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Berlin, 18 May 2023

Dear Staff of the IFRS Interpretations Committee,

**Outreach Request – IFRS 9 – Application of the ‘own use exemption’ in the light of current market and geopolitical questions**

On behalf of the staff of the Accounting Standards Committee of Germany (ASCG), I am responding to the Outreach Request as submitted to IFASS members on 13 April 2023.

Please find attached as an appendix the answers to the questions raised in your request as well as two additional comments on aspects that are deemed relevant with the matter but may go beyond the questions.

Our response is based on a survey among large audit firms in Germany and on additional feedback from preparers (covering companies from various industries) affected by the matter.

The feedback received indicates that – if the IFRS IC concludes that the principles and requirements in IFRS 9 do not provide an adequate basis for an entity to determine the required accounting – it might be adequate to add or change requirements in IFRS Standards to improve financial reporting. The matter has widespread effect and is expected to have a material effect on those affected. Our Outreach participants also hold the view that the matter can be resolved efficiently within the confines of the existing Standard and is sufficiently narrow in scope that the IASB can address it in an efficient manner, but not so narrow that it is not cost-effective to undertake the due process required to change a Standard.

If you would like to discuss our comments further or if you have any other questions, please do not hesitate to contact Jan-Velten Große ([grosse@drsc.de](mailto:grosse@drsc.de)).

Yours sincerely,

*Sven Morich*

Vice President

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## Appendix

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### Introduction

The IFRS Interpretations Committee (Committee) received a submission about the application of IFRS 9.2.4 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.

The submission described three fact patterns, which we have summarised below. We have attached the submission, which provides further information about the question and the alternative views the submitter has identified.

### Fact patterns identified

The submitter identified three common fact patterns related to the application of the requirements of IFRS 9.2.4 and .2.6(b):

#### ***Fact pattern 1: Purchased-as produced contracts***

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.<sup>1</sup> The contract obliges the company to acquire a fixed share of the energy produced (eg. 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.

Due to the company's production schedules, there are times when the company is unable to consume the energy that is delivered (ie. over weekends or during the night when facilities are closed). As there are no feasible option 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***

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.

Due to the current economical and geo-political 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 payment 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***

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).

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.

**Question in submission**

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.

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 para. 2.6(b) of IFRS 9.

The submitter offers a number of views and discusses the possibility of applying the 'own use' exemption for each of the fact patterns. Please refer to the extracts in the appendix for the detailed fact patterns and alternative views.

### **Information requested**

We would appreciate your input on the following based on your experience:

Q1. Are **fact patterns** such as the ones described the submission **common and/or widespread**? 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**?

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

Q2. Are there **any other facts patterns** which are in substance similar to the ones described in the submission?

Q3. 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).

Q4. 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**?

### **Outreach answers - Executive Summary**

Overall, our outreach on the application of the 'own use exemption' of IFRS 9.2.4 to energy contracts in the light of current market and geopolitical questions has shown diversity in practice and Outreach participants raised concerns about fair value accounting that do not result in a faithful representation of the economic substance of such contracts. They therefore urge the IFRS IC and the IASB to decide on the submission in a timely manner, as they expect increasing accounting impacts in 2023.

Whereas they deem the issue as outlined in the submission being highly relevant, Outreach participants pointed out that the issue is even more far-reaching – in particular, as any IFRS IC's deliberation might affect established accounting practices of applying the own use exemption to other fact patterns beyond power purchases.

Whilst Outreach participants are aware of the IFRS Foundation Due Process and authority of agenda decisions published by the IFRS IC as well as the additional due process step which requires the IASB to vote on and agree with agenda decisions, they would prefer a fast track procedure if the IFRS IC sees any indications that the above concerns give rise to standard setting activities by the IASB, so that these activities can be considered as soon as possible.

### **Outreach answers in detail**

**Q1a.** Yes, the fact patterns are common and widespread in Germany.

Fact pattern 1: For smaller and medium-sized entities, baseload contracts (with a fixed quantity) are particularly common, while for larger entities purchased-as-produced contracts are more common and widespread. Furthermore, the number of entities entering into purchased-as-produced contracts (eg. with a wind park operator) is increasing.

Fact pattern 2: It is very common and widespread for entities in Germany, irrespective of the size, in the light of unforeseen economic volatility driven by the geopolitical environment evolving during 2022.

Fact pattern 3: It is very common and widespread in Germany. To secure the company's demand for energy from renewable sources, entities usually enter into power purchase agreements to purchase energy at a fixed price. When entering into such contracts, we are 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.

The fact patterns described are not limited to specific industries. Instead, they are experienced by a variety of industries that commonly use commodities like electricity, oil or gas as a significant input factor. These issues also arise for companies that are generally purchasing quantities of energy and then selling to their customers.

**Q1b.** Yes, those fact patterns usually can have a material effect on entities' financial statements – in particular if fair value accounting needs to be applied. As energy prices are volatile and based on the long duration of those power purchase agreements, price changes can have material impacts on profit or loss through fair value changes.

**Q2.** For fact patterns 1 and 3 raised in the submission, the issue is primarily caused by the inability to store electricity at larger scale which is specific to those fact patterns and does not extend to other fact patterns where storage capacity would be easily available.

We note that similar fact patterns may exist in respect of fact pattern 2 from unforeseen changes in business practice, eg. 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. Nevertheless, we believe that practice would benefit from a common understanding articulated by the IFRS IC on how reductions of purchases driven by changes in the underlying operations impact the ability to account for underlying contracts as own use contracts.

**Q3.** The general understanding of the own use exemption may be similar amongst constituents. However, we have noticed a range of views on the application of the own use guidance in IFRS 9 for specific fact patterns. Not only the views taken by preparers and auditors often seem to be different but also the view amongst auditors may deviate as well. We have also learned that the application of the own use exemption across different jurisdictions may vary. This would include practical expedients taken by some regions or constituents.

In respect of all fact patterns, we observe diversity in practice in respect of how the own-use exemption have been applied, subject to individual facts and circumstances and, in particular, whether the individual fact pattern is material or not.

The focal question of whether and how to apply the own use exemption is about the frequency and magnitude of sales or net settlements (ie. whether sales/net settlements are infrequent and/or insignificant). This is particularly challenging, since there is no clear consensus about which periods (one day, or week, or even year) need to be considered when determining whether a deviation between energy consumption (“own use”) and energy delivery, resulting in sales or purchases, is significant.

**Q4.** Divergence in practice is neither limited to specific industries or jurisdictions, nor to specific fact patterns. We observe that the use of power purchase agreements is increasingly widespread across many industries due to the push to invest in renewable energy and to secure own electricity supply. We are aware, that the issue is primarily relevant in Europe (since electricity grids as well as energy markets are highly developed, thus allowing for immediate sales/purchases). However, we like to note that the issue also arises in regions/countries without such developed grids or markets, and thus maybe raising other aspects around this issue.

### **Our additional comments**

First, Outreach participants mentioned two technical questions which might deserve further consideration:

- When applying the own use exemption to physical PPA that appear to be settled net (for reasons not specified), the question of “tainting” arises.
- Further, even after the question of whether the own use exemption applies has been answered, additional follow-up questions may arise. A frequent question is whether, and to what extent, hedge accounting is applicable. This question relates to physical PPA as well as to PPA for which net settlement is contractually fixed (ie. “virtual or financial PPA”). In particular, the following details seem unclear, hence deserve consideration too:
  - Can the quantity of power delivered under a wind/solar PPA, which is always variable by nature, be designated for hedge accounting purposes?



- In considering the „own use“ quantity and the output from a PPA 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?

Second, outreach participants also pointed to virtual/financial PPA. While they acknowledge those contracts not being in the focus of this outreach, we note that for many entities of any size and industry those vPPA are a considerable part of their portfolio of energy contracts. If the overarching principle of appropriate and decision useful accounting were to be re-considered in respect of physical PPA, vPPA should not be left unconsidered.