the departure from principles-based standard setting in this case. While we believe the scope and drafting adequately precludes wider application, we are worried about the precedent that such a departure sets. Our view is that the risk of creating a precedent is inappropriate because the proposals may only be relevant for a limited period until:
 - (a) Technology improves – Advancements in storage technology may enable physical delivery of electricity consistent with the current own-use requirements regardless of whether the volume matches the purchaser's immediate usage requirements.
 - (b) Industry practices change – For example contracting practices may evolve to better manage volume risk, potentially reducing the need for specific accounting treatments.

We are concerned that the temporary nature of these practical amendments may become irrelevant and require further standard-setting to time to make further amendments. Therefore, as these proposals depart from principles-based standard-setting we recommend that the IASB only proceeds on the basis that it is temporary. We recommend a principles-based review of the hedge accounting requirements is undertaken to resolve the underlying issues.

3. We agree with the specific characteristics of contracts for renewable energy outlined in the proposed scope paragraph 6.10.1. The current focus on the nature of the source (wind, solar, water) is sufficient to capture the variability in output that is inherent to these renewable energy sources. While we note that there can be significant differences in the degree of variability depending on the renewable source, we do not believe this variability would impact the definition of these contracts.
4. However, we note that the proposed amendments to the own-use exception are also rooted in the fact that electricity cannot be stored economically. While this aspect is not explicit in the proposed amendments, we assume it is implicitly captured in the concept of exposure to volume risk.

5. To provide greater clarity and to future-proof the amendments, we recommend that the IASB consider whether the concept of economic storage can be explicitly included in the proposed amendments without causing unintended consequences.
6. One type of arrangement closely related to physical and virtual PPAs is sleeved PPAs, where a retailer acts as an intermediary between a renewable energy generator and a customer. These arrangements can have various structures and characteristics, which may affect their treatment under the proposed amendments. In a typical sleeved PPA, the retailer enters into back-to-back agreements with both the generator and the customer, managing the physical delivery of electricity and associated market risks. This structure allows customers to have a direct contractual relationship with a specific renewable energy project while benefiting from the retailer's expertise in risk management and ensuring a stable supply.
7. The general process of establishing a sleeving arrangement is:
 - (1) The buyer agrees to a PPA price with the renewable electricity generator for purchasing its electricity.
 - (2) The buyer enters into a back-to-back PPA with a retailer who supplies the electricity to the buyer's site – Typically includes a sleeving fee and provisions such as the retailer providing top up volumes.
 - (3) The generator transfers the volumes under the PPA to the retailer selling into the grid. The retailer will sleeve the PPA in its portfolio and provide electricity to the buyer.

These steps are illustrated in the diagram below.



8. The complexity and variety of sleeved PPA structures mean that their treatment under the proposed amendments may not always be clear. While some sleeved PPAs might fall within the scope of the proposals, others may not meet the specified characteristics, particularly regarding the degree of volume risk. Given this ambiguity, we recommend that the IASB

provide additional clarity by including an explanation about sleeved PPAs in the Basis for Conclusions. This would help preparers understand how to assess whether their specific sleeved PPA arrangements fall within the scope of the proposals and how the characteristics described in paragraph 6.10.1 might apply in the context of various sleeved PPA structures.

9. Sleeved PPA structures are also an example of how contractual arrangements can develop that will complicate the proposals. This further re-enforces our previous point that these proposals should be viewed as a temporary measure and a principles-based review needs to be undertaken.

Recommendations

10. We recommend that the IASB:
 - (a) Explicitly state that these amendments are intended to be temporary and commit to a principles-based review of the hedge accounting requirements to address the underlying issues in a more comprehensive manner.
 - (b) Consider whether the concept of storage of electricity can be included in the proposed amendments without causing unintended consequences. This could involve adding language that addresses the economic viability of storing electricity generated from renewable sources.
 - (c) Provide additional clarity in the Basis for Conclusions regarding the treatment of sleeved PPAs under the proposed amendments to help preparers understand how to assess whether their specific sleeved PPA arrangements fall within the scope of the proposals and how the characteristics described in paragraph 6.10.1 might apply in the context of various sleeved PPA structures.

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

11. We agree with the proposed changes to the own-use requirements in paragraph 6.10.3 of the amendments to IFRS 9. These proposals provide much-needed clarity on how entities should apply the own-use requirements to contracts for renewable electricity with specified characteristics. However, we have some observations.
12. As New Zealand’s electricity market is a gross pool market, achieving physical delivery is very difficult. For this reason, the proposals related to own-use have limited applicability in our jurisdiction. Despite this, we believe that the proposals will still be beneficial for some entities in New Zealand such as special purpose vehicles for renewable energy infrastructure projects . These entities often use PPAs to secure cash flows prior to commencing or completing a project
13. While we acknowledge the limited impact these proposals will have in New Zealand due to our gross pool market structure, we believe it is important to maintain consistency in standard-setting approaches across different types of contracts and markets.

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?

14. We broadly agree with the proposed amendments to the hedge accounting requirements in paragraphs 6.10.4-6.10.6 of IFRS 9 as a temporary solution to address the practical issues with applying hedge accounting to PPAs for entities in gross pool markets. However, we have some concerns and suggestions for improvement.
15. The hedge accounting proposals could provide relief from existing complexities in applying hedge accounting to PPAs. We believe that the option to hedge a nominal variable volume of electricity alleviates some of the most significant challenges of applying the current requirements.
16. Specifically, the proposals appear to be aimed at addressing the granularity with which entities would be required to model demand and supply for the purpose of applying the hedge accounting requirements while avoiding volume driven hedge ineffectiveness. However, it is not completely clear from the drafting whether the proposals are intended to have this effect. If that is the intention, we recommend the IASB clarify that in the amendments before they are finalised.
17. Similarly, the proposal to allow designation of a percentage of output for sellers of renewable electricity was viewed positively by our stakeholders. We agree that it is a pragmatic solution for cases like new renewable energy infrastructure development.

Concerns and Challenges:

18. Highly probable criterion:
 - (a) We have received mixed feedback from New Zealand stakeholders about the 'highly probable' criterion in paragraph 6.10.4(b):
 - (i) Concerns were raised about the potential complexity of meeting the documentation requirements for the "highly probable" criterion, particularly when modelling and documenting probability for numerous contracts across various time frames, including very long term contracts extending beyond 20 years. This complexity increases further as the frequency of clearing periods increases.
 - (ii) Conversely, we also received feedback suggesting that modelling energy output may not be as difficult as implied during this project and therefore that some entities are already applying hedge accounting for similar contracts under the existing requirements.

- (b) Stakeholders also raised some more specific questions about how outages and similar periods of low demand or consumption should be factored into the highly probable requirements.
19. Given these mixed concerns, we recommend that the IASB provide additional guidance or examples to clarify the application of the "highly probable" criterion in the context of contracts for renewable electricity.
20. Managing exposures collectively:
- (a) We believe the proposed amendments may have limited usefulness for large entities with extensive portfolios that manage their exposures collectively. These entities often employ complex risk management strategies that involve a mix of various instruments and contracts, including PPAs, spot market transactions and financial derivatives. The current hedge accounting requirements, and even the proposed amendments, do not adequately capture the economic reality of such portfolio-level risk management.
 - (b) The specific hedged item to hedging instrument approach required by current hedge accounting rules, and maintained in the proposed amendments, does not reflect how electricity retailers actually manage their risks. For instance, an entity might use a combination of PPAs, spot market purchases, and financial derivatives to manage its overall exposure to electricity price risk. However, the current and proposed hedge accounting models do not allow for cash flow hedges that constitute a net position as a hedged item (unless they relate to foreign currency risk), nor do they easily accommodate the dynamic nature of these risk management strategies.

Recommendation:

21. While we agree with the proposals as a temporary solution, we recommend a more holistic re-examination of hedge accounting to better reflect the economic reality of how these risks are managed by entities. During our outreach, stakeholders expressed a preference for maintaining a principles-based approach to hedging that would allow for effective economic hedges to be reflected in financial statements, regardless of the specific market structure or contract type.
22. Our view is that this implies an economic/portfolio hedging approach similar to that currently being developed in the dynamic risk management project may be appropriate for these entities. We encourage the IASB to consider how the principles from that project could be applied or adapted to address the hedging challenges specific to contracts for renewable electricity.
23. Furthermore, we believe the forthcoming Post-Implementation Review (PIR) of IFRS 9 presents an opportunity to consider a more comprehensive, principles-based approach to hedge accounting. This approach should consider various arrangements used in risk management strategies, including Financial Transmission Rights (FTRs). FTRs are a significant risk management tool frequently used by New Zealand entities, but they cannot be hedge accounted for under current or proposed rules. Including such instruments in a broader review of hedge accounting principles would help ensure that the standard better reflects the economic reality of risk management in diverse market structures.

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?

24. We partially agree with the proposed disclosure requirements in paragraphs 42T–42W of the amendments to IFRS 7. While we believe these disclosures are generally appropriate in large markets where PPAs are common, we have concerns about their application in smaller markets like New Zealand, where PPAs are relatively rare.

Commercial Sensitivity Concerns:

25. During our outreach, stakeholders raised concerns about the commercial sensitivity of disclosures related to PPAs. They emphasised that pricing information can be highly sensitive, particularly for high-value, long-term contracts involving extensive negotiations. In New Zealand, only 3-5 significant PPAs are currently being entered into per year, making it a small market for these contracts. Despite the requirements in paragraph B3 of IFRS 7 permitting aggregation to avoid disclosing commercially sensitive information, we are concerned that having such a low number of contracts could still make sensitive contract terms potentially identifiable.
26. As there is no generally applicable framework in IFRS that explains when information is commercially sensitive, in considering the concerns mentioned above we examined the current regulatory disclosure requirements in New Zealand for PPAs and other risk management contracts in the electricity sector. This analysis was conducted to identify:
- (a) Whether the information required in the ED is already publicly available and therefore unlikely to be commercially sensitive.
 - (b) If the information is not publicly available, whether the rationale for not making that information public is related to commercial sensitivity.
27. The current regulatory framework in New Zealand requires disclosure of key contract details such as volume and contract period for risk management contracts, including PPAs. Consistent with the decision made by the IASB during the development of the amendments, contract pricing information is not made publicly available due to its commercial sensitivity.
28. The regulatory approach in New Zealand also considers the ability of competitors to act on the information to the significant detriment of the entity. By not publishing contract prices or information about the parties to the contract, the current regulations aim to prevent the identification of specific entities and their contractual terms, which could be sensitive in a small market.

29. Our view is that the proposed IFRS 7 disclosures are broadly consistent with the current regulatory disclosure requirements in New Zealand, except for the option to disclose fair value, which we note is already required under the current requirements in IFRS 7 for PPAs being accounted for as derivatives.
30. However, the fact that IFRS disclosures appear within an entity's financial statements inherently identifies one party to the contract, which could potentially reveal commercially sensitive information in a small market like New Zealand. We are concerned that this risk could therefore result in entities attempting to obscure the information or otherwise failing to comply with the spirit of the requirements.

Fair Value Disclosure

31. We received mixed views from stakeholders regarding the requirement in paragraph 42T of the ED to disclose either the fair value or expected volume of electricity to purchased or sold under the PPA. Overall, we do not have any concern with retaining the option to disclose fair value as disclosure of the fair value of PPAs being accounted for as derivatives is already required under the current requirements.

Proportion of renewable electricity

32. In considering the drafting of paragraph 42U and 42V(a), we acknowledge the IASB's intention as outlined in BC41-BC48, to provide users with information about an entity's exposure to volume risk and variability in electricity prices through these disclosures. We agree that disclosing the proportion of total purchases and sales represented by contracts for renewable electricity is relevant to financial statements, as it relates to understanding financial effects and risks related to the contracts covered by the ED proposals.
33. However, we are concerned that the current description of the information to be disclosed under paragraphs 42U and 42V(a) may result in misinterpretation about the scope of the disclosures. Specifically, we are concerned that the current description implies the disclosures are a sustainability related metric outlining the proportion of electricity purchased or sold from renewable sources, as opposed to a disclosure highlighting the risk the entity is exposed to as a result of the specific contracts covered by the ED proposals.
34. To achieve the intended disclosure objective while addressing potential misinterpretation, we recommend entities are required to clearly label the disclosures to make it explicit that the proportion only relates to renewable electricity contracts with particular characteristics and providing guidance on how to present the information to avoid misinterpretation.

Scope of IFRS 7

35. We note that the proposed amendments would require disclosures for contracts that qualify for the own-use exception, which are currently outside the scope of IFRS 7. This creates a potential inconsistency in the application of IFRS 7. To address this, we believe it is necessary to include a specific scope-in paragraph in IFRS 7 for these contracts. This would ensure clarity and consistency in the application of the disclosure requirements.

Recommendations

36. We recommend:

- (a) Clarifying how the aggregation requirements in paragraph B3 of IFRS 7 can be applied in the context of PPAs to avoid disclosing commercially sensitive contract information, particularly in small markets like New Zealand where relatively few PPAs exist.
- (b) Considering whether there are common disclosure requirements among local market regulators in relevant jurisdictions to inform the disclosures in IFRS 7. Maintaining some degree of alignment would help ensure that commercially sensitive information is not disclosed, ensure consistency, and avoid potential conflicts or overlaps in disclosure requirements.
- (c) Requiring clear labelling of the disclosures to explicitly state that they relate only to renewable electricity contracts with particular characteristics (as defined in paragraph 6.10.1 of the ED), and providing guidance on how to present this information to avoid misinterpretation. This would help users understand the scope of the information presented and ensure a clearer understanding of what the disclosed information represents in the context of an entity's overall risk exposure due to contracts for renewable electricity.
- (d) Including a specific scope-in paragraph in IFRS 7 for contracts that qualify for the own-use exception but are subject to these disclosure requirements.

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?

37. We do not have any specific comments on these proposals except that we consider our comments in response to question four above are also relevant to the proposed disclosures for IFRS 19.

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?

38. We agree with these proposals. We believe the approach is pragmatic and appropriate to resolve the underlying issues in a reasonable timeframe.

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?

39. We agree with an effective date of 1 January 2025 as the amendments are intended to resolve a significant current issue.