Accounting for power purchase agreements in terms of IFRS

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Entities have increasingly entered into power purchase agreements (PPAs) over the past 10 years or so. This trend seems to be growing steadily as the drive towards renewable energy expands globally. A wide variety of labels are given to PPAs to describe the different variations of these agreements that exist in practice. This article briefly outlines some considerations that are relevant when accounting for these arrangements in terms of IFRS.

There is a global drive towards renewable energy. In this context, entities have increasingly entered into renewable power purchase agreements (**'PPAs'**). These agreements enable funding of the development of medium to long-term investments in renewable energy. They provide off-takers with a mechanism to secure a supply of green energy at a set price.

PPAs are categorised in various ways. These include on-site or off-site PPAs, physical or virtual/synthetic PPAs, retail or corporate PPAs, direct or sleeved PPAs, etc. This article outlines some considerations that are relevant when accounting for PPAs.

Lease

IFRS 16 governs lease accounting. A lease is:

> A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

The standard provides detailed guidance on the application of this definition. The right to use an asset requires that an entity controls the use of an identified asset for a period of time. IFRS 16.B9 states that this requirement is met if the customer has both

- The right to obtain substantially all the economic benefits from the use of the identified asset, and
- The right to direct the use of the identified asset.

Direct or on-site PPAs often meet these requirements.

The IASB's IFRS Interpretations Committee (**'the IFRIC'**) considered whether a PPA concluded in a gross pool electricity market where registered suppliers supply electricity into the grid from which a market operator distributes it to consumers was a lease. In the scenario considered, a supplier and consumer who were both registered participants in the gross pool electricity market concluded an agreement in terms of which they identified a specific windfarm and agreed to swap the spot price per megawatt of electricity supplied by that windfarm to the grid for a fixed price per megawatt, to be settled net in cash between the parties. The supplier also agreed to transfer all the renewable energy credits from the windfarm to the customer. The question was whether this arrangement, which essentially transferred price risk of the electricity produced by the windfarm to the customer, resulted in the customer obtaining the right to substantially all the economic benefits from the use of the windfarm. The IFRIC concluded in an agenda decision that since the customer does not have a right nor an obligation to obtain any electricity produced by the windfarm and supplied to the grid, it did not have the right to obtain substantially all the economic benefits from the use of the windfarm and the arrangement was therefore not a lease. This is the case despite the fact that it may in substance be economically similar to a PPA that involves taking direct delivery of the windfarm's electricity.

Derivatives and commodity contracts

PPAs represent contracts to buy (off-taker) or sell (generator or supplier) electricity, a non-financial item. If these contracts are settled net in cash or another financial instrument, they may have to be accounted for as financial instruments - in most instances, as derivatives - unless they were entered into by the entity for purposes of its own electricity usage requirements. Own-use contracts are generally accounted for as sales or purchases when the underlying transactions occur. However, even an own-use contract may in some instances be designated as measured at fair value through profit or loss.

If the PPA is entered into as a hedge for future electricity sales or purchases, as they often are, hedge accounting may also come into play.

In conclusion

The accounting considerations in this brief article are by no means intended to a comprehensive overview of all possible accounting considerations for PPAs. The detail terms and features of the PPA as well as the regulatory environment, rather than merely the label attached thereto, must be considered closely to identify the arrangement's accounting implications.

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