ICAEW
REPRESENTATION 62/24

CONTRACTS FOR RENEWABLE ELECTRICITY

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ICAEW welcomes the opportunity to comment on the Contracts for Renewable Electricity published by IASB on 8 May 2024, a copy of which is available from this link.

ICAEW supports the IASB's Contracts for Renewable Electricity project. We welcome the proposals as a step towards providing a solution to the challenges in applying IFRS 9 *Financial Instruments* to contracts for renewable electricity. We have highlighted some concerns and provided several recommendations, with the objective of supporting the effective practical application of the amendments.

While we broadly support the proposals, we suggest that there remains a need for a subsequent wider scope review of the own-use and hedge accounting requirements, given the narrow scope of this project and the fast-evolving landscape of renewable electricity contracts. We are also concerned that the proposed disclosure requirements are disproportionate and will not provide the most relevant information; we recommend that they are substantially limited.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)1908 248 250 F +44 (0)20 7920 0547 icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

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KEY POINTS

SUPPORT FOR THE PROJECT

1. ICAEW welcomes the opportunity to comment on this exposure draft (ED). We recognise the need to respond to the changing information needs arising from the growing prevalence of contracts for renewable electricity, and on balance, support the IASB's efforts to do so.
2. We agree that entities commonly experience challenges when applying IFRS 9 *Financial Instruments* to contracts to purchase electricity from nature-dependent sources. We recognise the issues highlighted in the ED, and agree that applying the current requirements can result in the provision of less useful information to users of financial statements.
3. While we would not typically support such a narrow-scope project, due to the potential unintended consequence that in fixing one issue another issue might be uncovered and therefore inconsistencies arise, we agree in this instance with the view that swift action and a timely solution is needed to support preparers and provide users with more useful information.
4. For the reasons explained above, we support the project as an initial solution to an immediate problem, but would urge the IASB to ultimately revisit this area and perform a broader scope review of the own-use exception and hedge accounting requirements. We suggest that the forthcoming IFRS 9 post-implementation review (PIR) of hedge accounting would be a well-timed opportunity for this wider review.
5. We also note that the proposals included in the ED are, on the whole, fairly rules-based. We have long supported accounting standards that are principles- rather than rules-based as we believe this approach is more likely to produce standards that are sufficiently flexible to accommodate complex and unforeseen eventualities and changes in the financial and economic environment. If the IASB perform a further, broader scope review, we suggest this should be principles-based to the extent possible.
6. On balance, we believe the proposals presented in the ED provide much needed improvements to the current accounting requirements. We have identified some issues and provided recommendations in our response with the objective of making the amendments easier for preparers to implement and operationalise.

RISKS OF THE NARROW SCOPE

7. The proposed amendments are narrow in scope and consequently we think there is likely to be a significant number of contracts that either:
   a) do not have the characteristics required to be in scope of the amendments, or
   b) have features that make it unclear whether they are in scope of the amendments.
8. One example of a type of contract that we think would fall outside of the scope requirements is baseload contracts. This is because baseload contracts usually have a fixed notional profile and therefore do not transfer volume risk to the purchaser in the same way as a pay-as-produced contract. Given their growing popularity we suggest the IASB may want to consider further outreach to understand the accounting challenges relating to baseload contracts to inform a future wider review of own-use and hedge accounting requirements.
9. For other types of contract structure, we believe it is more judgemental as to whether they would be in scope of the amendments. Examples of contract structures where it may be judgemental as to whether the purchaser has 'substantially all volume risk' include contracts with maximum caps, minimum floors, or collar arrangements, set at varying levels of risk. We would therefore recommend that illustrative examples are included in the amendments, to provide guidance on if, and how, contracts with similar fact patterns would be in scope.

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10. It is apparent that the power purchase agreement (PPA) market is rapidly evolving, and the narrow-scope nature of these amendments means that the accounting risks fast becoming out of step with real-world developments. Therefore, we reiterate our view that a broader, principles-based review of the accounting requirements in this area is needed.
11. While we recognise the need for the amendments as a timely solution to immediate challenges in applying IFRS 9 to contracts for renewable electricity, we believe that it is important they capture a worthwhile proportion of the contracts that face such challenges, without creating commercial or reporting issues for contracts that fall outside of the scope. We encourage the IASB to take this into account as a guiding principle when assessing evidence and research throughout the project.

PRACTICAL APPLICATION CONSIDERATIONS FOR OWN-USE AND HEDGE ACCOUNTING REQUIREMENTS

12. We support the proposed own-use requirements. We have suggested a number of minor amendments to this section to improve the practical application – these are set out in more detail as part of our response to Question 2.
13. We support the proposed amendments to hedge accounting requirements but believe that some changes are required to ensure the amendments work in practice, as explained in our answer to Question 3. This includes the need for additional guidance on what level of certainty the IASB supports for an entity establishing the point estimate for the variable volume of the hedging instrument when looking forward at hedge accounting capacity.

ONEROUS DISCLOSURE REQUIREMENTS

14. We are concerned that, as drafted, the disclosure requirements are disproportionate, excessive and will not provide users with the most relevant information. The requirements in paragraph 42V of the proposed amendments to IFRS 7 (in particular the requirement to disclosure the total net volume of electricity purchased, and the proportion covered by the contracts in scope), will be very onerous for preparers and we are not convinced that this information would be valuable to primary users. As explained in more detail in our answer to Question 4, we strongly recommend substantially limiting the disclosure requirements.
15. We are concerned that the scope of the disclosure requirements is too broad. We recommend that incremental disclosure requirements introduced by these proposals should be limited to those contracts for which an entity makes use of these amendments to the own-use exception or hedge accounting requirements.

ANSWERS TO SPECIFIC QUESTIONS

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?

Renewable electricity contracts excluded from scope

16. For the subset of renewable electricity contracts that are within scope, we agree the amendments provide a solution to some of the issues faced in applying the own-use exception or hedge accounting.
17. We note that the difficulty in applying IFRS 9 to PPAs, as identified in the Basis for Conclusions paragraph BC2, extends beyond the narrow scope of these amendments to electricity contracts more widely. For example, IFRS 9 can be challenging to apply to contracts for fixed volumes of renewable energy where the timing cannot be guaranteed to align with demand, which may result in electricity being sold during balancing windows. Similarly, it is difficult to apply hedge accounting requirements to contracts with a degree of fixing and a variable firming fee. Such contracts may also fall outside of the scope of these amendments.
18. We recognise that the objective of this ED is not to deal with these types of contracts but would urge the IASB to consider them as part of the IFRS 9 PIR on hedge accounting and the Pollutant Pricing Mechanisms project. While we are of the view that a broader scope review is ultimately needed in order to keep up with the evolving practise around PPAs, we welcome this ED as a narrow-scope solution in the meantime.
19. As noted, renewable electricity contracts are growing in prevalence, and the range of terms and conditions evolving quickly. There are many contracts with features that will make the assessment of ‘substantially all volume risk’ a significant judgement. This includes contracts with maximum caps, minimum floors, or collar arrangements on pricing and/or volume. Some contracts, for example, may have low caps, where it is apparent the purchaser does not have volume risk, whereas other contracts will have much higher caps that arguably do still expose the purchaser to the volume risk. There will then be contracts between the two, whereby it is particularly judgemental to assess where the volume risk lies. Given the complexity and variety of the structure of different renewable electricity contracts, the amendments would benefit from illustrative examples, with guidance on if, and how, contracts with similar fact patterns would be in scope.

Definition of ‘nature-dependent’

20. One of the characteristics required for a contract to be in scope of the amendments, as outlined in paragraph 6.10.1(a), is 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’. ‘Nature-dependent’ is currently undefined in the amendments, which may lead to interpretation differences as to which sources of electricity are in scope. We recommend that a definition of ‘nature-dependent’ is included to clarify this.
21. We further note that paragraph BC9 specifies that biomass energy and some contracts for hydroelectricity are excluded from scope but there is limited explanation provided as to why. We would suggest that the underlying principles distinguishing what should be in scope, and therefore also out of scope, are explained in the amendments. A definition of nature-dependent and the linkage to control and volume risk may help provide clarity as to the principles behind the scope, which could enable preparers to apply the same principles to other sources of electricity production. This may also make it clearer why biomass and some hydroelectricity contracts are excluded. There was some reasoning around the meaning of nature-dependency in staff papers earlier in the project and in our view, these could usefully be expanded upon and included in the final amendments.

Definition of ‘renewable’

22. Similarly, we have some concern that ‘renewable’ is not defined, which could lead to diversity in interpretation. However, we believe the other contract characteristics required to apply the amendments, as specified by paragraph 6.10.1, including the criteria that source of

production of the electricity is nature-dependent, would limit the scope to the intended contracts in most instances regardless of the inclusion or exclusion of the term 'renewable', particularly if the term 'nature-dependent' is expanded. On this basis, we recommend the word renewable is removed from the guidance.

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?

23. In general, we agree with the proposed factors in the amendments. We do, however, have some specific concerns and recommendations that we believe would make the amendments easier for preparers to operationalise.

Estimate for expected volumes

24. Paragraph 6.10.3(a) states that an entity does not have to prepare detailed estimates for periods that are 'far in the future,' when assessing whether the volumes expected to be delivered under the contract continue to be in accordance with the entity's expected purchase or usage requirements. This wording may risk inferring that, when assessing the own-use exception for other types of contracts that are outside of the scope of the amendments, an entity would have to prepare detailed estimates for periods that are far in the future. We recommend clarification is provided in the Basis for Conclusions noting that this is aligned to the existing approach for contracts applying the own-use exception.
25. Paragraph 6.10.3(a) also states that 'an entity shall consider reasonable and supportable information available at the reporting date about expected changes in the entity's purchase or usage requirements for a period not shorter than 12 months after the reporting date'. We are not clear from this wording whether an entity is required to consider reasonable and supportable information for a period beyond 12 months if known. Similarly, BC20(b) states that 'an entity shall not ignore reasonable and supportable information at the reporting date about changes in the entity's purchases or usage requirements over a period not shorter than 12 months after the reporting date' which risks implying that reasonable information after 12 months can be ignored. We recommend the IASB clarify if this is the intention and consider refining this wording to make clear the expectation for what information must be considered, and over what period, when assessing expected volumes to be delivered under a contract.

Definition of 'a reasonable time'

26. Paragraph 6.10.3(b) lists the criteria that must be met for the sale of unused renewable electricity to be in accordance with an entity's expected purchase or usage requirements. One of the criteria is that an entity expects to purchase an equivalent volume of electricity to that sold 'within a reasonable time (for example, one month) after the sale'. We are of the view that the example of one month is too short, as it does not allow for the impact of factors such as seasonality or shut-downs for maintenance. We recognise that one month is written as an example, but we believe it could result in limiting practice and therefore recommend this is replaced with factors and principles to consider in determining a reasonable time.

Design and operation of the market

27. Paragraph 6.10.3(b)(ii) specifies that for a sale of unused renewable electricity to be in accordance with an entity's expected purchase or usage requirements, one of the criteria

that must be met is that the 'design and operation of the market in which the electricity is sold results in the entity not having the practical ability to determine the timing or price of the sale'. We recommend rewording this criterion to make it entity specific, rather than a market-focused criterion. This is because there may be entities with the capability to store excess energy for own-use who instead choose to sell it, or they store to sell at a chosen time instead of for own-use. These entities are operating in the same market as an entity who cannot store electricity, and by focusing on the design of the market rather than an entity's capabilities, the current guidance does not clearly distinguish between these scenarios.

Oversized contracts

28. We disagree with the premise in BC20 that oversized contracts are never designed to be own-use. The nature of the electricity market can in some circumstances lead to entities oversizing contracts to guarantee sufficient own-use supply. One example of this would be an entity producing green hydrogen, where in every 15-minute balancing window they are required to demonstrate they have used green electricity to produce green hydrogen that is compliant with regulation. This entity is highly likely to have to oversize contracts to ensure the required levels of green electricity are available in each balancing window, which will subsequently result in the resale of excess power into the market. We note that the excess electricity would typically be sold at a loss, demonstrating that there is not a profit-making intention behind the contract being oversized. This is because when there is excess power, there is generally increased supply across all similar renewable power assets, depressing the electricity price. In this instance, the underlying intention for the PPA is that it is own-use, and it is accepted by the entity that there will be some loss-making sales to guarantee supply. We raise this as an example for the IASB to note in any future review of contracts for renewable electricity.

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?

29. We are supportive of the amendments to the hedge accounting requirements. We believe, however, they work better for producers than consumers in their current form.

Application by consumers

30. To support the application of the amendments by consumers, we recommend amendments, focused on providing clarity and consistency as well as navigating some of the practical difficulties likely to arise in this area, as follows:
31. **Length of the 'time bucket'** - IFRS 9 requires that an entity can identify that a hedged transaction has occurred as it is happening. This is a challenge for the contracts within the scope of the amendments, due to the variability of the hedging instrument. Applying the guidance in paragraph 6.10.4, we understand that entities would be identifying the pool of potential hedged transactions as they occur but only finally confirming which transactions are hedged when the notional of the hedging instrument has fixed for the period (which would normally be at the end of the relevant calculation period). If an entity then has a reporting date in the middle of a time bucket, (the time bucket being the period of time over which hedged transactions are identified and allocated to the hedging instrument), it would not be possible for them to establish which of the purchases that have occurred are their hedged

transaction at the reporting date. This uncertainty will exist until the hedging instruments' notional is fixed for the relevant period, which could impact the accuracy of the entity's financial reporting. We believe the variability of the hedging instrument will result in practical challenges around how entities identify hedged transactions that have occurred. To avoid diversity in practise, we recommend the IASB provide additional guidance in this area. This could be by developing guidance around accruing a 'best estimate' of the hedging instruments' notional as at the reporting date. Alternatively, another approach would be to include a requirement that for hedges in scope of this amendment, the time bucket does not go across an entity's reporting date.

32. **Identification of hedged transactions** - Given it is not always possible for an entity to identify their hedged transaction as it occurs, we recommend the amendments allow for more flexibility in how an entity identifies that the forecast transactions have occurred. For example, rather than having to classify the first X volume of transactions to occur in a period as the hedged item, entities may experience less fluctuation in hedge ineffectiveness due to timing differences if they are able to evenly spread the hedged item volume throughout the hedge period. Alternatively, we suggest the reclassification adjustment is based on the usage expected at the reporting date, and the ineffectiveness is determined based on actual usage at the reporting date.
33. **Point estimate** – As the PPAs in scope of these amendments have pay-as-produced features, the volume of electricity that will be purchased is uncertain. It is therefore unclear how an entity should establish a point estimate within the variable volume under the PPA, for use in a hedging relationship. How the point estimate is established has a significant impact on what it is possible to designate and therefore how useful the amendments are. We recommend the IASB provides further clarification over how to establish the point estimate for the variable volume of the hedging instrument when looking forward at hedge accounting capacity. In particular, it would be useful to understand what level of certainty the IASB expects, as entities often forecast at different levels of certainty. Our recommendation would be that this is required to be an entity's best estimate, being the level at which the volume of transactions is equally likely to go up or down when compared to the forecast.
34. **Recognition of hedge ineffectiveness** - We welcome the inclusion of examples of types of hedge ineffectiveness that may still arise for forecast energy transactions in paragraph BC37 of the Basis for Conclusions. We recommend expanding on this further by clarifying how to measure and when to recognise hedge ineffectiveness, as we would not necessarily expect all hedge ineffectiveness to be accounted for in the same way or to be recognised over the same periods. For example, we suggest hedge ineffectiveness in relation to basis risk would be best captured over the life of the contract, whereas it may be more appropriate for ineffectiveness due to timing differences to be recognised during an entity's normal operating cycle, due to the difficulty in making a detailed estimate of the exact timing of consumption and measuring ineffectiveness for periods further into the future.
35. **Expand the capacity test** - We are supportive of the approach taken in paragraph 6.10.4(b), which compares the designated variable volume of forecast electricity transactions with the total highly probable future electricity transactions, as a capacity test to ensure the designated volume does not exceed the expected total. We believe it would be beneficial to expand on this to include guidance as to what time frame this should be considered over and what level of probability should be used.

Other considerations

36. The hedge accounting arrangements that fall within these amendments are often complex and new to preparers. We recommend some clear illustrative examples are added to the amendments, to enable preparers to better understand their application.

37. We recommend paragraph 6.10.5 is updated to clarify that the reference to 'total future renewable electricity sales' relates to expected future sales, if that is the IASB's intention.

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?

38. We are concerned that, as currently drafted, the disclosure requirements could be overly burdensome for many preparers and require the disclosure of information that may be difficult to provide, while not providing the most useful information to users. We have outlined our suggestions and concerns further below.

Scope

39. Paragraph 42T of the proposed amendments to IFRS 7 *Financial Instruments: Disclosures* outlines that the disclosure requirements apply to all entities that are party to contracts for renewable electricity that have the characteristics in paragraph 6.10.1. This scope does not distinguish between qualifying contracts to which the exceptions in the ED are applied and those qualifying contracts to which the exceptions are not applied. We are concerned that this scope is too broad. We recommend that incremental disclosure requirements introduced by these proposals should be limited to contracts for which an entity makes use of these amendments to the own-use exception or hedge accounting requirements.
40. We recommend adding wording into IFRS 9 to direct preparers applying the own-use exception under these amendments to IFRS 7, as there are not similar disclosure requirements for other contracts where the own-use exception has been applied. This may lead to preparers overlooking the need for disclosure for these specific types of contracts if they are not clearly signposted.

Suggested amendments

41. We believe any additional disclosures ought to strike the right balance to ensure they provide users with the information they need without giving rise to excessive information or obscuring the information that is most relevant to readers.
42. We are concerned that the disclosures are overly burdensome, and also do not provide the most useful information to users. In particular, the requirements of paragraph 42V (to disclose the proportion of electricity purchased covered by the contracts, the total volume of electricity purchased and the average market price per unit of electricity) requires disclosure of information that is difficult to provide, likely to be commercial sensitive, and of limited relevance to users.
43. We are of the view that some of the disclosure requirements may relate to sustainability reporting information that should be disclosed outside of the financial statements. The requirement of 42V(a), to disclose the proportion of renewable electricity covered by the contracts to the total net volume of electricity purchased, is not financial information and might therefore be better positioned in an entity's sustainability reporting rather than in the financial statements.
44. We suggest limiting the disclosures to:
    a) the profit/loss impact of excess sales of renewable electricity in the period;
    b) the volume of excess electricity sold in the period;

c) the total expected volume expected to be sold or purchased across material contracts; and

d) qualitative disclosures of how an entity has arrived at its judgement that a contract qualifies to make use of the exceptions and, with respect to hedge accounting, how it has determined the volume to be designated, given these are the key changes introduced by the amendments.

Where possible, we suggest a tabular format would be most usable for investors.

45. If paragraph 42V(c) is included in the final amendments, then we believe further clarification on what is meant by average market price is required as this could vary day-by-day and by methodology applied.

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?

46. We agree with the proposed disclosure requirements for subsidiaries without public accountability; however, we note the suggestions and concerns in our response to Question 4 are equally applicable to the proposed amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*.

47. We note the proposed disclosure requirements in IFRS 19 do not include an equivalent to paragraph 42W in the proposed amendments to IFRS 7, which states that an entity should consider how much detail to disclose and the appropriate level of aggregation. We suggest that this guidance is also useful for subsidiaries without public accountability, and recommend it is replicated in the IFRS 19 amendments.

48. We have identified a minor drafting error with the amendments referring to paragraph 134(f) of IFRS 19, which we suggest should instead refer to paragraph 178(f).

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?

49. We support the transition requirements proposed. We note, however, that prospective application for hedge accounting with existing contracts will result in the designation of 'off-market hedges' (hedges where there is a difference between the hypothetical derivative and the actual hedging instruments due to movements in market rates between the inception of the contract and the designation of the hedge) which will be challenging for preparers. We have also recommended a number of clarifications below.

50. We think that the requirement in paragraph 6.10.3 requiring assessment of a contract at inception and at each subsequent reporting date might be unduly onerous and is likely to be very difficult to apply without the use of hindsight. Entities may have entered contracts within

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the scope of the amendments several years ago and it could be difficult for them to reassess all the factors in paragraph 6.10.3 at each previous reporting date, including the assessment of any failure to meet the own-use requirements. We think it would be helpful for the IASB to clarify whether on transition the assessment of these factors is only made at the date of initial application of the amendments.

51. We recommend amending paragraph 7.2.52 to be more specific about the changes that can be made to cash flow hedging relationships designated before the application of the amendments, aligned to the approach that was applied for IBOR reform.
52. We do not believe the requirement of paragraph 7.2.51 for an entity to adjust the opening retained earnings by the difference between the previous carrying amount and the carrying amount at the point of the amendments being issued is necessary and would recommend this paragraph is removed. We believe that intra-period adoption of the requirements would be better addressed by restatement in that period consistent with the guidance in paragraph 7.2.50.

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?

53. To allow entities sufficient time to adopt the amendments, we think it would be better for the IASB to specify an effective date of 1 January 2026 but with earlier adoption permitted so that they are available for entities to apply as soon as issued.