Energy Transition

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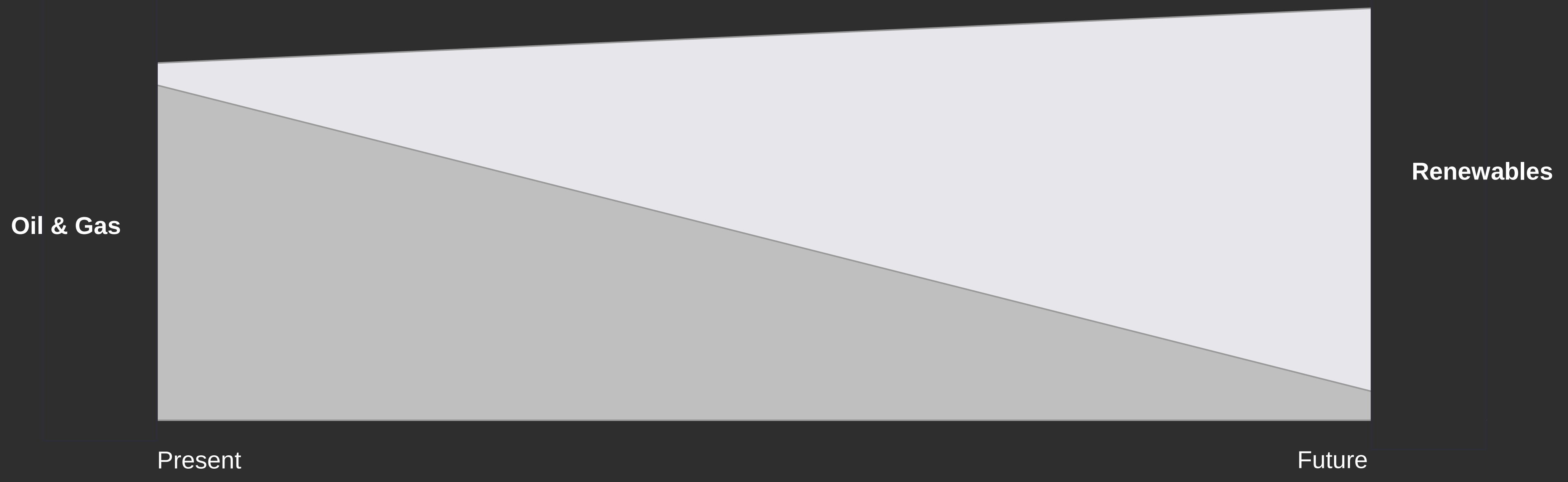
The better the question. The better the answer.
The better the world works.

From Oil & Gas to Energy



Consensus and clarity among peers:

- Business models and mindset
- Accounting policies

What about the transition period?

- Impact on business decisions
- Disposal of oil and gas assets
- "Stranded assets"
- Impact on accounting assessments
- Disclosures
- Regulatory expectations/requirements
- Internal control

Less consensus (and clarity):

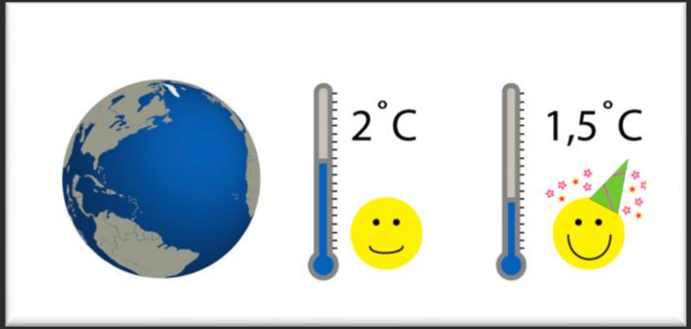
- New players
- New business models
- New geographical areas
- New accounting policies

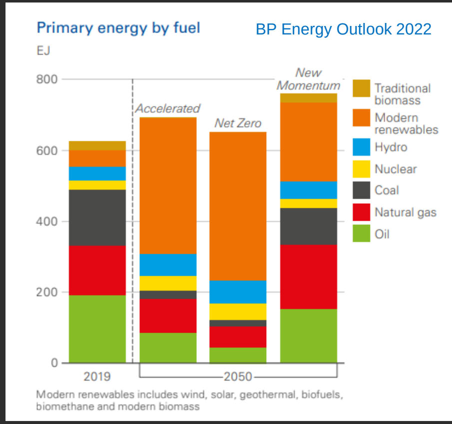
Impact on accounting estimates

Useful life

Removal year

Impairment





SARASIN & PARTNERS

IAS 36.33a

"Base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence."

IEA – World Energy Outlook Oct 2021
Brent Blend – 2021 real

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
Net Zero Emissions by 2050	42,2	41,6	41,0	40,4	39,8	39,2	38,6	37,9	37,3	36,7	36,1	35,5	34,9	34,3	33,7
Sustainable Development	44,3	45,7	47,1	48,6	50,0	51,4	52,8	54,3	55,7	57,1	56,8	56,5	56,2	55,9	55,6
Announced Pledges	45,4	47,9	50,5	53,0	55,6	58,1	60,7	63,2	65,8	68,3	68,2	68,0	67,9	67,7	67,6
Stated Policies	46,4	50,0	53,6	57,1	60,7	64,3	67,8	71,4	75,0	78,5	79,1	79,7	80,2	80,8	81,3

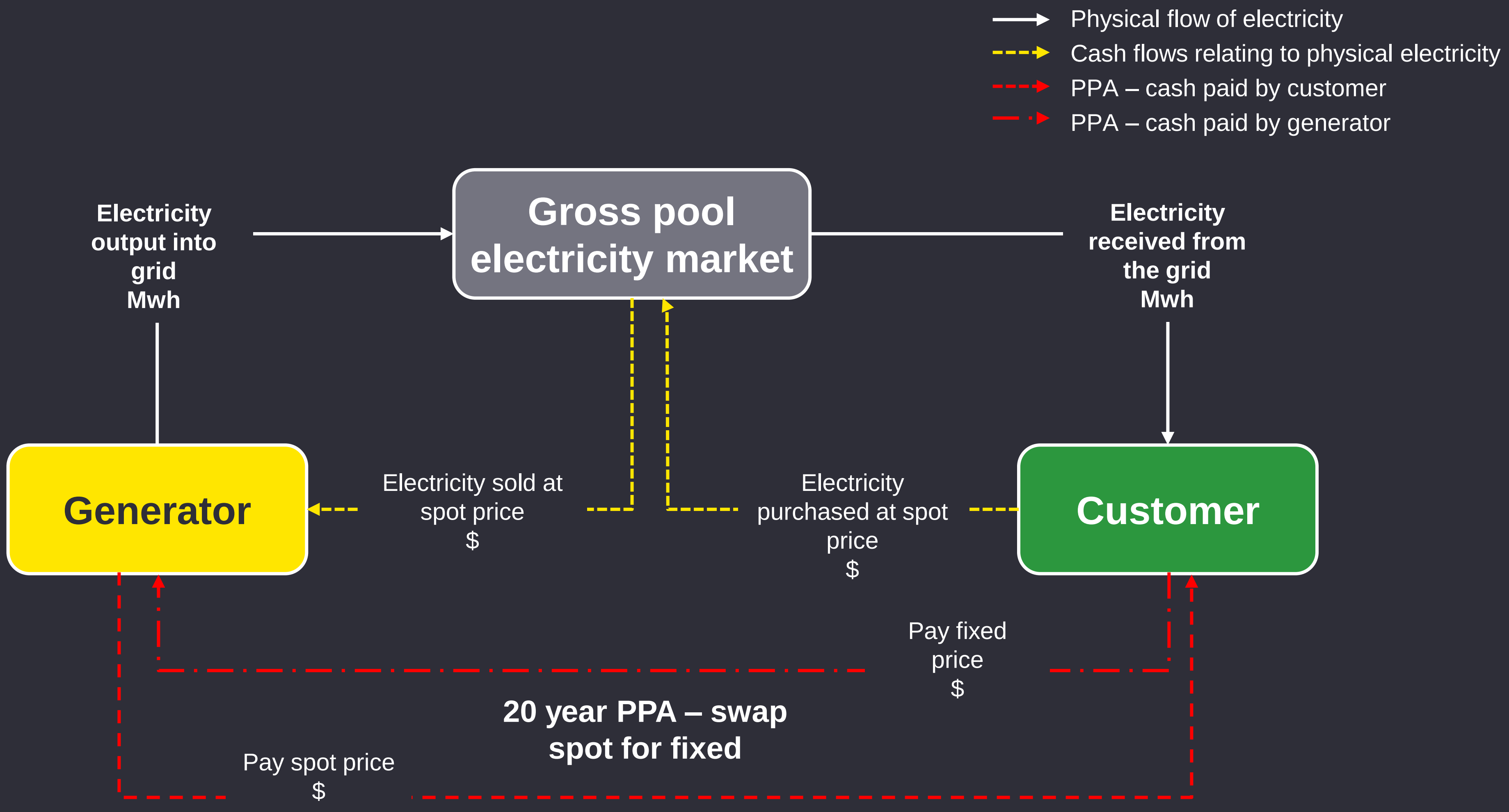
Power Purchase Agreements

Power Purchase Agreements (PPA)

- Given divergence in practice relating to the accounting for PPAs, item raised to IFRS IC

- Fact pattern
  - Gross pool electricity market: supplier and customer unable to enter into contracts directly for the purchase and sale of electricity
  - Synthetic CfD agreement swaps the spot price of the electricity supplied by a windfarm to the grid for a fixed price per megawatt, settled net in cash between Customer and Supplier
  - 20-year term

Power purchase agreements
Fact pattern illustrated



Power purchase agreements
IFRS IC conclusion

- IFRS IC concluded that arrangement does not represent a lease
  - Customer does not have rights to **substantially all of the economic benefits**
  - In a gross pool market, electricity consumed by customer cannot be contractually linked to the electricity that any specific supplier supplies. Therefore, the PPA does not provide the customer with **the right to obtain electricity from the identified asset (e.g., windfarm)** nor **the obligation to purchase any particular amount of electricity** either from the identified asset or the grid
  - **No basis for combining contracts** in accordance with paragraph B2 of IFRS 16 (i.e., entered into at or near the same time with the same counterparty or related parties of the counterparty)

Power purchase agreements
Accounting for Contract for Differences

- Outside of whether or not IFRS 16 applied, the accounting for the CfD was not addressed by IFRIC

- *Executory contact?*
  - Not possible in gross pool electricity market
  - In 2005, IFRIC concluded that a synthetic arrangement that results from linking a non-deliverable contract entered into with a customer to fix the price of a commodity with a transaction to buy or sell the commodity through an intermediary would not satisfy the normal purchase and sale scope exclusion (the “own use” exemption”) (of IAS 39 at the time, now IFRS 9)

- *IFRS 9 derivative contract?*
  - Non-financial item (i.e. electricity)
  - Net settled in cash
  - Fails to meet own use exemption

Power purchase agreements
UK CfD government scheme - overview

- UK government scheme
  - Since 2017, windfarm developers could apply to the Low Carbon Contracts Company (‘LCCC’) to obtain accreditation under the CfD
  - LCCC is controlled by the Secretary of State for Business, Energy and Industrial Strategy (BEIS), a government department
  - Price support scheme that encourages low carbon power generation
  - Guarantees minimum level of income per MWh produced
  - When the market price is lower than the strike price, the government pays the generator a top-up payment which is the difference between the market price and the strike price (‘the difference payment’) – and visa-versa when market price above strike

Power purchase agreements

UK CfD government scheme – accounting alternatives

Treatment	Comment

Government grant (IAS 20)
✓
	• Criteria met
	  • Para 3: assistance by government in the form of **transfer of resources** to an entity in return for **past or future compliance with certain conditions** relating to the operating activities of the entity
	  • Para 7: recognise when reasonable assurance that: (a) **the entity will comply with the conditions attaching to them**; and (b) the **grants will be received**
	  • Asset or income grant: no assistance provided for construction costs. Primary condition on receiving CfD income is **electricity generation (ie relating to income)**

Financial instrument (IFRS 9)
✓
	• Criteria met
	  • Value of the instrument **changes with an underlying economic item** (e.g. electricity spot price and inflation linked)
	  • **Requires no or little investment** to enter into financial instrument (i.e. no upfront fee paid to LCCC)
	  • **Settled at a future date** (i.e. settled on monthly basis throughout term)

Revenue (IFRS 15)
X
	• Not a contract with customer
	  • Customers are defined as a party that has *contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration*
	  • No transfer or sale of electricity to LCCC

Green energy certificates

Green energy certificates
Cap and trade schemes

- Whilst precise **terms vary between jurisdiction**, in general
  - Participants are allocated allowances equal to a cap
  - Allowances are tradeable
  - If at the end of a compliance period a participant's actual emissions exceed its emission rights, the participant is required to buy additional rights in the market or incur a penalty
- IFRIC 3 Emission Rights issued in 2004. However, the interpretation **met with significant resistance** and was **withdrawn in 2005**, despite the IASB considering it to be an appropriate interpretation of existing IFRS
- In the absence of any definitive guidance, an entity has the option to either
  - (a) **apply IFRIC 3**, which despite having been withdrawn, is considered by the IASB to be an appropriate interpretation of existing IFRS; or
  - (b) **develop its own accounting policy** for cap and trade schemes based on the hierarchy of authoritative guidance **in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors**

Green energy certificates

Cap and trade schemes (continued)

- In general, entities have adopted one of the following approaches

Approach	Comment

IFRIC 3 approach	• Identifies various items that are to be accounted for separately, including
	  • (a) **a government grant** – between amount paid and fair value of allowances issues are a government grant (IAS 20). Recognised as deferred income and subsequently recognised in P&L over compliance period; and
	  • (b) **an asset for allowances held** – allowances, whether allocated by government or purchased, were to be regarded as intangible assets (IAS 38) and measured initially at their fair value;
	  • (c) **a liability for the obligation to deliver allowances for emissions made**, recognised in accordance with IAS 37 – ie best estimate (market price) at period end

Net liability	• Emission allowances received by way of grant recorded at a nominal amount • Recognise a liability only once actual emissions exceed the emission rights granted • When recognised, liability measured at lower of the expected cost to purchase additional allowances in the market or the amount of any regulatory penalty
Government grant	• As with 'IFRIC 3' approach from asset perspective – ie recognise at fair value • Liability - rather than measuring the liability at the present market price of those allowances, liability is measured instead by reference to the amounts recorded when those rights were first granted (ie match with value of asset) • To the extent that emissions are not covered by emission rights, liability recognised at market price

Intangible assets

Carbon Emission Reduction
CCS accounting considerations

Carbon Emission Reduction
Reforestation

Regulated carbon markets /
EU ETS
$769bn 2021

Unregulated voluntary
carbon market (VCM)
$1bn 2021

- **Expense**
- **Biological asset**
- **Tangible asset**
- **Intangible asset**

IAS 38.8

"a resource controlled by an entity as a result of past events; and from which future economic benefits are expected to flow to the entity".

«identifiable non-monetary asset without physical substance»

IAS 38.12

An asset as identifiable if either criteria a or b is met:
«a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.»

CCS accounting considerations
Early project costs

- IFRS 6 applies to costs incurred in respect of exploration and evaluation activities and therefore is not applicable to CCS projects
- May result in costs (e.g. drilling to assess CCS reservoir) being expensed despite being similar to those capitalised under IFRS 6 (ie exploration drilling)
- At which point can early project costs be capitalised? IAS 38 states that development costs should be recognised if, and only if, an entity can demonstrate all of the following
  - Technical feasibility of completing the intangible asset so that it will be available for use or sale
  - The intention to complete the intangible asset and use or sell it
  - The ability to use or sell the intangible asset
  - ***How the intangible asset will generate probable future economic benefits***
  - The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
  - The ability to measure reliably the expenditure attributable to the intangible asset during its development

CCS accounting considerations

Other considerations

- Depreciation of new and existing (ie repurposed) asset components
- Impairment testing and CGU determination
- Government grants

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