

IFRS IC request for information - Application of the 'own use exemption' in the light of current market and geopolitical questions

- 1 The EFRAG Secretariat reached out to EFRAG FR TEG and EFRAG CFSS members to obtain input on the request for information. At the time of writing, some members were still in the process of collecting information while some responses represent personal feedback rather than information gathered from stakeholders. Below represents input from EFRAG CFSS members from Austria, Cyprus, Denmark, France, Germany, Norway and Sweden and one EFRAG FR TEG member.
- 2 EFRAG also had a session with the EFRAG FR TEG and the EFRAG User Panel on 10 May 2023 to obtain information and to inquire about users' information needs.
- 3 **Overall summary:**
 - (a) The following summarises the input received from EFRAG CFSS and some EFRAG FR TEG members:
 - (i) Issues related to the power purchase agreements mentioned in the IFRS IC submission are issues which create challenges under IFRS Standards at the moment. These agreements are common and widespread or are currently becoming increasingly common as part of transition plans and decarbonation commitments by entities across all sectors. [Denmark, Norway, France, Germany, Austria]
 - (ii) Therefore, it is very important that a solution reflects the substance of power purchase agreements rather than the form of the agreements. That is, the companies are essentially buying a contract to purchase green energy. The entity buys or sells electricity on the spot market generally not to earn a margin from a trading activity but to manage its electricity needs.
 - (iii) If these contracts would have to be accounted for under IFRS 9, this would fail to represent the performance of what is in essence a green energy supply contract to meet the entity's usage and (ii) would create volatility on an entity's performance that would be hard for users to understand, (iii) result in significant implementation costs, e.g. estimating unobservable valuation inputs over such long durations is extremely difficult and complex to determine their fair value.
 - (b) There were mixed views from some of the EFRAG User Panel members as follows:
 - (i) Preference for off-balance sheet treatment: The contract is executory and not a financial instrument. It has a dual purpose in securing energy for the entity and meeting its green ambitions/requirements. However, any information on economic consequences, e.g., taxes on the overproduction of renewable energy would be relevant.
 - (ii) Sympathy to keep the contracts as executory contracts. However, the contracts create risk due to the nature of the contracts (contractual

commitment to purchase any energy produced) and its long duration. However, the company would have to consider as a cost that it would end up having to measure what the risks / opportunities are, i.e., some fair value analysis to understand the economic implications from a risk management perspective. This user indicated that such complex power purchase agreements do exist. This user also raised a concern whether contracts could be captured which should not normally be in scope, for e.g., dairy contracts which wastes very rapidly. From the governance perspective, having the fair value and the volatility of that fair value would be relevant for a company to understand the risks.

- (iii) A suggested solution from a user was to reflect in the accounting fair value evaluations performed by the risk managers of a company.

Specific comments on the issue

- 4 In Cyprus, the facts patterns in the submission are not common and/or widespread, however, these contracts are prevalent in Italy. Below are specific details on prevalence for each of the fact patterns.
- 5 One EFRAG CFSS member provided general comments as follows (instead of specifically commenting on each fact pattern): [Denmark]
 - (a) Question 1b - Most corporates (consumers of electricity) consider that, in substance, they are purchasing electricity at a price, which is typically fixed. Normally this assessment is material.
 - (b) Question 2 - Fact patterns include judgements in respect of whether a power purchase agreement is physical or virtual (contains a derivative). Often power is purchased through a GRID, where the grid operator sells and buys at spot price. Judgements include how physical electricity transfer can be arranged and how a power purchase agreement could be considered physical in such a market. While the submission is from the perspective of the consumer, similar judgements for the suppliers of raw materials could be relevant, as they are also looking at IFRS 9.2.4 for guidance.
 - (c) Question 3 - There are a number of views of how to apply the own use criteria, especially where the power is purchased through a grid. Companies have differing views of whether power is "delivered" or whether it is a net settled financial contract.
 - (d) Question 4 - The mixed views in Q3 above applies to a mixed number of industries.
- 6 On accounting implications:
 - (a) Some of the EFRAG CFSS and FR TEG members indicated that companies are buying a contract to purchase green energy and the entity is solely using the market as a 'storage facility' or a constraint rather than resulting from an intention of generating a profit from short-term fluctuations in prices or dealer's margins. If these contracts would have to be accounted for under IFRS 9, this would fail to represent the performance of what is in essence an energy supply contract to meet the entity's usage and (ii) would create volatility on an entity's performance that would be hard for users to understand, (iii) result in significant implementation costs, e.g. estimating unobservable valuation inputs over such long durations is extremely difficult and complex to determine their fair value. [Denmark, France]

- (b) One of the EFRAG CFSS members considered that the own-use exemption is an area warranting the IASB's attention as the ongoing changes on the energy market are deeply transforming the way entities supply their electricity. [France]
- (c) One EFRAG FR TEG member suggested replicating in paragraph 2.6(b) of IFRS 9, the words "for the purpose of generating a profit from short-term fluctuations in price" which is included in paragraph 2.6(c) of IFRS 9. This may provide a solution for the power purchase agreements to remain as executory contracts rather than on-balance derivative financial instruments.

7 Below are responses to each of the fact patterns.

Fact pattern 1: Purchased-as produced contracts

1. Are fact patterns such as the ones described the submission common and/or widespread?

- 8 The fact pattern is or is becoming increasingly common and widespread. The fundamental issue in the submission, i.e., periods where there is a mismatch between supply and usage, is considered very widespread. [Norway, France, Austria, Germany]

If fact patterns are common and/or widespread:

a. are they common or widespread across all jurisdictions and industries, or are they common only in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?

- 9 This fact pattern is widespread across all jurisdictions and industries, e.g., TelCo entities use those contracts to operate their data centres or (ii) banks also use those contracts to supply of their branches' electricity. [France]
- 10 In Norway, the sellers are generally energy producers, to a large degree single purpose companies or smaller developers. Buyers in such contracts are often industrial producers, often in power intensive industries e.g., chemical or metallurgical production. After expected regulatory changes in Norway (mainly tax regulations), a wider variety of power consumers will probably enter into such contracts in the current and future years.
- 11 In Germany, for smaller and medium-sized entities, baseload contracts (with a fixed quantity) are particularly common, while for larger entities purchase-as-produced contracts are more common and widespread. Furthermore, the number of entities entering into purchased-as-produced contracts (e.g., with a wind park operator) is increasing. The fact pattern is not limited to specific industries.

b. if they are common does the accounting for those fact patterns have a material effect on entities' financial statements?

- 12 If such contracts fail the own-use criterion, the effect is typically material, as power contracts often are long-term and with projected significant volumes. The recent price volatility, also in the long-term prices, has increased the impact on profit or loss when recognising long-term contracts as derivatives at fair value. [Norway]
- 13 In Germany, yes, this fact pattern usually can have a material effect on entities' financial statements - in particular if fair value accounting needs to be applied.

2. Are there any other facts patterns which are in substance similar to the ones described in the submission?

- 14 In Norway, similar fact patterns which we have observed are:

- (a) purchases of fixed volumes per time period for which the usage varies throughout the day and week (e.g., a factory running only day-time or with two shifts), Volume differences may arise both due to variability in production and variability in demand. There might be different accounting assessments made for excess volumes depending on whether it is within the control of the entity or not, and whether it is planned or unplanned.
- (b) purchases intended to match the need of the process industry (e.g., a melting plant) for base load consumption (i.e., a fixed volume each hour of the year), with some periods of lower need due to technical issues at the consuming facility such as maintenance need, issues in the grid limiting transport capacity or temporarily closing of the connection.
- (c) base load contracts, which previously primarily were held by energy distributors and the process industries, are now also being entered into by businesses without 24/7/365 operations, and therefore have a clear oversized element. The sell-back need is therefore significant for these companies.
- (d) situations where volume is not consumed as contracted due to mandatory governmental load shedding or strong incentives or contractual obligations to use less power in periods of unbalance in the grid.
- (e) also for producers, compliance with the requirements in order to apply the own-use exemption is challenging, as periods of production lower than the contractual volume is hard to avoid for non-flexible sources as wind and solar.

3. If the fact patterns described in the submission are common and/or widespread, have you observed material diversity in how entities are applying the relevant IFRS Accounting Standards? If so, please describe the accounting observed with reference to the IFRS requirements applied (if known).

15 One EFRAG CFSS member observed diversity in views from its stakeholders:
[France]

- (a) some stakeholders say that those contracts meet the own-use exemption and thus, are not subject to the requirements in IFRS 9. Paragraph 2.6(c) under IFRS 9 does not apply. The entity may have an (involuntary) practice of taking delivery of the underlying contract and selling it within a short period after delivering but there is no intention to generate a profit from short-term fluctuations in price or dealer's margin. Also, the circumstance in paragraph 2.6(d) under IFRS 9 may arise but this does not automatically imply that the contract does not meet the own-use exemption as would happen if the circumstances described in paragraph 2.6(b) or (c) of IFRS 9 were to arise.
- (b) In contrast, some others say that view D¹ would apply. If an entity expects recurrent electricity sales to occur, there is an implicit (though involuntary) intention of trading. Accordingly, the contract would not meet the own-use exemption.

¹ Under this View D, the transactions on the spot market may lead to a breach of the requirement set out in IFRS 9.2.6(c) (generating profit from short term fluctuations in price or dealer's margin) because the company cannot rule out that profit arises from some sales transactions, even though this is not intended

- (c) Some others the existence of some reselling activity does not mean that the circumstances described in paragraph 2.6(c) under IFRS 9 automatically arise. Any such activity is compatible with the own-use exemption as long it is limited i.e., there is a tolerance threshold below which a contract can meet the own-use exemption. Assessing whether the contracts meet the own-use exemption depends on facts and circumstances.
- 16 In Norway, some diversity is observed. There are different views about whether any resale is seen as net settlement, or whether minor resales for reasons not foreseen at inception, such as when there is a break-down with need for repair or short-term production disruptions, are considered acceptable within an own use classification. For those holding the latter view, the approximate level of resale acceptable before this would be seen as a net settlement varies.
- 17 In Austria, most companies tend to use the 'own-use exemption' or intend to do so but companies are still in the discussion phase. However, there are also other opinions that the 'own-use exemption' should not be applied.
- 18 In Germany, diversity in practice is observed in respect of how strict the requirements to apply the own-use exemption have been interpreted, subject to individual facts and circumstances. The focal question of whether and how to apply the own use exemption is about the frequency and magnitude of sales or net settlements (i.e., whether sales/net settlements are infrequent and/or insignificant).
- 4. If you have observed material diversity, is the diversity present and similar across all jurisdictions and industries, or is the diversity only in evidence in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?*
- 19 The diversity described in response to Question 3 above is seen in all industries and without any known difference between geography inside Norway.
- 20 In Germany, divergence in practice is not limited to specific industries or specific fact patterns.

Fact pattern 2: Settlement of power purchase agreements

1. Are fact patterns such as the ones described the submission common and/or widespread?

- 21 The fact pattern has not been observed in and is not likely to be common in Norway and Austria.
- 22 It is very common and widespread for entities in Germany, irrespective of the size.
- 23 Fact pattern 2 is a variation of a fact pattern that is commonly seen in practice i.e., the occurrence of exogenous events that are infrequent (or non-recurring) and were not expected at the contract's inception such as a production breakdown, a financial crisis, strikes. When those events occur, they force the entity to settle net a contract. There is a question as to whether those events 'taint' the on-going contract (a question that the submission does not mention) as well as future contracts. This tainting matter may have material effects for those affected [France]

If fact patterns are common and/or widespread:

a. are they common or widespread across all jurisdictions and industries, or are they common only in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?

- 24 In Denmark, this is particularly widespread for high consumption industries (e.g., production using large volumes of energy

- 25 In Germany, the fact pattern is not limited to specific industries.
- b. if they are common does the accounting for those fact patterns have a material effect on entities' financial statements?*
- 26 In Germany, yes, this fact pattern usually can have a material effect on entities' financial statements – in particular if fair value accounting needs to be applied.
- 2. Are there any other facts patterns which are in substance similar to the ones described in the submission?*
- 27 A situation where individual contracts for each plant and where net settlement occurs for those contracts related to discontinued operations has been observed. This leads to questions of whether this establishes a practice of net settlement with tainting of the other contracts. [Norway]
- 28 In Germany, similar fact patterns may exist in respect of fact pattern 2 from unforeseen changes in business practice, e.g., due to a transition to a more sustainable production, which may impact the volume of procurements already contracted. However, such changes are less disruptive than the impacts that gave rise to the immediate need for energy savings and the related price volatility so that the account impacts are less significant than those related to fact pattern 2.
- 3. If the fact patterns described in the submission are common and/or widespread, have you observed material diversity in how entities are applying the relevant IFRS Accounting Standards? If so, please describe the accounting observed with reference to the IFRS requirements applied (if known).*
- 29 In France, their stakeholders considered that the fact pattern described in the submission does not provide sufficient information to conclude on whether the circumstances described in paragraph 2.6(c) of IFRS 9 arise.
- 30 In Germany, diversity in practice is observed in respect of how strict the requirements to apply the own-use exemption have been interpreted, subject to individual facts and circumstances. The focal question of whether and how to apply the own use exemption is about the frequency and magnitude of sales or net settlements (i.e., whether sales/net settlements are infrequent and/or insignificant).
- 4. If you have observed material diversity, is the diversity present and similar across all jurisdictions and industries, or is the diversity only in evidence in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?*
- 31 In Germany, divergence in practice is not limited to specific industries or specific fact patterns.

Fact pattern 3: Oversized contracts

- 1. Are fact patterns such as the ones described the submission common and/or widespread?*
- 32 It is very common and widespread in Germany. Also, there is an increased frequency of these fact patterns in Norway and France.
- (a) Oversized contracts arise due to more non-flexible renewable energy such as wind and solar. The problem of oversized contracts also arises due to regulatory changes making fixed price baseload contracts an alternative for more companies which by nature does not have a typical baseload demand. Long term contracts with baseload for shorter durations (meaning shorter than 7 years) are now offered after regulatory changes due to the energy crisis make such shorter contracts more tax beneficial. [Norway]

- (b) In Germany, when entering into such contracts, the EFRAG CFSS member has been told that entities often agree on volumes below expected energy requirements also considering the own use requirements, even if it might have been preferable agree a larger volume economically.
- 33 In Austria, they have not seen fact pattern 3.
- If fact patterns are common and/or widespread:*
- a. are they common or widespread across all jurisdictions and industries, or are they common only in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?*
- 34 In Norway, the frequency is currently limited, but with a clearly increasing trend.
- 35 In Germany, the fact pattern is not limited to specific industries.
- b. if they are common does the accounting for those fact patterns have a material effect on entities' financial statements?*
- 36 Generally, for entities affected, the effects on the entities' financial statements are/ are expected to be material as prices are volatile, volumes significant and the term of the contracts are typically not short-term (often several years and in many cases 10 years or more). [Norway, France]
- 37 In Germany, yes, this fact pattern usually can have a material effect on entities' financial statements - in particular if fair value accounting needs to be applied.
- 2. Are there any other facts patterns which are in substance similar to the ones described in the submission?*
- 38 No responses received.
- 3. If the fact patterns described in the submission are common and/or widespread, have you observed material diversity in how entities are applying the relevant IFRS Accounting Standards? If so, please describe the accounting observed with reference to the IFRS requirements applied (if known).*
- 39 In Norway, current discussions indicate that there are differing views. Assuming that any volumes sold in one hour and purchased in another hour represent a net settlement prohibiting own use accounting, contracts for electricity which is not capable of being stored will for most companies fail to meet the criteria at one point, and will therefore need to be accounted for as derivatives at fair value. Some have a practice of gauging the frequency and materiality of such peaks with own use only being acceptable if both low frequency and low materiality, whereas other see room for a slightly more liberal interpretation of the own use criterion. There are arguments observed that there is a difference with regard to net settlements within the entity's control and net settlements that occur outside the entity's control.
- 40 In France, at the contract's inception, entities usually apply View A² (or an approach similar to the one described in that view) as described in the submission. However, entities also subsequently monitor how the output acquired aligns with their consumption to assess whether the contract still meets

² View A - Since the output of the energy provider is variable by nature, the only way to assess the amount of output is by the use of probabilities. The fact that the amount of energy may exceed the demand of Company C is not most probable but possible. Company C therefore assumes that it assesses the contract based on the expected (most probable) amount of output to assess whether the contract is in line with its expected usage requirements. Therefore, it applies the own-use-exemption.

the own-use exemption. When the entity is over-supplied and is then forced to sell the excess electricity on the spot market (oversize situation), the entity usually assesses the frequency and magnitude of any oversize. There are differing ways of making such an assessment, depending on an entity's own facts and circumstances. In particular, some tolerance thresholds are applied to assess the magnitude of any oversize.

- 41 In Germany, diversity in practice is observed in respect of how strict the requirements to apply the own-use exemption have been interpreted, subject to individual facts and circumstances. The focal question of whether and how to apply the own use exemption is about the frequency and magnitude of sales or net settlements (i.e., whether sales/net settlements are infrequent and/or insignificant).

4. If you have observed material diversity, is the diversity present and similar across all jurisdictions and industries, or is the diversity only in evidence in particular jurisdictions or industries (please identify and describe those jurisdictions or industries)?

- 42 In Germany, divergence in practice is not limited to specific industries or specific fact patterns.

Other comments [Germany]

- 43 When applying the own use exemption to physical power purchase agreement that appear to be settled net (for reasons not specified), the question of "tainting" arises.
- 44 The question arises whether, and to what extent, hedge accounting is applicable. This question relates to physical power purchase agreement as well as to power purchase agreement for which net settlement is contractually fixed (i.e., "virtual or financial power purchase agreement"). In particular, the following details seem unclear, hence deserve consideration too:
- (a) Can the quantity of power delivered under a wind/solar power purchase agreement, which is always variable by nature, be designated for hedge accounting purposes?
 - (b) In considering the 'own use' quantity and the output from a power purchase agreement that fixes prices for several years, does an entity for hedge accounting purposes need to assess quantities on an hourly or daily basis, or is a monthly or yearly basis appropriate?