KPMG

Demystifying Data Centre Accounting

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Data centre companies operate in a dynamic and complex environment, facing unique accounting challenges that can impact financial reporting, compliance, and operational efficiency. KPMG's Accounting Advisory Services (AAS) team is here to help you navigate these challenges and achieve financial clarity and success.

Key accounting and reporting issues under IFRS	Key question	Impact on EBITDA/revenue
PPE vs Investment Property **Determining the right classification can have a huge impact!** Determining whether data centres are classified as Property, Plant, and Equipment (PPE) or Investment Property (IP) is key. If data centres are used in the production or supply of services, they are classified as PPE and depreciated over their useful life. Conversely, if data centres are held to earn rentals or for capital appreciation, they are classified as IP and are measured either at cost or fair value under IFRS, with changes in fair value recognised in profit or loss. If significant ancillary services are provided to tenants, the property may be classified as PPE rather than IP. Assessing whether these services are "significant" is subjective, making this a key area of judgement.	• **Are your data centres primarily used for operational purposes or for earning rental income and capital appreciation?** • **How significant are the ancillary services?**	Likely impact on EBITDA if fair value measurement model is chosen for investment properties.
Power fees - Principal vs Agent **Principal vs agent - Control is key!** When determining whether a data centre company is acting as a principal or an agent in power fee arrangements, the key question is to assess control. If the company controls the power before transferring it to customers, it acts as a principal and recognises revenue at the gross amount. If not, it acts as an agent and recognises revenue at the net amount of the fee or commission.	• **Do you control the power before it is transferred to your customers?**	Likely impact on revenue. EBITDA might also be impacted depending upon different arrangements.
Lease definition and classification: finance vs operating **Understanding lease dynamics can make all the difference!** For a data centre arrangement to qualify as a lease, the lessor must grant control over the use of specific assets, such as data centre space, server racks, or cooling systems, for a defined period in exchange for payment. Once determined to be a lease, the lessor must classify it as a finance lease, where the lessor transfers substantially all of the risks and rewards to the lessee, or an operating lease, which is any lease that does not meet the criteria for a finance lease. Data centre buildings can be held under a head lease and then subsequently sub-let which will also require classification analysis both for the head lease and sub-lease.	• **Does the agreement meet the definition of a lease?** • **Do you, as a lessor, transfer substantially all the risks and rewards of ownership of the lease?**	With finance lease classification, EBITDA is likely to be higher in the initial years, however, it would typically remain constant over the lease term in case of operating lease classification.
Separation of lease and non-lease components **Ensure accurate financial reporting!** Data centre leases often include both lease and non-lease components, such as cleaning and maintenance services (CAM). Companies (lessors) must separate non-lease components for accurate accounting under IFRS. Separating different lease components within a lease arrangement could also pose challenges. Lease components are accounted for under IFRS 16, while non-lease components are treated as service contracts and recognised generally under IFRS 15.	• **Are you accurately separating lease and non-lease components in your contracts?**	Likely impact on EBITDA.

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Hedging power purchases **Manage power price volatility effectively!** Data centres often use fixed-price forward contracts to hedge power price volatility. These can qualify for the own use exemption under IFRS 9 if intended for physical delivery and aligned with the company's expected usage. Under this exemption, such contracts are treated as regular purchase agreements, not derivatives. However, selling excess electricity back to the grid can void the own use exemption, requiring fair value measurement through profit or loss. In some cases, companies may choose to designate these contracts in all-in-one cashflow hedges to eliminate any profit and loss volatility.	• **Do your forward contracts qualify for the own use exemption?**	Both revenue and EBITDA are likely to be impacted.
Power purchase arrangements **Structure your agreements wisely!** Power Purchase Agreements (PPAs) are contracts with power suppliers for renewable electricity, often including energy attribute certificates. They enhance electricity supply security and help meet sustainability targets. These agreements can be structured in various ways to achieve specific objectives, depending the terms and conditions outlined in the contract. Key considerations may include: i) Does the contract contain a lease under IFRS 16? ii) Does it meet own use criteria, or does derivative accounting apply? Upcoming IASB changes to IFRS aim to address challenges in accounting for renewable energy contracts.	• **Do your PPAs transfer control and risks associated with the power generation assets to you?** • **Have you considered the forthcoming changes to IFRS, which could impact your PPA accounting and disclosures?**	Likely impact on EBITDA.
Revenue recognition **Get your revenue reporting right!** Data centre companies often offer a variety of services such as colocation space, power fee, installation, etc. These services can be bundled together in a single contract, creating a complex revenue recognition scenario with multiple performance obligations. Accurately identifying these obligations and recognising revenue can be challenging, potentially leading to inaccurate revenue recognition.	• **Are you recognising revenue in accordance with IFRS 15?**	Both revenue and EBITDA are likely to be impacted.
ESG reporting **Boost your reputation and compliance!** Environmental, Social, and Governance (ESG) factors are increasingly important for data centre companies under scope. ESG reporting includes disclosures on energy consumption and efficiency, disposal of IT equipments, carbon footprint and social impacts. Companies increasingly need to describe risk management approach to material ESG factors, including ESG metrics, within their annual report and accounts in order to meet regulatory requirements and investor expectations.	• **Are you effectively integrating ESG metrics into your financial reporting?**	ESG initiatives can lead to cost savings and improved investor confidence, indirectly impacting EBITDA.
Accounting for carbon credits **Capitalise on environmental initiatives!** An entity may plan to purchase carbon credits/offset credits that neutralise residual emissions which cannot be eliminated. Accounting for carbon credits can be very complex depending on the nature of such credits. For data centre companies, accounting for carbon credits generally involves recognising them as intangible assets or inventory. They are initially measured at cost and subsequently measured at fair value or amortised cost, depending on the initial classification.	• **Are you accounting for your carbon credits correctly?**	Likely impact on EBITDA.

How can we help?

KPMG provides expert guidance to help data centre companies address accounting challenges and the broader business implications they face. Our team offers tailored insights to meet your specific needs. Contact us to have a conversation about your challenges and to know more on how we can support you in addressing both immediate and long-term issues.

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