SAICA DIFFERENCE MAKERS™

05 August 2024

International Accounting Standards Board
7 West Ferry Circus
Canary Wharf
London E14 4HD
United Kingdom
Email: commentletters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON ED/2024/3 – *CONTRACTS FOR RENEWABLE ELECTRICITY* – PROPOSED AMENDMENTS TO IFRS 9 AND IFRS 7

In response to your request for comments on ED/2024/3 – *Contracts for Renewable Electricity* – Proposed Amendments to IFRS 9 And IFRS 7, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC), which comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this Exposure Draft.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Prof Ahmed Mohammadali-Haji
Chairperson: APC

Mulala Ratshitanga
Project Director: Financial Reporting

Cc: Bongeka Nodada
Executive: Corporate Reporting

Chartered Accountants Worldwide Member

NPO-020-050 VAT No. 4570104366 | 17 Fricker Place, Illovo, Sandton, Johannesburg, 2196 | Private Bag X32, Northlands, 2116 | TEL +27 8610 SAICA (72422), WEBSITE http://www.saica.org.za | EMAIL saica@saica.co.za | www.saica.co.za | www.accountancysa.org.za | Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People. Proudly South African.

OVERALL COMMENTS

It should be noted that similar to the dissenting views mentioned in the Exposure Draft, there were strong concerns raised by some members regarding the divergence from the general principles-based approach and the potential unintended consequences that this narrow "rules-based" approach specific for contracts for renewable electricity could have.

That being said, the majority of the members continued to be generally supportive of the Board providing additional guidance and relief to the own use exception in IFRS 9 for contracts for renewable electricity, subject to consideration being given to the additional improvements and clarification in the proposed guidance as detailed in our responses to the specific questions below, specifically clarifying what would be considered within the scope of the own use exception (as detailed under question 1) and how the own use requirement is applied (as detailed under question 2).

It should further be noted that there is a general disagreement with the proposed disclosure requirements as detailed under questions 4 and 5 and that there were also some disagreements raised on the proposed effective date of 1 January 2025 as detailed under question 7.

Our detailed responses to the specific questions are set out below.

Understanding the South African electricity environment

In order to provide additional context to some of the responses provided, we thought it best to provide additional information about the electricity environment in South Africa.

South Africa currently does not have an active market to trade electricity and hence entities historically rarely triggered the net-settlement provisions contained in IFRS 9 para 2.6 for power purchase contracts. However, we do envisage that as our electricity environment is rapidly developing, in the near future, more contracts could potentially be considered net-settled and hence within the scope of the amended guidance.

In addition, it should further be noted that due to the historic shortage in supply of electricity from South Africa's main electricity provider, ESKOM, many power purchase agreements historically were entered into mainly in order to secure the supply of electricity, rather than to purely transition to renewable electricity.

With regards to the hedging principles contained in the Exposure Draft, it should be noted that in our market we've not observed entities entering into the types of hedging contracts for renewable electricity contracts mentioned in the Exposure Draft yet and as such we currently did not provide detailed comments on the proposed amendments to the hedging principles.

SPECIFIC COMMENTS

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?

We recommend that the following key areas be clarified by the Board to ensure consistent application of the proposed guidance:

a) Paragraph 6.10.1(a) states that "*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*".

i) In our view, it is not clear whether this is referring to a "sole" source of supply of renewable electricity per contract. We can foresee a potential scenario where a customer may have a power purchase agreement which consists of a combination of both renewable energy sources and non-renewable energy sources, on the basis that the contract could be entered into for a dual purpose, i.e. to secure the supply of electricity and to source electricity from renewable sources. The question that arises is whether in such a scenario,

- the criteria of paragraph 6.10.1(a) are not met and hence the additional exception cannot be applied in its totality to such a contract,
- the contract can be split into the different components and each component be assessed separately against the requirements of paragraph 6.10.1(a), or
- it would be appropriate for a "substantially all" threshold to be applied to these in contracts similar to the requirements in paragraph 6.10.1(b), i.e. if substantially all the electricity is from renewable sources, the criteria in paragraph 6.10.1(a) can still be met.

We therefore recommend that the Board provide additional clarification guidance on what it considers to constitute the *"source of production of the renewable electricity is nature-dependent"* in this context.

ii) In addition to the above, a concern was raised that it is not clear how these scoping requirements should be applied in instances where there is an intermediary between the customer and the generator. For example, we can foresee a scenario where a customer enters into a power purchase agreement with an electricity supplier, where the electricity supplier is not necessarily the generator of the electricity. We recommend the Board provide further clarification on how the criteria in paragraph 6.10.1(a) should be applied in such a scenario and what is considered the "source of production of the renewable electricity", i.e. whether and to what extent can a "look-through" approach be followed.

b) Paragraph 6.10.1. (b) states that "*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*".

i) We observe from BC7 that the "pay-as-produced" features oblige the purchaser to buy electricity produced from a referenced production facility when the electricity is produced. In our view, the guidance is not clear on situations where there are multiple off takers from a single production facility. We recommend the Board clarify that the volume risk in paragraph 6.10.1(b) is referring

to the exposure under the contract and not the production facility to provide clarity for multiple offtake arrangements.

ii) We observe that the nature dependency creates uncertainty and that the volume risk exposure under contracts for renewable energy arises due to current challenges in storing electricity. We can foresee that there may be future technological advances of electricity storage solutions such as improved economical battery solutions. In order to future proof the amendments, we recommend the Board include considerations on how the electricity storage solutions would impact the application of paragraph 6.10.1(b), taking into consideration both the ability as well as the feasibility to store electricity as technological advancements may be adopted earlier in some jurisdictions compared to others. The feasibility to store electricity should be considered holistically to include operational, economical and technological feasibility.

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?

We recommend that the following key areas be clarified to ensure consistent application of the proposed guidance:

Paragraph 6.10.3(b)(iii) - states that the *entity expects to purchase at least an equivalent volume of electricity within a reasonable time (for example, one month) after the sale.*

i) Clarification is needed to understand whether reference to *"at least an equivalent volume"* requires it to be an excess purchase. We observe from paragraph BC20 the principle that the entity should remain in a *"net-purchaser position"* to meet the requirements of Paragraph 6.10.3(b)(iii). We recommend the Board update the wording in paragraph 6.10.3(b)(iii) to reflect this concept of the entity remaining a "net purchaser" over a reasonable amount of time, to make the wording in the proposed amendment clearer.

ii) Clarification would then further be needed to understand how the concept of *"net-purchaser position"* is applied, especially where entities are operating in different locations and jurisdictions and have access to different electricity grids, for example, does the purchase of at least an equivalent volume of electricity have to be by the same business unit or entity in the same location/jurisdiction as the excess sales.

iii) An example of an area that could need to be considered when applying the "*net-purchaser position*" is where entities enter into contracts for own use purposes, but production from the renewable energy plant starts before the related project construction is completed ("ramp-up contracts"). The entity may be in a "net seller position" until the construction is complete. Clarification is needed as to whether these situations have been considered by the Board and if these contracts are eligible for the own-use exemption on initial recognition when making the assessment in accordance with 6.10.3. For e.g., is the entity able to consider the 1–2-year period of selling

(during the construction period) in the context of the entire term of the power purchase agreement in making their own-use assessment?

iv) With reference to the electricity shortage in the South African market, and many other emerging markets, entities may enter into power purchase agreements with the primary objective of having access to a secure supply of electricity. In order to achieve this objective, entities might agree to over-sized contracts with renewable energy providers resulting in consistent selling activity due to the excess. In these situations, the purpose is still to obtain electricity for its own use. Clarification is needed as to whether these contracts would be eligible to meet the requirements of paragraph 6.10.3(a) & (b).

v) We are concerned that the reference to the "one month" example could be misinterpreted to create a "rule". On the basis that we are concerned that a one-month period is too short to cater for seasonality (for example, the production of solar energy is higher in summer months compared to winter months), we recommend that the Board delete the specific reference to the "one month" example in this paragraph.

In order to further address some of the points raised above, we recommend the Board consider including practical application guidance and illustrative examples to assist stakeholders with the application of the principles in Paragraph 6.10.3(b)(iii).

Additional consideration regarding intergroup arrangements

It should be noted that in South Africa, we apply IFRS® Accounting Standards in the separate financial statements of companies, even if the entity is part of a group for which consolidated financial statements are prepared.

We have seen scenarios locally where one entity within the group (for example the treasury company) enters into the contract for renewable electricity for the group as a whole. The treasury company would then on-sell the electricity to the other members in the group. We request that the Board consider providing additional relief for these types of contracts for the separate financial statements of the treasury company. We believe this can be achieved by expanding the reference to an *"entity's electricity demand"* in paragraph 6.10.3(b)(i) by considering the wider group level demand for such an individual entity. This can be ring-fenced to scenarios where the treasury company only sells the electricity to other entities within the group. If this additional relief is not provided, the result could be that the treasury company may be required to fair value the contract in its separate financial statements as it potentially won't meet the own use exception, whereas at the consolidated group level, the group would be able to apply the own use exception. We are of the view that this would not provide useful information to the users of those separate financial statements.

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?

As indicated above, in the South African territory, we currently have not seen these types of hedging contracts for electricity from renewable sources mentioned in the Exposure Draft and thus we are currently not in a position to conclude on whether we agree that the proposed amendments would assist with stakeholders' concerns. However, as we have a fast-developing electricity environment, we may see this become more prevalent going forward.

For this reason and given the complexity of hedge accounting, we recommend the Board provide practical application guidance and examples. In particular, we would recommend including practical examples of contracts which would qualify for hedge accounting and contracts which would not qualify for hedge accounting.

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?

We currently do not agree with the proposed disclosure requirements.

a) It is observed in paragraph 42T-42V of the proposed amendments to IFRS 7, that the disclosure requirements are applicable to contracts for renewable electricity which have the characteristics in paragraph 6.10.1 of the proposed amendments to IFRS 9. This could potentially be interpreted to capture more contracts than only those to which the proposed own use amendments have been applied. We also note that IFRS 7 and IFRS 13 already require disclosures for derivative contracts which would be expected to capture power purchase agreements accounted for as derivatives (for e.g., virtual power purchase agreements). It is our understanding that the intention is for the additional disclosure requirements to be applied more narrowly. We therefore recommend that the Board specifically clarify that the additional disclosure requirements apply only to the contracts for renewable electricity for which the own use exception under the proposed amendments of paragraph 6.10.3 have been applied.

b) We are of the view that the current proposed disclosure requirements in paragraph 42U and 42V are too detailed and have too much focus on non-financial sustainability reporting.

In our view, the disclosure objective should rather focus on how the exception in the amendment has been applied, i.e. disclosure requirements for considerations regarding the nature and extent of excess sales. We believe the amendment has been designed to provide specific relief to preparers based on the facts and circumstances and in our view, this provides more useful information for users of the financial statements in understanding how the preparer has applied the amendments.

In addition, in order to provide users with information regarding the future potential cash flows, we recommend the Board to consider requiring disclosure requirements similar to the disclosure requirements for contractual commitments currently included in other standards, for example IAS 16 (contractual commitments for the acquisition of property, plant and equipment) instead of the current requirements included in para 42V of the proposed amendment. Given that many of the contracts for renewable energy are long-term in nature, in our view this provides more useful information for users of the financial statements to understand an entity's exposure to future cash outflows.

c) Regarding some of the specific requirements, we have the following observations and recommendations

i) Paragraph 42T(a) - *requires disclosures regarding cancellation clauses*- Due to the fact that these contracts are long term in nature and are nature dependent, a recommendation was made to clarify that it should be clear that the cancellation clauses should include the ability to cancel by either party.

ii) We observe paragraph 42T(b)(ii) mentions that "*An entity is permitted to provide this information as a range for each of these periods: not later than one year; later than one year and not later than five years; and later than five years".* We are concerned that the time buckets provided in the paragraph seem to be prescriptive. We recommend the Board consider including some flexibility to allow preparers to choose a more specific range similar to the wording in IFRS 7 paragraph B11 which allows preparers to use judgement in determining the appropriate time bands for the liquidity risk disclosures.

iii) If the disclosure requirements in Paragraph 42V is retained, we note the following concerns, specifically linked to sub-paragraph (c) which requires disclosure of *"the average market price per unit of electricity in the markets in which the entity purchased electricit*y" together with sub-paragraph (d) explaining the difference to actual cost: Given the complexity surrounding pricing structures of electricity, especially in the South Africa context, in our view preparers will experience challenges to derive the average market price per unit of electricity. In addition, we are concerned that there is the potential of confidential information being required to be disclosed. We would therefore not be supportive of retaining this disclosure.

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?

We disagree with the proposed amendment to IFRS 19.

We do not support the proposal that the detailed disclosure requirements should be mandatory for subsidiaries without public accountability. We believe that the disclosures could be made optional in instances where the information would be considered useful to the users of these financial statements, for example by a provider of finance.

If the mandatory disclosure requirements are retained, we would request that an equivalent paragraph similar to the proposed amendment to IFRS 7 paragraph 42W which allows preparers to apply judgement in determining how much detail to disclose, be included for IFRS 19. Currently this paragraph is omitted from the proposed amendments to 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?

a) Some concerns were raised that applying the transition requirements for the own use exception without using hindsight would potentially be difficult to apply. A suggestion was made to include a provision that allows the own use exception assessment to be performed at the opening balance date of the comparative period (for example 1 January 2024), or on the date the amendments are issued, rather than requiring the assessment to be performed at contract inception date.
b) As mentioned above, as we currently have not observed these types of hedges in our territory, we do not have any specific comments on the transition requirements for the proposed hedge accounting.

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?

It is our understanding that the intention is for the additional disclosure requirements to be applied more narrowly only to the contracts for renewable electricity for which the own use exception under the proposed amendments of paragraph 6.10.3 have been applied. We have recommended the Board provide clarification of this in Question 4 above. Should our interpretation be incorrect, ie. the disclosure requirements are applicable wider to capture all contracts for renewable energy, for eg, renewable electricity contracts that are executory in nature and cannot be settled net in cash, we are

concerned that an effective date of 1 January 2025 would not provide preparers in South Africa with sufficient time to gather the required information for an effective transition. Significant effort may be required of preparers to source the data, particularly for the detailed disclosure requirements (if retained, refer our comments on question 4 above), in time to apply the standard from 1 January 2025. We acknowledge that there is a need for an earlier application date by some entities and specific jurisdictions that have urgently called for these amendments. We believe that this can still be achieved by allowing for early adoption. We further note that the proposed approach is inconsistent with that followed by the IASB on the recent IFRS 9 amendment dealing with the classification and disclosure of financial assets with environmental, social and corporate governance (ESG) and similar features. We therefore request that the Board provide the normal transition timeline with an option for early adoption to provide flexibility for those entities which require the proposed amendments to be applied earlier, but not require mandatory adoption from 1 January 2025 on all entities affected.