BHILAI BRANCH OF CIRC OF ICAI

Comment Letter on Exposure Draft issued by ICAI

Contracts Referencing Nature-dependent Electricity: Amendments to Ind AS 109 and Ind AS 107

Day/ Date	Thursday, 30th April, 2025	Team	CA Pradeep Pal CA Ajay Somani CA Prashast Vikram CA Rutuja Lathi

We welcome the opportunity to comment on the above-mentioned Exposure Draft (ED) issued by the Accounting Standards Board of ICAI on April 17, 2025. We appreciate the ASB's initiative to converge Ind AS with the recent IASB amendments (issued in December 2024) to IFRS 9 and IFRS 7.

1. Present Treatment under Ind AS 109 & Ind AS 107

A. Ind AS 109 – Financial Instruments

i. Contracts to buy/sell non-financial items like electricity are generally outside the scope of Ind AS 109 if they are settled by physical delivery and held for the purpose of the entity's own use (Paragraph 2.4).

ii. Such contracts fall under Ind AS 109 if:
- They are net-settled in cash or other financial instruments;
- They contain embedded derivatives;
- They are designated at fair value through profit or loss (FVTPL) to eliminate accounting mismatches (Paragraph 2.5);
- They are not held for expected purchase, sale, or usage requirements (Paragraph 2.6).

B. Ind AS 107 – Financial Instruments: Disclosures

Entities must disclose the nature and extent of risks arising from financial instruments.

No specific disclosure requirements exist for nature-dependent electricity contracts unless covered under Ind AS 109.

2. Proposed Changes as per ICAI Exposure Draft

The ED addresses accounting for contracts referencing nature-dependent electricity – typically renewable energy Power Purchase Agreements (PPAs) whose outputs vary with uncontrollable natural factors (e.g. weather) – by proposing targeted changes to Ind AS 109 Financial Instruments and Ind AS 107 Financial Instruments: Disclosures.

A. Amendments to Ind AS 109 – Financial Instruments

i. **Definition** (Para 2.3A): Introduces contracts referencing nature-dependent electricity (e.g., solar, wind), which expose entities to variability due to natural conditions.

ii. **Evaluation for Own Use** (Paras 2.8, B2.7, B2.8):
- Contracts may still be considered for own use if the entity is a net purchaser over a 12-month period.
- Assessment considers expected and historical usage.

iii. **Hedging Provisions** (Paras 6.10.1–6.10.2):
- Allows forecast transactions to be hedged even if variable in nature.
- Forecast transactions presumed highly probable.

iv. **Transition Provisions** (Paras 7.2.51–7.2.53):
- Retrospective application with option not to restate prior periods.
- Option to designate contracts at FVTPL at transition date.
- Prospective hedge accounting for new relationships.

B. Amendments to Ind AS 107 – Financial Instruments: Disclosures

i. Para 30A: Single note disclosure requirement for contracts.

ii. Para 30B: Risk-category-wise disaggregation of hedging contracts.

iii. Para 30C: Cross-referencing if disclosures are presented in other notes.

3. Suggested Refinements for Consideration:

Area	Current Proposal	Suggested Enhancement	Remarks
Disclosure Clarity	Ind AS 107.30A–30C disclosures required but no illustrative format provided	ICAI should issue illustrative disclosures (e.g., sample “single note” for a solar or wind PPA) under Ind AS 107.30A–30C	Help smaller companies and new preparers ensure consistency; minimize diversity in practice
Guidance or a quantitative threshold on 'Net Purchaser' Test / Own-Use Exemption	General guidance on using reasonable information for 12 months	ICAI should issue a Technical Guide or FAQs to support in applying the exemption consistently.	
Transition Clarifications	Optional designation at FVTPL at initial application (7.2.52) The amendments should be applied	ICAI should encourage disclosure of reasons for choosing FVTPL (even if not mandatory) The amendments should be applied retrospectively	Enhances transparency and helps users understand management intent at transition Retrospective application could create practical

Area	Current Proposal	Suggested Enhancement	Remarks
	retrospectively with the option to restate prior periods only if possible without hindsight. (Paragraphs 7.2.51–7.2.53)	with the option to restate prior periods only if possible without hindsight. (Paragraphs 7.2.51–7.2.53)	challenges. Clearer guidelines reduce administrative burden and ensure consistent implementation.
Interaction with Ind AS 37 (Onerous Contracts)	Reference made but no linkage provided	ICAI should clarify by way of FAQ: whether normal fluctuation in generation vs demand automatically triggers Ind AS 37 provisions	Avoids over-creation of onerous provisions unnecessarily
Scope - Nature-dependent Electricity	Contracts referencing nature-dependent electricity are defined as those exposed to variability in electricity due to uncontrollable natural conditions (e.g., weather). (Paragraph 2.3A)	Expand and clarify the definition of 'nature-dependent electricity' to explicitly include examples like wind, solar, and hydroelectric energy sources.	Clear examples will prevent misinterpretation and ensure consistent application, especially in the growing renewable energy sector.
Hedge Accounting	Contracts referencing nature-dependent electricity may be designated as hedging instruments for forecast electricity transactions. (Paragraphs 6.10.1–6.10.2)	Provide clearer guidance on the assessment and measurement of forecast transactions, particularly on how probability of forecast electricity transactions should be assessed and how deviations should be handled.	The volatility in nature-dependent electricity requires clearer guidelines to ensure accurate hedging and consistent reporting.
Disclosure Requirements	Entities must disclose information on contracts referencing nature-dependent electricity, focusing on variability in electricity and commitments. (Paragraphs 30A–30C)	Establish a standardized format for disclosures, including quantitative and qualitative information on effects of contracts on financial performance, commitments, and potential onerous contracts.	Standardized disclosures improve comparability and transparency. It helps stakeholders assess financial risks and volatility accurately.

Area	Current Proposal	Suggested Enhancement	Remarks
Measurement of Contracts	No specific guidance for measurement of contracts referencing nature-dependent electricity regarding fluctuating electricity prices and unused electricity. (Paragraphs 2.4–2.5)	Provide detailed guidance on how to measure such contracts, particularly focusing on fair value measurement of contracts involving unused electricity and fluctuating electricity prices.	Fair value measurement ensures consistent and accurate reporting of volatile electricity contracts, enhancing the financial transparency.

4. Detailed comments are set out below for your kind consideration:

I. Technical Observations on Accounting Treatment and Scope Exclusions

- The introduction of paragraphs 2.3A–2.3B in Ind AS 109, defining "***contracts referencing nature-dependent electricity***" and clarifying that these amendments are restricted solely to such contracts.
- The addition of Application Guidance (B2.7–B2.8) introducing the "***net purchaser" test*** enhances the consistency and rigor in applying the "own-use" exemption for renewable energy contracts.
- The application of hedge accounting (paragraphs 6.10.1–6.10.2) for variable nominal amounts of electricity, facilitating better alignment with economic hedging strategies.

Overall, the amendments preserve the integrity of Ind AS 109's scope principles and appropriately address industry-specific nuances.

II. Practical Implications for Renewable Energy Entities

- The amendments offer substantial relief and clarity for renewable energy producers and industrial consumers by safeguarding the own-use treatment where appropriate, thereby minimizing undue earnings volatility.
- The flexibility introduced for hedge accounting will encourage corporates to engage in long-term renewable PPAs without the fear of accounting mismatches.
- Entities involved in electricity trading activities are appropriately excluded from these relaxations, ensuring that trading contracts continue under fair value accounting.

III. Suggestions on Disclosure Requirements and Transition Provisions

- The proposed centralized disclosure notes (Ind AS 107.30A–30C) is highly welcome as it will enhance transparency regarding commitments, risks, and financial impacts related to nature-dependent electricity contracts.

- **Recommend that ICAI provide illustrative examples in the Implementation Guidance to assist preparers in understanding and complying with the new disclosure requirements.**
- The transition provisions (**allowing prospective application without restatement of prior periods**) are practical and should be retained as proposed.
- Further, entities should be encouraged to explicitly disclose the nature and quantitative impact of any adjustment to opening reserves upon initial application.

IV. Comments on Convergence with IFRS Standards

- Observed that the amendments are substantially converged with the IASB's December 2024 amendments to IFRS 9 and IFRS 7.

5. Impact Assessment on Financial Statements

The proposed amendments will affect several aspects of financial reporting – **recognition, measurement, disclosures, and hedging strategies** – for entities party to nature-dependent electricity contracts. Below, we summarize the impact in each area:

I. Recognition (Balance Sheet Presentation):

Contracts meeting the new own-use exception (net purchaser test) will no longer be recognized as financial instruments under Ind AS 109. Instead, they will be treated as executory contracts with no initial recognition on the balance sheet, except where they become onerous (in which case Ind AS 37 applies). This eliminates the need to account for such PPAs as derivatives at fair value, reducing reported derivative positions and associated P&L volatility. For example, entities with existing derivative liabilities on fixed-price PPAs (due to falling forward prices) can now derecognize these, unless they opt for FVTPL designation at transition. Conversely, contracts where the entity is a net seller will remain within the scope of Ind AS 109. Under the revised treatment, the income statement will reflect actual purchase costs and sale proceeds, improving earnings stability and aligning accounting with operational intent.

II. Measurement (Valuation and Profit & Loss Impact):

Contracts qualifying for the own-use exemption are no longer subject to fair value measurement, reducing the need for complex valuations and improving earnings stability. Entities may choose to apply hedge accounting, but it's no longer a necessity many may let contract cash flows flow through operations. However, for contracts still within Ind AS 109 (or voluntarily designated at FVTPL), fair value accounting and related P&L impact will continue. The amendments also enhance hedge effectiveness by permitting variability in volume, thereby reducing hedge ineffectiveness. For own-use contracts that become onerous, Ind AS 37 will apply, requiring provisions based on expected losses, and associated disclosures will inform users accordingly.

III. Disclosures:

The amendments introduce detailed disclosure requirements under Ind AS 107, particularly through a dedicated note on nature-dependent electricity contracts. This will enhance transparency by including both qualitative and quantitative data—such as commitments, usage, and surplus statistics—enabling users to better assess exposure to renewable PPAs. While key line items (e.g., revenue and expenses) may reflect a change in presentation, net profit remains unaffected by disclosure alone. These enhanced notes will be critical for auditors, regulators, and investors in evaluating classification decisions and understanding a company's commodity risk profile.

IV. Hedging Strategies and Derivative Use:

The amendments are likely to influence risk management strategies, encouraging companies to adopt renewable PPAs as natural hedges due to reduced accounting complexity. With clearer own-use classification and support for hedge accounting of variable volumes, entities can shift from financial to physical hedging, improving alignment between economic reality and accounting. This may result in increased use of cash flow hedge accounting, with timing differences deferred to OCI.