

IFRS Developments

Nature-dependent Electricity - IFRS 9 and IFRS 7 amendments

What you need to know

- ▶ The amendments to IFRS 9 *Financial Instruments* (IFRS 9) are to the own-use requirements and hedge accounting requirements. There are also amendments to IFRS 7 *Financial Instruments: Disclosures* (IFRS 7).
- ▶ Under the Amendments, the sale of unused nature-dependent electricity will be in accordance with an entity's expected purchase or usage requirements provided that specified criteria are met.
- ▶ The Amendments will allow an entity to designate a variable nominal volume of forecast electricity transactions as a hedged item, if specified criteria are met.
- ▶ The effective date of the Amendments is for annual reporting periods beginning on or after 1 January 2026, with early application permitted.

Introduction

On 18 December 2024, the International Accounting Standards Board (the IASB) published Amendments to IFRS 9 and IFRS 7 - Contracts Referencing Nature-dependent Electricity ('the Amendments'). The Amendments:

- ▶ Clarify the application of the 'own-use' requirements for in-scope contracts
- ▶ Amend the designation requirements for a hedged item in a cash flow hedging relationship for in-scope contracts
- ▶ Add new disclosure requirements

Scope of the amendments

The Amendments only apply to contracts that reference nature-dependent electricity. These are contracts that expose an entity to variability in an underlying amount of electricity because the source of electricity generation depends on uncontrollable natural conditions, typically associated with renewable electricity sources such as sun and wind ('in-scope contracts').

Contracts referencing nature-dependent electricity include contracts to buy or sell nature-dependent electricity, as well as financial instruments that reference such electricity. The Amendments cannot be applied by analogy to other contracts, items or transactions.

The IASB has clarified that other contracts, for example, contracts for electricity generated from biofuel, are not within the scope of the Amendments because such electricity generation is not subject to the same uncertainty as in-scope contracts.

How we see it

The Amendments scope in contracts for nature-dependent electricity that are both physically and virtually settled. However, the Amendments do not cover the accounting for renewable energy certificates (RECs), which typically accompany these contracts. The intention is for the scope to be narrow enough to minimise the risk of unintended consequences.



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Amendments to the own-use exception

IFRS 9 must be applied to contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments. There is an exception for contracts that were entered into, and continue to be held, for the purpose of the receipt or delivery of a non-financial item in accordance with an entity's expected purchase, sale or usage requirements. This is known as the 'own-use exception' from the scope of IFRS 9.

Some contracts referencing nature-dependent electricity may have features that expose an entity to the risk that it would be required to buy electricity during a delivery interval in which it cannot use the electricity. The design and operation of the market in which the electricity is transacted in may also require unused electricity to be sold within a specified time. Consequently, an entity may have no practical ability to avoid making sales of unused electricity.

When evaluating such contracts for the own-use exception, the Amendments require an entity to assess if it has been, and expects to be, a 'net purchaser' of electricity over the contract period. An entity will be a net purchaser of electricity if it buys sufficient electricity to offset the sales of any unused electricity in the same market in which it sold the electricity. An entity must make this net purchaser assessment based on reasonable and supportable information (that is available without undue cost or effort) about its past, current and expected future electricity transactions over 'a reasonable amount of time'. When identifying 'a reasonable amount of time' an entity must consider the variability of the amount of electricity generated due to the seasonal cycle of the natural conditions, and the variability in the entity's demand for electricity due to its operating cycle. However, a reasonable amount of time must not exceed 12 months.

For example, in a contract where the delivery of electricity is contractually capped at 100 units per day, which is in line with the entity's expected usage per day, the delivery may happen at certain intervals during the day (e.g. every hour). The risk, in such a case, is that the delivered volumes at a particular hour may exceed the entity's electricity needs at that time, resulting in sales of excess electricity during that interval. Such contracts would be eligible for the own-use exception provided that the other requirements are met.

The IASB has also clarified that, if the market offers an entity alternatives to selling its unused electricity, for example, making electricity storage facilities available, then the entity is not permitted to use the Amendments.

How we see it

The net-purchaser criteria could allow the application of the own-use exemption when an entity has frequent and substantial sales during the contract, but only on condition that it remains a net purchaser over 'a reasonable amount of time'.

Ongoing assessment based on reasonable and supportable information available at the reporting date about changes in the entity's purchase or usage requirements will ensure that contracts are reclassified prospectively as derivatives in a timely manner if and when the own-use exception requirements are no longer met.

Hedge accounting requirements

Entities are increasingly using contracts for nature-dependent electricity to fix the price at which such electricity will be sold or purchased. However, IFRS 9 historically required the hedged item to be designated as a specified nominal amount or volume. Any changes to the nominal amount or volume of the hedged item would result in the discontinuation of the hedging relationship. Some entities were still able to apply hedge accounting by designating a fixed hedged volume, but this resulted in ineffectiveness as a result of the hedging instrument having a variable volume.

To overcome this, the Amendments will now allow an entity designating a contract referencing nature-dependent electricity as the hedging instrument in a hedge of forecast electricity transactions, to designate a variable nominal amount of forecast electricity transactions as the hedged item. This designated variable nominal amount must be aligned with the variable amount of nature-dependent electricity expected to be delivered by the generation facility as referenced in the hedging instrument.

The Amendments also state that if the cash flows of an in-scope contract designated as a hedging instrument are conditional on the occurrence of the forecast transaction that is designated as the hedged item in accordance with the Amendments, this forecast transaction is presumed to be highly probable.

The other hedge accounting requirements of IFRS 9 continue to apply unchanged.

An example has also been added to the Illustrative Examples to demonstrate the application of the Amendments. It illustrates a possible way that an entity could designate forecasted electricity purchases with a variable nominal amount as the hedged item in a cash flow hedge.

How we see it

Although the Amendments provide a practical solution for in-scope contracts and should avoid hedge ineffectiveness due to volume uncertainty, entities must be aware that there may still be other sources of ineffectiveness in the hedging relationship. For example, ineffectiveness can arise due to differences between the timing and volume of spot purchases and the actual deliveries used to calculate the cash flows under the contract referencing nature dependent electricity; or basis differences between the spot price in the market in which forecast purchases are made (the hedged risk) and the market in which the contract referencing nature dependent electricity is settled.

Amendments to IFRS 7 Financial Instruments: Disclosures

IFRS 7 has been amended to require disclosures relating to contracts that have been excluded from the scope of IFRS 9 as a result of the Amendments. In such cases, an entity must disclose in a single note:

- ▶ Information about the contractual features that expose the entity to:
 - Variability in an underlying amount of electricity
 - The risk that the entity would be required to buy electricity during a delivery interval where it cannot use it
- ▶ Information about unrecognised contractual commitments arising from such contracts, including:
 - The estimated future cash flows from buying electricity under these contracts, disclosed in appropriate time bands
 - Qualitative information about how the entity assesses whether a contract might become onerous
- ▶ Qualitative and quantitative information about the effects on the entity's financial performance for the reporting period, based on the information that the entity used to assess whether it was a net purchaser of electricity. This includes:
 - The costs arising from purchases of electricity made under the contracts, disclosing separately how much of the purchased electricity was unused at the time of delivery
 - The proceeds arising from sales of unused electricity
 - The costs arising from purchases of electricity made to offset sales of unused electricity

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If in-scope contracts have been designated in a cash flow hedging relationship in accordance with the Amendments, then when making the disclosures required by IFRS 7.23A, an entity must disaggregate the information about the terms and conditions of these hedging instruments by risk category.

If information on other contracts referencing nature-dependent electricity is disclosed in other notes in the financial statements (including those designated in a cash flow hedging relationship in accordance with the Amendments), the entity must include cross-references to those notes in the single note outlined above.

How we see it

Obtaining the quantitative and qualitative data needed for the required disclosures may require additional effort and perhaps system updates. The IASB has clarified that the intention is not to disclose information for each contract separately. Entities will need to apply judgement to determine the appropriate level of aggregation to ensure that the disclosures are understandable and meaningful for users.

Transition

The Amendments are effective for annual reporting periods beginning on or after 1 January 2026. Early adoption is permitted, but this will need to be disclosed, and may be subject to local endorsement. Furthermore, the date of initial application must be the beginning of a reporting period, but might be a reporting period other than an annual reporting period.

The amendments relating to the own-use exception must be applied retrospectively. An entity is not required to restate prior periods, and it is only permitted to do so if this can be done without using hindsight. If prior periods are not restated, then any difference between the previous carrying amount and the carrying amount at the date of initial application of these amendments, is recognised in the opening retained earnings at the beginning of that reporting period.

The hedge accounting amendments must be applied prospectively to new hedging relationships designated on or after the date of initial application. An entity is permitted to discontinue a hedging relationship in which an in-scope contract has been designated as the hedging instrument, if the same hedging instrument is then designated in a new hedging relationship under the Amendments.

The IFRS 7 disclosure amendments must be applied when the IFRS 9 amendments are applied. If an entity does not restate comparative information, then the entity must not present comparative disclosures.

How we see it

The IFRS 7 and IFRS 9 amendments must be implemented at the same time. Therefore, if entities intend to early adopt the IFRS 9 amendments, they will also have to early adopt the amended disclosure requirements.