IFRS IC submission on power purchase agreements
Issues Paper

Objective

1 The objectives of this paper are to:

(a) provide EFRAG FR TEG and EFRAG UP with a summary of the submission received by the IFRS Interpretation Committee ("IFRS IC") about the application of paragraph 2.4 of IFRS 9 (i.e., "own-use exception") to contracts for the procurement of renewable energy;

(b) provide a summary of the feedback received by the EFRAG CFSS members on prevalence (verbal update only); and

(c) Seek EFRAG UP inputs on the users' information needs and observations in response to the IFRS IC request for information received by EFRAG.

EFRAG Secretariat's work plan

2 The IFRS IC received a submission about the accounting implications on certain power purchase agreements according to IFRS 9. The IASB requested IFASS members for input on prevalence and accounting.

3 EFRAG intends to summarise European input to the IASB. For this purpose:

(a) on 10 April 2023 the EFRAG Secretariat asked EFRAG CFSS members to provide input from their jurisdictions, including providing us a copy of their response if members had a direct request for input from the IASB, by 8 May 2023. The questions included in the IASB's information request are summarised in paragraph 18 of this paper;

(b) The EFRAG Secretariat will provide a verbal update on the input from CFSS members that would be received by the time the EFRAG FR TEG-UP joint meeting is held. This feedback will be use as a basis for discussion with EFRAG FR TEG-UP members.

4 Furthermore, the EFRAG Secretariat will seek EFRAG UP members views related to the different accounting practices for such a type of contract, both in term of quantitative impact in the financial statements and disclosure requirements. The scenarios can be summarised as follows:

(a) <u>Scenario 1</u> - At the inception a contract meets the requirements for the application of the "own-use exception" under IFRS 9.2.4: the contract is accounted for as a "normal" purchase or sale contract because it is excluded from the scope of IFRS 9 and, hence, it falls within the scope of IAS 37; or

(b) <u>Scenario 2</u> - At the inception a contract does not meet the requirements for the application of the "own-use exception" under IFRS 9.2.4: the contract falls within the scope of IFRS 9 and is accounted as a derivative financial instrument at fair value to profit or loss including the requirement to provide specific disclosures (disclosure requirements in accordance with IFRS 7 *Financial Instruments: Disclosures*).

Summary of the submitted fact patterns

5 The IFRS IC received a submission about the application of paragraph 2.4 of IFRS 9 to contracts for the procurement of renewable energy as part of a company's commitment to reduce the effects of climate change and to decarbonise their production and products. According to the submission, the 'own use' requirements in IFRS 9 worked well in stable supply conditions, but that the changing market conditions give rise to application challenges and result in accounting outcomes that do not result in a faithful representation of the economic substance of such contracts.

6 The submission described three fact patterns, which have been summarised below. Here the submission, which provides further information about the question and the alternative views the submitter has identified as included in the IFRS IC pipeline projects' page.

Fact pattern 1: Purchased-as produced contracts

7 To secure the company's own demand for energy from renewable sources, the company enters into a physical power purchase agreement with a wind park operator.

8 The contract obliges the company to acquire a fixed share of the energy produced (for example 50% of the production) at the time it is produced at a price per unit of energy that is fixed throughout the contract duration of 25 years. When the energy is produced, the energy provider feeds the energy produced to the grid and transfers the "energy credits" to the account of the company in exchange for the fixed priced per unit.

9 Due to the company's production schedules, there are times when the company is unable to consume the energy that is delivered (i.e., over weekends or during the night when facilities are closed). As there are no feasible options to store the energy, the company has to sell unused amounts from its account to third parties. The process of selling and repurchasing is delegated to a service provider for a fixed or formula-based fee and is designed to be on autopilot that acts without the intention of trading to realise profits. The sole purpose of this is to enable the company's operations. There is no explicit net settlement option within the contract.

Fact pattern 2: Settlement of power purchase agreements

10 Company B has contracts to purchase natural gas for use in its own production facilities. Based on the company's estimated gas demand for the next 12 months, the company contracted 80% of its forecasted demand in forward contracts to fix the price and secure physical supply in advance. The company has been using this mechanism for a long time and has taken all delivery of all energy contractually agreed upon. The company has never settled any contracts net.

11 Due to the current economical and geopolitical environment, the government has called for voluntary energy saving efforts to ensure sufficient supplies. To prevent any restriction on, and to maintain, its operations the company invested in energy saving efforts and reduce its demand by 30%. Since not all the forward contracts that are already in place were needed anymore, the company settled some of the contracts by entering into a compensation agreement with the supplier. The net settlements are structured as net payments for all unneeded amounts at that point in time calculated as the product of the amounts to be settled and the difference between the fixed price of contracts and the then current market price.

Fact pattern 3: Oversized contracts

12 To secure the company's demand for energy from renewable sources, the company enter into power purchase agreements to purchase energy at a fixed price. Output levels from renewable energy sources cannot be guaranteed but only be estimated with a degree of probability (for example at a 50% or 75% confidence level).

13 Therefore, the company bases its own use requirement on a probability-weighted expected value. Any additional demand would be procured from the spot market. Respectively any excess would be sold to the spot market. The contract does not permit net settlement and the company has no history of net settlements or profit taking of contracts that were classified as own-use in accordance with paragraph 2.4 of IFRS 9.

Questions in submission:

14 With regards to fact patterns 1 and 3, the submission asks about applying the own use requirements in paragraph 2.4 of IFRS 9 at inception of the contract under the assumption that the contract conditions do not change throughout the life of the contract.

15 For fact pattern 2, the submission asks whether the company has created a past practice of settling similar contracts net in case in accordance with paragraph 2.6(b) of IFRS 9.

16 The submitter offers a number of views and discusses the possibility of applying the 'own use' exemption for each of the fact patterns.

17 Please refer to the IFRS IC pipeline projects' page for the detailed fact patterns and alternative views.

Questions included in the IASB request

18 The IASB information request includes the following questions:

(a) Question 1 - Are fact patterns such as the ones described the submission common and/or widespread? If fact patterns are common and/or widespread:

(i) 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)?

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

(b) Question 2 - Are there any other facts patterns which are in substance similar to the ones described in the submission?

(c) Question 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).

(d) Question 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)?

Questions for EFRAG FR TEG-User Panel

19 Does EFRAG FR TEG-User Panel have comments or questions on the submitted fact patterns summarised in paragraph 5 to 17?

20 Which type of information EFRAG User Panel members would need to make their assessment related to the contracts described in the submission? How the information will be used by users of financial statements?

21 Do EFRAG User Panel members have input from their analysis of entities in response to the IASB’s request included in paragraph 18?

22 Do EFRAG FR TEG-User Panel members have comments on the different scenarios summarised in paragraph 4?