Snapshot

by Capital Markets & Accounting Advisory Services

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New ‘own-use’ and hedging guidance for contracts referencing nature-dependent electricity

What’s the issue?

Contracts for electricity generated from nature-dependent sources such as wind or solar have become more prevalent in many entities’ carbon mitigation journey.

These contracts are often structured as long-dated power purchase agreements ("PPAs") with a unique characteristic that nature-dependent sources determine whether and how much electricity is generated by the referenced facility at any point in time. This has created challenges in practice in accounting for these contracts - particularly the application of the MFRS 9 ‘own-use exemption' to contracts for the receipt of electricity that can be settled net ('physical PPAs').

What are the key changes?

1) The 'own-use exemption' amendments

- The amendments added the buyer's application guidance clarifying that the buyer are allowed to apply the MFRS 9 ‘own-use exemption’ to account for contracts referencing nature-dependent electricity if the buyer has been, and expects to be, a ‘net purchaser’ of electricity for the contract period, based on the criteria set in the standard.

What are the key changes? (continued)

1) The 'own-use exemption' amendments (continued)

- A buyer is a “net purchaser” if it buys sufficient electricity to offset any sales of unused electricity in the same market in which the entity sold the electricity. When determining whether it is a ‘net purchaser’, the buyer should consider reasonable and supportable information available without undue cost or effort about its past, current and expected future electricity transactions over a reasonable amount of time. Judgement needs to be applied when determining what is a ‘reasonable amount of time’ considering the seasonal cycle of natural conditions and the entity’s operating cycle. The amendments do, however, provide a 12-month backstop. As a result, when the buyer determines whether it has been a net purchaser, a 'reasonable amount of time’ should not exceed 12 months.

- The application guidance only applies if both of the following conditions are met:

  - the contract obliges the buyer to buy and take delivery of electricity when it is generated; as a result, the buyer is exposed to the risk of being required to buy electricity during a delivery interval in which it cannot use the electricity; and

  - the design and operation of the market in which the electricity is transacted under the contract require the buyer to sell any amounts of unused electricity within a specified time; as a result, the buyer has no practical ability to avoid selling any amounts of unused electricity.

What are the key changes? (continued)

2) The hedge accounting amendments

a) Variable notional amount

- For contracts referencing nature-dependent electricity designated as hedging instruments, the amendments permit an entity to designate the hedged item as 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.

b) Highly probable requirement

- If the cash flows of the hedging instrument are conditional on the occurrence of designated forecast transaction, that forecast transaction is presumed to be highly probable.

3) Disclosures

- The amendments added new disclosure requirements applying to physical PPAs for nature-dependent electricity that are accounted for as "own-use" contracts to enable investors to understand the effect of these contracts on an entity's financial performance and cash flows.

- New disclosures under the amendments include:

    - the contractual features that expose the entity to the variability of the underlying amount of electricity and to the risk that the entity would be required to buy electricity during a delivery interval in which it cannot use the electricity;

    - the unrecognised contractual commitments, including the estimated future cash flows from buying electricity under these contracts; and

    - the effect of the contracts on the entity's financial performance during the reporting period including:
        - the total cost of purchases under the contracts;
        - how much of the purchased electricity was unused;
        - the proceeds of sales of unused electricity; and
        - the cost of purchases made to offset the sales of unused electricity.

What are the key changes? (continued)

3) Disclosures (continued)

- For contracts referencing nature-dependent electricity designated as hedging instruments, an entity should disaggregate the information about terms and conditions of hedging instruments required by MFRS 7, so that this information is presented separately for contracts referencing nature-dependent electricity.

What is the impact of the new amendments and for whom?

- These amendments apply only to contracts referencing nature-dependent electricity that expose an entity to variability in the underlying amount of electricity because the source of its generation depends on uncontrollable natural conditions (such as the weather).

- The amendments do not apply to renewable energy certificates accompanied in those contracts referencing nature-dependent electricity.

Effective date and transition

The amendments are effective for annual reporting periods beginning on or after 1 January 2026. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

The 'own-use exemption' amendments

- Retrospective application, in accordance with MFRS 108 “Accounting Policies, Changes in Accounting Estimates and Errors” using the facts and circumstances at the date of initial application (the date when an entity first applies the amendments).

- An entity need not restate comparative information but is permitted to do so only if restatement is possible without the use of hindsight. If comparative information is not restated, the entity recognises the cumulative effect of initial application 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 meets the MFRS 9 ‘own-use exemption’ as a result of applying the amendments, an entity is permitted, at the date of initial application, to irrevocably designate this contract as measured at fair value through profit or loss.

Effective date and transition

The hedge accounting amendments

- Prospective application 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 applying the amendments.

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