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Questions concerning the impact of the spread of coronavirus on the financial statements and their audit (**Part 3, Update No.5 April 2021**)

Technical Guidance by the IDW

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1. Preliminary remarks

The corona pandemic has created numerous accounting and auditing issues in a very short time. The IDW addressed such issues directly and provided initial responses in close cooperation with its expert committees in the Technical Guidance issued on 4 and 25 March 2020 (Part 1 and Part 2). This guidance is accompanied by technical information, for example on labour and tax legislation and industry-related issues. Related guidance material is available on the IDW website at <https://www.idw.de/idw/im-fokus/coronavirus>.

New questions concerning accounting and auditing in practice continue to emerge. Naturally, the questions are also becoming much more detailed. In order to communicate possible solutions in a coordinated and well-founded manner, but also quickly, this guidance in Part 3 converts technical information into a question-and-answer format. Part 3 is being kept up to date with the latest developments by means of updates. New issues are added as updates, whether resulting from the pandemic's development or due to new "Corona legislation" that impacts on accounting or auditing. In addition, existing guidance will be updated, e.g., if certain aspects require special attention in the upcoming or current audit season or as opinions on issues that are currently uncertain develop further. Questions that have been supplemented or updated since to the last update are marked with the additions "New" or "Updated".

The fifth update mainly contains the addition of two new questions. These address the immediate write-off of so-called digital assets in the financial statements under German commercial law (question 2.3.15.) as well as the classification of silent partner contributions made by the German economic stabilisation fund [Wirtschaftsstabilisierungsfond] as debt or equity capital in the financial statements of the owner of the commercial business under German commercial law (question 2.3.16.).

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2. Selected questions regarding the effects on accounting under the German Commercial Code (Handelsgesetzbuch - HGB) and IFRS

2.1. Reporting in the notes to the annual financial statements and in the management report

Question 2.1.1: Should the effects of the corona pandemic in any case be included in the disclosures under HGB (supplementary report within the meaning of § [Article] 285 Nr. [Number]33 HGB)?

There is no general reporting obligation. The need to report depends on the individual company's exposure to the effects of the corona pandemic on its future development. A "nothing to report" is not required.

Question 2.1.2: What are the specific effects of the corona pandemic on the annual financial statements of a small or micro-corporation or on a company that prepares its annual financial statements in accordance with the German commercial law provisions applicable to all traders?

The legal representatives of small corporations (§ 267 Abs. [paragraph] 1 HGB) are not required to prepare a management report under § 264 (1) Satz [sentence] 4 Halbsatz [half-sentence] 1 HGB. In addition, pursuant to § 288 (1) Nr. 1 HGB, they are not required to include a supplementary report (§ 285 Nr. 33 HGB) in the note disclosures. For micro-corporations (§ 267a Abs. 1 HGB), neither a management report (§ 267a Abs.2 in conjunction with § 264 Abs.1 Satz 4 Halbsatz 1 HGB) nor notes are required (§ 264 Abs. 1 Satz 5 HGB). This also applies to companies that prepare their annual financial statements in accordance with the German commercial law provisions applicable to all merchants (e.g., partnerships with unlimited liability or companies that make use of the exemption provisions of § 264 Abs. 3 and 264b HGB in the context of preparing their annual financial statements). Consequently, it is questionable whether the corona pandemic nevertheless gives rise to reporting obligations for such companies.

According to the explicit statutory exemption provisions with regard to supplementary or management reporting (assuming the company is affected; see question 2.1.1.), no corresponding reporting is necessary. However, when there are material uncertainties in connection with events and circumstances that could cast significant doubt on the company's ability to continue as a going concern (so-called going concern risks), the party preparing the financial statements must report on them (*IDW AuS 270 (Revised)*, para. 9). Small corporations are required to include such reporting in the notes. For micro-enterprises and companies that prepare their annual financial statements in accordance with the provisions of German

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commercial law applicable to all merchants, the reporting must be included e.g., below the balance sheet (ref. IDW Technical Guidance of 25 March 2020, p. 4).

Question 2.1.3: The notes to the financial statements must report on events of particular importance that occurred after the end of the financial year, stating their nature and financial impact (§§ 285 Nr. 33 HGB). In general, an event is of particular importance if its effects are likely to have an effect on the (true and fair) view conveyed by the financial statements as of the balance sheet date and if, without this supplementary report, the development after the balance sheet date would be assessed significantly differently by the financial statement addressees. What details are required to meet this requirement?

A general reference to the corona pandemic is sufficient when presenting the nature of the transaction.

When presenting the financial impact, the assets and liabilities, financial position and financial performance must be taken into account to the extent that they are affected. Specific quantitative information is not required; qualitative reporting is sufficient. The verbal explanations must, however, sufficiently illustrate the impact on the economic situation of the company as a whole or the three categories (as above), if affected. The purpose of the provision which is to provide the addressees with at least basic information on the further development of the company as a basis for their decisions determines the threshold for reporting. In this respect, the period for which the financial effects are to be presented also extends from the beginning of the subsequent financial year to the date the preparation of the annual financial statements has been completed (in the case of companies subject to mandatory auditing, this is the date of the issuance of the auditor's report). For a consideration of events of particular importance that occurred thereafter, but before the adoption of the annual financial statements, see the IDW's Technical Guidance dated 25 March 2020, p. 32 (English version page 37).

Question 2.1.4: Is it possible to dispense with an otherwise obligatory supplementary report in the notes (§ 285 Nr. 33 HGB) by providing a reference to the reporting in the management report?

The HGB does not provide for an explicit cross reference and waiver of reporting in one of the reporting elements. Thus, the relevant reporting obligation must be complied with in both the notes and in the management report. Due to the similar nature of the report content, duplication cannot be ruled out. However, in order to increase transparency for the addressees - forward-looking information on the effects of the corona pandemic can be provided in a prominent place – and then, according to the accounting literature, it is considered permissible to include a cross reference the information presented in the Management Report in the supplementary report, provided identical information would otherwise have had to be included in both reports. The reference in the supplementary report must be unambiguous and clearly recognisable.

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Question 2.1.5: What disclosure requirements apply in the case of material uncertainties in the assessment of the going concern assumption?

In preparing financial statements, management is required to make an assessment of the entity's ability to continue as a going concern. If the financial statements may be prepared on the basis of the going concern assumption but, notwithstanding this, there are material uncertainties in connection with events or circumstances that may cast significant doubt on the entity's ability to continue as a going concern (= going concern risks within the meaning of *IDW AuS 270 (Revised)*), the preparer of the financial statements must disclose this fact and the planned handling of these risks in the notes - or, if there are no notes, e.g. under the balance sheet. In addition, when a management report has to be prepared, the risks threatening the existence of the entity must be reported in the management report, whereby the risks must be explicitly named as threatening the continued existence of the company (DRS 20.148 [German Accounting Standard – GAS 20 Paragraph 148]). In the notes to HGB financial statements, reference can then be made to the statements in the management report with a clear reference to the existence of a material uncertainty (going concern risk) or vice versa (see *IDW AuS 270 (Revised)*., para. 4, 24 et seq.).

A general reference to risks threatening the existence of the company as a result of existing uncertainties about the further course of the Corona pandemic and its effects on the business activity of the entity in the notes or management report alone is not sufficient. In order to meet the information needs of the addressees of the financial statements, in accordance with *IDW AuS 270 (Revised) para. 9*, management must clearly and unambiguously disclose in the financial statements the most important events or circumstances that may cast significant doubt on the entity's ability to continue as a going concern and the plans for dealing with these events or circumstances. For this purpose, the presentation of different scenarios with an indication of the assumptions made may be useful. Management must also clearly state in the financial statements that a material uncertainty exists in connection with events or circumstances that may cast doubt on the entity's ability to continue as a going concern and that the entity may not be able to realise its assets and settle its liabilities in the ordinary course of business (existence of a going concern risk) (for the auditor's evaluation, see section 3.4. and the IDW's Technical Guidance of 25 March 2020, sections 5.1. and 5.2.).

IFRS explicitly require management to report *material uncertainties related to events or conditions* that may cast significant doubt on the entity's ability to continue as a going concern (IAS 1.25). On 13 January 2021, the IFRS Foundation published additional guidance (*educational material*) for the assessment of the going concern premise and on the required disclosures.¹ The guidance is intended to support the consistent application of IFRS. They do

¹ Vgl. *IFRS Foundation*, Educational material, Going concern - a focus on disclosure, January 2021, accessible: <https://www.ifrs.org/news-and-events/2021/01/ifrs-foundation-publishes-edu-material-to-support-companies-in-applying-going-concern-requirements/>.

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not amend or supplement existing requirements, but rather provide an overview of the requirements of relevant standards. Accordingly, the IFRS Foundation first refers to the provisions of IAS 1.25 f., but emphasises that, with regard to the assessment of the going-concern premise, not only the specific provisions and disclosure requirements of IAS 1.25 f. must be observed, but also the overarching disclosure requirements of IAS 1. This includes, in particular, the disclosures of IAS 1.122 on discretionary decisions made by management in the application of accounting policies that have the greatest influence on the amounts reported in the financial statements. The disclosure requirement of IAS 1.122 also relates to narrow judgements made by management in assessing the going-concern premise or the existence of a material uncertainty (see IFRIC Update, July 2014, p. 6; see also questions 2.1.7. and 3.4.7.). In addition, disclosures about the sources of estimation uncertainty may become relevant in accordance with IAS 1.125-133.

Question 2.1.6.: Requirements concerning the accuracy of forecasts in the management report

GAS 20.130 generally foresees point forecasts, interval forecasts or qualified comparative forecasts as the type of forecast to be included in the (group) management report. According to GAS 20.133, entities need to report by exception, "If special circumstances result in an unusually high level of uncertainty surrounding the future development because of the macroeconomic environment, and the entity's ability to make forecasts is therefore significantly impaired, [...] [instead] only comparative forecasts or the presentation of the expected development in various scenarios of the financial and non-financial key performance indicators used for internal management purposes, disclosing their respective assumptions".

Can this relief be used for forecast reporting in (group) management reports to be prepared for reporting periods ending on 31.12.2020 or thereafter in the light of the effects (assumed for the future) of the Corona pandemic?

The relief may only be used if the two conditions stipulated in GAS 20.133 (unusually high level of uncertainty surrounding the future development because of the macroeconomic environment; significant impairment of the entity's/group's ability to forecast) are fulfilled cumulatively. A general reference to the (continuing) Corona pandemic alone is not sufficient (for an assessment of the situation at the beginning of the Corona pandemic, see the *IDW's Technical Guidance of 04.03.2020*, p. 4).

Whether the requirements are met is to be assessed in an appropriate manner on the basis of the circumstances existing at the time the preparation of the (group) management report is completed, i.e., generally the time the auditor's report is issued.

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A strong indication of unusually high uncertainty regarding future prospects because of the macroeconomic environment is, for example, when the current forecasts of renowned (national and/or international) economic research institutes regarding macroeconomic development in the forecast period (in Germany, in the EU and/or globally) diverge to an extraordinary extent.

A significant impairment of the entity's/group's ability to forecast is presumed when the preparer of the financial statements is able to demonstrate a high individual degree of impact on the entity/ group of the effects of the pandemic. The existence of budgets for (at least) the forecast period prepared for internal entity/group purposes and approved by any supervisory body of the (parent) company can be an indication that the presumption cannot be made.

Question 2.1.7: What are the expectations of the enforcement institutions (FREP, ESMA) with regard to reporting in connection with the effects of the Corona pandemic in the financial statements and management reports for the 2020 financial year?

On 9 November 2020, the German Financial Reporting Enforcement Panel (FREP) announced its focus areas for the 2021 examination season. The first four examination priorities are the same as those determined by the European Securities and Markets Authority (ESMA) and the national enforcement institutions at EU level, which are explained in detail in ESMA's public statement "*European common enforcement priorities for 2020 annual financial reports*" of 28 October 2020. The central topic is the requirement for adequate explanation and transparent presentation of the consequences of the Corona pandemic in entities' 2020 annual financial reports.

The first of the four European examination focal points is IAS 1 *Presentation of Financial Statements*. The focus is particularly on the requirements:

- 1) to assess the going concern assumption (also see question 2.1.5.),
- 2) the indication of significant judgements and estimation uncertainties (also see question 2.1.5.), as well as
- 3) the presentation of Corona-related items in the financial statements (also see question 2.3.7.).

Although ESMA's guidance on the presentation of the impacts of the Corona pandemic concerns IFRS financial statements and relates to the requirements of IAS 1, it can also serve as a point of reference and guidance for the presentation in financial statements under German commercial law.

The FREP has identified the group management report - and in particular risk reporting, taking into account the effects of COVID-19 - as one of the supplementary national examination focal

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points.² On the one hand, the focus is on the completeness and adequacy of reporting on material risks (§ 315 Abs.1 Satz 4 HGB). This applies to both individual risks and risks threatening the existence of the entity (§ 315 Abs. 1 Satz 4 HGB) as well as risks from the use of financial instruments (§ 315 Abs. 2 Satz 1 Nr. 1 HGB). These include, among other things, disclosures on the extent of default and liquidity risks as well as the presentation and explanation of material financial risks in connection with financial covenants (IFRS 7.18 et seq. and IFRS 7.31 et seq.). On the other hand, the FREP will pay attention to the consistency between risk and forecast reporting.

See question 3.4.6 regarding the [German] Auditor Oversight Body (AOB) work programme and the focal points of the auditor oversight by the German Chamber of Public Auditors (WPK) with regard to the effects of the Corona pandemic.

2.2. Accounting for payments in the context of governmental financial support measures

Question 2.2.1.: How are entitlements and payments in the context of short-time allowances³ to be recorded in the employer's financial statements?

Provided the legal requirements are met and the German Federal Employment Agency has been notified in due time, employees are entitled to short time working compensation from the Employment Agency. A corresponding notice of recognition is issued for this purpose. The employer is only responsible for handling payments as a trustee. The employer makes payments in advance and must then subsequently apply to the Employment Agency for reimbursement. The Employment Agency then issues a notice of recognition, on the basis of which the employer is reimbursed the short time working allowance (for details on the procedure, see the FAR's Technical Note dated April 3, 2020, p. 2 ff.)

Thus, from the employer's point of view, the short time working allowance is merely a so-called transitory item. In the profit and loss account under German commercial law, the employer's financial statements record neither expense nor income from the settlement of payments between employees and the Employment Agency. Corresponding to the monthly payments made to the employees, a claim against the Employment Agency is to be capitalized if all claim conditions including the effective submission of the notification of loss of working hours have been met on the balance sheet date and the application for reimbursement has been submitted

² See *FREP*, Examination Focus 2021, available at: https://www.frep.info/docs/pressemitteilungen/2020/20201109_pm.pdf.

³ For more information on the requirements for claiming short-time allowance, see the Technical Guidance of the IDW's Legal Committee (FAR) of 03.04.2020 and the IDW News exclusive of 22.09.2020.

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by the time the financial statements have been prepared or, with a near-certain probability, will be submitted within three months.

The above statements also apply to accounting in accordance with IFRS. Since short time working compensation is to be regarded as a transitory item and the IFRS do not contain any specific regulations in this regard, IFRS regulations dealing with similar or related issues must be applied when reporting to the employer (IAS 8.10 in conjunction with IAS 8.11(a)). The provisions of IAS 19.116 and IAS 37.53 for reimbursements are particularly relevant. In both cases, the prerequisite for the recognition of a claim against the Employment Agency is that the reimbursement of the short time working allowances already paid out by the employer is virtually certain. In analogy to the approach under German commercial law, this is assumed when all claim conditions, including the effective submission of the notification of loss of working hours, have been met as of the balance sheet date and the application for reimbursement has been submitted by the time the financial statements are drawn up or will almost certainly be submitted within three months.

In general, the short time working allowance is only granted subject to reservations and until a final review has been carried out (ref. IDW's Legal Committee (Fachausschuss Recht – FAR) Technical Guidance of 03.04.2020, p. 3 et seq.). In principle, this does not preclude the recording of advance payments as claims in line with the above guidance.

Question 2.2.2: According to § 2 Para. 1 KugV, the employer can apply for partial or full reimbursement of the social security contributions that he alone has to bear (see FAR Technical Note of 03.04.2020, p. 8).

How are the reimbursements of social security contributions granted by the Federal Employment Agency to the employer in connection with the payment of short-time work compensation accounted for?

The employer has (in contrast to short-time work compensation) its own direct claim against the Employment Agency. Under German commercial law, the claim for reimbursement is a non-repayable grant that must be recognized in the income statement under other operating income or as a reduction of personnel expenses (see *IDW St/HFA 1/1984*, section 2a). Since the provision of non-repayable grants is dependent on the fulfilment of certain statutory conditions (KugV in conjunction with SGB III), the income effect of the grants must be linked to the fulfilment of these conditions and the "offsetting" of the associated expenses in order for the beneficiary to be able to report an accurate profit and loss account. Therefore, an immediate complete recognition of non-repayable grants at the time they are approved is generally not appropriate (ref. *IDW St/HFA 1/1984*, section 2a).

In the case of grants for which - as in this case - a legal claim exists, the claim is capitalised as a receivable provided the company has fulfilled the relevant requirements (including

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notification to the Employment Agency) for the provision of the grant on the balance sheet date and the required application has been submitted or will almost certainly be submitted at the time the financial statements have been prepared (see question 2.2.1.). If a non-repayable grant is paid out before the recipient has fulfilled the material conditions for the grant, the amount received is to be recorded as a liability under other liabilities until it has been used as intended (ref. *IDW St/HFA 1/1984*, section 2b).

The general provisions apply to the information in the notes to the financial statements prepared in accordance with German commercial law.

For financial statements prepared in accordance with IFRS, the reimbursement of social security contributions by the Employment Agency constitutes a so-called performance-related grant (grants related to income as per IAS 20.3). Such government grants may only be recognised as receivables if there is reasonable assurance that the company will comply with the conditions attaching to them and that the grants will be received (IAS 20.7). This is analogous to the German Commercial Code (HGB), if all conditions for entitlement, including the effective submission of notification of loss of working hours, are fulfilled as of the balance sheet date and the application for reimbursement has been submitted by the time the financial statements have been prepared or will almost certainly be submitted on time within three months.

Grants related to income must be presented - either separately or under a general heading (e.g., "other income") - as a component of income. Alternatively, they can be deducted in reporting the related expense (IAS 20.29 et seq.). In this case, the accounting policies applied (including presentation methods) as well as the nature and extent of the government grants and other forms of government assistance recognized must be disclosed in the notes (IAS 20.39).

Question 2.2.3: How do employers account for the obligations to employees to compensate for loss of earnings by means of top-up amounts to the short time working allowance that they have assumed voluntary or in fulfilling a provision under a collective bargaining agreement or works agreement?

The wages and salaries paid to employees during the period of short-time working but reduced during the period of short-time work, plus any top-up amounts to the short-time working allowance, are to be regarded as part of the performance and remuneration obligations arising from the employment relationship (labour law). Accordingly, the top up amounts for short time working compensation are recognized as current personnel expenses. Due to the presumption of equilibrium between performance and consideration within the employment relationship, the formation of a provision pursuant to § 249 (1) sentence 1 (2) HGB is not applicable.

The regulations on short time working compensation and any top-up amounts paid in this

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context are designed to ensure the continuance of the employment relationship. The primary objective of the regulations on short-time work compensation is to enable companies to retain their existing and proven workforce by avoiding redundancies. This avoids a costly rebuilding of the necessary workforce after the end of the crisis and enables a rapid ramp-up of production and efficiency. Accordingly, in assessing the balance of benefits and consideration, all benefits and consideration over the expected remaining term of the employment contract must be included. Under these conditions, even in the case of "zero short-time work", there is no application of paragraph 32 (2) of *IDW AcS HFA 4* for the formation of a provision for impending losses. This is because an imbalance which is likely to be only temporary and to the detriment of the employer does not trigger the requirement to form a provision.

The same applies to accounting under IFRS. The top-up amounts paid by the employer are part of the short-term employee benefits within the meaning of IAS 19.9 and must therefore be recognised as current personnel expenses. The formation of a provision is not permitted, since the entitlement and obligation arising from the unfulfilled continuing obligation between employer and employees are balanced up to the time of payment.

Question 2.2.4.: When and how are claims for Corona grants relating to support periods before 01.01.2021 (so-called November and December grants, tide-over aid I and II) to be accounted for in the HGB financial statements or in the IFRS financial statements as at 31.12.2020?

HGB

Time of recognition

All of the afore-mentioned government grants must be accounted for in accordance with *IDW St/HFA 1/1984* and constitute non-repayable government aid, to which the applicant has no legal claim (under civil law) (even if and insofar as the applicant fulfils all material requirements). Rather, the aid is provisionally granted at the discretion of the relevant approval authority whereby the total amount of which is limited to the public sector budget funds specifically allocated for this purpose. According to *IDW St/HFA 1/1984*, section 2.b) paragraph 1 sentence 1, a requirement for the recognition of a grant claim ("other assets" in the statement of financial position) in financial statements prepared in accordance with German commercial law as at 31.12.2020, is that the reporting entity has fulfilled the eligibility conditions by the balance sheet date (however, the submission of the application *by the balance sheet date* is not constitute such a condition, if and as long as the application can still be made subsequently) and that the grant has been approved without any payment reservation before the preparation of the financial statements has been completed.

When, even before the date on which a final settlement notice is issued, the provisional granting of aid is virtually certain in the specific circumstances of the individual case, and provided the requirements are met, it appears appropriate to determine the date on which the

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claim is accounted for in the financial statements under German commercial law in accordance with the principles for grants for which there is a legal right of claim. The special circumstances that justify such accounting treatment by way of exception exist if it can be assumed that the competent authority has virtually no discretionary powers with regard to the granting of the benefit when the applicant has met the requirements and that the total government budget funds made available for the aid in question will almost certainly be increased in line with requirements should they be insufficient to cover the total benefits applied for. In the opinion of the IDW, it is reasonable in the current pandemic situation to assume for the time being that such special circumstances exist with regard to the Corona grants. Following this view, grants – without legal entitlement but which, under the conditions described above, are to be treated for accounting purposes in the same way as grants with a legal entitlement – are, according to *IDW St/HFA 1/1984*, Section 2.b) Para. 1, sentence 2, to be capitalized as a balance sheet item "other assets" as a claim (in the accounting sense) if the accounting entity has fulfilled the requirements as of the balance sheet date and the necessary application has been made or will be made with a probability bordering on certainty at the time the preparation of the financial statements has been completed.

If, due to the existence of a margin of judgment as to whether the requirements are met as of the reporting date, it cannot be assumed with sufficient certainty that the Corona aid will be granted, such that a legal entitlement will arise at a later date, recognition in the financial statements as of December 31, 2020 is not possible on the merits of the case.

In the case of those Corona grants, for which, under the applicable conditions for the grant, an application can only be submitted by a so-called third-party reviewer, submission of the application on time, before the preparation of the financial statements has been completed can also be regarded as a possible indicator that the requirements have been met as of the reporting date. This is because the submission of an application goes hand in hand with the fact that an expert third party (WP, vBP, StB, RA) was able to fulfil the task assigned to him of examining the eligibility to file an application and the existence of the circumstances justifying the amount of a claim.

It is not a prerequisite for the recognition of an entitlement to a Corona grant in the financial statements as of December 31, 2020, that the so-called final settlement notice has already been issued by the time the preparation of the financial statements is completed.

When (especially for grants above a certain value) EU Commission approval is required in order to assume the Corona aid complies with EU state aid law, and although such approval is still outstanding as at the reporting date, if by the time the preparation of the financial statements is completed this approval has been granted, the subsequent qualification of the permissibility of such aid can be applied retrospectively back to the reporting date ("clarifying the legal situation").

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Accounting for interim payments

Without a final settlement notice for at least the same amount having been issued to date, it cannot be concluded *per se* from the fact that an interim payment has been granted that the requirements have been met for granting the Corona financial aid (in the amount of the interim payment) as at the reporting date. Interim payments already received by the reporting date must be recognized as a liability ("other liabilities" in the statement of financial position) if there is insufficient certainty at the time the preparation of the financial statements is completed that the conditions for application will be met and that the recipient will subsequently be legally entitled to that aid.

Income statement

Unless Corona aid received qualifies - exceptionally - as an investment grant and is thus accounted for in accordance with *IDW St/HFA 1/1984*, Section 2.d)d1), Corona financial aid received must be recognized in the income statement under other operating income. It is not possible to report the income under revenue, because the reporting entity does not provide any (counter-)service (either to the grantor or to a third party) in return for the receipt of the Corona financial aid in question in the current context (refer to the question), which, however, is a prerequisite under Section 277 (1) HGB for income to qualify as revenue.

Disclosures in the (consolidated) notes

If the legal right to a claim for Corona financial assistance only materialises after the reporting date, any amounts capitalized for this purpose that are larger in amount must be explained in the (consolidated) notes (§ 268 Abs.4 Satz 2 in conjunction with § 298 Abs. 1 HGB, if applicable). Furthermore, income resulting from the receipt of Corona financial assistance must be regarded as income of exceptional significance, so that pursuant to § 285 Nr. 31 and § 314 Abs. 1 Nr. 23 HGB, the amount and type of the individual items of income have to be disclosed in the (consolidated) notes, unless the amounts are of minor significance.

Consideration of new information obtained up to the date of completion of the preparation of the financial statements

New or improved information obtained between the time of application and the end of the preparation of the financial statements that (a) the amount of a grant awarded/approved after the reporting date is too high in the light of this information, or (b) in the case of a grant decision that has not yet been issued, that the circumstances presented in the application give rise to the expectation that an unjustifiably high grant amount will be awarded, shall be taken into account as a reduction in the measurement of a claim (in the accounting sense) already to be capitalized in accordance with the above principles. Even in cases where no application has been filed by the end of the preparation of the financial statements, but a claim has nevertheless already been capitalized, all knowledge of circumstances that substantiate the

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amount of the claim and that is obtained by the end of the preparation of the financial statements shall be taken into account in the measurement of the recognized asset.

IFRS

Under IFRS, Corona grants are *grants related to income* as defined in IAS 20.3. Such government grants may only be recognized as a receivable if there is *reasonable assurance that* the entity will comply with the conditions attaching to them and that the grants will be received (IAS 20.7). With regard to the presentation of grants received in *profit or loss, they may be presented either* as a component of profit or loss - either separately or under a main heading (e.g., "other income") - or offset against the corresponding expenses (IAS 20.29 et seq.). In this context, the disclosure requirements of IAS 20.39 must be observed.

2.3 Further questions on the annual and consolidated financial statements – Updated and new question added

Question 2.3.1.: In the light of the facilitation created by § 1(4)(1) of the COVMG, what conditions must also be satisfied for the permissibility of an advance payment on the anticipated financial statement profit of a German Stock Corporation?

In contrast to a GmbH (German company with limited liability), an stock corporation is not permitted to make a so-called advance distribution (see § 57 Abs.3 German Stock Corporation Act (Aktengesetz (AktG)). However, § 59 AktG provides for the possibility of making a pre-payment to the shareholders after the end of the financial year on the expected net retained profits before a corresponding resolution on the appropriation of profits has been passed by the Annual General Meeting (§ 119 Abs. 1 Nr. 2 and § 174 Satz 1 AktG). The permissibility of an advance payment is generally subject to the Articles of Association authorising the Management Board to do so (§ 59 Abs.1 AktG). However, the admissibility according to § 1 Abs. 4 Satz 1 of the Law on Measures in Company, Cooperative, Association, Foundation and Condominium Law to Combat the Effects of the COVID 19 Pandemic (COVMG) does not require such an authorization in the Articles of Association - initially limited in time until 31 December 2021 (§ 1 GesRGenR COVMVV).

The conditions for the admissibility of an advance payment are still very restrictive, despite the relief granted by the COVMG. In addition to the requirements of § 59 Abs. 1 AktG, according to which the payment may only be made after the end of the fiscal year and a (sufficiently high) net profit is expected to be available, paragraph 2 additionally requires that:

- provisional accounts for the past financial year show a net profit for the year,

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- the advance payment comprises at most half of the amount remaining from the net income for the year after deduction of those amounts which are to be allocated to revenue reserves according to law or the Articles of Association, and
- the advance payment does not exceed half of the net profit for the previous year.

Furthermore, § 59 Abs. 3 AktG (as before) provides that the payment of a discount requires the approval of the Supervisory Board.

If, in the current situation, advance payments are to be made against the background that the Annual General Meeting will be held after a time delay, the aforementioned conditions should, however, generally be fulfilled or achievable because the audited annual financial statements approved by the Supervisory Board (§ 172 Satz 1 AktG) are already available. In these cases, advance payments based on § 1 Abs.4 COVMG have a secure legal basis.

What effects does the payment of an advance payment have on the annual financial statements of the stock corporation for the financial year in respect of which the advance payment is to be made (past financial year)?

Since the payment of the advance payment is not (yet) to be regarded as a measure of appropriation of the annual result within the meaning of § 268 Abs. 1 Satz 1 HGB, it does not affect the statement of financial position and income statement of the stock corporation for the past financial year. In particular, it does not lead to a supplement (in the form of a special item) to the so-called income statement extension statement pursuant to § 158 Abs. 1 Satz 1 AktG.

If, in exceptional cases, the annual financial statements have not yet been audited at the time of the approval of the Supervisory Board required under § 59 Abs.3 AktG for the resolution of the Management Board on an advance payment, the advance payment must be disclosed in the proposal for the appropriation of profits to be included in the notes to the financial statements in accordance with § 285 Abs.34 HGB. If, however, the annual financial statements have already been audited and adopted at this time - as is usually the case - without the advance payment being specified in the proposal for the appropriation of profits contained in the Notes, this does not result in a subsequent requirement to amend the annual financial statements; neither a supplementary audit within the meaning of § 316 Abs.3 Satz 1 and 2 HGB nor a new adoption of the annual financial statements are required in this respect.

Question 2.3.2: According to IFRS 9, financial assets must (only) be reclassified if the business model for managing the financial assets changes. Such changes are very rare according to the IASB's explicit expectation.

May financial assets be reclassified as a result of the corona pandemic? When should a reclassification be shown in the financial statements?

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A financial asset is classified upon initial recognition. Within the scope of classification, the financial asset is allocated to a business model of the company and - taking this into account - the measurement category is determined for subsequent measurement (IFRS 9.3.1.1). Reclassifications may only be made in connection with a change in the business model for the management of financial assets (IFRS 9.4.4.1)⁴. As expected, a change of business model occurs only very rarely (IFRS 9.B4.4.1).

The occurrence of the corona pandemic may indeed lead to a change in the business model. However, according to IFRS 9.B4.4.1, a reclassification of financial assets requires that the change

- be determined by the *entity's senior management* as⁵ a result of external or internal changes,
- is *significant to the entity's operations*, and
- can be evidenced to external parties (*demonstrable*).

According to IFRS 9.B4.4.1, the business model of a company is only changed if the company either *begins or ceases to perform an activity that is significant to its operations*. Whether the conditions for changing the business model of a particular portfolio in the context of the Corona Pandemic are met depends on whether the measures adopted have a demonstrable significant impact on the respective business activities of a company as a whole.

Financial assets must be reclassified prospectively from the *date of reclassification* (*reclassification date* as defined by IFRS 9, Appendix A), i.e., the reclassification is made at the beginning of the reporting period following the decision to reclassify (full reporting period or interim reporting period) (IFRS 9.5.6.1, IFRS 9.B5.6.2). Retroactive reclassification to a reporting date prior to the date of reclassification is therefore precluded.

The above comments apply exclusively to financial assets. Financial liabilities may not be reclassified (IFRS 9.4.4.2).

Question 2.3.3: To what extent are reclassifications of financial instruments into or out of the trading portfolio possible under German commercial law at credit institutions against the background of the Corona crisis?

According to the provisions of § 340e Abs.3 Satz 1 and 2 HGB, financial instruments held in a bank's trading portfolio must be measured at fair value less a risk discount. Subsequent reclassification from other valuation categories to the trading portfolio is precluded.

⁴ See also *IDW AcS HFA 48*, section 4.3, for general information on reclassifications according to IFRS 9.

⁵ For the term "*senior management*", see *IDW AcS HFA 48*, para. 242.

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Reclassification *from* the trading portfolio is precluded unless extraordinary circumstances, in particular serious impairments of the tradability of the financial instruments, result in the bank giving up its intention to trade (§ 340e Abs. 3 Satz 3 HGB). A decline in price alone does not impair the tradability of the financial instruments. This excludes, in particular, reclassifications which are intended solely to structure or smooth the annual result, i.e., solely to avoid devaluations.⁶

Question 2.3.4: For financial assets that are measured at amortised cost or fair value with recognition of changes in value in other comprehensive income (IFRS 9.4.1.2, IFRS 9.4.1.2A), for leasing receivables, *contract assets* within the meaning of IFRS 15, *loan commitments* and financial guarantees that are subject to the impairment provisions of IFRS 9.2.1(g), IFRS 9.4.2.1(c) or IFRS 9.4.2.1(d), an impairment loss is recognised for expected credit losses (IFRS 9.5.5.1).

What effects does the corona pandemic have on the determination of impairment?

The principles set out in IFRS 9 continue to apply when determining impairment (see *IDW AcS HFA 48*, section 5.2.). Particular attention must be paid to the following aspects:

- In principle, all reasonable and reliable information about past events, current conditions and projections of future economic conditions must be taken into account for the recognition and measurement of expected credit losses, provided that this information is relevant to the credit risk of the financial instrument under consideration and is available at the reporting date without unreasonable cost or delay. In view of the corona pandemic, a critical assessment must be made as to whether forward-looking information has been taken into account to a sufficient extent or to what extent the past can still be considered an indication of future developments. Where appropriate, the existence of government support measures must also be taken into account on the basis of general requirements. An adjustment of the previous methodology or a so-called "management adjustment" may also be appropriate, the derivation and justification of which must be documented.
- In order to determine a significant increase in the credit default risk or the amount of the impairment, especially for the simplified approach within the meaning of IFRS 9.5.5.15 et seq., an assessment is considered at collective level, provided there are *shared credit risk characteristics* within the meaning of IFRS 9.5.5.5. Such common/homogeneous credit risk characteristics are, for example, the credit rating, the type of collateral, the date of initial recognition, the residual maturity, the industry, the geographical location of the obligor and the value of the collateral relative to the financial asset if this affects the probability of a default. In view of the corona pandemic, a critical assessment must be made as to whether the previous portfolio formation is still appropriate or whether a more

⁶ See *IDW AcS BFA 2*, para. 23 et seq.

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extensive breakdown is required. This could be the case, for example, with newly emerging cluster risks.

In addition, an appropriate explanation of the effects of the corona pandemic should be provided in the notes to the financial statements where these are material.

For interim financial statements, an assessment must be made as to whether a significant reportable event has occurred as a result of changes in customer credit risk (IAS 34.6. and .15 et seq.).⁷

For further information on the effects of the corona pandemic on impairments of financial instruments in accordance with IFRS 9, see also the Technical Notes of the IDW Bankenfachausschuss (BFA – Banks Committee).

Question 2.3.5: With hedge accounting according to IFRS 9, among other things, a *highly probable forecast transaction* may be designated as the underlying transaction within the scope of a hedging relationship (IFRS 9.6.3.3). This can, for example, be future sales.

What effects does the corona pandemic have on the accounting treatment of such hedging relationships?

In light of the corona pandemic, a critical assessment must be made as to whether the hedged future transaction will continue to occur with a high degree of probability within the appropriately specified and generally narrow time frame (for relevant aspects of the analysis, see *IDW AcS HFA 48*, Paragraph 344). The point of reference for the assessment of when a highly probable transaction is present is the previously established *accounting policy* and the concrete documentation of the hedging relationship.

Accordingly, if the occurrence of a transaction (in whole or in part) is no longer expected with a high degree of probability, the hedging relationship (in whole or in part) must be terminated (IFRS 9.6.5.6, IFRS 9.B6.5.26, IFRS 9.B6.5.27(b)). In particular, reference may not be made to a correspondingly higher transaction volume in/at an earlier or later period or date, unless this was part of the originally planned and sufficiently identified expected transaction. Something different may apply in individual cases if the original, sufficiently identified expected transaction does not occur as planned due to an unforeseeable event - e.g., the corona pandemic - but is nevertheless carried out sooner or later within a reasonable period of time and with sufficient certainty (see *IDW AcS HFA 48*, paragraph 347).

If the hedging relationship is terminated, the amounts recognised in the *cash flow hedge reserve* must be left there (IFRS 9.6.5.12(a)), provided that the transaction *is still expected to*

⁷ See also ESMA, Public Statement: Implications of the COVID-19 outbreak on the half-yearly financial reports, 20.05.2020.

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occur, even if it is no longer highly probable. Otherwise, it must be recognised immediately as a *reclassification adjustment in profit or loss* (IFRS 9.6.5.12(b)).

Irrespective of this, possible effects on the effectiveness of the hedging relationship must be considered.⁸

Question 2.3.6: IFRS accounting for leases requires the lessee to recognise a *right of use asset* and a *lease liability* at the *commencement date of the lease* (IFRS 16.22). Subsequently, the right of use must be depreciated on a scheduled basis in accordance with the provisions of IAS 16 "Property, Plant and Equipment" (IFRS 16.31).

Can the scheduled depreciation of the right of use by the lessee be suspended in the event of a significantly restricted possibility of use of, for example, a rented property during the Corona pandemic?

The lessee (hire-purchaser) is generally required to depreciate the right to use a leased asset from the time it is made available until the end of its useful life or - if this occurs earlier - until the end of the lease term (IFRS 16.32).

IFRS 16.31 refers to the provisions of IAS 16 "Property, Plant and Equipment" with regard to determining the depreciation method for the right of use. According to IAS 16.60, the depreciation method must correspond to the expected pattern of consumption of the future economic benefits embodied in the asset by the entity. Rights of use under property rental agreements are regularly depreciated on a straight-line basis, as the economic benefit of the right of use is the possibility of using the rented space and - as the area of the rented space does not change - the consumption of the benefit remains the same over the term of the agreement.

In accordance with IAS 16.55, scheduled depreciation of an asset ends (only) on the date on which the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5, but no later than the date on which it is derecognised, whichever is earlier. Consequently, depreciation does not cease when the asset is no longer in use or is no longer used (unless the asset is already fully depreciated).

Even a property whose use is restricted by an official order can still be used by the tenant with restrictions but nevertheless (e.g., by allowing access at any time to store inventory there or to carry out cleaning or renovation work). The tenant still derives an economic benefit from the right of use, so that the scheduled depreciation of the right of use must be continued throughout the period of the restricted use of the property.

⁸ See IDW AcS HFA 48, paragraph 346.

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In analogy to the regulations of IAS 16.79, disclosure of the carrying amount of temporarily significantly restricted rights of use within the meaning of IFRS 16 is recommended, as this disclosure could be considered relevant for the users of the financial statements.

Irrespective of the above, the provisions of IAS 36 require the determination of whether the right of use is impaired and, if so, whether an impairment loss must be recognised (IFRS 16.33).

The restricted ability to utilise real estate due to official orders can give rise to doubts on the part of the lessor as to the lessee's ability to pay. What accounting impact might result from this for the lessor in the context of an operating lease?

As a result of the individual impacts of the Corona pandemic, the lessor may have doubts about the lessee's ability to pay and thus about the collection of rental income. In contrast to the requirements for revenue recognition under IFRS 15, according to which collectability must generally be probable (IFRS 15.9(e)), the realisation of rental income under IFRS 16 does not require an assessment of the lessee's ability to pay (IFRS 16.81). Therefore, irrespective of any existing doubts about the collection of rental payments, the lessor must first recognise a (rental-) receivable for outstanding operating lease receivables in the full amount, for which, as appropriate, an impairment or risk provision for the amount of the expected credit losses must be recognised in accordance with the provisions of IFRS 9 (IFRS 9.2.1(b)(i), IFRS 9.5.5.1).

Question 2.3.7.: The corona pandemic, as a largely unforeseeable exogenous event, will regularly mean that many entities may not achieve their original forecasts for economic development. How can the effects of the corona pandemic be appropriately presented in the IFRS financial statements, depending on the circumstances and their significance in the individual case?

Even in an exceptional situation such as the Corona pandemic, the general regulations of IAS 1 on the presentation of financial statements must be observed. This applies in particular to any planned "special disclosures" or similar.

In its public statement on the European focal issues for enforcement for 2020 financial reports⁹, published on 28 October 2020, ESMA expressly urges the preparers of financial statements to be careful and cautious with regard to any intended separate presentation of the effects of the COVID-19 pandemic in the statement of financial performance (e.g., pro-forma presentations or similar). Qualitative and quantitative information on significant effects of the corona pandemic and the methods used to determine them should present a clear and

⁹ See ESMA, Public Statement „European common enforcement priorities for 2020 annual financial reports“ of. 28.10.2020, page. 4; also see ESMA, Public Statement: Implications of the COVID-19 outbreak on the half-yearly financial reports of. 20.05.2020, page. 4

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unbiased view of the multiple areas impacted by COVID-19. As part of the explanations of the amounts shown and disclosed in the statement of financial performance the disclosures may be provided as a separate disclosure (*single note*) in the notes to the financial statements or clear and unequivocal cross-references may be made between the relevant sections in the notes. The IDW expressly endorses this statement.

Question 2.3.8: On 28 May 2020, the IASB published the amendment standard "Covid-19-Related Rent Concessions - Amendment to IFRS 16" and thus created a (temporary) practical relief for lessees. In the case of COVID-19-related rent concessions (e.g., deferral of rent instalments or rent discounts), an assessment of whether a modification of the lease within the meaning of IFRS 16 exists may be waived under certain conditions. As a supplement to the IASB amendment standard "Covid-19-Related Rent Concessions - Amendment to IFRS 16", the following example considers the accounting for rent concessions by the lessor.

For example, a lessor provides a lessee with hardware for two years within the framework of an operating lease. The *commencement date* within the meaning of IFRS 16 is January 1, 2020. The lessee is obliged to make a fixed monthly lease payment. After two years the leased asset must be returned to the lessor. The lessee recognises the lease payments on a straight-line basis. Due to the corona pandemic, the two parties to the contract agree on 1 March 2020 that the lessor will waive the lease payments to the lessee for the next three months (March to May 2020).

How does the lessor have to account for the remission of the three-monthly instalments in the financial statements?

Due to the Corona pandemic, the original terms of the lease were adjusted so that the lessee is no longer obliged to pay the three lease instalments from March to May 2020. This reduces the fee to be paid for the lease, so that this contractual adjustment represents a *lease modification* within the meaning of IFRS 16 (IFRS 16, Appendix A).

The remission of the three leasing instalments is accounted for by the lessor as a new lease from the effective date of the change (here: 01.03.2020) (IFRS 16.87). Consequently, it recognises the income from the new lease by spreading all agreed lease payments (taking into account any lease payments made or deferred in advance) on a straight-line basis between 1 March 2020 and 31 December 2021 (IFRS 16.81).

How would the lessor have to account when the three leasing payments for the period from March to May 2020 were not waived but merely deferred and thus only the payment obligation for the lessee was only temporarily waived. The lessee must then pay the deferred lease payments in addition to the originally agreed monthly lease payments during the period between October and December 2020.

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At least in the case of a (short-term) deferral of lease payments without interest on arrears, the total consideration to be paid for the lease does not change, so that it does not appear appropriate to assume a modification of the lease as defined by IFRS 16.¹⁰

IFRS 16 does not contain any explicit rules on the financial statement presentation of a deferral of lease payments within the framework of an operating lease. As the total consideration to be paid remains unchanged, it is permissible for the lessor to continue to recognise income from the lease on the same systematic basis as before the agreed deferral (here: on a straight-line basis). The amount of the amounts recorded each month therefore does not change.

Question 2.3.9.: Some rental agreements contain so-called *force majeure* clauses, which apply in the event of serious unforeseen circumstances beyond the control of the parties to the agreement. For example, such a clause may exempt the affected party from some or all of its obligations under a contract if a global pandemic (e.g., according to the WHO declaration) has been explicitly identified as a "force majeure" circumstance. However, the nature or form of the clauses may vary, so that it is sometimes unclear which rights apply in the event of a pandemic and whether the clause is applicable to the circumstances arising from COVID-19 at all.

What is the financial reporting impact of force majeure clauses in connection with the Corona pandemic on leases under IFRS 16?

First, a legal assessment must be made as to whether the clause in question is applicable in the context of the Corona pandemic. Both the wording of the clause and the relevant laws and regulations must be taken into account. Measures taken by governments in response to COVID-19 could, in some circumstances, also be interpreted as *force majeure*.

As such clauses are already included in the original terms of the agreement, their application, where applicable, does not constitute a modification of the lease as defined by IFRS 16.

If the application of a force majeure clause results, for example, in reduced lease payments, it seems appropriate to recognise these amounts as negative variable lease payments that are not index-linked or rate-dependent (see IFRS 16.27(b)). Such variable lease payments should not be reflected in the measurement of the lease liability but are recognised by the lessee in *profit or loss in the period* in which the event giving rise to the reduced lease payments occurs (IFRS 16.38(b)). Although this rule applies specifically to lessees, it is also applicable by analogy to lessors, as the general definition of variable lease payments applies to both lessees and lessors (IFRS 16, Appendix A).

If a *force majeure clause* grants one contracting party the right to re-enter into negotiations with the other contracting party again under specified circumstances, it is necessary to assess

¹⁰ See. IASB Staff Paper Agenda Ref 32B, Accounting for covid-19-related rent concessions, April 2020, Para. 11.

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whether the negotiated changes must be accounted for, for example, as a modification of the lease as defined by IFRS 16.

Where a force majeure clause becomes relevant, additional disclosures will regularly be required to enable users of the financial statements to understand the effects on the financial statements (IFRS 16.51, IFRS 16.89).

Question 2.3.10.: Do the deadlines extended during the coronavirus pandemic for the submission of accounting documents to the operator of the Bundesanzeiger (Federal Gazette) apply in respect of the fulfilment of the disclosure obligations according to § 325 HGB? – Updated

No, the statutory filing deadlines continue to apply unchanged. Therefore, even under the current circumstances, for non-capital-market-oriented entities the deadline ends at the end of one (period) year after the reporting date of the financial year to which the accounting documents relate (§ 325 Abs.1a Satz 1 in conjunction with Abs.1 and Abs.4 Satz 2 HGB).

However, in coordination with the Federal Ministry of Justice and Consumer Protection (BMJV), the Federal Office of Justice (BfJ), first announced on 15 December 2020 and later updated with a time extension in February 2021 on its homepage an easing of the disclosure of accounting documents with a year end of 31 December 2019 (available at https://www.bundesjustizamt.de/DE/Themen/Ordnungs_Bussgeld_Vollstreckung/Jahresabschluss/Jahresabschluss_node.html, accessed on 06.04.2021). According to this, the BfJ will not initiate any administrative fine proceedings pursuant to § 335 HGB before 01.03.2021, for failure to file on time. This also applies to entities whose statutory deadline for the disclosure of accounting documents expires during the first quarter of 2021. With this relief, the concerns of all parties involved should be adequately taken into account due to the ongoing coronavirus pandemic and the problems it has caused in practice.

In contrast, no relief was or is planned for reporting periods ending before 31 December 2019.

Question 2.3.11.: Degressive depreciation in the balance sheet under German commercial law

The Second Corona Tax Relief Act of 29 June 2020 (BGBl. I page. 1512) (re)introduced geometric-degressive tax allowance for wear and tear (AfA) of up to 25% p.a. of the respective residual book value for movable fixed assets acquired or produced after 31 December 2019 and before 1 January 2022 (§ 7 Abs.2 EStG (Einkommenssteuergesetz – German Income Tax Law).

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Can this depreciation method also be used without further ado as the basis for measuring the straight-line depreciation of the asset in question over its normal useful life in financial reporting under German commercial law?

Since the abolition of the so-called reverse and the corresponding opening clauses under German commercial law authoritativeness [*Translators note: previously there was a direct correlation between expenditure in the P&L and tax deductibility in accounting under German commercial law – now abolished*] by the German Accounting Law Modernisation Act (BilMoG) in 2009, scheduled book values determined in accordance with depreciation methods permissible under tax law may no longer be adopted without further consideration in the financial statements under German commercial law. The prerequisite for this is that the consumption of value reflected by the declining-balance depreciation corresponds to the actual wear and tear of the asset or that this wear and tear is presented appropriately. In other words, scheduled depreciation justified *exclusively* on the basis of corresponding tax provisions may not be applied under German commercial law. Nevertheless, there is scope for discretion in determining the depreciation method under German commercial law. However, the application of depreciation in decreasing annual amounts under German commercial law is ruled out for such assets, the value of which decreases evenly over the normal useful life. The explanations in *IDW AcH HFA 1.015*, which was prepared in 2009 on the occasion of the BilMoG, can be applied accordingly in the current situation.

If the (temporary) reintroduction of the possibility of declining-balance depreciation of certain assets for tax purposes is taken as an opportunity to question the appropriateness of the depreciation schedule (§ 253 Abs.3 Satz 2 HGB) for assets of the same type and function, which has been used as a basis under German commercial law up to now, the following must be taken into account: The principle of consistent valuation (§ 252 Abs. 1 Nr. 6 HGB) only permits the application of the declining balance method of depreciation in the financial statements prepared in accordance with German commercial law if the straight-line method of depreciation was previously applied to assets of the same type and function in those financial statements, but the change to the declining balance method of depreciation contributes (in exceptional cases) to the financial statements providing a better true and fair view of the net assets, financial position and results of operations in accordance with generally accepted accounting principles, so that a departure from the principle of objective consistency is to be regarded as justified (§ 252 Abs. 2 HGB in conjunction with section in conjunction with *IDW AcS HFA 38*, paragraph 15). However, it will then be difficult to justify that asset of the same type and function, which are acquired or produced after the date of expiry of the declining balance depreciation option for tax purposes (after 31 December 2021 according to the current legal position) and must therefore be depreciated on a straight-line basis for tax purposes, are also depreciated on a straight-line basis in the financial statements under German commercial law. Such a procedure is likely to be regularly classified as contradictory to the justification for

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the previous change from straight-line to declining-balance depreciation (prohibition of arbitrariness).

As a rule, it is to be assumed that an application of the geometric-degressive depreciation in the financial statements under German commercial law is not permissible according to § 7 Abs. 2 EStG, so that taxable temporary differences arise in the annual financial statements under German commercial law due to the accelerated tax depreciation, which are to be taken into account when accounting for deferred taxes.

Question 2.3.12.: Permanent usage relationships with continued collection of fees

A business merchant concludes contracts with his customers for the use of a facility and/or an object for payment (e.g., operator of a fitness studio). The contracts do not have a fixed term but are concluded "until further notice". Payment is made by monthly direct debit. Due to an official order issued in response to the Corona pandemic, the facility and/or the object is temporarily not allowed to be opened and/or used. Notwithstanding this, the direct debit is not suspended, so funds will continue to be debited from clients' bank accounts.

What are the accounting consequences of this situation in the business merchant's annual financial statements under German commercial law?

In as far as the customers are entitled to claim a repayment from the merchant under civil law and the customers do not irrevocably waive this claim (in which case other operating income would exist), the merchant must in principle balance the income to his bank account by recognising a repayment liability. The realisation of sales revenue is ruled out due to the lack of performance by the merchant. If the merchant enters into agreements with his customers that the latter may use the facility and/or the object during a period within a future business year without having to make further payment to the merchant for this possibility of use, no liability but instead deferred income is recognised.

Question 2.3.13.: Subsequent valuation of securities held as fixed assets

How is the fair value of shares in related entities (§ 266 Abs. 2 A.III.1. HGB), of equity investments (§ 266 Abs. 2 A.III.3. HGB) and of (other) securities held as fixed assets (§ 266 Abs. 2 A.III.5. HGB) to be determined for the purposes of subsequent valuation in accordance with § 253 Abs. 3 Satz 5 and 6 HGB in the annual financial statements? (*This question/answer supplements or substantiates the statements in Part 2 of the Technical Guidance "Effects of the spread of the coronavirus on the financial statements and their audit" of 25.03.2020 in Section 3.2.2, subsection "Asset Items", p. 14/37.*)

For those shares in related entities (§ 271 Abs. 2 HGB) and equity investments (§ 271 Abs. 1 HGB), which the financial statement preparer does not intend to sell (in the short-term) and for

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which such a sale does not have to be assumed for other reasons, the fair value shall be determined by applying a future earnings valuation method (capitalised earnings value or DCF method) in accordance with *IDW AcS HFA 10* (equity value), irrespective of whether the shares in question are publicly traded or not. When there is an intention and ability to continue the investment, no stock exchange price is directly relevant for the assessment of whether these shares are likely to be permanently impaired within the meaning of § 253 Abs. 3 Satz 5 HGB, since the subjective entity value is applicable to the valuation (see *IDW AcS HFA 10*, para. 5 et seq.). A stock exchange price can only serve to gauge the plausibility of the fair value so determined.

When there is an intention to sell, the share valuation shall be based on the objectified enterprise value. If there is a binding offer for the acquisition of such shares, this shall be used instead of the objectified entity value (see *IDW AcS HFA 10*, para. 11 et seq.). Even when there is an intention to sell, a possible stock exchange price only serves to gauge the plausibility of the valuation of the shares in such an entity. The stock exchange price (for these shares) is only directly authoritative if such shares are to be sold on the stock exchange.

The above systematic of *IDW AcS HFA 10* also applies to other securities held as fixed assets (i.e., such shares in entities that do not qualify as shares in related entities and also not as equity investments) that are not publicly traded (on the balance sheet date).

For other securities held as fixed assets which are publicly traded (at the latest on or at least up to the balance sheet date), the closing price on the stock exchange resulting from a trading transaction on the last trading day of the reporting period is to be regarded as the fair value. In assessing whether such securities held as fixed assets are likely to be permanently impaired within the meaning of § 253 Abs. 3 Satz 5 HGB when the closing price is lower than the last book value (and which have a sufficiently long trading period until the valuation date), the indicator criteria of the Insurance Committee in *IDW AcS VFA 2* in conjunction with the reporting on its 149th meeting can also be used by accountants outside the insurance industry (in this respect, reference is made to the explanations in Part 2 of the Technical Guidance).

Question 2.3.14.: Rent concessions in the case of a tenant accounting according to the HGB

Scenario 1 (rent concession ex post): Against the background of the Corona pandemic and the official measures taken to contain its impact on health ("lockdown"), a landlord (partially) waives the rent due for a period of use in the past for a tenant who prepares financial reporting under the German Commercial Code. Otherwise, there is no adjustment of the conditions of the lease (e.g., amount of the monthly rent or term of the lease). The question is how the (partial) waiver is to be reflected in the tenant's financial statements.

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A rent concession granted ex post constitutes a unilateral (short-term) support measure of the landlord in favour of the tenant, i.e., the tenant has no obligation in return. If the tenant had already paid the rent due to the landlord for the period of use in question, he acquires through the "waiver" a repayment claim against the landlord which he must immediately recognise in full as other operating income (§ 275 Abs. 2 Nr. 4 or Abs. 3 Nr. 6 HGB). Recording the income in the form of a reduction of the rental expense is not possible due to the prohibition of netting (§ 246 Abs. 2 Satz 1 HGB).

Insofar as the tenant still owed the (partially) waived rent up to the time the rent concession became legally effective, the debt, insofar as the waiver, is sufficient, is to be derecognised immediately in the full amount with a corresponding effect on income. In this case the recognition of a negative rental expense is also not permissible.

Under the principle of the reporting date [cut-off], in both cases the recognition of the repayment claim or the reduction in rent liability in the tenant's financial statements with a corresponding effect on income requires that the (partial) waiver/remission has become legally effective up to the tenant's reporting date. The waiver agreement (§ 397 Abs. 1 BGB (Bürgerliches Gesetzbuch - German Civil Code)) becoming legally effective only in the new business year is a legally substantiating event which in principle does not have a retroactive effect on the last balance sheet date. Regarding the prerequisites for the possibility, according to the prevailing opinion, of taking account of restructuring measures in the financial statements with retroactive effect on the last balance sheet date, see the comments in the IDW's Technical Note of 25 March 2020, p. 7.

The income resulting from the (partial) waiver of the landlord's claim for rent is generally to be disclosed in the (consolidated) notes pursuant to § 285 Nr. 31 or § 314 Abs.1 Nr. 23 HGB. If the (partial) waiver did not become legally effective until after the balance sheet date but before the end of the preparation of the financial statements (and there is no retroactive reference to this balance sheet date as a reorganizational measure), provided the waiver qualifies as a "transaction of special significance" there is also an obligation to disclose the facts and its financial effects in the supplementary report of the (consolidated) notes pursuant to § 285 Nr. 33 or § 314 Abs. 1 Nr. 25 HGB.

Scenario 2 (rent concession ex ante): Due to a lockdown (see scenario 1), the landlord temporarily waives his claim to future rent (attributable to periods of use in the future) regulated in the original contract or temporarily reduces such a claim after conclusion of the original lease by concluding a corresponding debt amendment agreement (§ 311 Abs. 1 BGB) or (future-oriented) waiver agreement (§ 397 Abs. 1 BGB). Apart from that, there is no adjustment to the lease conditions (e.g., term of the contract). The question is how the situation is to be reflected in the tenant's financial statements.

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An ex ante rent concession serves as a temporary (short-term) measure for the landlord to provide economic support to the tenant, which is determined for only one or a few specific partial period(s) (e.g. month or quarter) of the remaining lease term. If this view is followed, the rent reductions are only to be taken into account (in the form of a reduced rent expense) in the partial period(s) to which they relate.

If the tenant has made advance rent payments up to the respective balance sheet date, which have (also) been paid with regard to the partial periods of the selective support, the tenant has to record a repayment claim in this respect, with a corresponding reduction of the prepaid expenses.

The rent concession is recognized in the balance sheet with effect for or from the financial year in which the rent concession becomes legally effective.

If applicable, disclosures pursuant to § 285 Nr. 33 or § 314 Abs. 1 Nr. 25 HGB are also required in the supplementary report in the (consolidated) notes.

Question 2.3.15.: Immediate write-off of so-called digital assets in the financial statements under German commercial law - **New**

According to a BMF (Bundesfinanzministerium – German Ministry of Finance) letter dated 26 February 2021 (BStBl. I p. 298), for tax purposes it is permissible (option according to para. 1: "may") to use a normal useful life of one year within the meaning of § 7 Abs. 2 EStG for the assessment of the straight-line depreciation of certain so-called digital assets (computer hardware and software for data input and processing) specified in the letter in profit calculations for financial years ending after 31 December 2020. As a result, the assets falling within the scope of the BMF letter (irrespective of whether they are movable or stationary, depletable or non-depletable, capable of being used independently or non-independently) can be immediately claimed as operating expenses for tax purposes in the financial year of their acquisition or production. Thus these assets are neither "capitalised" nor subject to pro rata temporis depreciation for tax purposes, since according to § 7, Abs. 1 EStG (see BFH, judgement of 26.08.1993 - file no. IV R 127/91, BStBl. II 1994 p. 232) no deduction for wear and tear is to be recorded for assets with a useful life of up to one year. A normal useful life of one year can not only be used as a basis for taxable profit calculations for financial years ending after 31 December 2020, but can also be applied to corresponding assets that were already acquired or produced in earlier financial years and for which a useful life other than one year was previously used as a basis (immediate write-off). The regulation was introduced in the short term through administrative channels with the aim of further

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stimulating the economy and as an incentive for companies to invest more in digitalisation.

It is questionable whether the option under tax law to use a useful life of one year as a basis may also be used without further ado to measure the scheduled depreciation of the asset in question in accounting under German GAAP. Closely related to this is the question of whether the authoritativeness principle means that the impermissibility of a useful life of only one year under German commercial law results in an inability to exercise this tax option, so that the intended advantage or incentive impact comes to nothing.

Since the abolition of the so-called reverse authoritativeness as well as the corresponding opening clauses under German commercial law by the German Accounting Law Modernisation Act (BilMoG) in 2009, book values determined on the basis of normal useful lives permissible solely for tax purposes may no longer be simply adopted in commercial accounting. Instead, the prerequisite for this is that such a useful life is justified independently from (preferential) tax regulations. The useful life estimate must be based on operational reality. Thus, the assumption of a useful life of only one year for the favoured digital investments is generally not permissible for accounting purposes under German commercial law. However, immediate depreciation is also permissible for accounting purposes under German commercial law if the asset in question meets the criterion of a low-value asset within the meaning of § 6 Abs. 2 Satz 1 EStG (acquisition or production costs ≤ EUR 800; see HFA, IDW Life 2017, p. 848). If the option of immediate write-off is used for tax purposes without the application of a useful life of only one year being justified for the asset in question for accounting purposes under German commercial law, this triggers a requirement to recognise deferred tax liabilities (§ 274 Abs.1 Satz 1 HGB) or - for those accounting entities that do not fall within the scope of application of § 274 HGB and also do not voluntarily apply this provision (see IDW AcS HFA 7 (Revised) para. 18, and IDW AcS HFA 34, footnote 9) - the requirement to form a deferred tax liability provision according to § 249 Abs. 1 Satz 1 alt. 1 HGB (see IDW AcS HFA 7 (Revised) para. 26 et seq.).

In the IDW's opinion, the use of an actual useful life of more than one year for accounting purposes under German commercial law does not mean that the tax option of using a fictitious useful life - granted by the tax authorities to achieve a non-accounting purpose - is rendered meaningless by the authoritativeness principle (§ 5 Abs.1 Satz 1 Halbsatz 1 EStG). In the opinion of the tax authorities, the so-called tax option exception pursuant to § 5 Abs. 1 Satz 1 Halbsatz 2 EStG, according to which the authoritativeness of the German commercial-law principles of proper accounting is subject to the reservation of the choice of a different approach within the scope of the exercise of a (solely) tax option, is to be subsumed not only in tax-law options, but also in tax options resulting from a BMF letter (see BMF letter of 12 March 2010, BStBl. I p. 236, para. 12).

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Question 2.3.16.: Classification of silent partner contributions made by the economic stabilisation fund as debt or equity capital in the commercial business' financial statements under German commercial law – New

As one of the first of the legislator's reactions to the Corona pandemic, the Economic Stabilisation Fund (Wirtschaftsstabilisierungsfonds – WSF), a special federal government fund without legal capacity, was created in March 2020 by the Economic Stabilisation Fund Act (Wirtschaftsstabilisierungsfondsgesetz – WStFG). Also, the existing Financial Market Stabilisation Fund Act - now the Stabilisation Fund Act (StFG) – has been amended and expanded. The WSF has a volume of EUR 600 billion, of which up to EUR 100 billion may be used for so-called recapitalisation measures to strengthen the debt or equity capital of qualifying companies (§§ 22 and 24 Abs. 1 Satz 1 StFG). Among other things, up until 31 December 2021, the WSF may, upon application, pay in a contribution so as to participate ("owners of the business entity") in stabilisation-worthy companies within the economy as a silent partner (referred to in the law as a silent partnership) (§§ 22 Abs. 1, 26 StFG). Standardised conditions apply in the WSF for recapitalisations up to a volume of EUR 100 million. More detailed information on silent partnership contributions can be found in the fact sheet "Recapitalisations: Silent partnership and subordinated loans" (status: 12 February 2021). In the case of a recapitalisation with a volume of, or exceeding, EUR 100 million individual structuring is undertaken in line with the requirements of the StFG (Financial Sector Enterprises) and the Economic Stabilisation Fund Implementation Ordinance (WSF-DV).

The question arises as to whether and, if so, under which conditions a silent partnership contribution by the WSF may be disclosed as (financial statement) equity in the commercial business' financial statements under German commercial law.

Because such funding is provided on the basis of a legal debt, the receiving entity's accounting for silent partnership contributions follows an analogous application of the principles developed for profit participation capital, which are set out in the IDW Statement of the Accounting and Auditing Board: On the treatment of profit participation rights in the annual financial statements of corporations (IDW St/HFA 1/1994).

Irrespective of the fact that some formulations in the above-mentioned WSF leaflet could suggest that the silent partnership contributions made by the WSF qualify per se as equity capital in the receiving entity's financial statements, each contract governing the establishment of a silent partnership must be assessed in detail by the accounting entity (and its auditor) as to whether the following four criteria are cumulatively fulfilled (see IDW St/HFA 1/1994, Section 2.1.1):

- Subordination in the event of insolvency or liquidation,
- Remuneration dependent on performance,

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- Participation in losses up to the full amount of the contribution, and
- Longer-term nature of the capital transfer.

Only when this is the case, is the silent partnership contribution presented within equity (as a separate item). If the criteria are only partially fulfilled, the transferred funds are to be shown as liabilities; a presentation as a special item between equity and provisions cannot be considered.

It is therefore not valid to generally assume that silent partnership contributions made by the WSF always qualify as equity capital in the receiving entity's balance sheet. Statements in the WSF leaflet that could suggest an accounting classification of WSF silent partnership contributions as the receiving entity's equity capital cannot replace a thorough assessment of the existence of the above-mentioned criteria.

3. Selected issues concerning the impact on the financial statement audit

3.1. Effects of the postponement of the Annual General Meeting on auditor appointment

Question 3.1.1: If a statutory auditor has been providing audit services to a public interest entity for 20 or more consecutive years as at 16.06.2014, may he/she still be allowed to carry out the audit of the annual financial statements as at 31.12.2020, even if the general meeting and hence the election of the statutory auditor is postponed to a date after 16.06.2020 as a result of the corona pandemic?

According to the wording of Article 41 (1) of the EU Audit Regulation (EU-APrVO), a Public Interest Entity (PIE) may not enter into or renew an audit engagement as of 17 June 2020 if that statutory auditor has provided audit services for this PIE for 20 and more consecutive years (so-called "long-runners") at the date of the entry into force of the EU-APrVO (16 June 2014). Assuming that the audit engagement within the meaning of Article 41 (1) EU APrVO has been granted before 17.06.2020, the auditor may still carry out the audit of financial statements for the period ending on 31.12.2020. If the current corona pandemic leads to the postponement of general meetings, a strict interpretation based on wording that itself is not entirely clear might result in the companies concerned having to tender for the audit for the calendar year 2020 in addition to the burdens resulting from the crisis.

In contrast, the Committee of European Auditing Oversight Bodies (CEAOB), is of the opinion that the beginning of the financial year to be audited can be used as a basis for the audit engagement; i.e. according to this view, the audit of financial statements for financial years commencing before 17 June 2020 (e.g. for a financial year 2020 from 01.01.2020 to 31.12.2020) may still be carried out by the previous auditor (see CEOB, Guidelines on the

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duration of the audit engagement, question B.9 p. 6: "[...] the audited entity will not be allowed to renew or enter into an audit engagement [...] for periods that start on or later than 17 June 2020"). An often-unavoidable postponement of the Annual General Meeting 2020 will not bring forward the change of auditor and the associated obligation to tender for so-called "long-runners". This view appears justifiable, not least because a formal reference to the time of the appointment of the auditor cannot be justified given the spirit and purpose of the Audit Regulation. Neither the issue of familiarity nor the quality of the audit will be changed by the fact that the auditor for the financial year 2020 will be appointed on 15 June in one case and on 20 June in another.

Question 3.1.2: What are the options for action in the event of a postponement of the Annual General Meeting with regard to the election of the auditor for the auditor's review of the condensed financial statements and the interim management report within the framework of the half-yearly financial report according to WpHG?

If, as a result of the corona pandemic, the review of the half-yearly financial report (§ 115 Abs. 5 Satz 1 WpHG (Wertpapierhandelsgesetz – German Securities Trading Law) needs to be carried out before the ordinary Annual General Meeting of the current financial year, there is, on the one hand, the option of appointing the auditor of the previous financial year to perform this review in analogue application of § 318 Abs. 2 Satz 2 HGB (Alternative 1: acceptance by default). This means that the election of the auditor by the Annual General Meeting is not necessary. The general view in German accounting literature assumes this admissibility, although it has not been clarified conclusively in Court. Otherwise, § 318 Abs. 2 Satz 2 HGB does not apply to new appointments in the context of the external rotation requirement under Article 17 of the EU Audit Regulation.

On the other hand, after the first six months of the financial year an application pursuant to § 115 Abs. 5 Satz 2 WpHG in conjunction with § 318 Abs. 4 HGB for an appointment of a replacement auditor by the Courts (Alternative 2: auditor replacement order). However, the admissibility of the legal appointment has similarly not been clarified conclusively by the Court. In the context of an auditor replacement order, the Court would have to examine in any case whether the fictional effect of § 318 Abs. 2 HGB would intervene. Should the predominant opinion in the accounting literature prevail, there would be no capacity for a replacement order.

Since the review of the half-yearly financial report is voluntary (§ 115 Abs. 5 Satz 1 WpHG), it would also be possible to waive the review of the half-yearly financial, taking the associated consequences into account (Alternative 3: waiver). However, this would have to be disclosed in the half-yearly financial report in accordance with § 115 Abs. 5 Satz 6 WpHG and could - especially if this were done only in the current situation, and contrary to the previous year's practice - be viewed negatively by the capital market.

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Alternatively, according to the prevailing opinion in accounting literature, it is possible for the Supervisory Board to engage the auditor to perform a review prior to the auditor's election and subject to election by the Annual General Meeting (Alternative 4: conditional commission). This enables the auditor to begin the review as soon as possible and to issue a review report on the results of the review shortly after the election by the Annual General Meeting, which can then be published immediately with the half-yearly financial report.

3.2 Impact of the Corona pandemic on the auditor's risk assessment and determination of materiality

Question 3.2.1: Is there an increased risk of material misstatement of the financial statements in relation to the Corona pandemic?

In many cases, yes. The impact of the Corona pandemic may increase the risk of both material unintended misstatements (error) and intended misstatements (fraud). This includes the emergence of new risks. The auditor has to assess the factors for a possible increased risk in the context of his risk assessment (see also the explanations in sections 5.1 and 5.2 in the IDW's Technical Guidance dated 25 March 2020 (Part 2)).

The risk of material misstatement due to error may be increased, for example, due to the following factors:

- Changes in working conditions, such as increased home office working, may require the adaptation of internal controls (adaptation of control design). This can lead to controls being less suitable for detecting or avoiding errors. For example, the frequency of controls may be reduced in the case of changed working conditions or controls may be transferred to other, less experienced persons (see also question 3.3.2.).
- Due to staff shortages, there can be considerable time pressure in generating accounting-relevant information.
- Forecast information and accounting estimates, which were previously determined on the basis of reliable information about the future economic development of an industry, for example, require a more complex determination as a result of increased uncertainties.
- State aid (e.g., liquidity aid) is being applied for under considerable time pressure, which due to the urgency of the situation, may mean it is granted by the authority by approving the application subject to final verification that the recipient fulfils the application criteria at a later point in time. This leads to the risk of the incorrect reflection of entitlement to this aid in financial reporting (e.g., recognition of receivables, consideration in the assessment of the ability to continue as a going concern).

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The risk of material misrepresentation due to fraud may be increased, for example, due to the following factors:

- The change in the design of controls resulting from increased home office working may override the existing segregation of duties, creating opportunities for deception and asset misappropriation.
- The entity may be experiencing a slump in demand due to the Corona pandemic and there is nevertheless a lot of pressure on management to achieve certain financial targets. This can lead, for example, to an increased risk of early revenue recognition or the recognition of fictitious revenues, as well as the omission of necessary individual bad debt adjustments on receivables despite customers' economic difficulties.
- The company may be currently less affected by the Corona pandemic than expected by the addressees. Against this background, there are incentives for management to create hidden reserves, for example by bringing forward expenses contrary to the principle of accrual accounting or by "postponing" sales to the next financial year, overvaluing provisions or undervaluing inventories.
- When concluding new contracts that are important for the operational business, less attention may be paid to the integrity of the contractual partners due to existing economic pressure.

Identified risk factors shall be taken into account in the development of the auditor's work programme (see *IDW AuS 210*, para. 23). If, in the auditor's judgement, the risk of misstatement is increased, appropriate audit procedures directed at the identified and assessed risk of material misstatement will be necessary (see *IDW AuS 210*, para. 40 - 59).

Question 3.2.2: What impact does the Corona pandemic have on the determination of materiality?

The Corona pandemic can, in principle, have an impact on materiality for the financial statements as a whole applicable to the audit, due to changes in the magnitude of certain reference values (e.g., turnover, profit, balance sheet total, equity). The general principles according to *IDW AuS 250 (Revised)* (or *ISA [DE] 320*) apply. Assistance can be found in the *Q&A on ISA [DE] 320 or IDW AuS 250 (Revised)* developed by the *IDW* working group "ISA Implementation".

According to these principles, it may make sense to adjust the reference value for one-off or extraordinary impacts. This presupposes that the resulting change in the reference value in the Corona pandemic is assessed as unlikely to be sustained (see *Q&A on ISA [DE] 320 or IDW AuS 250 (Revised)*, question 3.2.9). The use of average values from previous years as a reference also presupposes that previous levels are likely to be reached again (see *Q&A on ISA [DE] 320 or IDW AuS 250 (Revised)*, question 3.2.10). However, an adjustment of the reference values or the use of average values of previous years will usually not be appropriate

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if the corona pandemic has a lasting negative impact on the demand for the company's products (e.g., companies in the fifth category according to Annex 2). If an entity has already undergone sufficiently concrete structural changes (e.g., discontinuation of important business areas), the use of multi-year average values taking into account planned figures for future periods can be considered (see Q&A on ISA [DE] 320 or IDW AuS 250 (Revised), question 3.2.11).

If the corona pandemic is associated with a sustained drop in earnings and profits, in principle the auditor can also consider a change in the benchmark used as a reference value. The prerequisite for changing of the benchmark is that the users of the financial statements primarily orient themselves to other benchmarks than previously (see re the determination of materiality for companies with weak earnings Q&A on ISA [DE] 320 and IDW AuS 250 (Revised), questions 3.2.18 and 3.2.19). question 3.2.18 and 3.2.19).

If weak sales lead to a loss situation, this can, in principle, also justify a change to another suitable benchmark (see Q&A on ISA [DE] 320 or IDW AuS 250 (Revised), question 3.2.15).

When determining performance materiality for the financial statements as a whole, indications of an increased aggregation risk may have to be taken into account as a result of the Corona pandemic, which ceteris paribus leads to a lower performance materiality being determined. For example, a high degree of estimation uncertainty in the financial information caused by the effects of the Corona pandemic may be such an indication (see Q&A on ISA [DE] 320 or IDW AuS 250 (Revised), question 4.4).

The auditor may also consider determining materiality for individual types of transactions, account balances or financial statement or management report disclosures (specific materiality) based on the Corona pandemic. This is necessary when it is expected that misstatements of amounts below the level of materiality for the financial statements as a whole will influence the economic decisions of financial statement users made on the basis of the financial statements or the management report (see IDW AuS 250 (Revised), para. 16). The determination of specific materiality levels can thus be appropriate in the Corona pandemic, for example, if certain financial figures are relevant for the fulfilment of eligibility requirements for government aid measures or for compliance with contractual credit clauses.

3.3. Impact of access and travel restrictions and the increased client' s use of remote working

Question 3.3.1: Can the audit procedures required by the IDW Auditing Standards or ISAs also be performed remotely if, for example, the client denies the audit team access to its premises?

Yes. The auditor must determine the type and scope of the audit procedures required in each

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individual case within the scope of his own responsibility and in accordance with his professional judgement and taking into account professional requirements and statutory regulations. Neither the IDW Auditing Standards nor ISAs nor statutory regulations deal with the issue of from which location the audit procedures are to be performed. Therefore, in principle, audit evidence can be obtained both on-site at the client's premises and through remote audit procedures.

By making use of today's technical possibilities, in addition to on-site audit procedures, it is also possible to use remote audit procedures, e.g., in the form of video conferences, tours with image transmission via smartphone or tablet, inspection of scanned or photographed documents or screens, if necessary supplemented by a short visit with an appropriate security distance, use of the postal service and remote access for exchanging documents. Depending on the individual case, the auditor must assess whether he can obtain sufficient appropriate audit evidence in this way.

The present catalogue of questions and answers contains an overview of the types of audit procedures mentioned in *IDW AuS 303 (Revised)*, as an appendix, together with information on how these can be performed, if necessary, by means of so-called remote audit procedures, taking into account the specific circumstances of the company to be audited.

If audit procedures are carried out "remotely", the requirements of the IDW Auditing Standards or ISA must nevertheless be complied with. This applies, among other things, to the assessment of the relevance and reliability of the information used as audit evidence (see *IDW AuS 300 (Revised)*, paragraph 8) and the documentation of the audit procedures.

Audit evidence obtained through remote audit procedures is subject to different – usually higher – reliability risks than audit evidence obtained directly, i.e., e.g., by inspecting original documents, by physically inspecting an asset, by observing or reconstructing procedures or controls on site or by personal interviews with direct perception of the other person's body language (see also *IDW AuS 300 (Revised)*, paragraph A29). These risks must be adequately addressed (see in detail question 3.3.4. on assessing the reliability of audit evidence obtained through real-time video technologies and question 3.3.8. on assessing the reliability of audit evidence available in electronic form).

Question 3.3.2: What are the effects of introducing or extending "remote work" on the client side on the Statutory Auditor's assessment of control risk?

In identifying and assessing risks of material misstatement of the financial statements and management report (misstatement risk), the auditor is required to obtain an understanding of the company's internal control system and perform follow-up tests of controls relevant to the audit. If the auditor bases his risk assessment and the determination of the type, scope and timing of the meaningful audit procedures on the expectation that internal controls are

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operating effectively, tests of controls must also be performed on appropriate controls in order to validate the expectations regarding the reliability of the controls (see *IDW AuS 261 (Revised)* paragraph 74; *IDW AuS 350 (Revised)* paragraph 47b).

Since the middle of the first quarter of 2020, in particular, the spread of the coronavirus in Germany has prompted more and more companies to employ staff in a home-office environment. This has an impact on the organization and, where applicable, the business activities of the companies as well as on the processes and controls for preparing financial statements and management reports. As a result of the introduction or expansion of "remote work" by the audit client, the control risk with regard to audit-relevant controls may need to be reassessed (see. *IDW AuS 261 (revised)*, paragraph 77). Examples of this are:

- The control design is changed (e.g., reduction of the frequency of control execution) in order to enable the control to be executed despite the large number of the client's employees working in home office.
- The control design is not adapted, although relevant processes have actually changed due to the "home office" work of various client employees (e.g., a change in the person performing the control in the case of manual controls).
- In order to enable or extend the homeworking of client employees, access rights are changed extensively, so that it is necessary to reperform the assessment of whether the protection against unauthorized modification of accounting-relevant data by appropriate and effective controls is still effective.
- If new technologies such as online trading platforms or a cashless payment system are introduced in the short term, it is possible that the automatic or manual controls implemented have not yet been fully developed.

If the auditor wishes to continue to rely on the control environment and relevant controls, the risks resulting from such changes need to be identified and conclusions drawn for designing further audit procedures. In some cases, this may lead to a stronger focus on substantive audit procedures. However, in the case of significant control deficiencies, substantive analytical audit procedures can only be used to a limited extent. They are then not suitable as the sole procedures (see *IDW AuS 312*, para. 24). In addition, it must be taken into account that a particular control can only be included in a "rotation plan", if the design of that control remains unchanged (see *IDW AuS 261 (Revised)*, para. 78, according to which, for non-significant risks, a test of operating effectiveness must be carried out for the individual unchanged control at least every third consecutive audit).

Question 3.3.3: What possibilities does the auditor have to obtain sufficient appropriate audit evidence if the inspection of tangible assets or the observation of the inventory on site is currently not possible due to access and travel restrictions?

If the inventories are material, the auditor must - as far as practicable - observe the physical

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inventory in order to obtain sufficient suitable audit evidence, in particular regarding the existence, completeness and nature of the inventories. In doing so, the auditor must satisfy himself that the inventory procedures are being handled properly (ref. *IDW AuS 301*, paragraph 7). If it is not possible to observe the inventory, e.g., due to the nature of the inventories or their storage location, alternative audit procedures must be used to obtain sufficient suitable audit evidence (ref. *IDW AuS 301*, paragraph 20 et seq.).

IDW AuS 301 mentions e.g., the following alternative audit procedures:

- inspection of documents relating to the subsequent sale of certain items of stock bought prior to the date of stocktake.
- if participation in the year-end inventory is not possible, observation of control counts on an alternative date, in conjunction with verification of interim stock changes.

The statutory provisions and the Auditing Standards do not contain any statement as to whether the procedures of inspection and observation require the physical presence of a member of the audit team at the location of the asset to be inspected or the inventory to be observed. In principle, the available technologies allow the statements to be verified by means of real-time image transmissions via a smartphone or tablet PC (e.g., checking the presence of inventories), provided certain basic requirements are met in order to adequately counteract reliability risks associated with such procedures in the specific individual case (see also question 3.3.4.).

For example, the use of drones may also be considered, e.g., to compare outdoor storage locations with existing drawings in the context of an inventory check, or to assess the degree of completion of investments in property, plant and equipment.

However, depending on the client's circumstances (e.g., the volume and type of storage of the inventories), the inspection of inventories or observation of the inventory using remote inspection technologies may involve higher risks with regard to the reliability of the audit evidence in relation to the existence, completeness and quality of the inventories in comparison with inspection and observation by physical presence on site.

Question 3.3.4: Under what conditions can real-time video technologies be used for inventory observation purposes and what are the risks involved?

A basic prerequisite for the use of real-time video technologies for the purpose of obtaining audit evidence will be that the auditor can control the image transmission and that suitable image and sound quality can be guaranteed. The ability to control is necessary to allow the auditor, at his discretion, to inspect certain storage locations in more detail for the purpose of checking the condition and existence of stocks or, if necessary, to have packaging opened in

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order to check the contents.

In addition, the auditor will need to address the following issues relating to the reliability of the audit evidence obtained and take action to address these issues:

- Does the approach chosen allow the auditor to assess the existence and completeness of the assets to be included? In order to be able to control the image transfer in a meaningful way, the audit team must first be familiar with the conditions on site and at the storage locations and have obtained an understanding of the planned procedure for taking inventory and its control by the client. In this context, it is particularly important to know how the client itself ensures the complete recording of all existing assets and at the same time ensures that no double counting or recording of non-existing assets takes place.

For initial audits, site plans alone will usually not be sufficient. In the case of initial audits, it will generally be necessary for the auditor to convince himself of the actual existence and arrangement of the premises and storage locations by means of a possible preliminary inspection of the premises (e.g., warehouse) alone, possibly also by means of organising his/ her own use of drones in the run-up to the inventory (especially in the case of external warehouses).

In order to be able to assess the presence of the elements from the inventory, measures should be taken – as would be the case of personal presence – to ensure that no double counting takes place for elements selected and checked from the inventory ("sheet to floor"). This can also be achieved when using real-time video technology by ensuring that inventory that is already recorded or checked is marked accordingly. In order to ensure complete recording, the entire warehouse should also be walked through via video feed and selected stocks checked to see whether they have been included in the inventory ("floor to sheet").

- Can the nature of the inventory be assessed? If the image transmissions are not high resolution, it may not be possible to detect indications of damage or indications of obsolete inventory. The method may therefore not be suitable for assessing the condition of the entire inventory.
- If, in individual cases, the auditor assesses a higher risk with this type of inventory observation, he may, for example, consider using a higher number of random samples. If there is an increased risk of material misstatement due to fraud, attention should be paid to the unpredictability of the control counts initiated by the auditor in order to reduce the risk of undetected manipulation.
- Are suitable members of the audit team deployed for the inventory audit? Consideration should be given to deploying more experienced staff.

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If, in the course of the risk assessment, the auditor has identified a higher risk of material misstatement in relation to the existence, completeness or condition of inventory items, e.g., because the inventory-related internal control system was not assessed as being fully reliable, it will be necessary to use professional scepticism in assessing whether relevant and reliable audit evidence can be obtained using remote audit procedures. This is particularly true where there is an increased risk of fraud. In certain cases, it may therefore be useful or necessary to personally inspect at least part of the inventories during the stocktaking, e.g., high-value inventories.

Question 3.3.5: If on-site observation by the Statutory Auditor is not possible due to access restrictions to the premises, is it possible to arrange for the client's Internal Audit staff to participate in the physical inventory on behalf of the Statutory Auditor?

No. This would mean including Internal Audit staff in the audit team of the Statutory Auditor. This is not permissible because § 319 Abs. 3 Satz 1 Nr. 4 HGB prohibits the integration of employees of the company subject to audit - and thus also of internal audit personnel (ref. *IDW AuS 321 (Revised)*, paragraph 27).

Question 3.3.6: Is it a problem if the group audit team cannot visit the component-auditors or the component-management on site due to maturity constraints or cannot attend final meetings between the component-auditor and the component-management?

The Auditing Standards do not provide for a general obligation for on-site visits or personal attendance at closing meetings between the component auditor and component management. Mandatory requirements for the involvement of the Group audit team in the activities of component auditors are set out in *IDW AuS 320 (Revised)*, paragraph 28 et seq., with regard to risk assessment in the case of significant components or further audit activities in the case of significant risks, and in *IDW AuS 320 (Revised)*, paragraph 39 et seq.

Irrespective of the minimum requirements laid down there, the nature, scope and timing of the involvement depends on the understanding of the component and the respective component auditor. For example, depending on the significance of a component for the significant risks identified from the Group's perspective and the understanding of the component auditor, the Group audit team may have identified significant matters to be discussed with the component auditor, component management or Group management. In addition, the group audit team may consider further integration necessary, such as a review of working papers or parts of the working papers of the component auditor or participation in the component auditor's final meeting (see *IDW F & A on ISA 600* or *IDW AuS 320 (Revised)*, question 7.2.6.).

Video conference systems will generally facilitate a discussion of significant matters with the component auditors and participation in the final meeting with the group or the component

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management. If, the Group audit team decides that a review of the working papers of the component auditors is necessary, a solution should be agreed with the component auditors in the current pandemic situation, taking into account security and confidentiality aspects. The review could be made possible by means of remote access to the component auditor's digital audit file with read authorization or via web meetings.

Question 3.3.7: In the current situation, the electronic transmission of information and documents to or from clients assumes increased importance. What needs to be considered in this context in regard to confidentiality and data protection?

Auditors currently receive more and more documents in the form of encrypted and unencrypted e-mails. The exchange of documents in a virtual data room, where the client and the auditor each can log in with a username and password, is recommended. A prerequisite for the data room is that it complies, in particular, with the respective requirements pertaining to confidentiality and data protection. The IDW issued the "Assistance for commissioning service providers" on 10 April 2019 as guidance when a virtual data room provided by a service provider is used as Software as a Service (SaaS). The guidance addresses the compliance with criminal and professional law requirements for the commissioning of IT service providers who provide virtual data rooms and is available on the IDW website at: <https://www.idw.de/blob/115228/d19d2eacc9b219c48d6da319044a81ef/down-services-assistance-2019-data.pdf>

Question 3.3.8: What audit procedures are appropriate for assessing the reliability of audit evidence in electronic form?

If the auditor uses information prepared by the company, he must assess whether the information is sufficiently reliable for his objectives (see *IDW AuS 300 (Revised)*, paragraph 10). The reliability of information to be used as audit evidence by the auditor is influenced by the nature and source of the information and the circumstances under which it is obtained. Original documents are generally considered more reliable than copies or scanned documents. If, for example, contracts are only available in large numbers as copies or in digital form (e.g., PDF files), the auditor can counter the associated higher reliability risks in various ways. For example, he can carry out a sample selection or a conscious selection of a number of documents for which, due to the small number, and despite existing restrictions an inspection of the respective original document can be organized. From the sample, for example, conclusions can be drawn about the reliability of electronically available documents that were created in a comparable process and released by the same persons.

The adequacy and effectiveness of the company's internal controls are also important for assessing the reliability of documents available in electronic form. A simple form of control may

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consist of maintaining the principle of dual control when releasing documents on the client's part.

Evaluations from the client's IT system (e.g., lists of totals and balances), which the auditor is currently unable to generate himself due to the lack of remote access to the client's systems, only constitute reliable audit evidence if they were retrieved with reports that were checked for completeness and accuracy by the auditor by means of appropriate audit procedures or by auditing general IT controls and for which the parameter settings of the IT system are clearly recognizable or the parameter settings can be reproduced in another suitable form. Depending on the constellation, it may be advisable to request a screenshot of the technical name of the report and the respective query.

Question 3.3.9: Can third-party confirmations be obtained in electronic form?

Yes. Obtaining third-party confirmations in electronic form, e.g., by e-mail, is permissible if the auditor adheres to the requirement for him to maintain control over the confirmation process and any doubts about its reliability are countered by appropriate auditing procedures (for details, see *IDW F & A on ISA 505* and *IDW AuS 302 (Revised)*, Section 7).

In practice, the safest and at the same time most expedient way to maintain control over sending confirmations to third parties by e-mail is to send them directly to the third party from the auditor's own e-mail address (i.e., by a member of the audit team) and to request a reply directly to the auditor's e-mail address. Sending a confirmation request via a client's e-mail account is not permitted, as in this case the client can exercise control over the actual sending and, for example, only the client (and not the auditor who may have been copied in cc:) receives feedback on the transfer (e.g., in the form of absence or non-delivery notifications). Sending of request e-mails by the client also involves the risk that many third parties who have been asked to reply to the request e-mails will then reply to the client by clicking the "reply button". The reply does not then - in the absence of direct dispatch to the auditor - constitute a third-party confirmation as defined in *IDW AuS 302 (Revised)*, paragraph 6(a).

It is necessary to consider that a breach of data protection regulations may occur if, when obtaining third party confirmations, an unencrypted e-mail contains a specific amount (receivable or payable) of the client's balance, e.g., in euros, vis-à-vis the third party and the third party has not given its consent to the unencrypted transfer of data concerning it. Thus, it should either be ensured that the client itself has obtained permission from the recipients of the confirmation request or that the requests do not contain any specific amounts (open confirmation requests; see *IDW AuS 302 (Revised)*, para. 6), in order to exclude a violation of data protection regulations.

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In order to eliminate doubts about the reliability of the responses obtained to the confirmation requests, the auditor may, for example, contact the confirming third party directly (by telephone) to orally confirm the content of the response received.

Question 3.3.10.: Are there specific documentation requirements when the audit is carried out remotely on a large scale?

The general requirements for documentation in the working papers apply (ref. *IDW AuS 460 (Revised)*). The procedure for obtaining audit evidence will therefore be reflected in documenting the type, scope and result of the audit procedures. It should be explained that a deviation from the previous audit procedure has been made and the reasons for this and that in this manner sufficient appropriate audit evidence could be obtained.

For the relevant reporting obligations in the long-form audit report in connection with any significant problems that may have arisen during the audit, e.g., in obtaining audit evidence, see the IDW's professional guidance dated 25 March 2020, p. 29.

Question 3.3.11: What problems can arise in the audit of financial statements as a result of the current pandemic situation if the entity subject to audit outsources parts of its accounting - including the related business processes - to service companies?

As part of the audit planning, the auditor must gain an understanding of whether and how the client uses outsourced services and to what extent this affects the client's internal control system relevant to audit. An understanding of the nature and significance of the services provided by the service provider and their impact on the outsourcing entity's internal controls relevant to the audit must be sufficient to provide a basis for identifying and assessing the risks of material misstatement. If the information provided by the client is insufficient for this understanding, the auditor must perform further audit procedures in relation to the service provider (see *IDW AuS 331 (Revised)*, paragraph 14). If the auditor intends or has to rely on relevant controls at the service provider for the purpose of the audit, he or she must also assess the effectiveness of these controls at the service provider (see *IDW AuS 331 (Revised)*, paragraph 19).

Frequently, service companies that offer standardized services for a large number of companies commission a separate assurance engagement on the internal control systems related to the services, so that the auditors of their clients do not have to perform their own audit procedures at the service company and the service company does not have to prepare corresponding audit evidence for each individual auditor and provide employees to answer questions.

Auditors of outsourcing entities often rely on this assurance report on the service-related internal control systems in accordance with *IDW AsS 951 (Revised)* (Type 1 or 2 reporting) in

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order to obtain the necessary understanding for the assessment of the risks of misstatement and audit evidence for the adequacy and effectiveness of the controls at the service company relevant to the audit of the financial statements.

However, as a result of the recent pandemic, the preparation of *IDW AsS 951 reports* may be delayed or such reports may not be available at all (for information on how to deal with such a situation, see questions 3.2.12. to 3.2.15.).

Question 3.3.12: Can the auditor obtain the necessary understanding of the nature and importance of the activities provided by a service provider be obtained by remote auditing procedures?

In principle, the necessary understanding of the nature and importance of the work performed by a service provider and its impact on the internal controls of the entity subject to audit that are relevant to the financial statement audit can also be gained through audit procedures that are not performed at the client's premises.

For example, the auditor may request from the audit client the following documents and review them

- User manuals
- System overviews
- Technical handbooks
- Contract or agreement on the scope of services between the outsourcing entity and the service provider
- Reports from service providers, internal audit or supervisory authorities on controls at the service provider.

From these documents, the auditor of the outsourcing company can obtain initial information on the design of controls relevant to the audit. However, reading this information alone will not be sufficient to obtain sufficient appropriate audit evidence about whether the controls of the service provider have been adequately designed and implemented.

Question 3.3.13: Is it always necessary to obtain reporting in accordance with *IDW AsS 951 (Revised)* (Type 1 or Type 2) if the entity subject to audit outsources functions that are an integral part of its business activities to a service company?

No. Where there is a high degree of interaction between the activities of the service provider and those of the outsourcing entity, the outsourcing entity may have implemented effective controls itself over the transactions processed by the service provider. For example, if there is a high degree of interaction between the activities of the outsourcing entity and those of the

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service provider, the outsourcing entity may approve transactions and the service provider may process and book these transactions. In this case, it may not be necessary to gain an understanding of the relevant controls at the service company and a report according to *IDW AsS 951 (Revised)* may not be required. Instead, the auditor may perform audit procedures on relevant controls at the outsourcing entity to obtain audit evidence about their adequacy and effectiveness.

For example, an enterprise that has outsourced its payroll accounting can set up controls over the sending and receiving of payroll information that can prevent or detect material misstatements in the financial statements, e.g., comparing the data transmitted to the service provider with analyses provided by the service provider after the data has been processed (see *IDW AuS 331 (Revised)*, paragraph A10).

In other situations, there may be less interaction between the outsourcing entity and the service provider (for example, a financial services provider buying and selling securities on an escrow basis for the entity). There is less interaction between the two parties when the service provider triggers or first records, processes and posts the business transactions of the outsourcing entity. In these cases, the outsourcing entity may rely on controls at the service company. In such cases, it may be essential to gain an understanding of the design and implementation of controls at the service provider.

Question 3.3.14. If reporting according to *IDW AsS 951 (Revised)* (Type 1) is not available or is delayed due to pandemic-related restrictions, can the auditor obtain the necessary understanding of the design and implementation of controls at the service company in another way?

If a report according to *IDW AsS 951 (Revised)*, which is generally considered necessary, is not available and the nature of the activities performed by the service provider is relevant to the audit, the auditor should discuss with management the expected date of receipt of the report and point out the necessity of this report for the further performance of the audit

If it is unlikely that the report will be available in time, the auditor should consider what alternative audit procedures may be performed to obtain evidence about the design and implementation of audit-relevant controls at the service provider. If it is unlikely that it will be possible for the auditor to travel to the service provider's premises to perform audit procedures, for example due to travel and contact restrictions, the auditor may consider using the previous period's reporting in accordance with *IDW AsS 951 (Revised)* and performing the following audit procedures for the current reporting period:

- Contacting and interviewing the responsible persons in the service company via the company subject to audit:

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- what significant changes have been made within the service-related internal control system, including relevant procedures or controls, to accommodate remote workers and changed process flows,
- events within the service system which affect the ability of the service provider to meet its obligations to the outsourcing undertaking.

These interviews should be documented.

- Read the system documentation and all changes to contracts and service level agreements that affect significant system changes.
- Reading messages from the service company to the outsourcing company about the measures taken in connection with the pandemic and the impact on the service-related internal control system.

The auditor must assess whether, under the currently more difficult conditions, these audit procedures and any further audit procedures at the outsourcing company are sufficient to obtain suitable audit evidence for assessing the adequacy of the relevant controls for the current reporting period. If, in the auditor's professional judgment, sufficient suitable audit evidence has not been obtained after these audit procedures have been performed to determine whether appropriately designed controls are implemented at the service company, a scope limitation may exist which, according to *IDW AuS 405*, leads to a modification of the audit opinion on the financial statements in the auditor's report.

Question 3.3.15.: Can the auditor obtain sufficient appropriate audit evidence on the effectiveness of controls in the service provider if a type 2 report according to *IDW AsS 951 (Revised)* is not available or is delayed?

If a Type 2 report in accordance with *IDW AsS 951 (Revised)* is not available at the time of the audit, the auditor should discuss with management by what date the report is expected to be received. Depending on the expected delay, the auditor may discuss with management the possibility of postponing the delivery of the long-form audit report and the auditor's report on the entity's financial statements until the report in accordance with *IDW AsS 951 (Revised)* has been received and all questions arising from the use of the report have been clarified. If the entity needs to have audited financial statements by a certain date, the auditor may, if necessary, ask management to contact key users of the audited financial statements, such as shareholders or financing banks, in a timely manner to determine whether an extension of the deadline is possible.

If the report is not expected to be available in a timely manner within a reasonable period of time, the auditor is unlikely to be able to rely on the effectiveness of controls at the service provider. In this case, the auditor should consider revising the audit strategy and adopting a

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substantive audit approach when he or she cannot rely on effective internal controls. If a substantive audit approach does not result in sufficient appropriate audit evidence and type 2 reporting is not available in accordance with *IDW AuS 951 (Revised)*, the auditor should assess whether there is a limitation of scope.

Question 3.3.16: Is the auditor also allowed to "virtually" attend the financial statement meeting (Bilanzsitzung) of the supervisory board or audit committee or is his physical presence mandatory?

Article 171 Abs. 1 Satz 2 AktG makes it mandatory for the auditor to participate in the negotiations of the Supervisory Board or the Audit Committee on the annual and, where applicable, consolidated financial statements (so-called "financial statement meeting" – Bilanzsitzung). The same applies to a GmbH with an optional supervisory board on the basis of the reference in § 52 Abs. 1 GmbHG, unless the articles of association provide otherwise, as well as to a GmbH with a supervisory board by operation of law on the basis of the respective special legal references (including in § 25 Abs. 1 MitbestG or § 1 Abs. 1 Nr. 3 DrittelbG). Within the framework of the Transparency and Disclosure Act (TransPuG), the legislator has already waived the requirement of "meeting" for a mandatory meeting of the supervisory board; it is sufficient that the supervisory board "holds" one meeting (§ 110 Abs. 3 Satz 1 AktG). At least in justified exceptional cases, which undoubtedly include pandemic-related travel and stock exchange restrictions, mandatory meetings of the Supervisory Board or Audit Committee, and in particular the Bilanzsitzung, can therefore also be held in the form of a video conference (ref. explanatory memorandum to the RegE of the TransPuG, BT-Drucks. 14/8769, p. 17). Even if all members of the Supervisory Board are physically present, the auditor does not have to be physically present as well but can be connected to the discussions via telephone or video conference.

3.4. Assessment of future-related matters, including the going concern assumption, as well as prognostic disclosures

Question 3.4.1: Can future-related matters in the financial statements and/or prognostic disclosures in the management report be assessed at all in the current situation with an unusually high degree of uncertainty, or is an audit scope limitation to be assumed in general?

The modification of the auditor's opinion due to an audit scope limitation is only possible if the auditor is not able to obtain sufficient appropriate audit evidence on the accounting information of the audited company. However, the considerable uncertainties inherent in the forward-looking matters impacting the financial statements (e.g., forecast of future surpluses for the purpose of determining estimated fair values, liquidity forecast for the purpose of assessing

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the ability to continue as a going concern) and prognostic information in the management report due to the dynamic development of the coronavirus pandemic do not in themselves constitute grounds for the existence of an audit scope limitation. An audit scope limitation with regard to the assessment of accounting information based on future-related matters, or in relation to prognostic information in the management report may be present, for example, if the auditor does not obtain sufficient appropriate audit evidence for the purpose of assessing the underlying assumptions made by management (see also question 3.3.2.).

Question 3.4.2: How can the assumptions made by management be assessed by the statutory auditor?

A forecast includes the assumptions made by management regarding the occurrence of future events (e.g., the further spread of the corona pandemic and the effects on customer behaviour) as well as management's intended actions (e.g., regarding claims for various measures of government support or adjustment of the business model).

The assumptions made by management must be justified sufficiently. The auditor will therefore regularly assess them to determine whether they are based on current information, whether they are consistent with the assumptions made internally for other purposes (e.g., budget planning) and whether they are consistent with available forecasts made by important institutions on overall economic development (e.g., forecasts of the Federal Government, the German Council of Economic Experts, the EU Commission and leading economic research institutes). In addition, the auditor will have to assess whether management's actual actions are not contradictory to the assumptions made (e.g., whether actual application or preparation of an application for state liquidity aid is included in a liquidity forecast). In contrast, the auditor's opinion does not include any statement concerning whether or not the expectations underlying the forecast statements or the accounting information relating to the future will materialise.

Question 3.4.3: Unprecedented public support measures have been put in place to avert business crises caused by the corona pandemic. In this context, which aspects may have to be taken into account by the auditor in assessing the appropriateness of the going concern assumption?

For a large number of companies, the corona pandemic is an event that may cause significant doubts about the company's ability to continue as a going concern. The auditor must perform additional audit procedures at these companies to determine whether the accounting going concern basis of accounting used by management (hereinafter going concern assumption) is appropriate and whether there is a risk that could jeopardise the company's existence (see *IDW AuS 270 (Revised)* paragraph 21). If management intends to make use of government support measures, these are countermeasures which management must take into account in their assessment of the ability to continue the company's operations. If the company has not

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yet received a binding commitment to provide specific assistance, management's assessment must also cover the fulfilment of the conditions for entitlement (see question 3.4.13 re consideration of insolvency measures in general).

The public sector's support measures essentially serve to cope with the acute liquidity crisis. The eligibility for taking advantage of these support measures may be decisive for management to assume the company's ability to continue as a going concern over the forecast period (on the appropriate forecast period see questions 3.4.10. and 3.4.11.). On the other hand, the ability to continue the company's operations could be adversely affected if the company's business model is no longer viable due to the consequences of the corona pandemic, even after the acute liquidity crisis has been overcome, and the company does not adjust or plan to adjust its business model accordingly.

Question 3.4.4: In which cases should a reference to a threat to the existence of the company be made in the auditor's report?

A going concern risk exists if the financial statements can be prepared based on the going concern assumption but, notwithstanding this, there are material uncertainties related to events or circumstances that may cast significant doubt on the entity's ability to continue as a going concern. This is the case if the enterprise may not be able to realise its assets and pay its debts in the ordinary course of business (*IDW AuS 270 (Revised)*, paras. 23, 24 letter b), i.e., there is a risk, which can be considered more than slight, that the business activity will have to be discontinued in the forecast period or foreseeably thereafter. An indication of the existence of a material uncertainty exists, for example, if management base their assessment of upholding the going concern assumption on reorganisation measures that have not yet been initiated but are planned and whose realisation is uncertain (see also question 3.4.13.).

If there is a material uncertainty appropriate information to the users of the financial statements is required in the financial statements and - if relevant – this must also be provided in the management report (see questions 2.1.5. and 2.1.6.). In this case, the auditor must include a corresponding section in the auditor's report (separate section entitled "Material uncertainty in connection with the continuation of the company's business activities"; see § 322 Abs. 2 Satz 3 and 4 HGB and *IDW AuS 270 (Revised)*, paragraph 29).

Question 3.4.5: Is the Corona pandemic likely to increase the use of reference paragraphs to material uncertainties?

In principle, it can be assumed that due to the Corona pandemic, more references to a material uncertainty (threat to the company as a going concern) will be included in auditors' reports. The uncertain financial, operational and other framework conditions due to the ongoing Corona pandemic regularly represent events or circumstances within the meaning of *IDW AuS 270 (Revised)* that may raise significant doubts about a company's ability to continue as a going concern. Auditors will therefore increasingly perform additional audit procedures within the

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meaning of *IDW AuS 270 (Revised)*, para. 21., in order to be able to evaluate whether the management's assessment of the company's ability to continue as a going concern is appropriate and, if so, whether a material uncertainty exists.

Auditors should discuss with their clients at an early stage their expectations regarding management's reporting in the financial statements and management report on the Corona pandemic and possible threats to the company's existence.

Question 3.4.6.: Is it to be expected that the assessment of the appropriateness of the going concern assumption will increasingly be the subject of external and internal reviews?

The [German] Auditor Oversight Body (AOB) has already included the assessment of the appropriateness of the presentations in the (consolidated-) notes and (group) management report on the impact of the Corona crisis and the assessment of the appropriateness of the going concern assumption by the auditor as focal points of inspections in its work programme for 2020¹¹. In accordance with the published work programme, AOB also obtains an overview of the measures taken by firms to obtain professional advice on significant doubtful issues in connection with the assessment of the going concern assumption. In addition, the WPK [Wirtschaftsprüferkammer – German Chamber of Public Auditors] has determined as a focus of its review of the financial statements for 2021¹², among other things, the entity's reporting of in the management report on significant individual risks and, if applicable, on going concern risks in connection with the effects of the Corona pandemic as well as the reference to going concern risks in the auditor's report. It can also be assumed that due to the Corona pandemic and the expected higher number of corporate insolvencies, the assessment of the going concern assumption will also be increasingly reviewed within the framework of the external quality control and the internal monitoring.

See question 2.1.7. regarding the expectations of the enforcement institutions (FREP, ESMA) regarding the reporting in connection with the effects of the Corona pandemic in the financial statements and management reports for the 2020 financial year.

Question 3.4.7: How should so-called "close call" situations be dealt with in the auditor's report?

In some situations, events or circumstances are identified that may give rise to significant doubts about the company's ability to continue as a going concern, but which do not result in a material uncertainty (threat to the company as a going concern) (see also *IDW AuS 270*

¹¹ See APAS, Work Programme 2020, available at: https://www.apasbafa.bund.de/APAS/DE/Publikationen/workprogrammes/workprogrammes_node.html.

¹² See WPK, Focus of the WPK's review of financial statements 2021, available at: <https://www.wpk.de/neu-auf-wpkde/alle/2020/sv/schwerpunkte-der-abschlussdurchsicht-der-wpk-fuer-2021/>.

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(Revised), paragraph A30). If this result is based on a narrow discretionary decision, the term "close call" is often used.

In such close call situations, in accordance with *IDW AuS 270 (Revised)*, 26 et seq., the auditor must assess whether the financial statements and the management report contain appropriate disclosures in this regard, taking into account the requirements of the applicable accounting framework. In this context, IFRS requires disclosures about significant judgements made by management in assessing the existence of a material uncertainty (see IAS 1.122 in conjunction with IFRIC Update July 2014, p. 6; see also question 2.1.5).

No disclosures are required about events and circumstances that may cast significant doubt on the entity's ability to continue as a going concern, but do not represent a material uncertainty in the notes to the financial statements prepared in accordance with the German Commercial Code (HGB), (see also *IDW AuS 270 (Revised)*, paragraph A31). If the financial statements have been prepared in accordance with accounting principles for a fair overall presentation, the auditor may, nevertheless, conclude in some cases that additional disclosures are necessary to achieve a fair overall presentation (§ 264 Abs.2 Satz 2 HGB).

Furthermore, information on the corresponding risks may be required in the management report. If, for example, management identifies events or circumstances that could raise significant doubts about the company's ability to continue as a going concern and take appropriate measures to limit the risk, GAS 20.157 requires that both the events and circumstances and the measures taken by management be disclosed in the management report. This also applies if a material uncertainty does not exist after taking into account the measures to limit the risk.

If, against this background, the auditor considers disclosures on a "close call" situation to be necessary in the financial statements and, if applicable, in the management report, the effects on the audit opinion depend on the adequacy of the disclosures made by management in this regard. If, in the auditor's opinion, the disclosures are appropriate, the auditor issues an unqualified opinion; otherwise, the auditor must modify the opinion in accordance with *IDW AuS 405*, if necessary.

In the case of a "close call" situation, the auditor will regularly have dealt intensively with the question of whether a material uncertainty exists. Accordingly, matters that have led to a "close call" situation in the context of the assessment of the ability to continue as a going concern may constitute a key audit matter that must be reported on in the auditor's report, especially in PIE audits in accordance with *IDW AuS 401* (see section 3.6).

Question 3.4.8.: Is a "close call" situation to be reported in the long-form audit report?

The auditor will assess whether a close call situation, as described in question 3.4.7, should be reported in the long-form audit report as an event that impairs development (see section 3.5).

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In the case of statutory audits of PIEs, the reporting obligation pursuant to Article 11 (2) (i) EU-Audit Regulation must also be observed. According to this, in cases where the auditor has identified events or circumstances that may cause significant doubts about the entity's ability to continue as a going concern, the long-form audit report shall present the measures taken into account in assessing the entity's ability to continue as a going concern (see in this regard *IDW AuS 450(Revised)*, para. P35/1). Since in the case of the "close call" the result is that there is no material uncertainty, the reporting obligation pursuant to Article 11 (2) (i) EU-Audit Regulation can be fulfilled in reporting on management's assessment of the entity's position (see *IDW AuS 450 (Revised)*, para. P35/2).

Question 3.4.9.: Does the opening of insolvency proceedings lead the entity to a mandatory departure from the going concern accounting principle?

Pursuant to § 252 Abs. 1 Nr. 2 HGB, management assumes the continuation of the entity's activities, provided that there are no factual or legal circumstances to the contrary. On the other hand, financial reporting using the going concern basis of accounting is inappropriate if management is forced to depart therefrom (i.e., they have no realistic alternative) or if the decision has been made to liquidate the entire entity or to discontinue business operations. Examples of a generally required departure from the going concern basis of accounting are when

- management determines that an insolvency petition is required,
- an insolvency application has been filed, or
- insolvency proceedings have been opened with claims on the entity's assets.

In these cases, there are regularly legal or factual circumstances that stand in the way of maintaining going concern valuations.

Since the accounting principle of going concern is linked to the business activity as such, financial reporting using going concern valuations may be permissible in individual cases even if a reason for insolvency exists, e.g. if, due to advanced reorganisation steps within the framework of an insolvency plan, it is sufficiently substantiated and documented that the business activity will be continued even after the opening of insolvency proceedings, at least within the forecast period (see *IDW AuS 270 (Revised)*, para. A34).

Question 3.4.10.: What are the effects of the temporary reduction in the forecast period for the over-indebtedness test under the COVID 19 Insolvency Suspension Act on the assessment of the going concern assumption?

For the calendar year 2021, because of the uncertainties caused by the Corona pandemic a forecast period of only four months is to be used as a basis for the over-indebtedness test, provided the (potential) over-indebtedness is due to the Corona pandemic (§ 4 of the COVID 19 Insolvency Suspension Act, amended to this extent, among others). In this case, a minimum

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period of twelve months from the balance sheet date is still to be taken as a basis for the financial reporting assessment of the continuation of the company's activities under German commercial law (see *IDW AuS 270 (Revised)*, para. 18; for a further extension of the forecast horizon, see question 3.4.11. below).

Question 3.4.11.: When should the entity extend its forecast horizon beyond the minimum period of twelve months from the reporting date?

If no events or circumstances have been identified that could cause significant doubts about the entity's ability to continue as a going concern, a forecast horizon of twelve months from the balance sheet date is generally sufficient. The same applies if such events or circumstances have been identified and management can demonstrate on the basis of plausible and justified assumptions that they do not represent a material uncertainty (see *IDW AuS 270 (Revised)*, para. A13).

At the latest in the case of an imminent insolvency, management will prepare a going concern forecast under insolvency law (or have such forecast prepared). The information obtained from the insolvency forecast cannot be disregarded in management's assessment of the entity's ability to continue as a going concern. The same applies to the auditor's evaluation of this assessment. In this context, the IDW expert committees are currently discussing selective adjustments to the application notes in *IDW AuS 270 (Revised)*, which are currently still based on the previous version, which currently still refer to the legal situation applicable until 31 December 2020, to the amendments to the InsO that came into force on 1 January 2021 as a result of the Act on the Further Development of Reorganisation and Insolvency Law of 22 December 2020 (SanInsFoG)¹³¹⁴.

Even if initially no reason is seen for the preparation of a going concern forecast under insolvency law, management will have to be asked, especially in crisis situations, to analyse the extent to which planned or expected events or circumstances are known that may call into question the appropriateness of the going concern assumption subsequent to the minimum forecast period of twelve months from the balance sheet date. The auditor must ask management whether they have any such knowledge.

The degree of uncertainty associated with the effects of an event or circumstance increases the further in the future the event or circumstance is. Therefore, when considering events or circumstances further in the future, the indications of going concern problems must be significant before the auditor is required to consider taking further action (see *IDW AuS 270 (Revised)*, paragraph A16).

If relevant events or circumstances are identified outside the forecast period on which management has based their assessment, the auditor will evaluate the extent to which this

¹³ BGBl 2020, Part I, p. 3256.

¹⁴ Changes to *IDW* is generally permissible *270 (Revised)* were published in *IDW Life 3/2021*.

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influences management's assessment of the continuation of the company's activities and, if necessary, consider further audit procedures (in particular the audit procedures mentioned in *IDW AuS 270 (Revised)*, para. 21).

In addition, the auditor may consider it necessary to extend the forecast horizon beyond the twelve months after the balance sheet date if the preparation of the financial statements or management report is significantly delayed (see *IDW AuS 270 (Revised)*, paragraph A44). This will be the case, in particular, if the financial statements are prepared only a few weeks or months before the end of the new financial year and the original forecast period would thus be shortened significantly.

Question 3.4.12.: Due to the high degree of uncertainty regarding future economic development, management does not wish to make a going concern forecast under German commercial law, as they are not of the opinion that they can assess the probabilities for conceivable future scenarios with any degree of certainty. Such an assessment is also not required by the German Commercial Code (HGB), since according to Article 252 para.1 no. 2 HGB, the going concern assumption is to be used in valuation, unless factual or legal circumstances contradict this. How does the auditor deal with management's intended behaviour?

Although the HGB does not explicitly require management to make a specific assessment of the entity's ability to continue as a going concern, this assessment is a prerequisite for the preparation of HGB financial statements and affects issues of recognition, measurement (§ 252 Abs.1 Nr. 2 HGB), disclosure and/or the notes to the financial statements (see *IDW AcS HFA 17*). Thus, even when preparing all HGB financial statements, it is ultimately necessary for management to make an assessment of the entity's ability to continue as a going concern (see *IDW AuS 270 (Revised)*, para. 5). According to IAS 1.25 et seq. this assessment is explicitly required.

The assessment of the entity's ability to continue as a going concern always involves a discretionary decision by management at a certain point in time about the inherently uncertain future effects of events or circumstances (so also *IDW AuS 270 (Revised)*, para. 8). The Corona pandemic has increased the uncertainties in many cases. These can be countered by scenario analyses (see question 2.1.5.). These uncertainties do not justify a waiver of an assessment of the entity's ability to continue as a going concern (see also question 3.4.1.).

Furthermore, a detailed analysis by management assumes increased importance as a basis for the going concern assessment, especially in the course of the Corona pandemic. Prior to the pandemic, detailed assessment measures could be dispensed with if the entity had achieved sustainable profits in the past, had easy access to financial resources and there was no threat of financial statement over-indebtedness (see *IDW AuS 270 (Revised)*, para. A8). In view of the extensive uncertainties associated with the Corona pandemic, such what was

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permissible in the past cannot currently be transferred to the future without further consideration.

If management is not prepared to make their assessment of the entity's ability to continue as a going concern after being requested to do so by the auditor, the auditor must weigh the effects on the auditor's report (see *IDW AuS 270 (Revised)*, para. 33).

Question 3.4.13.: What are the requirements for the consideration of restructuring measures in the assessment of the going concern assumption?

If management has taken remedial measures, these are included in their assessment of upholding of the going concern assumption. The auditor has to evaluate whether the consequences of these plans are likely to improve the situation and whether management's plans are feasible under the given circumstances (*IDW AuS 270 (Revised)*, para. 21 b)). If, at the time of issuing the auditor's report, the reorganisation measures have not yet been initiated, but are planned, and if their realisation is uncertain, this is an indication of the existence of a going concern risk. However, the going concern -assumption is only to be refuted if the business activity has already been discontinued or there is no realistic alternative to this (see IAS 1.25 and question 3.4.9).

The well-founded possibility of being able to take advantage of financial support (e.g., aid loans) from third parties shall generally be taken into account, even if this support has not yet been secured by legally binding claims of the entity by the date of the auditor's report. However, the auditor may consider it necessary to request written confirmations, including the underlying terms of the support, from third parties and to obtain evidence of their ability to provide such support (see *IDW AuS 270 (Revised)*, paragraph A21). If the entity cannot count on the support of banks or other external third parties and the appropriateness of the going concern assumption is ultimately based on the fact that *shareholders* of the entity (with sufficient creditworthiness) undertake to support the entity financially and such undertakings do not exist by the date of the auditor's report, management cannot, however, assume that the going concern assumption is appropriate (see *IDW AuS 270 (Revised)*, para. A34).

For consideration of government support measures, see also question 3.4.3.

Question 3.4.14.: What should be done if those providing financial support make their consent to aid measures dependent on the existence of an auditor's report?

In some cases, providers of financial support make their approval of aid measures dependent on the existence of an auditor's report. At the same time, however, the aid measures may be the prerequisite for assuming that the entity can continue as a going concern.

In these cases, the entity subject to audit may wish to be able to announce [it expects to receive] an auditor's report containing an unmodified opinion in order to obtain (unconditional) commitments from finance providers to grant financial support. The announcement of an

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unmodified audit opinion in the auditor's report is the auditor's notification of intent to issue the auditor's report with an unmodified opinion (see *IDW AuS 400 (Revised)*, paragraph A72). Since in such cases it must always be assumed that the communication will be brought to the attention of third parties, it is recommended that the auditor obtain legal advice in each individual case (see *IDW*, WPH-Edition, Rechnungslegung & Prüfung, 17th edition, ch. M, para. 1261).

If the financial support upon which the appropriateness of the application of the going concern assumption depends has not been bindingly promised by the date of the auditor's report (e.g., because the announcement of an unmodified opinion in an auditor's report is not eligible or other reasons still prevent the funds being granted), the financial statements may not be prepared under the going concern assumption. If the financial statements are nevertheless prepared under the going concern assumption, the auditor shall express a modified opinion on the financial statements in accordance with *IDW AuS 405*.

3.5. Reporting on facts that impair development

Question 3.5.1: Under what circumstances can the effects of the corona pandemic be qualified as damaging to development and how can these be distinguished from risks to the survival of the entity i.e., as a going concern?

Pursuant to § 321 Abs. 1 Satz 3 HGB, the auditor is required to report on facts and circumstances established during the performance of the audit which may significantly impair the development of the audited entity or jeopardize its existence. A going concern risk within the meaning of § 321 Abs. 1 Satz 3 HGB exists if there is uncertainty regarding the ability to continue as a going concern, the occurrence of which is not so probable that the assumption of a going concern has to be abandoned, but due to the possible effects and the not only latent probability of occurrence, appropriate information to the addressees of the financial statements is required (ref. *IDW AuS 270 (Revised)*, paragraph 23). Facts and circumstances impairing development are regularly preceded by risks that threaten the entity's existence. However, these must be facts and circumstances that cause more than just a tense economic situation of the entity. These may be facts and circumstances such as the "break" of central, previously positive trends, a sharp decline in incoming orders or official requirements with serious effects on business activity or profitability, without the risk of business operations being discontinued in the foreseeable future. It will not always be possible to distinguish clearly between facts and circumstances that could impair development and risks that could jeopardize the company's continued existence, and these must always be assessed on the basis of the circumstances of the individual case.

In the case of entities which, for example, have to accept losses in sales or earnings during the corona pandemic, but are expected to be able to largely compensate for these losses after

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the crisis (e.g. entities in certain areas of the retail trade), pandemic-related facts that impair development will be less frequent, taking into account the special circumstances of the individual case (see also Annex 2 "Systematization of companies in the corona pandemic"; entities in the third category).

If, on the other hand, the negative effects of the pandemic can only be partially compensated (see also Annex 2; entities in the fourth category), the effects of the corona pandemic may be a developmentally damaging fact, especially if the effects have serious consequences for business activities and profitability. A fact or circumstance impairing development may immediately or subsequently result in events or circumstances which may cast significant doubt on the ability of the entity to continue its business activities as a going concern. This may be the case, for example, if the loss of sales leads to financial difficulties which, without countermeasures, mean that there is no realistic prospect of repayment of loan liabilities on maturity or the extension of these loans (ref. *IDW AuS 270 (Revised)*, paragraph A5). Due to such events or circumstances, the auditor can come to the conclusion, in the context of his or her assessment of the appropriateness of the going concern assumption, taking into account any countermeasures, that there is already a risk that could endanger the entity's existence (ref. *IDW AuS 270 (Revised)*, paragraph 23; on the consideration of public support measures when assessing the appropriateness of the going concern assumption, see question 3.3.3.).

The greatest challenges are faced by those entities where the corona crisis has had a sustained negative impact on the success of the business model (entities in the fifth category according to Annex 2). If such entities are unlikely to be able to survive in the long term with their current business model, this is at least one factor that will impair their development. In addition, a pandemic-related threat to the continued existence of these entities may already exist. If such an entity - despite possible realistic financing over the next twelve months - does not adapt or plan to adapt its business model, the assumption that the entity will continue to operate as a going concern may no longer be upheld (see also question 3.3.3.).

Question 3.5.2: How does the auditor's reporting of facts that impair development differ from reporting of risks to the company's existence and what are the differences in the presentation of the financial statements?

The following table summarises the main differences and similarities in the presentation of circumstances and facts impairing development and risks threatening the company's existence in the financial reporting under German commercial law and in the auditor's reporting:

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Report/Display in:	Existence of circumstances and facts that are detrimental to development	Existence of risks threatening the existence of the entity
(Consolidated) financial statements	In exceptional cases, it may be necessary to present matters, for example, if omitting them would not give a true and fair view of the entity's financial situation and performance would not be conveyed (ref. <i>IDW AuS 270 (Revised)</i> , paragraph A31).	Information in the notes or below the balance sheet, or if applicable, reference to the management report if applicable (ref. <i>IDW AuS 270 (Revised)</i> , paragraph 24 et seq.)
(Group) Management Report	Usually part of the risk report (§§ 289 Abs. 1 Satz 4, and 315 Abs. 1 Satz 4 HGB)	Part of the risk report (§§ 289 Abs. 1 Satz 4, and 315 Abs. 1 Satz 4 HGB; ref. GAS 20.148)
Auditors' report	No reporting obligation	Separate section entitled "Material uncertainty in connection with the continuation of the entity's operations" (§ 322 Abs. 2 Satz 3 HGB; <i>IDW AuS 270 (Revised)</i> , paragraph 29 et seq.)
Long-form audit report	Generally following management's statement on the assessment of the entity's situation of the legal representatives (§ 321 Abs. 1 Satz 3 HGB)	Generally following the management's statement on the assessment of the entity's situation (§ 321 Abs. 1 Satz 3 HGB; pursuant to Article 11 (2) letter i EU-APrVO including a summary of countermeasures)

The respective facts must already be mentioned in the long-form audit report if they could seriously impair the development or jeopardize the continuation of the entity's business activities and not only when the development of the audited entity is already significantly

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impaired, or its existence is specifically endangered (ref. *IDW AuS 450 (Revised)*, paragraph 36).

3.6. Illustration of the effects of the corona pandemic as a Key Audit Matter ("KAM") in the auditor's report

Question 3.6.1.: Are the current effects of the corona pandemic relevant for the reporting of Key Audit Matters (KAM) in the audit opinion?

When *IDW AuS 401* "Notification of key audit matters in the auditor's report" is applicable to the audit of financial statements, current circumstances and restrictions resulting from the corona pandemic may require a special focus in determining key audit matters to be reported in the auditor's report. *IDW AuS 401*, paragraph 9, defines key audit matters as those matters which, in the auditor's professional judgment, were most significant in the audit of the financial statements for the current reporting period. Key audit matters are selected from matters that have been discussed with the persons responsible for supervision. These include the "most significant assessed risks of material misstatement", which have been identified in accordance with Article 10(2)(c) EU-APrVO, which must be described in the auditor's report in support of the audit opinion.

If an auditor is required to report on key audit matters under *IDW AuS 401* or Article 10 EU-APrVO, the auditor must assess whether the effects of the corona pandemic represent such a matter in individual cases (e.g., challenges for the group audit team resulting from travel restrictions, significant changes in audit strategy, etc.; see *IDW AuS 401*, paragraph A21). Audit areas that do not normally represent a particularly important audit subject matter may also become one due to the effects of the corona pandemic (e.g., value appraisals, increased estimation uncertainties, etc.).

Question 3.6.2: In the current environment, what additional considerations can be used to determine whether a matter is a Key Audit Matter?

In order to determine the Key Audit Matters (KAM), first of all those matters that have to be discussed with the persons responsible for supervision and which require special attention by the auditor during the audit must be determined (see *IDW AuS 401*, paragraph 12 et seq.). In the current environment, the determination of these matters and the selection of those matters from them that were most significant in the audit may be influenced by, for example, the following:

- *Problems in obtaining sufficient appropriate audit evidence: Pandemic circumstances may cause problems in performing audit procedures, evaluating the results of those procedures and obtaining relevant and reliable evidence as a basis for the audit opinion;*

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this may include, for example, the valuation of financial instruments or the calculation of other fair values (see IDW AuS 401, paragraph A30).

- *Certain events or transactions that have a significant effect on the financial statements: The Corona Pandemic often involves developments that affect several items in the financial statements in different ways and/or result in unusual or non-recurring business transactions (e.g., new impairment of non-financial or financial assets or reduced recoverability of deferred tax assets).*

Question 3.6.3: Where in the auditor's report should the auditor report on KAM that also contains material uncertainties in connection with the continuation of the entity's activities (risks threatening the existence of the entity)?

Significant uncertainties in connection with the continuation of the company's operations often, but not necessarily in every case, represent a significant risk of material misstatements in the annual or consolidated financial statements and thus meet the key audit matter (KAM) definition in Article 10 (2) (b). c EU-APrVO (see reporting on the 259th HFA meeting, item 5. on APAS Announcement No. 9 of 26 February 2020). If there is a significant risk of material misstatement in the case of material uncertainties in connection with the continuation of the business activities of PIE, Article 10 (2) lit. c EU-APrVO is relevant and the auditor's report must contain the information required under this provision, including a summary of the auditor's reactions to this risk. In this case the auditor - as per *IDW AuS 270 (Revised)*, paragraph A37, second sub-item, the auditor is obliged to provide the information required under Article 10 (2) letter c EU-APrVO in the section "Material uncertainty in connection with the continuation of the company's operations".

3.7 Inclusion of an Emphasis of Matters Paragraph related to the Corona pandemic

Question 3.7.1: Under what circumstances may an Emphasis of Matter Paragraph be included in the auditor's report? When may such a reference not be made?

IDW AuS 406, paragraph 10, regulates the requirements for including an emphasis of matter paragraph in the auditor's report. In principle, the auditor must include an emphasis of matter paragraph in the auditor's report if he considers it necessary to draw the attention of the addressees to a matter presented or disclosed in the financial statements, the management report or in another subject matter of the audit which, in his opinion, is of fundamental importance for the addressees' understanding of the subject matter of the audit.

However, an emphasis of matter paragraph shall not be included in the auditor's report if

- in accordance with *IDW AuS 405*, the circumstances of the audit mean the audit opinion has to be modified e.g., because the management of the audited entity has not adequately presented the facts, e.g., the exceptionally high uncertainty in

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connection with the Corona pandemic, in the financial statements or management report,

- in accordance with *IDW AuS 270 (Revised)* the circumstances of the audit are indicative of a material uncertainty in connection with the continuation of the business activity (going concern risks) is required, or
- the matter has been determined to be a key audit matter to be reported in the auditor's report in accordance with *IDW AuS 401*.

In addition, an emphasis of matter paragraph may not be included if the matter relates to another subject matter to be reported only in the long-form audit report.

See the explanations in questions 3.7.3. and 3.7.4. regarding whether, or in which constellations, the inclusion of an emphasis of matter paragraph can be considered in connection with the Corona pandemic.

Question 3.7.2: How must an emphasis of matter paragraph be designed?

IDW AuS 406, para. 11, regulates how such an emphasis of matter paragraph is to be structured.

Thereafter, this emphasis of matter paragraph must

- be made in a separate section in the auditor's report with an appropriate heading that includes the phrase "emphasis of matter",
- contain a clear description of the matter emphasised and a reference to where in the financial statements, in the management report or in the other subject matter of the audit (see *IDW AuS 406*, paragraph 8 d) the relevant information describing the matter in full can be found,
- include a statement that the audit opinion on the subject matter concerned is not modified with respect to the matter that has been emphasised.

The emphasised may only relate to information presented or indicated in the relevant subject matter of the audit.

Question 3.7.3: Is a general reference to uncertainties related to the Corona pandemic useful?

No. Due to the often general nature of an emphasis of matter paragraph and the fact that such a paragraph may not be used as a substitute for a separate section outlining a threat to the entity's existence or a key audit matter (KAM) (see question 3.7.1.) that may be required, a general (EOM) paragraph does not usually appear to be the appropriate means to adequately take into account the uncertainties in connection with the Corona pandemic (see already *IDW Technical Guidance of 25 March 2020*, p. 31).

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Emphasis of matter paragraphs should therefore only be used within narrow limits and are also not generally recommended internationally (see e.g., the IAASB <https://www.ifac.org/system/files/publications/files/Staff-Alert-Auditor-Reporting-Final.pdf>, last accessed on 28.01.2021). *IDW AuS 406*, paragraph A9, also states: "Frequent use of emphasis of matter paragraphs may reduce the effectiveness of such communications by the auditor".

Question 3.7.4.: In which cases may the inclusion of an emphasis of matter paragraph related to the Corona pandemic be appropriate?

IDW AuS 406, paragraph A8, provides the following examples of cases in which the auditor may consider it necessary to include an emphasis of matter paragraph:

- an uncertainty regarding the outcome of extraordinary legal disputes or regulatory measures;
- a significant event that occurred between the reporting date and the date of the auditor's report;
- a catastrophic event that has had or continues to have a significant impact on the assets, financial position or earnings of the company.

As described in question 3.7.1., the emphasis of matter paragraph according to *IDW AuS 406* is only considered if, due to the addressed facts no modification of the auditor's report has to be made, the facts do not imply any material uncertainty with regard to the ability of the company to continue its business activities and it is also not a key audit matter to be communicated in the auditor's report according to *IDW AuS 401*. Against this background, the following constellations are conceivable, for example, in which an emphasis of matter paragraph relating to the Corona pandemic may be deemed necessary:

1) *Corona pandemic has strong impact on turnover and earnings*

A company in the tourism industry is experiencing a massive drop in turnover and earnings as a result of the Corona pandemic. To bridge related short-term liquidity problems, the company is drawing on reserves built up in prior years. The company is also part of a group that could bridge further short-term liquidity gaps. It is expected that the company will not need further assistance. After the Corona pandemic, the company is expected to continue to have a viable business model. Management reports on the effects of the Corona pandemic appropriately in the notes and management report. Management and the auditor have come to the conclusion that there is no material uncertainty (threat to the company's existence).

In the auditor's opinion, management's assessment and justification that the company's existence is not endangered despite the massive decline in turnover and earnings is of fundamental importance for the users' understanding of the annual financial statements and the management report.

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2) *External ratings*

A company that is not a public interest entity (PIE) rents commercial property. In the course of the Corona pandemic and due to official requirements, there is an increase in rental losses and terminations. The rental losses and terminations do not constitute a material uncertainty (threat to the company's existence), as it can be reasonably expected that they can be largely compensated for by savings in expenses. It is uncertain whether, and to what extent, the income from the properties will increase again in the new financial year. An external expert has therefore included a reference to a significant valuation uncertainty for the commercial properties recognised as fixed assets in his expert opinion. Management has appropriately presented this valuation uncertainty in the notes and in the risk report as part of the management report.

Notwithstanding this uncertainty, the auditor was able to obtain sufficient appropriate audit evidence regarding the valuation of the properties. Because commercial real estate represents a very large proportion of the assets of the company being audited and because, in the auditor's judgment, the uncertainty of the valuation is fundamental to the users' understanding of the financial position and results of operations, the auditor considers it necessary to draw the attention of the users of the financial statements to this fact.

If, however, the audit client is a PIE, it would be obvious in the case described that the auditor determines the valuation of the real estate as a key audit matter within the meaning of *IDW AuS 401* (Key Audit Matters, KAM). In this case, an emphasis of matter paragraph should not be included in the auditor's report instead of the required KAM reporting (see question 3.7.1.).

3) *Departure from the accounting principle of going concern*

The management of a hotel company (not a PIE) in the immediate vicinity of a trade fair, which primarily accommodates business travellers, have come to the conclusion that the application of the going concern basis of accounting is not appropriate due to the ongoing Corona pandemic and the feared further reduction in travel activities thereafter. They therefore prepare the financial statements on a non-going concern basis and present this appropriately in the financial statements and management report.

The auditor considers it appropriate to draw the attention of the addressees to the departure from the accounting principle of going concern (see also *IDW AuS 270 (Revised)*, A33 and Example 5 of Annex 1 to *IDW AuS 270 (Revised)*).

4. Further issues – **New question added**

Question 4.1: What are the legal consequences of the right to refuse performance for consumers and micro-entrepreneurs, the so-called moratorium?

Pursuant to Article 240 § 1 Abs. 1 and Abs. 2 EGBGB (Einführungsgesetz BGB – German

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Introductory Law to the Civil Code), consumers and micro-entrepreneurs (as defined in Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ EU No. L 124 of 20 May 2003, p. 36) are entitled to a period of grace with regard to claims arising from contracts concluded before 08.03.2020 (with the exception of rental, lease, loan and employment contracts) i.e., a right of refusal of performance limited until 30.06.2020. This temporary right extended to consumers and micro-entrepreneurs, however, only refers to "material continuing debts", which are defined as those "necessary to be covered by basic services".

A right to refuse performance is the right of the debtor to refuse performance to the creditor. Accordingly, the debtor must assert this right against the creditor (so-called objection). If the debtor has a right to refuse performance and therefore does not perform, he is not in default (§ 286 Abs 1 BGB). Accordingly, no interest on arrears is owed (§ 288 Abs. 1 BGB). However, the so-called primary obligation to perform remains in principle and is to be fulfilled after the expiry of the period of grace.

In order to assert his right to refuse performance, the debtor must not only invoke his right, he must also prove that he is unable to perform precisely because of the Co-vid 19 pandemic ("it is not possible to perform without endangering his reasonable subsistence or the reasonable subsistence of his dependent relatives", "it is not possible to perform or it would not be possible for the company to perform without endangering the economic basis of its business"). Since the establishment of a temporary right to refuse performance represents a serious encroachment on fundamental rights, the right does not apply if it is "unreasonable for the creditor for his part" to waive performance.

The above-mentioned amendments have come into force retroactively as of 01.04.2020 and are valid until 30.09.2022.

Question 4.2: What are the legal consequences of protection against termination for private and commercial tenants?

According to Article 240 § 2 EGBGB, landlords are not allowed to terminate rental contracts (residential and commercial contracts) if the tenant does not pay the rent in the period from 01.04.2020 to 30.06.2020 if this non-payment is caused by the effects of the COVID-19 pandemic. The regulation applies to leases, accordingly.

The tenant has to substantiate the connection between the non-payment (i.e., non-payment of rent) and the effects of the COVID-19 pandemic. While the landlord cannot terminate the lease due to non-payment of rent during the aforementioned period, the tenant's payment obligation - subject to other contractual or legal rights - remains in principle, i.e., the tenant is still obliged to pay and may be in default (in the event of non-payment despite due date). In contrast to the period of grace for consumers and micro-entrepreneurs (see question 4.1.), the tenant is not

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granted a right to refuse performance, which means that the encroachment on the landlord's rights is less severe. The landlord is "only" temporarily restricted in his (so-called secondary) right to terminate the lease due to late payment. The landlord retains the right to terminate the contract for other reasons, for example because his inability to pay has causes other than the COVID-19 pandemic.

This law does not grant a tenant a separate right to rent reduction.

The above-mentioned changes came into force retroactively as of 01.04.2020 and are valid until 30.06.2022. This means that the landlord can terminate the lease after this date (i.e., as of 01.07.2022), taking into account the applicable lease law, for payment arrears that occurred between 01.04.2020 and 30.06.2020 and were not settled by 30.06.2022. Accordingly, tenants have approximately two years to make good their arrears of rent incurred during this acute period.

Question 4.3: What are the legal consequences of the deferral in consumer contracts?

Pursuant to Article 240 § 3 EGBGB, claims of the lender for repayment, interest or redemption payments under consumer loan agreements concluded before 15 March 2020 and which are due between 1 April 2020 and 30 June 2020 are deferred for a period of three months from the due date. The borrower must prove to the lender that due to COVID-19 he has suffered a loss of income (e.g., by presenting an employer's certificate). In addition, the borrower must demonstrate that without the deferral of the due claim, his reasonable livelihood or that of his dependants would be endangered.

The deferral has the effect of postponing the specified due date of the claim. During the period of deferral, it thus has the effect that consumers cannot be in default with these claims (§ 286 Abs. 1 BGB). Accordingly, no default interest is owed (§ 288 Abs. 1 BGB). The loan agreement is extended by the period of the deferral (maximum three months), so that the due date of the claims which only become due after the expiry of the deferral is postponed by (maximum) three months. This prevents the consumer from being charged twice due to the simultaneous maturity of two instalments (deferred and regular instalment after the deferral has expired).

Cancellations by the lender due to late payment, a significant deterioration in the financial circumstances of the consumer or the value of collateral provided for the loan are excluded until the end of the deferral. Due to the considerable economic loss suffered by the lender as a result of the deferral, there may be cases in which the deferral is unreasonable for the lender. The need to balance these interests can lead to the regulations do not being applicable in exceptional cases. In its question and answer paper on the regulations, the Federal Ministry of Justice and Consumer Protection (BMJV) mentions "situations in which the contractual relationship is permanently disrupted due to serious culpable violations of consumer rights or due to abusive behaviour" (BMJV, Questions and Answers: Deferral in the context of consumer

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loan agreements during the Corona crisis of 23.03.2020, available at [#https://www.bmjv.de/DE/Themen/FokusThemen/Corona/Downloads/032320_FAQ_deferral.pdf?__blob=publicationFile&v=3">#](https://www.bmjv.de/DE/Themen/FokusThemen/Corona/Downloads/032320_FAQ_deferral.pdf?__blob=publicationFile&v=3)

The changes described above came into force retroactively as of 01.04.2020 and are valid until 30.09.2022.

Question 4.4: Is the auditor disqualified as an auditor because of a threat to independence due to the application for Corona bridging assistance for the audit client?

The application for corona bridging assistance on behalf of the audit client (applicant) does not lead to a disqualification as auditor, provided the auditor assesses the comprehensibility of the applicant's information ("third party reviewer") based on information provided by the applicant (advance VAT return, annual VAT return, etc.) and does not determine the information himself (see IDW, Fachlicher Hinweis of 16 July 2020, "Auftrag des Wirtschaftsprüfers zur Beantragung der Corona-Überbrückungshilfe"). In this case, there is no self-reveiw threat prohibition, because a further review of the information is generally permissible during the audit (see explanatory texts on § 33 Abs. 2 BS WP/vBP). The application for Corona bridging assistance, in particular forwarding the application documents signed by the audit client to the competent authority, does not constitute an inadmissible representation of interests either, because, from an objective point of view, the auditor checks the applicant's information on the basis of the work assigned to him by the BMWi and, in this respect, performs this check in the public interest. In the PIE area, the stricter regulations of the EU-APrVO must be observed, in particular the so-called blacklist of Article 5 (1) subparagraph 2 EU-APrVO.

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Appendix 1: Overview of possible audit procedures that can be performed remotely

Audit procedures pursuant to <i>IDW AuS 303 (Revised)</i>, A11 et seq..	Possibility of carrying out remote verification actions, taking into account the conditions set out in point 3.2?	Examples
<p>Inspection/examination</p> <p>Investigation of internal or external records or documents in paper or electronic form or on other media or the physical examination of an asset.</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Use of real-time image transmission, e.g., for <ul style="list-style-type: none"> ○ Inventories ○ Inspection of parameter settings of the IT system ○ Inspection of the data centre ○ Selection of paper receipts. • Scanning of recordings in paper form and supply by clients. • External access (e.g., via VPN) to the IT system of the client.
<p>Monitoring</p> <p>Viewing processes or procedures carried out by other people.</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Observation of the activities carried out by employees of the company by means of live image transmission, e.g., inventory, goods receipt, goods dispatch. • Observation of control activities carried out by employees in the IT system via video recording or web meeting (e.g., electronic release of an order).

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Audit procedures pursuant to <i>IDW AuS 303 (Revised)</i>, A11 et seq..	Possibility of carrying out remote verification actions, taking into account the conditions set out in point 3.2?	Examples
External Confirmations	Yes	<ul style="list-style-type: none"> • Obtaining external confirmations by means of electronic dispatch under the control of the auditor (determination of the information to be obtained, selection of the third party, design of the confirmation request, dispatch).
Recalculations Checking the arithmetical correctness of documents or records.	Yes	<ul style="list-style-type: none"> • Check formulas in client spreadsheets. • Scanning of records in paper form and forwarding them to clients with subsequent recalculation. • Recalculation of numerical entries in documents or in records by using data analysis ("replication" of the calculation logic of the IT system).
Traceability Independent performance of procedures or controls by the auditor that were originally performed as part of the internal control system (ICS).	Yes	<ul style="list-style-type: none"> • Analytical audit procedures • Assessment of financial information by analysing plausible relationships between both financial and non-financial data.

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Audit procedures pursuant to <i>IDW AuS 303 (Revised)</i>, A11 et seq..	Possibility of carrying out remote verification actions, taking into account the conditions set out in point 3.2?	Examples
Analytical audit procedures Assessment of financial information by analysing plausible relationships between both financial and non-financial data.	Yes	<ul style="list-style-type: none"> • Data analyses under access to client data.
Consultations	Yes	<ul style="list-style-type: none"> • Participation in telephone/ • videoconferencing of the management / the persons responsible for monitoring. • Conducting telephone or web meetings with members of the management, the supervisory board chairman, the internal audit, other employees of the client.
Obtaining written declarations	Yes	<ul style="list-style-type: none"> • The handwritten signature of the legal representatives and, if applicable, of the persons responsible for monitoring under the DOC, as required <i>by IDW AuS 303 (Revised)</i>, paragraphs 9, 32, can be replaced by a qualified electronic signature. • Other written declarations in the sense of <i>IDW AuS 303 (Revised)</i>, paragraph 13, do not need to be signed. The text form is sufficient.

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Appendix 2: Systematisation of companies in the Corona pandemic

Systematisation of companies in the Corona pandemic

