INSTITUT DER WIRTSCHAFTSPRÜFER

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Impact of the Ukraine war on accounting and its audit (2nd update, April 2022)

Technical guidance by the IDW

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1. Preliminary remarks

The invasion of the Ukraine by Russian forces on 24 February 2022 constitutes a far-reaching event that will also leave clear traces in the global economy and thus in corporate financial reporting. The impacts were immediately felt in the commodities and financial markets, and the democratic states united in imposing harsh sanctions against Russia. The consequences for Russia and the imposing states are immediately apparent, but in the longer term there will also be significant consequences for the global economy. At present, it is hardly possible to comment on how long this crisis will last, which may also be intensified by further actions on the part of Russia.

Certain parallels to the beginning of the Corona pandemic are evident in regard to the possible consequences for financial reporting and auditing. Many financial statements as of 31 December 2021 have either not yet been (finally) prepared and audited or have not yet been adopted or approved. In the case of financial statements that have been audited, the date of completion of their preparation corresponds to the date of the auditor's report or the date of its issuance. The question of significance for the financial statements and the audit of the financial statements of affected companies comes to the fore. Such questions relate to the content of reporting on subsequent events in the notes to the financial statements and management report [hereinafter "report on subsequent events"] in particular. These act as a kind of "corrective", since reflection of post balance sheet events in the statement of financial position and the statement of financial performance is not permitted under the reporting date principle for financial statements as at 31 December 2021. For balance sheet dates after the outbreak of war, numerous follow-up questions will arise.

Significant risks affect the entire economy, e.g., within its supply chains (especially with regard to energy demand), on its sales markets, or with regard to the supply of credit by banks or from cyber-attacks. Such risks then indirectly affect the entire financial sector (value of investments in the economy, inflation, etc.). The extent of any resources the public sector will make available in the form of government support measures remains an overarching question. In addition, it is abundantly clear that the path to a sustainable transformation of the economy will have to be reconsidered without – and this should be clearly emphasized – losing sight of the goal.

As an immediate reaction to the outbreak of the Corona pandemic, the IDW published technical guidance which were continuously updated, to provide the profession and companies with guidelines for dealing with the evolving situation. This paper on the consequences for financial reporting and auditing is intended to follow this example. The initial focus is on questions relating to the reporting date of 31 December 2021.

With the updates, new issues are added, whether as a result of the development of the war or the state reactions to it in the form of the imposition of further sanctions and the Russian counter-reactions, but also as a result of corporate reactions, which are currently evident in the

withdrawal from markets in Russia, among other things. In addition, existing statements are updated, e.g., if certain new aspects require special attention or opinions have been formed on existing questions of doubt or have developed further. Chapters, sections and questions that have been updated or supplemented compared to the previous version of the Technical Guidance are marked "Updated" or "New".

With the **first update on 08.04.2022**, questions on the possible consequences for the end of the first quarter of the current calendar year (see Chap. 3 (HGB) and 4 (IFRS)) were added. Accordingly, the comments on the effects on the audit of financial statements with regard to the audit of financial statements with a reporting date after the outbreak of war have also been supplemented (see Chap. 5). In addition, further aspects of the impact on the audit of financial statements have been deepened or newly included, such as questions on special features of audits of consolidated financial statements and on reporting on breaches of sanctions (new sections 5.4. and 5.8.). Statements on the effects of sanctions imposed on contractual relationships are now also included in the Technical Guidance (see Chap. 6).

This **second update** answers further questions that may arise, especially in connection with the accounting of financial instruments according to IFRS against the background of the war in Ukraine (see the updated or supplemented section 4.3.).

These explanations apply across the board, regardless of the sector to which the company belongs. Special features of certain sectors (especially in the financial sector or in the energy sector) will be included as necessary in the form of supplements to this technical guidance or published as separate Technical Guidance (an overview of IDW information and guidance on the effects of the war in Ukraine can be found on the IDW website at https://www.idw.de/idw/themen-und-branchen/russland-ukraine-krieg). In addition, the IDW will also address the long-term consequences for the economy and the profession going forward.

In order to ensure the paper can be used as a stand-alone reference document, references to other sources (especially the technical guidance on the Corona pandemic) are limited to what is necessary.

2. Effects on the financial statements as at the reporting date 31.12.2021 (HGB ("German GAAP") and IFRS)

Question 2.1: How should the post reporting date event "Ukraine war" be qualified for the purposes of HGB [Handelsgesetzbuch: German Commercial Code] accounting and IFRS accounting (adjusting event vs non-adjusting event)?

HGB accounting

The direct and indirect effects of the war are to be classified as non-adjusting events with regard to reporting dates prior to 24 February 2022. The unlawful crossing of the borders of Ukrainian territory (or the entry into Ukrainian airspace) by the Russian military on that very day is to be regarded as the decisive event. According to the reporting date principle (Article 252 para. 1 no. 3 (if applicable in conjunction with Article 298 para. 1) HGB), the accounting consequences (measurement and recognition) are in principle only to be taken into account in the (consolidated) balance sheet and (consolidated) income statement of consolidated/annual financial statements with a reporting date after 23 February 2022. Only in cases in which the going concern assumption can no longer be maintained due to the effects of the war (see IDW AcS HFA 17, para. 2, in conjunction with IDW AuS 203 (Revised), para. 9) something else would apply.

IFRS accounting

Events that provide (further) substantial evidence of conditions that already existed at the end of the reporting period must be taken into account (adjusting events) and require an adjustment of the corresponding amounts in the financial statements (IAS 10.3(a) in conjunction with IAS 10.8). In contrast, events that indicate conditions that arose after the reporting period cannot be taken into account in the statement of financial position and statement of financial performance (non-adjusting events) (IAS 10.3(b) in conjunction with IAS 10.10). The guidance above on HGB accounting also applies to the qualification of the direct and indirect effects of the outbreak of war as a non-adjusting event in annual or consolidated financial statements prepared in accordance with IFRS as at a reporting date prior to 24 February 2022.

A deterioration in the financial position and operating results that occurs after the reporting period may indicate a need to consider whether the preparation of the financial statements on the basis of the going concern assumption is still appropriate (IAS 10.15). For this purpose,

the company must consider all available information about the future (but at least the first twelve months after the reporting period) (IAS 1.26).

Question 2.2: How does the outbreak of the Ukraine war affect the report on subsequent events in the (consolidated) notes in HGB accounts and IFRS financial statements?

Since the outbreak of war is to be classified as a non-adjusting event according to the guidance to question 2.1., this must be reported in the (consolidated) notes to the (consolidated) accounts pursuant to (German) commercial law as at 31 December 2021 if there is an "event of special significance" according to Article 285 no. 33 or Article 314 para. 1 no. 25 HGB. In this report on subsequent events, the nature and financial effects of the event must be disclosed. The decision of whether the outbreak of war (and the associated direct and indirect economic consequences) is then of special significance for the individual company must be made on a case-by-case basis. In general, an event is of particular significance if its effects are likely to influence the view conveyed by the financial statements as at the reporting date and if, in the absence of the report on subsequent events, this would lead the financial statement users to a significantly different assessment of the entity's significantly different future.

A general reference to the outbreak of the Ukraine war is sufficient to fulfil the requirement to disclose the type of event in the (group) notes. The presentation of the financial effects must take into account the net assets, financial position and results of operations, insofar as these are affected. Concrete quantitative information is not required; qualitative reporting is sufficient. However, the verbal explanations must sufficiently clarify the effects on the economic situation of the entity as a whole or on these three aspects, respectively (if affected). The purpose of this provision is to provide the financial statement users with at least basic information relevant to the further development of the entity as a basis for their decisions, and so this should be taken as the benchmark. In the context of the report on subsequent events, the period for which financial effects are to be disclosed extends appropriately from the beginning of the following financial year to the time of completion of the preparation of the annual financial statements (in the case of audited financial statements, this is the date the auditor's report is issued).

According to IFRS, if a non-adjusting is material, the nature of the event must be disclosed (IAS 10.21(a)). According to IAS 10.21(b), an estimate of its financial effect, or a statement that such an estimate cannot be made, must also be disclosed in the notes.

Question 2.3: What are the specific effects of the outbreak of the Ukraine war on the HGB annual financial statements of a small or micro-sized corporation or on an entity

that prepares its annual accounts in accordance with the provisions of commercial law applicable to all merchants?

According to Article 264 para. 1 sentence 4 half-sentence 1 HGB the executive directors of small corporations (Article 267 para. 1 HGB) are not obliged to prepare a management report. Pursuant to Article 288 para. 1 no. 1 HGB, they also do not need to include a report on subsequent events (Article 285 no. 33 HGB) in the notes. For micro-corporations (Article 267a para. 1 HGB) neither a management report (Article 267a para. 2 in conjunction with Article 264 para. 1 sentence 4 half-sentence 1 HGB) nor notes are required (Article 264 para. 1 sentence 5 HGB). This also applies to entities that prepare their annual financial statements in accordance with the provisions of [German] commercial law applicable to all merchants (e.g., partnerships with unlimited liability or companies that make use of the exemption provisions of Articles 264 para. 3, 264b HGB when preparing their annual financial statements). Consequently, it is questionable whether the outbreak of the Ukraine war nevertheless gives rise to reporting obligations for such entities.

In view of the explicit legal exemption regulations with regard to the report on subsequent events and the management report, the legislator has judged any corresponding reporting to be unnecessary. However, if there are material uncertainties in connection with events and circumstances that could raise significant doubts about the entity's ability to continue as a going concern (so-called going concern risks), the reporting entity must disclose them (IDW AuS 270 (Revised), para. 9; see question 2.5.). Small corporations that do not voluntarily prepare a management report must include such a disclosure in the notes. For micro-corporations and entities that prepare their annual financial statements in accordance with the provisions of commercial law applicable to all merchants (and do not voluntarily prepare notes and/or a management report), the disclosure is to be presented e.g., below the balance sheet.

Question 2.4: Is it possible to dispense with an otherwise obligatory report on subsequent events in the notes to the accounts (Article 285 no. 33 HGB) by reference to the reporting in the management report?

The German Commercial Code does not provide for an explicit reference option and a waiver of disclosure in one of the reporting elements. Thus, in principle, the relevant disclosure requirement must be fulfilled both in the notes and in the management report. Due to the similar content of the reports, duplication cannot be ruled out. In order to increase transparency for the financial statement users and enhance the clarity of reporting – a single central placement of future-related information on the effects of the outbreak of the Ukraine war – is viewed as permissible when the report on subsequent events refers to the disclosures in the management report provided identical information would otherwise have to be included in both places. The same applies to the reverse case of the recommended reference in the management report to the information in the report on subsequent events (GAS 20.114). The references in the report

on subsequent events to the management report or in the management report to the report on subsequent events must be unambiguous and clearly recognizable.

Question 2.5: Which disclosure requirements have to be observed in the case of material uncertainties in the assessment of the going concern assumption (HGB and IFRS)?

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 way of addressing of these risks in the notes or, if there are no notes, e.g. below the balance sheet. It is advisable to make this disclosure in the report on subsequent events or at the beginning of the notes (if necessary, with reference to the report on subsequent events). In addition, if a management report is prepared, the risks threatening the existence of the entity must be disclosed in the management report, whereby the risks must be explicitly named as threatening the existence of the company (GAS 20.148). In the notes to HGB financial statements, reference can then be made to the disclosures in the management report with 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.).

It is not sufficient to include only a general reference to risks threatening the existence of the company as a result of existing uncertainties about the further course of the war in Ukraine and its direct and indirect effects on the entity’s business activities in the notes or management report. In order to meet the information needs of the financial statement users, the executive directors must, in accordance with IDW AuS 270 (Revised), para. 9, clearly and unambiguously disclose in the financial statements the most important events or circumstances that may cast significant doubts on the company's ability to continue as a going concern and the plans for dealing with these events or circumstances. For this purpose, it may be useful to present different scenarios with an indication of the assumptions made. The executive directors must also clearly disclose in the financial statements that there is a material uncertainty related to events or conditions that may cast doubt on the entity's ability to continue as a going concern and that the entity may not be able to realize its assets and settle its liabilities in the normal course of business (going concern risk).

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 educational material for the

assessment of the going concern premise and the required disclosures.[1] The guidance is intended to support the consistent application of IFRS. They do not amend or supplement existing requirements, but instead summarize the requirements of relevant standards. Accordingly, the IFRS Foundation first refers to the regulations of IAS 1.25 et seq., but emphasizes that, with regard to the assessment of the going concern assumption, not only the specific regulations and disclosure requirements according to IAS 1.25 et seq. must be observed, but also the overarching disclosure requirements in IAS 1. This includes, in particular, the disclosures according to IAS 1.122 on judgements made by management in the application of accounting methods that have the most significant effect on the amounts recognized in the financial statements. The disclosure requirement in IAS 1.122 also applies to management's “close call” judgements regarding the assessment of the going concern assumption or the existence of a material uncertainty (see IFRIC Update, July 2014, p. 6). In addition, disclosures on sources of estimation uncertainty may become relevant in accordance with IAS 1.125-133.

Question 2.6: How does the outbreak of the Ukraine war affect (group) management report? What requirements are to be placed on the accuracy of the forecasts in the (group) management report?

In many cases the outbreak of the Ukraine war will be reflected in the (group) management reports for financial years ending on 31 December 2021, at least in the risk reports. In principle, if the possible further developments can lead to negative deviations from the entity’s or the group’s forecasts or targets, and if this concerns a significant individual risk and otherwise no accurate picture of the entity’s or the group’s risk situation is conveyed there is an obligation to disclose in the risk report (see GAS 20.11 and 20.146 et seq.; on the requirement to take into account risks that have arisen after the end of the reporting period, see GAS 20.155).

If current events have already given rise to a change in management’s expectations with regard to the forecast performance indicators, this must be appropriately reflected in the forecast report. GAS 20.130 generally requires forecasts to be included in the (group) management report to constitute point forecasts, interval forecasts or qualified comparative forecasts. According to GAS 20.133, entities or groups need to report by way of exception, “[i]f 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 nonfinancial key performance indicators used for internal management purposes are sufficient, whereby the assumptions applied in each case shall be disclosed”. In the opinion of the IDW, the requirements for claiming this relief may be met for companies whose activities are or are

[1] Ref.: IFRS Foundation, Educational material, Going concern – a focus on disclosure, Januar 2021, https://www.ifrs.org/content/dam/ifrs/news/2021/going-concern-jan2021.pdf

reasonably expected to be significantly affected by the direct and/or, above all, the indirect effects of the war in Ukraine. However, the relief may only be used if the two conditions mentioned 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 make forecasts) are fulfilled cumulatively. A general reference to the Ukraine war and its consequences alone is not sufficient. Whether the requirements are fulfilled must be properly assessed on the basis of the circumstances existing at the time of the completion of the preparation of the (group) management report, i.e., generally the time the auditor's report is issued. With regard to those (group) management reports, whose preparation will be completed close to the outbreak of war (24 February 2022) the IDW is of the view that it can generally be assumed that the condition of an exceptionally high degree of uncertainty with regard to future prospects due to macroeconomic conditions is fulfilled. It is currently not possible to predict how the degree of uncertainty may change with increasing time between the date of the outbreak of war and the date of completion of the preparation of the (group) management report, so an individual case assessment is required at the time of preparation. The second prerequisite, a significant impairment of the company's or group's ability to forecast, presupposes a high level of impact on the individual entity or group resulting from the direct and/or indirect effects of war, which must be demonstrated by the preparer of the financial statements.

A complete waiver of forecast reporting is not permissible.

Question 2.7: What impact can the outbreak of the Ukraine war have on financial reporting if the annual/consolidated financial statements and, if applicable, the (group) management report have already been prepared and audited before 24 February 2022, but the annual/consolidated financial statements had not yet been adopted or approved up to that date?

If the annual/consolidated financial statements had not already been adopted or approved by the competent corporate body prior to the outbreak of war (24 February 2022), it is incumbent upon this body to decide whether the developments that have occurred since the completion of the preparation and the audit of the annual/consolidated financial statements and the (group) management report are of such significant importance for the entity or the group that the audited annual/consolidated financial statements (here: the report on subsequent events) and/or the audited (group) management report still need to be amended prior to the adoption or approval of the annual/consolidated financial statements. In any case, it will be assumed that such an amendment will be required in those cases in which the going concern assumption can no longer be maintained due to the direct and/or indirect effects of the Ukraine war. When the annual/consolidated financial statements and/or (consolidated) management report are

revised, this entails the requirement for a supplementary audit pursuant to Article 316 para. 3 sentences 1 and 2 HGB (see also question 5.10.1.).

3. Impacts on financial reporting under [German] commercial law for balance sheet dates after the outbreak of war

3.1. Optional exclusion of subsidiaries from the group financial statements

Question 3.1.1: Can the Ukraine war and the developments and events caused directly or indirectly by it give rise to a case for the application for the possibility of using the consolidation option pursuant to Article 296 para 1 no. 1 HGB for Ukrainian, Russian or Belarusian subsidiaries (registered office)?

Pursuant to Article 296 para. 1 no. 1 HGB, a subsidiary need not be included in the group financial statements of the parent company by way of full consolidation if severe and long-term restrictions substantially hinder the exercising of the parent company's rights (which may continue under formal law) with respect to the assets or management of the subsidiary.

In addition to restrictions on the exercise of rights at the subsidiary by virtue of agreements under company law or contractual arrangements (which should only rarely be relevant in the present context), the restrictions can also be constructive in nature. The latter include political, economic or financial restrictions (see GAS 19.82), in particular restrictions as a result of (possibly threatened) government enforcement measures (GAS 19.85 lit. d).

The restrictions on the exercise of rights must be cumulatively both severe (in terms of scope) and permanent (expected temporal extension); they may alternatively relate to the assets or the management of the subsidiary. Restrictions on the assets must relate at least to material elements of the assets or materially impair the ability to obtain benefits from the assets; material restrictions on the management exist if material decisions concerning the operating and financial policy of the subsidiary cannot be enforced by the parent company or prevented (e.g. by a veto) or reversed by third parties (GAS 19.83). The permanence of the restrictions on exercising rights is not to be understood in the sense of a general anticipated minimum duration of the restrictions; in each individual case, therefore, a forward-looking decision must be made in accordance with the activities of the subsidiary as to whether control within the meaning of Article 290 para. 1 sentence 1 HGB may actually not be exercised (GAS 19.84).

In terms of time, the restrictions must have been in effect by the group balance sheet date at the latest. If severe restrictions existing on the group balance sheet date and to be regarded as lasting at that date cease to exist before the preparation of the group financial statements is completed, this does not lead to a retroactive lapse of the optional exclusion from the group (GAS 19.84). Conversely, this also means that developments and events that only occur after

the group balance sheet date may not per se lead to the conclusion that a restriction already existed on the balance sheet date. Article 296 para. 1 no. 1 HGB is not applicable to the past balance sheet date in the case of such so-called "non-adjusting" events on the group financial statements. However, in these constellations, if the new events initiate a problem with data collection, the optional exclusion from the group pursuant to Article 296 (1) no. 2 HGB could be applicable (see question 3.1.2.).

Question 3.1.2: Can the Ukraine war and the developments and events caused directly or indirectly by it with regard to Ukrainian, Russian or Belarusian subsidiaries (administrative headquarters) give rise to a case of application for the possibility of using the consolidation option pursuant to Article 296 para. 1 no. 2 HGB?

Pursuant to Article 296 para. 1 no. 2 HGB, a subsidiary need not be included in the consolidated financial statements of the parent company by way of full consolidation if the information required for the preparation of the consolidated financial statements cannot be obtained without disproportionately high costs or unreasonable delay. In the opinion of the IDW, the effects of the outbreak of the Ukraine war can fulfil the conditions for an unreasonable delay within the meaning of the provision in individual cases if the so-called "reporting packages" cannot be delivered to the parent company or can only be delivered with considerable delay. This does not apply if it is possible to make a suitable extrapolation of financial information already available or if preliminary figures are available that can be adjusted selectively with reasonable effort.

The minimum extent of the delays that must be expected despite reasonable efforts in order to be considered unreasonable cannot be stated generally or by specifying a concrete period of time calculated from the consolidated financial statement reporting date. However, if the expected delay in obtaining reasonably reliable information from the subsidiary is so long that waiting to prepare the consolidated financial statements and group management report on time within five or four months after the consolidated balance sheet date would be detrimental to this aspect of the consolidated financial statements and group management report, it must be assumed that the delay would be unreasonable (GAS 19.90).

<u>Question 3.1.3:</u> What are the consequences for the consolidated financial statements if, for a subsidiary that was fully consolidated on the previous group balance sheet date, when the option under Article 296 para. 1 no. 1 or 2 HGB is now used for the consolidated financial statements to be prepared on the most recent group balance sheet date?

If the inclusion of a subsidiary in the consolidated financial statements by way of full consolidation is no longer necessary or no longer possible according to the explanations to questions 3.1.1. and 3.1.2. the executive directors of the parent company must examine – except where Article 290 para. 5 HGB applies, i.e., when the group financial reporting obligation continues to apply – whether the investment in the subsidiary concerned is to be measured subsidiarily in the consolidated financial statements at its equity value according to Article 312 HGB (GAS 26.11). If an equity valuation of the shares is also ruled out (either because the parent company no longer exercises a significant influence on the business and financial policy of the investee on the current consolidated balance sheet date or can no longer exercise such an influence or because of § 296 para. 1 no. 2 HGB analogously), the investment must be measured in the consolidated financial statements at (amortized) cost. In the case of a transition from full consolidation to the equity method or to the measurement of the holding at (amortized) cost, a transitional consolidation (in this case a downward consolidation) is to be carried out in accordance with GAS 23.187-190. The transitional consolidation itself does not affect profit or loss; however, the subsequent lower of cost or market test may result in a requirement for unscheduled depreciation of the investment. The permissible use of the full consolidation option must be justified in the notes to the consolidated financial statements in accordance with Article 296 para. 3 HGB.

3.2. Impairment test

<u>Question 3.2.1:</u> The war in Ukraine and its direct and indirect consequences can give rise to the need for write-downs of both fixed and current assets. What aspects apply in this context?

Intangible fixed assets (including goodwill) and tangible fixed assets

In the case of intangible fixed assets and tangible fixed assets, a write-down is required in accordance with § 253 para. 3 sentence 5 HGB if the fair value on the date of the financial statements is likely to be permanently lower than the last carrying amount. Neither the determination of the lower of cost or market value nor the criterion of permanence are standardised in law. In practice, there are various forms/comparative values for the lower of cost or market value. There are no special features due to the current valuation situation, which is 13haracterized by the effects of war.

An impairment of fixed assets with a finite useful life is generally assumed to be permanent if the fair value on the date of the financial statements is lower than the value resulting from

scheduled depreciation for a significant part of the remaining useful life. In the case of tangible fixed assets other than buildings, it may be assumed that the fair value at the date of the financial statements is likely to be lower than the amortized cost of the asset for a significant part of the remaining useful life if this relationship (i.e. amortized cost > fair value at the date of the financial statements) is to be expected for more than half of the remaining useful life or a period of more than five years according to the knowledge at the time the preparation of the financial statements is completed. In the case of real estate, an impairment that is *not expected to be permanent may* only be assumed if, on the basis of demonstrable circumstances, it can be expected that already in the medium term, i.e. within a period of generally a maximum of three to five years, the reasons existing on the measurement date for an impairment will no longer apply; in the case of buildings that have a particularly long expected remaining useful life on the measurement date (i.e. usually a period of at least 40 years), it may be appropriate to extend the period from three to five to up to ten years (see *IDW RS IFA 2*, para. 40).

The following applies to the discontinuation or restriction of the use of tangible fixed assets (e.g., due to disruptions in the supply chain caused by the expansion of war):

- Temporarily inoperative sites or sites with temporarily qualified use must continue to be depreciated according to schedule. Additional impairments may be required if the use is expected to be limited permanently.
- (Expected to be permanently) decommissioned sites are to be written down to their market value (in case of doubt the scrap value) at the time of decommissioning.

If the reasons for a lower valuation existing after an impairment write-down no longer exist on a later balance sheet date, a reversal of the impairment is required (Article 253 para. 5 sentence 1 HGB). This does not apply to goodwill (see below).

Due to the effects of war, it may be necessary to test the recoverability of goodwill arising as a result of the capital consolidation of subsidiaries (Article 301 HGB, share deal) or as a result of the acquisition of a company through an asset deal (Article 246 para. 1 sentence 4 HGB). The consequences of war may have increased the likelihood that the fair value of goodwill from the acquisition of (subsidiary) companies has been reduced due to worsening business prospects (e.g., because of problems in selling or buying markets) and also falls below the residual book value previously reported. The procedures for determining any need for an impairment of goodwill from capital consolidation and of shares valued at equity in the group financial statements are set out in detail in GAS 23 and GAS 26. It is appropriate to apply the procedure set out in GAS 23 for determining any need for an impairment of goodwill from capital consolidation accordingly to the determination of any need for an impairment of goodwill from an asset deal in the annual financial statements. If recoverability is not given, an impairment (write-down) must be undertaken. The same applies to the entity’s interests in associated companies and joint ventures that were last reported in the group financial statements using the equity method at a value that is higher than the carrying amount of the

investment in the parent company's financial statements. If long-term equity investments in subsidiaries, joint ventures or associates are written down in the parent company's annual financial statements, this is an indication of a possible need for impairment in the group financial statements. Due to Article 298 para. 1 HGB, the regulations for the annual financial statements apply accordingly to the evaluation of a (non-scheduled) depreciation requirement (see below under "Long-term financial assets"). Where goodwill has been written-down, there is a ban on reversal of write-downs (Article 253 para. 5 sentence 2 in conjunction with Article 298 para. 1 HGB).

Long-term financial assets

Pursuant to Article 253 para. 3 sentence 5 HGB, financial assets must only be written down in the event of an impairment that is expected to be permanent; if the impairment is not expected to be permanent, there is a write-down option pursuant to Article 253 para. 3 sentence 6 HGB. There is no explicit legal answer to the question of whether an impairment that has occurred on the date of the financial statements compared to the last carrying amount is likely to be permanent. However, recognized regulations have been developed in this regard in practice.

For interests in **affiliated companies** (Article 271 para. 2 HGB) and long-term equity **investments** (Article 271 para. 1 HGB), for which a (short-term) sale is not intended on the part of the accounting entity and such a sale is also not to be assumed for other reasons, the fair value is to be determined (equity value) by applying an income value approach (capitalized earnings value or DCF method) in accordance with *IDW RS HFA 10,* irrespective of whether the shares in question are traded publicly or not (for the procedure for the forecast of future earnings and for determining the discount interest rate, please refer to the FAUB's Technical Guidance dated 20 March 2022 "Effects of Russia's war against Ukraine on company valuations"). In the case of a continuing intention and ability to hold an equity interest, any stock exchange price does not play a direct role in assessing whether these shares are likely to be permanently impaired within the meaning of Article 253 para. 3 sentence 5 HGB, as the subjective enterprise value is decisive for the measurement (see *IDW RS HFA 10*, para. 5 ff.). However, a stock exchange price may serve to check the plausibility of the determined lower of cost or market value.

If there is an intention to sell, the measurement of such company interests is to be based on the objectified enterprise value. If there is a binding offer for the acquisition of such shares, this is to be used instead of the objectified enterprise value (see IDW RS HFA 10, para. 11 et seq.). Even in the case of intention to sell, any existing stock exchange price for the measurement of such shares thus serves as a plausibility check. Only if such company interests are intended to be sold on the stock exchange should the stock exchange price (for these interests) be directly relevant.

The above system of IDW RS HFA 10 also applies to other long-term securities (i.e., those company interests that do not qualify as interests in affiliated companies and also not as participations) that are not publicly traded (on the date of the financial statements).

For other long-term securities that are traded publicly (at the latest on or at least until the date of the financial statements), the lower of cost or market value is the closing price on the last trading day of the reporting period as a result of a trading transaction. For the evaluation of whether such securities of the fixed assets for which the closing price is below the last book value (and which have a sufficiently long trading period up to the measurement date) are likely to be permanently impaired within the meaning of Article 253 para. 3 sentence 5 HGB, the indicator criteria of the IDW's Insurance Committee in IDW RS VFA 2 in conjunction with the reporting on its 149th meeting may also be referred to by preparers outside the insurance industry. According to this, the impairment of such securities is to be regarded as likely to be permanent if either

a) the fair value (= market value/trading price) of the security was permanently more than 20% below the last carrying amount in the six months preceding the date of the financial statements, or

b) the fair value of the security has been below the last carrying amount for a period longer than one financial year and, in addition, the (simple) average of the daily closing prices of the security over the last twelve months has been more than 10% below the last carrying amount.

If the fair value of financial assets is determined using an income approach and if this results in a value that is lower than the previous carrying amount of the long-term equity investment or the shares, it must be assumed as a rule - i.e. in the absence of substantiated triggering events to the contrary - that the impairment is likely to be permanent and that an impairment write-down is therefore necessary.

Inventories

In determining the production costs, only appropriate portions of the indirect material costs, the indirect labor costs and the depreciation and amortization of fixed assets may be taken into account in accordance with Article 255 para. 2 sentence 2 HGB, insofar as these are caused by production. Due to the effects of war, temporary shutdowns or restrictions on use may result in severe limitations on the utilization of appendices. The same applies if production processes, e.g., due to the interruption of supply chains, have to be interrupted in turn. The overhead costs attributable to these periods represent costs that are not appropriate and not caused by manufacturing. As so-called "idle time costs", they must not be included in the production costs

of inventories (see also *IDW RS HFA 31 (Revised)*) but represent expenses of the period in which they are incurred.

Write-downs on inventories are to be undertaken in accordance with Article 253 para. 4 HGB. If, in the absence of a stock exchange or market price to be determined on the date of the financial statements, the fair value applicable on the date of the financial statements for an inventory asset (i.e. unfinished and finished products, unfinished services and goods) that is to be valued basically on the basis of the sales market is determined retroactively for the purpose of loss-free measurement, the (probable) realizable sales proceeds (less any sales deductions) are to be added to the sum of the last book value of the asset (= continued acquisition or production costs) (less any sales reductions) the sum of the last carrying amount of the asset (= amortized cost) and the (pro rata) costs expected to be incurred after the date of the financial statements until disposal (in the case of finished goods and goods for resale): packaging costs and outward freight, general distribution costs, administrative costs, borrowing costs for storage until disposal; in the case of unfinished products or services: additional production costs still to be incurred until completion based on full costing). If the carrying amount (reduced by any sales reductions) falls short of this sum, the previous carrying amount must be written down by the difference in order to anticipate the loss that would otherwise arise on disposal. If the reasons for a previous write-down no longer apply, a reversal of write-down is required in accordance with Article 253 para. 5 sentence 1 HGB. The recovery in value does not necessarily have to be conditional on the elimination of exactly those ("same") reasons that were the cause of the previous write-down in order to initiate the reversal of write-down requirement.

Current receivables

Debtors of the reporting entity may (have) experienced financial difficulties as a result of the effects of war, which has increased the risk of default (or of not fulfilling trade receivables in full or on time) (possibly significantly). This must be taken into account by making write-downs to the "lower of cost or market value" (individual value adjustments) in accordance with Article 253 para. 4 HGB. Reversals of write-downs are required under Article 253 para. 5 sentence 1 HGB.

3.3. Restricted cash and cash equivalents

Question 3.3.1.:How should restricted cash be treated in the balance sheet?

The balance sheet item "B.IV. Cash-in-hand, central bank balances, bank balances and cheques" in accordance with Article 266 para. 2 HGB must include cash-in-hand and bank

balances (including foreign currency). As the designation "liquid assets/funds/resources", which is widespread in practice, suggests, the contents of the items are highly liquid assets.

However, if there are restrictions on disposal in the form that, for example, a (bank) account held abroad for the reporting entity has been frozen or such an account has been blocked due to sanction measures, the respective credit balance affected must be **shown** under other assets (see Schubert/Waubke, in: Grottel et al. (eds.), Beck'scher Bilanz-Kommentar, 12th ed. Article 266 HGB, note 155); alternatively, it may also be shown in a separate item formed in accordance with Article 265 para. 5 sentence 2 HGB (see Adler/Düring/Schmaltz (ADS), Rechnungslegung und Prüfung der Unternehmen, 6th ed., Article 266 HGB, para. 152). The same applies if the credit balance on a currency account may not (or no longer) be disposed of because of restricted convertibility. If a material amount of corresponding bank deposits is reported under other assets, an explanation in the notes is recommended.

Independent of the question of recognition, any restrictions on the ability to dispose of the assets must be taken into account in the measurement of the corresponding assets in accordance with general principles.

If the reporting entity's power to dispose of the **assets** is limited due to restrictions in such a way that these assets are **no longer attributable to the entity** (Article 246 para. 1 sentence 2 HGB), they are to be **de-recognized and accounted for as expenses**. If the amounts are not insignificant, they must be disclosed in the notes to the financial statements in accordance with Article 285 no. 31 or Article 314 para. 1 no. 25 HGB.

Question 3.3.2.: How should restricted cash and restricted cash equivalents be treated in the cash flow statement?

The cash fund of a cash flow statement, which must be prepared in accordance with Article 264 para. 1 sentence 2 or Article 297 para. 1 sentence 1 of the German Commercial Code (HGB) and is specified by GAS 21 for consolidated accounting, is made up of cash and cash equivalents.

By definition, cash includes cash-in-hand and demand deposits. Cash equivalents are defined as short-term, highly liquid financial resources held as a liquidity reserve that are readily convertible to cash and are subject to an insignificant risk of changes in value. In addition, they may have a maximum remaining time to maturity of three months at the date of acquisition (GAS 21.9).

Only highly liquid funds are to be included in the cash fund (see GAS 21.B15) in order to ensure an accurate inclusion **of the** entity's/group's **liquid funds. Consequently, it is necessary to examine** whether, due to the concrete restrictions existing in each individual case, the maturities or remaining times to maturity required by GAS 21 are still given and thus whether continued inclusion of the affected cash and cash equivalents in the cash fund is justified. A changed balance sheet presentation (see the comments on question 3.3.1.) of financial

resources according to GAS 21.9 under other assets or in a separate item and no longer under the balance sheet item B.IV. Cash-in-hand, central bank balances, bank balances and cheques" *alone,* however, is no reason not to include them in full in the cash fund of the cash flow statement. The definition of GAS 21.9 in the delimitation of cash and cash equivalents of the cash fund does not place restrictions on (only) particular balance sheet items. If it is determined during the review of the restrictions that the requirements for highly liquid financial resources are no longer fulfilled, a separate disclosure **of the non-cash changes in the cash fund** is required analogous to GAS 21.35 et seq. in order to reconcile its amount at the beginning of the reporting period to the amount at the end of the reporting period. In this constellation, there is no need for separate disclosures of restricted cash funds.

If, despite the restrictions on disposal, the definition of cash funds may still be fulfilled, a **reconciliation may be necessary** with regard to the balance sheet item "B.IV. Cash-in-hand, central bank balances, bank balances and cheques" and any cash and cash equivalents not included in the item (GAS 21.52 lit. b). According to GAS 21.52 lit. e, **restricted holdings** must, in addition, be included in the supplementary disclosures to the cash flow statement.

3.4. Provisions

Question 3.4.1.: What impact may the war in Ukraine and its direct and indirect consequences have on the recognition and measurement of provisions?

Requirement to set up provisions for expected losses from executory contracts

Particularly for **pending sales transactions** with agreed fixed fees on the date of the financial statements, the outbreak of war, but especially the increases in energy prices caused by the war, as well as the prices of particular raw materials or other input factors required for the provision of one's own contractually owed delivery or other service, may result in the need to set up provisions for expected losses. This is the case if the value of the delivery(s) or other service(s) still to be provided by the reporting entity under a synallagmatic contract after the date of the financial statements falls short of the value of its consideration. If the expected loss from the pending sales transaction relates to assets capitalized on the date of the financial statements, the expected loss is first to be recognized by means of a write-down of the assets directly affected; a provision for expected losses is only to be set up for a loss exceeding this amount (see in detail *IDW RS HFA 4*).

When assessing whether a provision for expected losses has to be set up, the executive directors should also check whether the underlying contracts contain *force majeure* or comparable clauses that suspend or cancel the delivery or performance obligation of the reporting entity and for this reason the requirement to recognize a provision for expected losses does not apply.

Provisions for uncertain liabilities due to any breach of sanction rules

If, prior to the date of the financial statements, the reporting entity may have breached any sanctions imposed as a result of the outbreak of war, the executive directors must, on the basis of the general criteria, examine whether any such breach should give rise to a provision for uncertain liabilities for an imminent penalty or an imminent administrative fine or monetary fine. In this context, with regard to the criterion of an obligation to a third party that is certain or sufficiently likely to arise, special consideration must be given to whether the punishment of breach, if any, requires the fault of the persons whose actions are to be attributed to the reporting entity in accordance with Article 31 of the German Civil Code (BGB).

Measurement of uncertain cash performance obligations to be fulfilled in the currency of one of the warring parties

Since Article 256a sentence 1 HGB only regulates liabilities (and not provisions), provisions (= uncertain liabilities) are not covered by its scope. In addition, according to Article 253 para. 1 sentence 2 HGB, provisions are to be recognized on each balance sheet date in an amount required for settlement on the basis of a reasonable commercial assessment; a "revaluation" is carried out for them on each balance sheet date, in which changes in exchange rates are also to be taken into account with an effect on value; this applies independently of whether the changes in exchange rates have the effect of decreasing the provision (in case of a foreign currency depreciation) or increasing the provision (in case of a foreign currency appreciation). In this respect, the maximum value principle - independent of the (expected) remaining time to maturity of the uncertain liability - does not apply.

Restrictions on the transfer of funds

The recognition of a liability or a provision in the statement of financial position and its measurement are not affected by the circumstance that the entity that has a cash payment obligation (due) to a Russian or Belarusian creditor at the date of the financial statements may not fulfil its obligation because certain Russian banks have been excluded from the SWIFT payment settlement system and, accordingly, funds cannot be transferred to accounts held with those banks on behalf of the creditors.

If the relevant private law (contractual) or the relevant supra- or international regulations underlying or laid down for the respective debt relationship provide for the basic accrual of interest on arrears in the event of late payment, the executive directors must examine whether, beyond the continuation of the primary debt, a debt item is to be recognized for interest debts incurred up to the date of the financial statements.

3.5. Foreign currency translation

Questions regarding the currency translation of Ukrainian hryvnia, Russian rouble and Belarusian rouble into euro may arise for foreign currency transactions in the annual or

consolidated financial statements and for the translation of foreign currency financial statements in the context of the preparation of the consolidated financial statements.

<u>Question 3.5.1.:</u>How are the exchange rates for the conversion of foreign currency transactions to be determined if official exchange rate quotations are no longer available?

The war against Ukraine and the imposition of sanctions and restrictions on Russia and Belarus shall have led to severe volatility in the exchange rate of the Ukrainian hryvnia, the Russian rouble and the Belarusian rouble. In particular, the restrictions against the Russian central bank are likely to limit Russia's ability to stabilize the exchange rate of the rouble and may have an effect on the ability to exchange roubles for other currencies, if necessary.

The question therefore arises as to which exchange rates are to be used for foreign currency transactions both at the moment of initial recognition and in the context of subsequent measurement if the European Central Bank or the German Bundesbank no longer provide exchange rates for the relevant dates or locations. As long as the currencies are still convertible, unofficial or grey market rates are to be used in the absence of official exchange rates, provided they are known. The exchange rate (bid or ask price) to be used is that with which the respective transaction is or may be settled (principle of itemized measurement; Article 252, para. 1, no. 3 HGB). When determining the exchange rate to be used for conversion, all known facts and circumstances in the individual case must be taken into account, e.g., whether amounts of the required magnitude can be procured at all on the grey/black market, as well as the prudence principle under commercial law (Article 252 para. 1 no. 4 HGB) (see e.g., Schubert/Waubke, in: Grottel et al. (eds.), Beck'scher Bilanz-Kommentar, 12th ed., Article 256a HGB, note 14).

According to GAS 25, non-monetary assets and foreign currency liabilities are generally translated at the bid rate at the moment of initial recognition, while monetary assets (e.g., receivables) are translated at the ask rate (GAS 25.10 et seq.). Instead of differentiated (bid or ask) rates, average rates for the period may also be used for initial recognition for reasons of simplification if the associated impairment of the asset and income situation is immaterial (GAS 25.14). Against the background of a possible increase in volatility, it is necessary to critically examine whether the prerequisites for the use of period-related average rates for the currencies concerned are still fulfilled for the ongoing recording of transactions in the local currencies or, if necessary, the periods for determining the respective average rate must be shortened, i.e. e.g. use of weekly instead of monthly average rates.

For the **subsequent measurement** of non-monetary assets, currency translation only takes place if these can be (re)procured exclusively in foreign currency. In this case, the value in foreign currency determined in accordance with Article 253 para. 3 sentences 5 and 6 or para. 4 HGB must be converted at the respective closing rate and compared with the carrying amount carried forward in euros. According to GAS 25.20 in conjunction with B7, exchange

rate-related impairments of non-monetary assets are only of a temporary nature in exceptional cases, which must then be proven by the (parent) company, e.g., on the basis of the development of any forward exchange rates, which should, however, be ruled out in the absence of quotations. Within the framework of the subsequent measurement of monetary assets and liabilities, GAS 25 differentiates between changes in value due to exchange rates and (other) changes in fair value. Article 256a of the German Commercial Code (HGB) applies to exchange rate-related changes in value, which, according to GAS 25.23, as a special valuation regulation for "monetary items", takes precedence over the regulation of Article 253 HGB, the validity of which otherwise remains unaffected. Therefore, exchange rate-related loss allowances are to be recognized independently of whether they are permanent or merely temporary (GAS 25.28 in conjunction with .26), while this is still relevant for other changes in fair value. When assessing whether a write-down is to be undertaken for monetary assets, it should be noted in this context that changes in the lower of cost ormarket value due to exchange rates and (other) changes in fair value according to GAS 25.24 may also offset each other.

It should be noted that according to GAS 25.33 currency translation differences, irrespective of whether they arise from the subsequent measurement of non-monetary or monetary assets and liabilities, are always to be recognized in profit or loss. However, this does not apply to differences from the currency translation of assets and liabilities denominated in foreign currencies that are part of (continuing) hedging relationships within the meaning of Article 254 HGB.

The above statements apply accordingly to the translation of foreign currency transactions in the financial statements adjusted to conform to uniform group accounting policies of the subsidiaries included in the group financial statements (Article 298 para.1 HGB).

According to Articles 284 para. 2 no. 1, 313 para. 1 sentence 3 no. 1 HGB, disclosures on the translation of foreign currency transactions/items must be made in the (group) **notes as part of the explanation** of the accounting and valuation techniques used in the (group) financial statements.

Question 3.5.2: What are the impacts of the use of the option to include subsidiaries in Ukraine or Russia in the consolidated financial statements pursuant to Article 296 para.1 no. 1 HGB on the translation of foreign currency financial statements?

If, as a result of the war or any government enforcement measures, there are severe and long-term restrictions on the management and/or property rights of the parent company and, as a result, the option of inclusion pursuant to Article 296 para. 1 no. 1 HGB is exercised, a change

of the method of **consolidation or inclusion to the measurement at** equity or at cost shall be made (GAS 25.70 et seq.) (see also question 3.1.3.).

In the event of a transition from full consolidation **to equity method measurement** (see GAS 23.187), the amount of the currency translation differences recognized in equity attributable to the shares remaining in the group must be carried forward either separately in group equity or as part of the equity value in accordance with the rules described in GAS 25.90 et seq. An equity difference from currency translation recognized as a separate item in equity that is proportionately included in the adjustment item for non-controlling interests is to be offset against the adjustment item for non-controlling interests together with the net assets proportionately attributable to these interests that are removed from the group financial statements due to deconsolidation, without this having any effect on profit or loss (GAS 25.68, GAS 23.184).

In the case of a transition from full consolidation **to measurement at cost, the currency translation differences recognized in equity attributable to** the shares remaining in the group must be offset against the acquisition value of the shares, which corresponds to the proportionate net assets at the carrying amount at group financial statement level attributable to them at the time of the change in status (see GAS 23.190), i.e. a difference on the assets or liabilities side increases or decreases the acquisition value.

According to GAS 25.105 et seq., disclosures on the translation of foreign currency financial statements must also be included in the **notes to the consolidated financial statements** as part of the explanation of the accounting and valuation techniques used in the group financial statements (Article 313 para. 1 sentence 3 no. 1 HGB).

Question 3.5.3.: Is an inflation adjustment in the currency conversion required for subsidiaries from Ukraine or Russia?

At present, it cannot be assumed that either the Ukraine, Russia or Belarus is a **hyperinflationary economy** according to the criteria of GAS 25.97 and the overall consideration of these indicators required by GAS 25.98, especially because the cumulative inflation rate over three years is not 100% or more. Depending on further developments, this evaluation may change for future balance sheet dates, e.g., if strict foreign exchange control is applied to protect the local currency (especially the rouble).

3.6. Notes to the financial statements

Question 3.6.1: Which disclosure requirements in the notes to the financial statements should be accorded particular consideration for financial statements

prepared in accordance with commercial law with a balance sheet date after 23 February 2022?

In addition to the note disclosure requirements already addressed in the comments on other issues in this Technical Guidance, the following note disclosure requirements in particular may be accorded increased significance depending on the entity-specific impact of the war in Ukraine and should therefore be considered particularly critically in terms of their relevance:

- Articles 285, nos. 3 and 3a, 314 para. 1 nos. 2 and 2a HGB: reassessment of the requirement to disclose off-balance-sheet transactions and other financial commitments, if necessary, because the reporting responsibilities are subject to the provision that the disclosures are required for the assessment of the financial position or are of significance and the liquidity position may have been impacted negatively by the war and its direct and indirect effects.
- Articles 285 no. 27, 314 para. 1 no. 19 HGB: in the case of contingent liabilities or not recognizing a provision, disclosures of the reasons for the assessment according to which the risk of recourse is not so high as to require the recognition of a liability or a provision.
- Articles 285 no. 31, 314 para. 1 no. 23 HGB: The amount and nature of expenses and income of extraordinary size or extraordinary significance, to the extent that they are not insignificant; the extraordinary significance shall be deemed to exist.

Small limited partnerships, micro-sized entities with limited liability and entities that prepare their annual financial statements in accordance with the provisions of commercial law applicable to all merchants (e.g. partnerships without limited liability or entities that make use of the exemption in Articles 264 para. 3, 264b HGB when preparing their annual financial statements) are either exempt from the duty to report on significant events occurring after the balance sheet date or do not prepare notes to the financial statements at all. If, in conjunction with such entities, there are significant uncertainties related to events or conditions that could raise significant doubts about the entity's ability to continue as a going concern basis (so-called going concern risks), the reporting entity must report on this (*IDW AuS 270 (Revised)*, para. 9). If notes to the financial statements are prepared, disclosures on these risks must be included in the notes, otherwise they must be disclosed below the balance sheet.

In addition, it should be noted that

- disclosures or explanations in the notes cannot be a substitute for recognition of matters in the balance sheet and the profit and loss account,
- "proforma financial information" disclosures (e.g. how high would the sales have been if there had been no war in Ukraine) are not appropriate, as they cannot be determined in a sufficiently objective manner,

- it may be necessary in particular cases, to the extent that this is necessary for the welfare of the Federal Republic of Germany or any of its states, not to make disclosures under Article 286 para. 1 HGB. This provision may be relevant, for example, for companies in the arms and defense industries.

4. Effects on IFRS financial reporting for balance sheet dates after the outbreak of war

4.1. Control according to IFRS 10

Question 4.1.1: What are the possible implications for the evaluation of *control* over a subsidiary under IFRS 10?

According to IFRS 10, the assessment of control over a subsidiary must always be undertaken in consideration of all facts and circumstances of the individual case. Even if the (parent) entity is directly affected (e.g., by an investee based in Ukraine, Russia or Belarus), no general assertions can be made regarding the question of control. In such a case, the assessment of the existence of control must still be undertaken on the basis of the general principles of the standard and in consideration of the framework conditions applicable at the time of the evaluation.

An investor controls an investee if (and only if) (1) the investor has power over the investee, (2) has exposure, or rights, to variable returns from its involvement with the investee and (3) has the ability to use its power over the investee to affect the amount of the investor's returns (IFRS 10.7).

The control concept of IFRS 10 is based on a secured legal position that gives rise to power arising from rights. Only those rights that are substantial *(substantive)* are to be taken into account (IFRS 10.B22 et seq.). If there are material barriers that prevent the holder from exercising the rights, they are not substantive according to IFRS 10 and therefore do not have to be taken into account (further).

The assessment of whether control exists in accordance with the principles of IFRS 10 is to be made in the overall view of all relevant facts and circumstances; if facts and circumstances indicate that there are changes to one or more of the three elements of control, the assessment made is to be reviewed and revised if necessary (cf. IFRS 10.8).

If, for example, the possibility of control was affirmed in the past due to an existing majority of voting rights and the investee was therefore consolidated, any restriction on the exercisability of the unchanged voting rights held may lead to these voting rights no longer being determined as substantive and thus there may no longer a basis for the assessment of control according

to IFRS 10. In contrast to German commercial law, control may be lost in the case of unchanged voting rights, for example, if the relevant corporate organ can no longer be appointed through voting rights due to government intervention or if government requirements for operational work restrict the voting rights' owners' power of disposal.

The question of whether existing rights are no longer substantive within the meaning of IFRS 10 may be determined on the basis of the factors listed in IFRS 10.B23; the determination requires in any case taking into account all relevant facts and circumstances in the overall view. In this respect, high requirements are to be set for the extent and expected duration of the restrictions. Deconsolidation on the basis of foreseeable temporary restrictions will only be considered in extremely exceptional cases. In this context, the following individual regulations are emphasized without excluding other possible factors:

- The inability of the holder of the rights to obtain the information necessary to exercise its rights may result in the rights no longer being substantive (IFRS 10.B23(a)(v)).
- Legal or regulatory requirements can prevent the holder from exercising its rights or, if necessary, also lead to changes in the normal statute of *corporate governance*, for example, if supervisory bodies with the power of control should in future be composed on a parity basis or even with a majority of state representatives (IFRS 10.B23(a)(vii)).

Restrictions on export of assets do not in themselves constitute a loss of control; rather, the implications for the definition of control given above need to be evaluated.

If the current facts and circumstances lead to a strengthening of lender's rights, e.g., due to existing covenants, the implications of these "new" rights must be evaluated with regard to the continued control of the investee in question (cf. IFRS 10.B26 in conjunction with IFRS 10.8).[2]

Question 4.1.2: Does IFRS provide for an option comparable to Article 296 (1) HGB?

In the context of IFRS financial reporting, there is no optional exclusion from group accounting comparable to the provisions of Article 296 (1) HGB. If the question of control (see question 4.1.1.) is answered in the affirmative, consolidation must be undertaken. Otherwise, there is an obligation to deconsolidate or change of the method of consolidation or inclusion.

4.2. Impairment test according to IAS 36

Question 4.2.1: Depending on the direct and/or indirect impact of the events in Ukraine and the current sanctions against or by Russia on the reporting entity, there may be effects on the *impairment tests* of assets in accordance with IAS 36.

[2] See also *IFRS IC*, IFRIC Update, Agenda Decision "Effect of protective rights on an assessment of control", September 2013.

Which assets are subject to the requirements of IAS 36?

Within the scope of IAS 36 are numerous types of non-financial assets, such as intangible assets, goodwill and property, plant and equipment, as well as rights-of-use assets, biological assets and investment property measured at cost.[3] IAS 36 also applies to company interests in associates and joint ventures accounted for using the equity method.[4] For other financial assets, on the other hand, the impairment rules of IFRS 9 are relevant.

Question 4.2.2: When should an impairment test be performed ?

An impairment test must be performed for all assets within the scope of IAS 36 if there is at the end of the reporting period any indication that an asset may be impaired (IAS 36.9). This applies to both annual financial statements and interim financial statements (cf. IAS 34.30(a)). Independent of the existence of such an indication (or triggering event), goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use must be tested for recoverability at least annually (cf. IAS 36.10).

In particular, if the entity is directly affected by the events of the war (e.g., due to manufacturing plants in Ukraine), but also if it is indirectly affected (e.g., supply chain problems, market downturns, reduced growth expectations), there is an increased likelihood of the existence of one or more indications that an asset may be impaired.

Question 4.2.3: In conjunction with the war in Ukraine, what indications of impairment may exist?

Indications for an impairment of assets or cash-generating units due to the current situation in Russia, Belarus and Ukraine - taking into account both external and internal sources of information - can be, for example:

- Significant changes with an adverse effect on the entity have taken place during the period or will take place in the near future in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated (IAS 36.12(b)).
  - Significant adverse changes in commodity and other market prices
  - Increased costs and/or business interruptions due to supply chain issues
  - Restricted access to assets or operations located in Ukraine, Russia or Belarus
  - Production restrictions due to staffing shortages

[3] For exceptions to the scope of application, see IAS 36.2 et seq.

[4] Long-term equity investments accounted for using the equity method must be tested in accordance with IAS 36 if there are triggering events or objective indications of an impairment (IAS 28.32 in conjunction with IAS 36.8). Whether such objective indications exist is to be determined according to IAS 28.40 in accordance with the special regulations in IAS 28.41A-41C.

  - Restrictions on market access as a result of sanctions
  - Threatened or directly threatened expropriations
  - Asset transfer and convertability Rizks
  - Negative changes in exchange rate parities.
- Substantive evidence of obsolescence, theft, sequestration or physical damage to assets.
- A decision by a reporting entity to undertake significant changes in the light of changing political and business conditions in the affected areas, for example:
  - Closure of assets or groups of assets
  - Plans to discontinue an operation to which an asset belongs
  - Plans to dispose of an asset before the previously expected date of disposal
  - Reassessment of the useful life of an asset as finite rather than indefinite.

A further triggering event for impairment is when, in view of recent stock market declines, the carrying amount of the net assets of the reporting entity exceeds its market capitalization. In this case, an impairment test must generally be undertaken for all assets or cash-generating units (IAS 36.9; for exceptions see IAS 36.15, IAS 36.99).[5]

Question 4.2.4: What should be considered when determining the recoverable amount?

An asset or cash-generating unit (e.g., a manufacturing plant located in Ukraine or Russia) is impaired if its carrying *amount* exceeds its recoverable amount. In other words, the reporting entity is unable to realize the carrying amount - either through use or sale.

The recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs of disposal and its value in use (IAS 36.18).

IFRS 13 is decisive for the determination of the fair value (IAS 36.6 in conjunction with IFRS 13.5 et seq.).[6] Costs of disposal are determined in accordance with the provisions of IAS 36.

The value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit (IAS 36.6). In accordance with IAS 36, he may be determined by using two different approaches. In contrast to the *'traditional approach'*, in which a single cash flow is used to determine the present value, the *'expected cash flow approach'* is based on several probability-weighted cash flows (see IAS 36.A2, .A4 et seq.). The application of the

[5] For *further* details, see also the *IDW statement on financial reporting: Einzelfragen zu Wertminderungen von Vermögenswerten nach IAS 36 (IDW RS HFA 40)* (Status: 14.06.2016), Para. 10 et seq.

[6] See in addition the *IDW statement on financial reporting: Einzelfragen zur Ermittlung des Fair Value nach IFRS 13 (IDW RS HFA 47)* (Status: 06.12.2013) as well as *IDW RS HFA 40,* para. 15 et seq.

expected cash flow approach is recommended for the consideration of developments as a result of the war in Ukraine, since the required modelling of different scenarios and the assignment of probabilities to these scenarios may make the uncertainty resulting from the events in Ukraine transparent and comprehensible.

The discount rate to be used is a pre-tax rate reflecting the current market assessment of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted (IAS 36.55, IAS 36.A15 et seq.).[7] The rate is the return that investors would require if they were to choose an investment whose cash flows would be equivalent (in terms of amounts, timing and risk profile) to the cash flows the entity expects to derive from the asset (cf. IAS 36.56). Even in the current situation of the war in Ukraine, the discount rate is based on long-term analyses of average market returns and on a market risk premium that is currently at the upper end of the range of historically measurable market risk premiums (see FAUB cost of capital recommendation of 25 October 2019, available at https://www.idw.de/idw/idw-aktuell/neue-kapitalkostenempfehlungen-des-faub/120158). No reasons for a change in the methodology for deriving the discount rate have been identified so far. The increased uncertainty due to the war in Ukraine must be taken into account in the design and not reflected by flat-rate increases in risk premiums.[8]

The aforementioned assertions and recommendations must also be observed in principle for [determining] the fair value less costs of disposal, insofar as this is determined using a discounted cash flow method.

The determination of the recoverable amount will represent a severe challenge for those preparing the financial statements and their auditors, since the extent and duration as well as the consequences of the war in Ukraine are currently difficult to forecast. It is therefore all the more advisable to explain management's assumptions and estimations pervasively in the notes and, in particular, to address the effects of the war when presenting sensitivity analyses (IAS 36.132, .134, IAS 1.125 et seq.). Similar to the corona pandemic, it is to be expected that the bandwidths of the changes in material parameters considered possible in the sensitivity analysis will be higher than before.

[7] For further explanations on the discount rate, see *IDW RS HFA 40*, para. 33 in conjunction with *IDW RS HFA 40*, para. 52.

[8] Cf. *IDW*, Fachlicher Hinweis des Fachausschusses für Unternehmensbewertung und Betriebswirtschaft (FAUB) zu den Auswirkungen von Russlands Krieg gegen die Ukraine auf Unternehmensbewertungen of 20.03.2022.

4.3. Financial Instruments - Updated

4.3.1. Classification and measurement (without impairment) - New

Question 4.3.1.1: What are the implications of war and (mutual) sanctions for market considerations in determining fair value under IFRS 13? - New

Derivation of fair value from market

According to IFRS 13.9, fair value is the price that would be received to sell an asset or paid to transfer a liability in an *orderly transaction* between market participants at the measurement date. The current market conditions on the measurement date are to be taken into account. The standard refers to the so-called *principal market* or, subsidiarily, to the most *advantageous market*. The principal market (or the most advantageous market) is determined by taking into account the business activities of an entity and the associated market access (cf. IFRS 13.19). The principal market is the market with the greatest volume and level of activity for the asset or liability (IFRS 13, Appendix A).

The entity must have access the principal (or most advantageous market) at the measurement date (IFRS 13.19). The entity does not need to be able to sell (or transfer) the particular asset (or liability) on the measurement date to be able to measure fair value on the basis of the price in that market (IFRS 13.20). Restrictions on the sale of an asset at the measurement date do not prevent access to the principal or most advantageous market. Rather, as a characteristic feature of the asset to be valued, they influence the amount of the fair value, provided they would also be taken into account by other market participants when pricing the asset (IFRS 13.11(b), IFRS 13.12, IFRS 13. BC46 and Illustrative Examples 8 and 9 in IFRS 13.IE27 et seq.).[9]

Against the background of the current situation in Ukraine and the current (mutual) sanction measures with regard to Russia and Belarus, it must be examined whether orderly transactions can be observed on the corresponding market, especially for financial assets and liabilities that are measured at fair value. In this context, it is also necessary to examine the extent to which trading restrictions for financial instruments (e.g., Russian sovereign bonds) have had an effect on the existence of markets. Furthermore, it is necessary to examine whether the reporting entity still has access to the markets (e.g., due to Russian measures regarding Russian financial markets). If there is no longer market access, information from these markets can generally not be used to determine the fair value. Even if there is a market and the reporting entity has access to such a market, it is necessary to analyze whether the transactions in this market can be regarded as ordinary.

[9] See also *IDW Statement on financial reporting: Einzelfragen zur Ermittlung des Fair Value nach IFRS 13 (IDW RS HFA 47)* (Status: 06.12.2013), para. 15 et seq.

Orderly vs. forced transactions and active market

A transaction is 'orderly' within the meaning of IFRS 13 if a market presence is assumed for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving the assets or liabilities concerned (see IFRS 13, Appendix A). If available, transactions on an active market are to be assumed. An active market is characterized by the occurrence of transactions involving the asset or liability for the asset or liability taking place with sufficient frequency and volume to provide pricing information on an ongoing basis (see IFRS 13, Appendix A). Forced transactions do not represent orderly transactions.

IFRS 13.B37 et seq. contains specific requirements in the event that the volume or level of activity for an asset or liability has significantly decreased in relation to normal market activity for that asset or liability. Reporting entities must first examine whether corresponding indicators exist for the affected markets. In the event that transactions in a market as defined above have significantly decreased, further analysis is required to determine whether transaction prices or market price quotations still actually represent fair value. If this is not the case, revisions to the transaction prices/market quotations or a change in the valuation procedures or methods are necessary. The revisions must also reflect the risk from the perspective of the market participants, even if the appropriate adjustment in this regard is difficult to determine. The use of several valuation techniques to determine fair value may also be justified. According to IFRS 13.B40, the weighting of the triggering events for fair value obtained from the use of multiple valuation techniques must take into account the reasonableness of the range of fair value measurements. The objective is to determine the point within the range of values that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed (IFRS 13.40). This is likely to be the case in the current environment.

If the volume and/or level of activity in the respective markets is reduced, it does not automatically follow that the transactions are not orderly. Rather, this must be examined in a next step (see IFRS 13.B43 et seq.). In doing so, a reporting entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available (IFRS 13.B44). Indicators of a transaction not being ordinary include that

- in a particular period prior to the measurement date, there was no adequate exposure to the market to allow for marketing activities that are usual and customary for transactions under current market conditions;
- there was no generally accepted marketing period;
- the seller had to sell in order to fulfil regulatory or legal requirements (compulsion).

If transactions are not orderly, little or no weight may be placed on transaction prices to determine fair value. If there is insufficient information to conclude that a transaction is orderly, the transaction price is considered in the fair value determination but may not directly represent fair value. If the transaction price is an 'arm's length' price, further analysis is required to determine the weight to be given to it in the measurement (see IFRS 13.B44).

Consequences of the interaction of market access and (in)active markets for the determination of fair value

A reporting entity that has previously derived the fair value of financial instruments from a market in Ukraine, Russia or Belarus shall assess whether access to that market still exists. If there is still access to the market and the fair value was determined in the past as a price in an active market for identical assets or liabilities (Level 1 input), it is also necessary to determine whether the market is still active within the meaning of IFRS 13 (see above). If the market is still active, the fair value must be determined as before. If the market is no longer active, other valuation techniques must be used (using Level 2 and/or Level 3 inputs).

If there is no longer access to a previous market in Ukraine, Russia or Belarus, it is necessary to clarify whether there are other markets for the same asset to be valued to which the reporting entity shall have access (e.g., stock exchange in another country). In the case of several markets, the principal market or, subsidiarily, the most advantageous market must be identified (see above). If access to this market exists and the market may also be classified as an active market within the meaning of IFRS 13, the price determined on this market on the measurement date is to be used for the fair value determination (Level 1 input). If, on the other hand, this market is not active, other valuation techniques are to be applied (using Level 2 and/or Level 3 inputs).

If a reporting entity no longer has access to a previous market in Ukraine, Russia or Belarus and no alternative market (or market access) exists, then the price from such a market (active or inactive) may be used in the fair value determination as part of an appropriate valuation procedure. Under no circumstances, however, can these market prices be adopted without further consideration (i.e., without taking into account any further required adjustments within the meaning of IFRS 13. A fair value determined in this way does not result in a categorisation in Level 1 of the fair value hierarchy.).

Commodity derivatives

The above considerations also apply to contracts on energy and commodity markets, which are accounted for as financial instruments (see IFRS 9.2.4). For example, at the beginning of March 2022, the London Metal Exchange (LME) suspended trading in nickel at short notice due to major distortions.

<u>Question 4.3.1.2:</u> What does the current market situation mean for the applicable valuation techniques and inputs(Level 2 and 3)? - New

According to IFRS 13.61, an entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure the fair value. As many (relevant) observable inputs as possible and as few non-observable inputs as possible must be used. As already presented in question 4.3.1.1., it is no longer possible to allocate a fair value to Level 1 of the fair value hierarchy according to IFRS 13 if the fair value could not be observed in an active market to which the reporting entity has access.

In the application of valuation techniques then required, it should be noted that, based on the current situation, the liquidity of financial instruments in particular must be taken into account appropriately. For this purpose, an up-to-date liquidity spread from the point of view of the market participants is to be used as an input.

Further risks that market participants would price into the measurement must also be taken into account. These also include risks that cannot be found directly in the contract terms (e.g., transfer risks, see questions 4.3.2.1. and 4.3.2.6.).

At present, it may prove difficult to determine an appropriate interest rate for discounting (e.g., for rouble instruments). Corresponding uncertainties must be taken into account in the measurement. It should also be noted that markets with large bid-ask spreads may currently exist (especially for currency issues). In principle, if an asset or a liability measured at fair value has a bid price and an ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value (see IFRS 13.70). An evaluation must be made as to whether it is still appropriate from the point of view of a market participant to use market mid-market prices.

Furthermore, the effects of the current market situation with regard to increased default risks must be taken into account when determining fair values. This may also affect accounting entities outside Ukraine, Russia and Belarus.[10]

According to IFRS 13, the fair value is to be determined as of the reporting date. Therefore, the inputs used must be updated on the respective measurement date.

<u>Question 4.3.1.3:</u> What should be considered with regard to the risk of change of the currency in which the transaction is executed? - New

Certain Russian sovereign bonds denominated in USD, EUR or other currencies contain clauses that provide for optional payment in roubles. Such clauses in the original contract represent an option to be considered in the fair value determination.

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[10] See questions 4.3.1.6 et seq.

Question 4.3.1.4: How should guarantees contained in financial instruments be dealt with when determining fair value? - New

Guarantees must be taken into account when determining the fair value according to IFRS 13, if they are an integral part of financial instruments and not accounted for separately. Guarantees must be examined to determine whether they also apply in the event of war and/or whether they are recoverable under current conditions.

4.3.2. Impairment - Updated

Question 4.3.2.1: The war in Ukraine is an unforeseen event with severe political, social and economic effects. The war itself, but also the responses to it, are enormously dynamic. The current uncertainty poses challenges for accounting entities when applying the impairment model under IFRS 9. - What are the fundamental considerations?

Although the war in Ukraine is a regionally limited event, it may have significant indirect consequences far beyond the region of Ukraine, Russia and Belarus. In addition, the current war has led to government sanctions, the legal effects of which are unclear, and which have a particular impact on the transfer routes of contractually agreed cash. Transfer risk, as a subcategory of credit risk therefore plays a significant role in the evaluation of credit risk.

Question 4.3.2.2: Which financial instruments are subject to the impairment model of

The requirements of IFRS 9 for determining and recognising a loss allowance for expected credit losses apply to all debt instruments classified as follows:

- at amortised cost using the effective interest method, or
- at fair value income through other comprehensive income (FVOCI).

In addition, the impairment requirements are relevant for all lease receivables, contract assets within the meaning of IFRS 15 as well as issued financial guarantee contracts and irrevocable loan commitments that are not measured at fair value through profit or loss (see IFRS 9.5.5.1).[11]

Question 4.3.2.3: What are the special features of trade receivables and lease receivables? - New

A simplified impairment model is mandatory for trade receivables and contract assets without a significant financing component (see IFRS 9.5.5.15(a)(i)). For trade receivables and contract

[11] For further information on the scope of the impairment requirements of IFRS 9, see *IDW RS HFA 48*, paragraph 254 et seq.

assets with a significant financing component as well as for lease receivables, there is an option to apply the simplified model (see IFRS 9.5.5.15(a)(ii) and IFRS 9.5.5.15(b)).

According to the simplified approach pursuant to IFRS 9.5.5.15, stage 1 of the general impairment model is omitted, i.e. loss allowances are always measured at an amount equal to lifetime expected credit losses.

The calculation of expected credit losses on trade receivables may, under particular circumstances, be based on a *provision matrix*. Forward-looking information must also be taken into account here. Since the provision rates used in the provision matrix are derived from the past experience of the reporting entities, they must be critically evaluated with regard to the current situation and revised if necessary. This should be accompanied by an evaluation of the extent to which provision matrices used in the past, which are based on shared credit risk characteristics, e.g., with regard to geographical regions, can continue to be used with regard to trade receivables affected by war or whether a separate consideration is required for these (see IFRS 9.B5.5.35).

Question 4.3.2.4: Which provisions of IFRS 9 are highly likely to lead to expenses for financial assets measured at amortised costs in the current situation?

According to IFRS 9, the following regulations have an influence on the determination of the amortised costs of financial assets and, in the current situation, are very likely to cause expenses to be recognised in profit or loss:

- Impairments (esp. transferring financial assets between the three stages and *credit-impaired* status; see IFRS 9.5.5.1, IFRS 9, Appendix A),
- estimation of contractual cash flows (IFRS 9.B5.4.6) and
- modifications (IFRS 9.5.4.3).

Each of the aforementioned provisions shall have an effect on the profit *or loss* for the period if the conditions are met.

Question 4.3.2.5: What are the indicative factors for the evaluation of the impact of the war in the Ukraine on reporting entities?

The impact of the war must be assessed individually for each entity. On the one hand, the impact may be direct, e.g., due to direct business relations with Ukraine, Russia and/or Belarus. Such a direct exposure is characterised, for example, by a borrower experiencing financial difficulties because he may not realise any, or fewer, sales or because he himself is affected by customer defaults. On the other hand, a borrower may have an indirect exposure, i.e., be indirectly affected by the events of the war. Such so-called "indirect effects" can result, for example, from problems in the supply chain, an increase in costs (including raw

material/energy prices), the current inflation trend or also generally from a worsened macroeconomic market assessment.

Question 4.3.2.6: What is the relationship between the findings of a default occurring and the credit-impaired status when determining expected credit losses?

Due to different (sanction) measures and circumstances, including their legal evaluation, it may currently be difficult to clearly determine a default for specific exposures (hereinafter: default status). Although the determination of the default status represents an important element of the impairment model according to IFRS 9, the standard does not contain a concrete definition of a default. The reporting entity must therefore establish a definition as part of its accounting policies. In practical application, the reporting entity must ultimately build on this to form an expectation regarding the collectability of the contractual cash flows based on all reasonable and supportable information[12]. According to IFRS 9.B5.5.37, qualitative indicators must also be taken into account. In this context, according to the impairment model of IFRS 9, the reason for cash flows failure is irrelevant (e.g., lack of solvency or willingness to pay). In the current situation, transfer risk will be of particular importance in determining expected credit losses and stage transfer.

The term 'default' is used in different contexts. The default status is often equated with the status 'credit-impaired' and in this case leads to an allocation to stage 3 according to the impairment model of IFRS 9. In contrast to the determination of the default status, however, IFRS 9 involves more concrete specifications with regard to 'credit-impaired'. According to this, a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred (see also the exemplary list in IFRS 9, Appendix A).

Question 4.3.2.7.: What has to be taken into account when determining a significant increase in the credit risk (SICR) and thus a possibly required stage transfer (with the consequence of measuring the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses)?

At each reporting date, an entity shall assess whether the credit risk on a financial instrument within the scope of the impairment requirements of IFRS 9 (see question 4.3.2.2.) has increased significantly since initial recognition (IFRS 9.5.5.9). The decisive factor for this assessment is the comparison between the risk of a default occurring (= *probability of default,* PD) on the reporting date with the risk of a default occurring determined at the date of initial recognition (IFRS 9.5.5.9). The PD is the decisive for determining the existence of a necessary

[12] For further information on the topic of 'reasonable and supportable information', see *IDW RS HFA 48*, paragraph 305 et seqq.

stage transfer. Existing collaterals and thus the loss given default (LGD) therefore only play a role in determining the amount of expected credit losses.[13]

In general, depending on how the reporting entity is affected by the events of the war and the sanctions introduced, a regional and/or sector-specific consideration of the exposures will be necessary. In this context, a changed portfolio assessment may be necessary due to changed risks in the affected countries, e.g., if Ukraine was assigned to a portfolio together with other Eastern European countries before the outbreak of war and the assets of the portfolio no longer have shared credit risk characteristics within the meaning of IFRS 9.B5.5.5 due to the war. A corresponding consideration also arises in the assessment of a stage transfer, which according to IFRS 9.5.5.4 may not only take place at the level of the individual exposure, but also at the collective level. This may also apply only as an intermediate step on the way to an individual evaluation.

If the credit risk has increased significantly, a transfer to Level 2 shall be undertaken for a financial instrument that was previously assigned to Level 1, whereby the loss allowance for the financial instrument shall no longer be measured at an amount equal to the 12-month expected credit losses, but with an amount equal to lifetime expected credit losses (IFRS 9.5.5.3 et seq.). If, in addition to a significant increase in credit risk on the reporting date, there is additional objective evidence that the financial instrument is credit-impaired (Level 3), the determination of interest revenue for the financial instrument must be revised in subsequent reporting periods in addition to determining the expected credit losses over the (remaining) term, i.e. the interest revenue must in future be calculated on the basis of the net carrying amount (IFRS 9.B5.5.33).

The stage transfer is based on the consideration of reasonable and supportable forward-looking information, the effects of which on the credit risk are derived from past experience. Such a dynamic extreme situation as the current war event with its (potential) consequential effects leads to great estimation uncertainties and margins of discretion that have to be exercised appropriately. The judgements and the assumptions on which the estimates are based must be represented transparently in the notes (see especially IAS 1.122 and IAS 1.125). This also applies to many issues concerning the determination of the amount of expected credit losses.

Question 4.3.2.8.:What should be considered when determining expected credit losses?

When determining expected credit losses, effects on the recoverability of collaterals must be taken into account in addition to the probability of default. This applies all the more if the collateral is located in a crisis country or is restricted by sanction measures. In addition, possible *force majeure clauses that exclude* the provision of collateral in the event of force *majeure must be evaluated for collateral agreements.* If financial guarantees are considered

[13] For the consideration of collaterals, see also *IDW RS HFA 48*, para. 284 et seq.

an integral part of a financial asset, their terms must also be considered with regard to possible exclusions relating to armed conflicts and taken into account accordingly when determining the amount of expected credit losses.

The main focus must be placed on scenario building when estimating the expected cash flows. The determination of the relevant scenarios, their likelihood of occurrence, but also the granularity with regard to the risk factors plays a decisive role here. Regional and sector-specific aspects are of particular importance in the context of risk assessment.

In particular, the use of *post-model adjustments may be necessary to take into account the* aforementioned aspects in order to reflect those effects that have not yet been included in the impairment models - especially for determining the probability of default (PD), the loss given default (LGD) and the exposure at *default (*EAD). When determining the amount of *post-model adjustments,* care must be taken to ensure a sufficient analysis of the causes so that, for example, existing corona pandemic-related *post-model adjustments can be distinguished* and justified from new *post-model adjustments that become necessary as a result of* the war in Ukraine. When deciding on the formation of post-model *adjustments, in addition to* the reasons for their formation, circumstances must also be defined in which amounts not used up to that point are to be released because the reasons for their formation no longer apply.

Entities should ensure transparency in the presentation and information provided when using *post-model adjustments.*[14]

<u>Question 4.3.2.9:</u>What should be taken into account when determining impairments on financial assets by insurance companies that still apply IAS 39 (old version)?

According to the impairment model of the old version of IAS 39 (incurred loss model), an entity (insurance company) shall determine at the end of each reporting date whether there is any objective evidence that a financial asset (or a group of financial assets) is impaired. An asset is impaired and impairment losses are incurred if, only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. Losses from expected future events are not recognised regardless of the likelihood of their occurrence (IAS 39.58 et seq. (old version)).

For financial assets within the categories loans and receivables and held-to-maturity, this means that an impairment loss must be recognised in the amount of the difference between the present value of the estimated future cash flows discounted at the original effective interest rate and the asset's carrying amount (IAS 39.63 (old version)). For available-for-sale financial

[14] See *ESMA, Public* Statement, ESMA coordinates regulatory response to the war in Ukraine and its impact on EU financial markets, 14.03.2021, and correspondingly *ESMA*, Public Statement, European common enforcement priorities for 2021 annual financial reports, Priority 3: ECL disclosures of credit institutions - Management overlays, p. 7.

assets measured at fair value, a reclassification to profit or loss of the measurement effects previously recognised in the revaluation surplus (other comprehensive income) in equity is to be performed if there is objective evidence that the asset is impaired (so-called recycling, IAS 39.67 (old version)). For investments in equity instruments in the available-for-sale portfolio, IAS 39.61 (old version) contains separate regulations according to which this entry must be made in profit or loss if the fair value is significantly or prolonged below the cost.

Question 4.3.2.10.: What has to be considered in case of a change of the contractual terms and conditions (modification)?

In the case of a non-substantial modification[15], the new contractual cash flows are to be discounted at the original effective interest rate and the difference to the previous carrying amount is to be recognised in profit or loss. The mathematical procedure for determining the effect on profit or loss thus corresponds to that for calculating the expected credit losses in accordance with IFRS 9.B5.5.33 and thus also IFRS 9.B5.4.6.

A substantial modification, on the other hand, leads to the derecognition of the financial asset and the initial recognition of a new financial asset, so that either an allocation to Stage 1 must be undertaken or (if the status 'credit-impaired' exists) treatment as a purchased or originated credit-impaired financial asset in accordance with IFRS 9.5.5.13 et seq. becomes necessary.

In any case, the loss allowance for the financial asset must be updated before a modification is recognised[16]. If a modification of the contract is creditworthiness-induced, i.e., if at least one of the events listed in Appendix A to IFRS 9 for a credit-impaired financial asset exists, the allocation to Stage 3 and the recognition of an impairment loss shall take precedence.

Question 4.3.2.11.: When may a (partial) write-off be required?

If there is no reasonable expectation of recovering a financial asset is its entirety or a portion thereof, a write-off, i.e., a (partial) derecognition, has to be undertaken (IFRS 9.5.4.4).

4.3.3. Hedge Accounting - New

Question 4.3.3.1: What effects might the war in Ukraine have on hedging relationship accounting? - New

The war in Ukraine may have an effect on both the ability to apply hedge accounting and the effectiveness of hedging relationships.

[15] For the differentiation between substantive and non-substantive modifications, see *IDW RS HFA 48*, para. A8 et seq.

[16] For further information on the modification of financial assets, see *IDW RS HFA 48*, esp. para. A1 and A13 et seqq.

For example, the entity might (have to) change its intention to perform purchases or sales to the extent planned or be qualified to perform planned corporate actions in light of financial difficulties or the general economic difficulties in conjunction with the war in Ukraine.

The ability of contracting parties and customers to perform transactions with the reporting entity could also be affected by sanctions, for example, if these counterparties are unable to fulfil their obligations in the current environment.

Effects on forecast transactions

If the entity determines that a forecast transaction is no longer highly probable but still likely to occur, the hedging relationship shall be discontinued (IFRS 9.6.5.6) and the gain or loss on the hedging instrument that was accumulated in other comprehensive income shall not be reclassified to profit or loss until the forecast transaction occurs.

If, on the other hand, a transaction is no longer expected to occur within an appropriately specified and generally narrow time frame, the hedging relationship must be discontinued and the entity must immediately reclassify any accumulated gains or losses from the hedging instrument accumulated in the cash flow hedge reserve to profit or loss (IFRS 9.6.5.6, IFRS 9.6.5.12(b), IFRS 9.B6.5.26, IFRS 9.B6.5.27(b)). In particular, no reference may be made to a correspondingly higher transaction volume in an earlier or later period as a substitute, unless this was part of the originally planned and sufficiently identified forecast transaction. However, something else may apply in individual cases if the original, sufficiently identified forecast transaction does not occur as planned due to an unforeseeable event but is performed earlier or later within a reasonable period of time and with reasonable certainty (see IDW RS HFA 48, para. 347).

Entities that apply the hedge accounting requirements of IFRS 9, rather than IAS 39, shall undertake an adjustment of the hedge ratio in accordance with risk management (rebalancing) if the change in the hedged item – e.g. in the form of a reduction in the designated quantities of a forecast transaction – has had an effect on the designated hedge ratio (IFRS 9.6.5.5, IFRS 9.B6.5.7 ff. and IDW RS HFA 48, para. 371 et seqq.).

If a sufficiently identified forecast transaction that was designed within an appropriately specified and fundamentally narrow time frame (is expected to) occur earlier or later within that time frame, this does not affect the designation of the original hedge. However, this may have an effect on effectiveness. In the event of a later occurrence of the forecast transaction, the hedging instrument may be prolonged, or a new hedging instrument may be designated, provided this is evident from the documentation of the hedging relationship (follow-up hedging) (see IDW RS HFA 48, para. 346).

Rolling hedging strategies

Similar requirements also arise for so-called rolling hedging strategies. If, for example, the completion of a project is postponed as a result of delivery bottlenecks and thus also the receipt

of the purchase price agreed for this project and hedged with regard to its exchange rate risk, an entity may ‘roll forward’ the hedging effect achieved by means of the original hedging transaction (e.g. foreign currency forward) to the new expected end of the project and thus the expected due date for receipt of the purchase price payment by means of a subsequent hedging transaction (e.g. foreign currency swap). The prerequisite for this is that the entity has documented such a hedging strategy in its risk management strategy and determined corresponding risk management objectives. It must be highly probable that both a postponement of project completion and the associated purchase price payment dates can be reliably determined.

Hedge ineffectiveness

A change in the timing of a hedged forecast transaction that remains highly probable of occurring may also have an effect on the profit or loss of the entity. Hedge ineffectiveness may exist, for example, because there is a difference between the amount and/or timing of the hedged item and the hedging instrument. It is common practice for entities to determine a ‘hypothetical derivative’ that reflects the timing and amount of the hedged item and use the measurement of that derivative to compare with the hedging instrument to determine the amount of hedge ineffectiveness to be recognised in profit or loss (see *IDW RS HFA 48*, para. 366 et seqq.). If the timing and/or amount of the hedged item changes in response to an unforeseen economic event with severe effects such as the war in Ukraine, the entity must revise the hypothetical derivative to reflect the changes in relation to the hedged item also for effectiveness recognition purposes.

Effects of credit risk on hedging relationships

In addition, increases in the credit risk of the entity or the counterparty as a result of the war or the sanctions imposed as a result can lead to the effectiveness of the hedging relationship being impaired as a result (see *IDW RS HFA 48*, para. 367) or even the requirements for the application of hedge accounting no longer being met if the credit risk dominates the changes in value resulting from the economic relationship between the hedging instrument and the hedged item (IFRS 9.4.1(c)(ii), see also *IDW RS HFA 48*, para. 362).

Foreign currency basis spreads

The current economic consequences triggered by the war increase the volatilities of the markets and thus the costs of hedges also against balance sheet risks. Increased volatilities (e.g., of foreign currency basis spreads) can significantly increase the ineffectiveness of hedging relationships if they are part of the hedging relationship. This applies under both IFRS 9 and IAS 39.

Cost of hedging

IFRS 9 allows the time value of an option or the forward element of a forward contract and/or a foreign currency basis spread to be separated in the context of determining the hedging

instrument or to be left out of the hedging relationship as a non-hedging part of the hedging instrument (see IFRS 9.6.5.15 et seq.). The non-designated component of the hedging instrument then does not lead to ineffectiveness of the hedging relationship but represents costs of the hedge (see IFRS 9.B6.5.29 et seq.). The changes in value of the non-designated components are recognised in other comprehensive income, insofar as they relate to the hedged item. A reclassification to profit or loss must be undertaken if the hedged item has an effect on profit or loss. If it is no longer expected that the amount thus recognised (or a part thereof) may be realised in future periods, the amounts recognised in other comprehensive income must be reclassified immediately to profit or loss (see IFRS 9.6.5.15 et seq.; IFRS 9.B6.5.29; IFRS 9.B6.5.34, see also *IDW RS HFA 48*, para. 376 et seq.).

4.3.4. Presentation and disclosures - New

Question 4.3.4.1: Due to economic difficulties initiated by the war in Ukraine, there may be effects on the recognition of financial liabilities in the balance sheet. What should prerparers pay attention to? - New

Breach of covenants

If covenants are not satisfied at the end of the reporting period and the counterparty then has a right to early settlement, the entity is not permitted to present the liability as non-current unless the debtor has an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see IAS 1.69(d)). This also applies if the breach of the covenant has resulted in the liability becoming payable on demand and the lender has waived its right to require immediate repayment after the end of the reporting period but before the authorisation of the financial statements (see IAS 1.74). In these cases, the liability has to be classified as current. Something else applies if the breach of the covenants has already been cured by the end of the reporting period through negotiations with the lender and, as a result, a period of grace at least the next twelve months has been agreed within which immediate repayment may not be demanded (see IAS 1.75).[17]

In the case of payment delays or defaults as well as breaches of covenants, there are disclosure requirements in addition to the effects on the balance sheet as mentioned above (see IFRS 7.18 f., IAS 34.15B(i) as well as IDW RS HFA 24, para. 20). For example, the disclosure of the resulting liquidity risk is required by IFRS 7.31 et seqq., if material loans or

[17] The statements are based on the current provisions of IAS 1 (i.e. no consideration of the *Amendments to IAS 1 Presentation of Financial Statements: Classification of Liabilities as Current or Non-current and Classification of Liabilities as Current or Non-current - Deferral of Effective Date* of the IASB dated 23 January 2020 and 15 July 2020, which have not yet been adopted into EU law, as well as the planned amendments according to IASB ED/2021/9 *Non-current Liabilities with Covenants - Proposed amendments to IAS 1*, November 2021).

risk concentrations are involved (see IDW RS HFA 24, para. 28). Such disclosure requirements may also be necessary for interim financial statements in 2022 (see IAS 34.15C).

Disclosures on liquidity risks due to potential breaches of covenants

Foreseeable effects on the financial position may arise, in particular, from the threat of (potential) breaches of covenants caused by the war in Ukraine.

Based on the provisions for the covenants contained in the contractual terms of the financial liabilities, a risk analysis should be carried out on the basis of the current circumstances with regard to the preconditions for their becoming effective.

Accelerated repayment clauses, the terms of which can sometimes only be assessed after consultation with a legal adviser, could include the following:

- Clauses on (threatened) expropriation
- Cross-default clauses
- Payment moratorium clauses
- Insolvency clauses
- Rating-related clauses
- Material adverse effects clauses.

Concerning the notes, IFRS 7.B11F(f) requires that the disclosure requirements according to IFRS 7.39(c) (i.e., the description of how liquidity risk inherent is managed) also include whether the entity has financial liabilities that contain accelerated repayment clauses. If the imminent effectiveness of one of the above clauses becomes evident and there is materiality in terms of amount, there is an obligation to disclose the effect on the liquidity risk even if the breach of covenants has not occurred but potentially affects the payment dates. In principle, according to IFRS 7.39(a) and (b), a description of the liquidity risk is to be undertaken in the notes by means of a maturity analysis for (non-derivative and derivative) financial liabilities, whose remaining contractual maturities are to be represented (typically in tabular form). The description of effects on liquidity risk triggered by potential breaches of covenants is therefore made by (i) naming the affected financial liabilities and (ii) describing to what extent a shortening of the remaining contractual maturities is to be expected.

Question 4.3.4.2: What should be considered with regard to the disclosures on capital? - New

Due to the current circumstances, the disclosures according to IAS 1.134 et seq. are of particular importance. In particular, compliance with the minimum capital requirements in regulated industries must be addressed.

4.4. Restrictions on disposal of cash and cash equivalents

Question 4.4.1.:What special features may arise in conjunction with cash and demand deposits?

Sanctions or other legal actions may result in restrictions on cash and demand deposits, their ability to be used or transferred. For example, the exclusion of particular financial institutions from the *Society for Worldwide Interbank Financial Telecommunication* (SWIFT) will affect the conduct of banking transactions in which those financial institutions are involved.

Against this background, on the one hand, there may be effects on the classification of cash and demand deposits as cash and cash equivalents. In this context, it must be assessed whether a restriction is so far-reaching that it prevents inclusion in cash and cash equivalents. Moreover, investments, e.g., in money market funds, no longer fulfil the requirement for inclusion in cash equivalents if there is a risk of significant changes in value (see IAS 7.6).

Classification as cash and cash equivalents, on the other hand, may result in disclosure requirements. For example, IAS 7.48 requires disclosure of the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group, together with an explanation of the nature of the restriction. This is the case, e.g., when cash and demand deposits are freely transferable within the country but not within the group, e.g., due to foreign exchange restrictions.

4.5. Provisions

Question 4.5.1.: Under what conditions may it be necessary to establish a provision for an onerous contract in accordance with IAS 37?

The war in Ukraine may lead to the following developments, for example:

- Price changes on relevant procurement and/or sales markets, especially for raw materials and energy
- Performance failures in relationships with business partners (e.g., suppliers) based in Ukraine or Russia or whose value chain has links to these countries
- Qualified availability of own personnel resulting in delayed production and sales processes or replacement procurement at higher costs.

Such and further developments can have the effect that the profitability of existing executory contracts changes to the detriment of the entity. For example, a trading company may have contractually committed to sell a product to a customer at a fixed price, which it can now only purchase at a higher price due to price changes on the markets in the meantime, or a manufacturing company may not be able to meet contractually agreed delivery dates to customers due to difficulties in the supply chain and therefore finds itself exposed to penalties.

In such cases, it must first be assessed in accordance with IAS 36 whether the (non-current) assets dedicated to these contracts are impaired; if necessary, impairment losses must be recognised (IAS 37.69).

Subsequently, the recognition of a provision for onerous contracts must be examined. IAS 37 requires the recognition of a provision for a present obligation under a contract when the contract is or becomes onerous (IAS 37.66). A contract is onerous if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under the contract. Unavoidable costs are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil it (IAS 37.68).

These rules apply to all contracts, independent of their term. The issue is likely to have particular relevance in the firm's practice for long-term contracts (‘continuing obligations’). This applies in particular to (long-term) procurement or sales contracts for goods as well as service contracts. In the case of sales contracts, in addition to the evaluation according to IAS 37, the effects on the determination of revenue according to IFRS 15 must also be assessed (e.g., if it turns out that contractual penalties will have to be borne by the entity).

In the special situation of the war, the assessment of contracts under IAS 37 must take into account whether they contain clauses on exceptional situations (e.g., force majeure clauses). If such clauses exist, it must be analysed how these clauses affect the rights and obligations of the entity in the individual case and thus also the unavoidable costs and the economic benefits expected to be received under the contracts. In addition, the entity should also consider the extent to which contractual terms are actually effective or enforceable in the current situation in the specific individual case (for example, in view of measures ordered by governments that may conflict with contractual terms, e.g., embargoes, or due to the factual circumstances of the war, such as the destruction or insolvency of business partners).

According to IAS 37, provisions shall not be recognised for future operating losses that are not yet reflected in current contracts and thus obligations (e.g., expected losses due to price changes in the meantime or other adverse economic developments from future business activities, IAS 37.63 et seqq.). Recognising provisions for operating losses is also ruled out in cases where, e.g., due to temporary closures of (production) sites, personnel is released from work by the entity with continued payment of wages/salary and temporarily does not perform any work; in these cases, the usual presumption of balance for employment relationships applies with regard to performance and consideration. In the cases mentioned, however, a test for impairment in accordance with IAS 36 may have to be performed for those assets that are associated with the respective economic disadvantages (IAS 36.9 and IAS 36.12).

4.6. Foreign currency translation

Question 4.6.1: What are the particularities of foreign currency transactions against the background of the war in Ukraine?

The war in Ukraine and the imposition of sanctions and restrictions on Russia and Belarus have led to severe volatility in the exchange rate of the Russian rouble, the Ukrainian hryvnia and the Belarusian rouble. In particular, the restrictions against the Central Bank of Russia are expected to limit Russia's ability to stabilize the exchange rate of the rouble and could have an effect on Russia's ability to exchange roubles for other currencies.

The question therefore arises as to which exchange rates are to be used for foreign currency transactions both at the time of initial recognition and in the course of subsequent measurement.

A foreign currency transaction shall be initially recorded in the reporting entity's functional currency by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. For practical reasons, an average rate may be used if it represents an approximation of the current rate at the time of the transaction. However, the use of an average rate in the case of highly volatile exchange rates is not appropriate (IAS 21.21 f.). In view of the high volatility of the exchange rates of the above-mentioned currencies, it should therefore be critically examined whether the use of average rates is still permissible.

IAS 21 prescribes the use of closing rates for the translation of particular balance sheet items. According to IAS 21.8, the closing rate of a currency is defined as a spot exchange rate at the end of the reporting period, whereby the spot exchange rate is the exchange rate for immediate delivery. In determining whether a rate is a closing rate, it is necessary to consider whether the currency is available at an officially quoted rate at the end of the reporting period and whether the quoted rate is available for immediate delivery. In firm practice, a customary delay in the receipt of funds is acceptable.

The European Central Bank (ECB) has stopped publishing its Euro-Russian rouble exchange rate since 01.03.2022. Companies must therefore check at each preparation date whether officially quoted exchange rates are available from alternative sources that fulfil the requirements of IAS 21 for a closing rate.

If the exchange of the Russian rouble (or Ukrainian hryvnia or Belarusian rouble) is temporarily lacking on the date of the transaction or a subsequent date of the financial statements, entities should apply the rate that applies on the first subsequent date at which exchanges could be made (IAS 21.26). In this regard, the IFRS IC had determined in September 2018 in the context of an agenda decision on determining the exchange rate in the case of long-term foreign

exchange restrictions[18] (at that time in conjunction with Venezuela) that in such a case, all significant restrictions on the entity obtaining access to or using assets and fulfilling liabilities must be disclosed in accordance with IFRS 12.20 and IFRS 12.22. Entities should also disclose in the notes the exchange rate used for translation and explain how it was derived. Further they should disclose any significant accounting policies and judgements used in determining the exchange rate as well as existing estimation uncertainties (see IAS 1.117-124 and IAS 1.125-133).

In addition, the volatility of exchange rates can have effects on non-monetary items with regard to potential impairments. For example, IAS 36.54 provides for the calculation of value in use to estimate future cash flows in the currency in which they will be generated and to discount them at an interest rate appropriate for that currency. An entity then translates the present value using the spot exchange rate at the date of the value in use calculation.

Question 4.6.2: What should be considered in the case of foreign operations and consolidtaed financial statements?

When business operations are exercised by foreign operations, the financial statements of those foreign operations shall be translated into a presentation currency of the group for inclusion in the financial statements of the reporting entity by consolidation or the equity method (IAS 21.44). The process of translation involves, as with the translation of foreign currency transactions, determining appropriate exchange rates to use in translating the income statement and balance sheet items of the foreign operation and recognising the financial effects of changes in exchange rates in the financial statements of the reporting entity.

According to IAS 21.39, the financial statements of a foreign operation whose functional currency is not the same as the parent's presentation currency (and is not the currency of a hyperinflationary economy) shall be translated into the presentation currency of the parent for group purposes as follows:

- at the spot exchange rate at the date of that statement of financial position (assets and provisions) and
- at the exchange rate valid at the time of the respective transactions or, for the sake of simplicity, at an average rate if necessary (income and expenses).

For the translation of the net investment of a foreign operation, parents usually use the exchange rate that would apply if dividends from the foreign operation were transferred to the parent at the end of the reporting period. This is appropriate because this rate would generally apply if funds from the foreign operation were transferred to the parent at the end of the

[18] See *IFRS IC*, IFRIC Update, Agenda Decision 'Determination of the exchange rate when there is a long-term lack of exchangeability', September 2018.

reporting period. However, the restricted ability to exchange into roubles or hryvnia may have an effect on the exchange rate to be used.

In determining appropriate rates, as with the translation of foreign currency transactions during the reporting period, consideration should be given to whether the rates available fulfil the requirements of IAS 21. Entities should disclose the rate used for translation and explain the effect of that rate in the notes.

4.7. Presentation and disclosures

Question 4.7.1: The war in Ukraine as an unforeseeable exogenous event will regularly lead to the fact that the original forecasts for the economic development of many entities will not be achieved. How can the effects be appropriately represented in the IFRS financial statements according to the circumstances and their significance in the individual case?

Even in such an exceptional situation, the general rules of IAS 1 on the presentation of financial statements must be observed. This also applies in particular to any planned ‘separate presentation’ or similar.

Qualitative and quantitative information about significant effects of the war and the methods used to determine them should provide a clear and unbiased picture of the areas affected. The disclosures may be made as part of the explanations of the amounts presented in the profit or loss in a single note within the financial statements or, if the effects are explained in more than one location in the notes, clear and unambiguous cross references may be made between the relevant sections within the notes.

Question 4.7.2: Which disclosures in the notes should be considered in IFRS consolidated financial statements with a reporting date after 23 February 2022, especially in view of the war in Ukraine?

In addition to the disclosures in the notes on the matters described above, the following disclosures may obtain particular significance in the context of the war in Ukraine, depending on the entity's specific involvement, and should therefore be considered carefully:

General disclosures according to IAS 1

- Going Concern
  - Significant doubt upon the entity's ability to continue as a going concern (IAS 1.25)
  - Close call decisions that there is no significant doubt upon the entity's ability to continue as a going concern (IAS 1.122).
- (Other) judgements that have most significant effect on the amounts recognised in the financial statements (IAS 1.122), e.g.

    - Consolidation issues,
    - Evaluation of the reassessment of options to extend a lease,
    - Evaluation of which level of the fair value hierarchy an asset or a liability is to be categorised to.
- Assumptions and disclosures about major sources of estimation uncertainties (i.e., those with a significant risk that a material adjustment to the carrying amounts of assets and liabilities will be required within the next financial year). This includes, in particular, the nature and carrying amounts of the assets and liabilities concerned at the end of the reporting period (IAS 1.125).
- Disclosures on material items of income or expense (nature and amount) (IAS 1.97).

Reporting by operating segments according to IFRS 8

- Entity-wide disclosures, i.e., information about geographical areas (IFRS 8.33)
    - Revenues generated from external customers, separated into revenues to customers in the reporting entity's country of domicile and revenues to customers in foreign countries. If the revenues with an individual foreign country are material, separate disclosures are required.
    - Specified non-current assets located (i) in the entity's country of domicile and (ii) in all foreign countries in total. If assets in an individual foreign country are material, separate disclosures are required.

      Materiality/significance in this context is not defined in IFRS 8. Independent of the thresholds according to the entity-specific accounting method (or (group) accounting guideline), it is recommended in the context of the war in Ukraine to also report lower values voluntarily. Such voluntary information could be important against the background that the countries directly affected (Russia, Belarus, Ukraine) may be affected as a whole rather than individually.
- Information about major customers with more than 10 % of the entity's total revenue. A major customer also includes groups of entities being under common control, to the extent known to the reporting entity (IFRS 8.34).

Other disclosures

- Disclosures on government grants (see IAS 20.39).
- Qualitative and quantitative disclosures on credit risk, liquidity risks and market risks that arise from financial instruments to which the entity is exposed at the end of the reporting period. In case of doubt, these disclosures must be made separately for the countries concerned (see IFRS 7.31-42).

- Sensitivity disclosures for recurring fair value measurements categorised within Level 3 of the fair value hierarchy (see IFRS 13.93(h)).
- Disclosures on plan assets. Presentation may need to be undertaken with greater disaggregation than is usually appropriate (i.e., at the level of the countries concerned, see IAS 19.136(a)).
- Disclosures on non-adjusting events after the reporting period (see IAS 10.21).

Question 4.7.3: Which disclosures should be considered in condensed interim financial statements in accordance with IAS 34?

Disclosures in a condensed interim financial statement are limited to 'significant events and transactions' as defined in IAS 34.15-15C and to 'other disclosures' explicitly listed in IAS 34.16A.

According to the disclosure requirements in IAS 34.15-15C an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period must be included. The list of examples in IAS 34.15B(a)-(m) is not exhaustive. In the context of the war in Ukraine, e.g., impairment losses on non-financial and financial assets, credit defaults, changes in the business circumstances and changes in the classification of financial assets may be relevant. Therefore, it is recommended to follow the disclosures that also have to be made in annual financial statements (see question 4.7.2.).

Of the disclosures listed in IAS 34.16A, the following could be particularly relevant:

- Nature and amount of items that are unusual because of their nature (IAS 34.16A(c))
- Nature and amount of changes in estimates (IAS 34.16A(d))
- Disclosures on changes in the composition of the entity (IAS 34.16A(i))
- Sensitivity disclosures for recurring fair value measurements of financial instruments categorised within Level 3 of the fair value hierarchy (IAS 34.16A(j) in conjunction with IFRS 13.93(h))
- Events after the reporting date of the interim financial statements (IAS 34.16A(h)).

5. Impact on the audit of the financial statements

5.1. Impact on risk identification and assessment

Question 5.1.1.: Is there an increased risk of material misstatement in the financial statements as at 31.12.2021 in connection with the current war induced events?

In some cases, yes. The impact of the Ukraine war may increase the risk of material misstatement resulting both from error and from fraud. As part of the auditor's risk assessment, the auditor must assess the factors for any possible increased risk. The basis for this assessment is to obtain an understanding of the entity to be audited, its legal and business environment and the internal control system (for examples of aspects of obtaining an understanding that are relevant in the context of the war events, see question 5.1.2.).

An increased risk of misstatements in the financial statements as at 31 December 2021 resulting from errors may impact the report on subsequent events in the notes in particular (see questions 2. 2. to 2. 4.) as well as the forecast report and the risk report within the management report (question 2. 6.). This may be the case, for example, when potential adjusting events occur shortly before the planned date of the auditor's report and management is under high time pressure in determining and reflecting the events in the financial statements and the management report.

Furthermore, the risk of misstatement due to error in the forecast report and risk report within the management report may be increased if, as a result of the war induced events, the forecasting uncertainty has increased significantly from the point of view of the audited entity (see IDW AsS 350 (Revised), para. 43 et seq.). Forecasting uncertainty may be increased in the following cases, for example (see also the aspects of gaining an understanding listed in question 5.1.2:

- The supply chains (procurement side) involve entities with their headquarters and/or main area of activity in the war zone. •
- The supply chains (procurement side) involve companies that are subject to sanctions, e.g. by the European Union or the USA. •
- Major sales markets are within the war zone. •
- Major sales markets are no longer accessible as before due to sanctions against previous business partners or the entity withdraws voluntarily from these markets. •
- The likely development of the projected financial performance indicators depends significantly on the development of the capital markets. •

- The entity has made high investments in the war zone or in Russia/Belarus and/or has high amounts due from business partners directly or indirectly affected by the Ukraine war.
- The entity operates an energy-intensive production and is expected to be severely affected by rising energy prices as a result of the war induced events.
- The entity is an electricity and gas supplier who is affected by rising costs of security deposits in trading as well as replacement risk in the event of a default by its contractual partners.
- The entity operates in an industry that will be strongly affected by a weakening investment and consumer climate as a result of the war.

The auditor's risk identification and assessment procedures also include the identification of any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (see IDW AuS 270 (Revised), para. 15 and A5). The impact of the war induced events may lead to such events or circumstances (for the assessment and evaluation of the going concern assumption, see question 2. 5. or section 5.3.).

The risk of material misstatement due to fraud may be increased, in particular, if the entity fears a slump in demand due to the war induced events and the management is under high pressure, for example, to achieve certain financial targets in the future or there are incentives to maximize the financial targets for the financial year subject to audit.

Question 5.1.2.: What is the impact of the war events on risk identification and assessment in the audit of financial statements for reporting dates after the outbreak of war?

As part of the auditor's activities to identify and assess risks of material misstatement in the financial statements, the auditor must obtain an understanding of the entity to be audited, its legal and economic environment and the system of internal control (see*. IDW PS 261(Revised), para. 13 et seq.* paragraph 13 et seq.; ISA [DE] 315 (Revised), paragraph 11 et seq.). In connection with the war events, the following aspects, among others, may be of importance in obtaining this understanding (see also the cases of possibly increased forecast uncertainty mentioned in question 5.1.1):

- Impact of the war on the stability of supply chains and the prices of raw materials, intermediate products and services to be procured
- Impact of the war on investment climate and the possibility and intention to continue operating in the sales markets in Russia and Belarus
- Existence, nature and extent of restrictions on control rights in relation to subsidiaries located in Russia or Belarus (see also sections 3. and 4.1.)

- Risks from possible forced administration and subsequent expropriation of Russian investee companies
- Divestments and demergers/unbundling of group structures already carried out or planned
- Type and scope of assets for whose valuation an increased forecast uncertainty is to be taken into account, e.g., in the case of valuation with an income capitalization approach or discounted cash flow method
- Effects of the sanctions imposed on Russia and Belarus or on certain individuals as a reaction to the war of aggression and possible counter-reactions on the company and its business partners (see also Chapter. 6)
- Consideration of the respective current sanctions framework in the company's accounting-related system of internal control, e.g., with regard to the effects on the accounting of pending sales and procurement transactions (see also questions 3.4.1. and 4.5.1.).
- Existence, nature and extent of any restrictions on the disposal of cash and cash equivalents of subsidiaries located in Russia due to Russian countermeasures to prevent capital outflows (see also sections. 0. and 4.4.)
- Effects of the possibility for Russian persons and companies to use intellectual property, such as patents of patent holders from the EU, among others, without their consent and without paying a fee.
- The nature and extent of claims against Russian persons or companies, including those requiring authorization from Russian authorities for settlement
- The extent to which the entity is exposed to heightened risks of cyber-attack that may affect accounting-related IT systems and management's preparedness for such cyber-attack.

The aforementioned aspects can increase the complexity of the preparation of financial statements and the degree of subjectivity in the recognition and measurement of items in the financial statements and in the presentation in the notes and management report. Complexity and subjectivity can increase the vulnerability of financial reporting to unintentional misstatements. The dynamics of change in the legal and economic environment associated with the war (e.g., expansion of EU sanctions as well as countermeasures from the Russian side) can also increase the susceptibility to errors.

The risk of material misstatements due to fraudulent acts may also be increased due to the war events (for audit procedures for risk assessment see *IDW PS 210*, para. 22 et seq.; ISA [DE] 240, para. 17 et seq.), e.g., in the following cases:

- The company has to shut down production due to problems in the supply chain or suffers a slump in sales as a result of withdrawal from markets in Russia and Belarus, and there is high pressure on management to achieve certain financial targets anyway. This can lead to an increased risk of early revenue recognition or the recognition of fictitious revenues and the omission of necessary impairments.
- The company is currently not yet significantly affected by the war events. However, it is expected that a possibly weakening investment and consumption climate could have a strong impact on the company in the future. Against this background, there are incentives for the 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 business year, overvaluing provisions or undervaluing inventories (see also question 5.1.1. on the audit of accounting for reporting dates before the outbreak of war).

The auditor's risk identification and assessment procedures also include the identification of any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (see *IDW PS 270 (Revised)*, paragraphs 15 and A5). The effects of the war events may lead to such events or circumstances (for the assessment and evaluation of the going-concern premise, see. question 2.5. or section 5.3.).

5.2. Determination of relevant events occurring after the reporting period

Question 5.2.1: The development of the war and the reactions to it in the form of sanctions and other measures may lead to events relevant to the report on subsequent events or the disclosure in the management report occurring (possibly shortly) before the planned date of the auditor's report. How can the auditor react in this situation in order to assess whether the events have been appropriately reflected in the financial statements and, where applicable, the management report?

The auditor has to assess the effects of events after the reporting period on the entity's financial reporting as well as on the auditor's reporting in the long-form audit report and the auditor's report. By performing suitable audit procedures, the auditor must obtain sufficient appropriate audit evidence to identify events between the balance sheet date and the date of the auditor's report that may have an impact on the financial reporting (see IDW AuS 203 (Revised), para. 11; ISA [DE] 560, para. 6). The potential effects on financial reporting include, for example, necessary disclosures in the report on subsequent events for non-adjusting events and related additions to or adjustments of the risk report or forecast report within the management report (for the classification of the outbreak of war as giving rise to non-adjusting events see question 2.1.), as well as the necessity of appropriate disclosures in the event of a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as going concern (see question 2. 5.). At the same time, it must be ensured that non-adjusting

events occurring after the reporting period are not reflected in the statement of financial position and statement of financial performance, with the exception of a necessary departure from the use of going concern basis of accounting (see IDW AuS 203 (Revised), paras. 9 and 11).

The determination of events between the reporting date and the date of the auditor's report includes the following audit procedures (see IDW AuS 203 (Revised), para. 13 et seq.; ISA [DE] 560, para. 7, A7 et seq.):

- Obtain an understanding of the actions taken by management to ensure full recognition of the effects of the Ukraine war relevant to the annual financial statements and management report.
- Critical reading of minutes of shareholders' meetings and board/management meetings that may have already taken place since the beginning of the war.
- Critical reading of entity-internal ad hoc reports or similar on the effects of the war on the entity.
- Inquiring of management and, where applicable, those charged with governance about the effects of the war induced events on the entity, e.g, with regard to suppliers, sales markets or investments in the war zone or in Russia/Belarus, as well as with regard to dependencies on the development of the capital and energy markets.

In the case of audits of consolidated financial statements, the group auditor must ensure that for those components whose “reporting packages” are subjected to audit procedures the relevant events after the reporting period related to the Ukraine war are identified and assessed within the framework of “subsequent events reporting” (see IDW AuS 203 (Revised), para. 17; IDW AuS 320 (Revised), para. 35). When the reporting package of a component is subject to review by an auditor, see para. 36; with the same in ISA [DE] 600, para. 38 et seq.). For this purpose, it can also be helpful for the group auditor to supplement the audit instructions for component auditors accordingly.

If having to perform further audit procedures has an impact on the timing of the audit, e.g., if new events occur shortly before the planned reporting schedule, the auditor must communicate with those charged with governance on this matter (see question 5.9.1.).

5.3. Evaluation of prospective financial information including the use of going concern basis of accounting and prospective disclosures

Question 5.3.1: Is a limitation on the scope of the audit to be assumed if prospective disclosures in the financial statements or the management report are subject to an exceptionally high degree of uncertainty as a result of the current war?

A modification of the opinion in the auditor's report due to a limitation of the scope of the audit is only considered if the auditor, after exhausting all reasonable possibilities, is not able to obtain sufficient appropriate audit evidence on the financial reporting information of the audited entity. The significant uncertainties inherent in the forward-looking matters in the financial statements (e.g. liquidity forecast for the purpose of assessing the ability to continue as a going concern, forecast of future surpluses for the purpose of valuing assets using the capitalized earnings value or discounted cash flow method) and in the prospective disclosures in the management report that are due to the dynamic development and unclear consequences of the war induced events do not, by themselves, establish the existence of a limitation of the scope of the audit. A limitation of the scope of the audit with regard to prospective financial information may exist, for example, if the auditor is unable to obtain sufficient appropriate audit evidence for the purpose of assessing the managements' underlying assumptions (see question 5.3.2.).

Question 5.3.2: How can the auditor evaluate the assumptions made by management?

A forecast includes managements' assumptions as to the occurrence of future events (e.g., on the (global) economic consequences of the war and the of the imposed sanctions on supply chains, interest rate development and inflation) as well as on the executive directors' intended actions (e.g., regarding the adjustment of supply chains and the countermeasures to expected price increases for energy purchases).

Managements' assumptions must be sufficiently justified. The auditor will therefore regularly assess whether they are based on current information, whether they are consistent with the assumptions made internally for other purposes (e.g. updated budget planning as a result of the current war induced events) and whether they can be reconciled with any external forecasts of macro-economic development that take account of the war induced events that may already be available at the time the preparation of the financial statements and the management report is completed (date of the auditor's report). (e.g., with the updated economic forecast for the years 2022 and 2023 published on 30 March 2022 by the German Council of Economic Experts). In addition, it will be necessary to assess whether, the initial short-term measures and actions already taken by management do not contradict the assumptions made. The auditor's opinion, on the other hand, does not include any statement as to whether the expectations underlying the prospective financial information will materialize.

<u>Question 5.3.3:</u> Due to the high degree of uncertainty regarding the effect of the war induced events on the audited entity's industry, the management does not want to make a going concern forecast under [German] commercial law, as they do not believe that they can assess the probabilities of conceivable future scenarios with any degree of certainty. How does the auditor deal with this?

Managements' assessment of the company's ability to continue as a going concern is a prerequisite for the preparation of HGB financial statements and affects questions concerning recognition, measurement (Article 252 para. 1 no. 2 HGB), presentation and/or the notes to the financial statements (see IDW AcS HFA 17). Thus, it is ultimately necessary for management to make an assessment of the entity's ability to continue as a going concern when preparing any HGB financial statements, (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 judgement as to inherently uncertain future effects of events or circumstances by the executive directors at a certain point in time (see also IDW AuS 270 (Revised), para. 8*; on the forecast horizon, see* 8; on the forecast horizon, see question 3.4.11. of the IDW's technical guidance on the effects of the coronavirus on accounting and its audit, Part 3, 5th update of April 2021 (available at: https://www.idw.de/idw/themen-und-branchen/coronavirus)). The war induced events have increased the uncertainties in many cases. Scenario analyses can address these (see question 2.1.5.). These uncertainties do not justify the waiver of an assessment of the company's ability to continue as a going concern.

Furthermore, a detailed analysis by the executive directors as a basis for assessing the entity's ability to continue as a going concern is of heightened importance, at least in the case of entities that are severely affected by the war, e.g., because they have made significant investments in the war zone or in Russia/Belarus.

If the executive directors are 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 consider the implications for the auditor's report (see IDW AuS 270 (Revised), para. 33).

5.4. Special issues for the performance of audits of consolidated financial statements

<u>Question 5.4.1:</u> What problems can arise in the context of group audits when obtaining audit evidence if there are subsidiaries based in Ukraine or in Russia or Belarus, and how can the group auditor react to this?

The specific impact on the audit of the consolidated financial statements depends strongly on the respective circumstances. Problems in obtaining audit evidence may arise, for example, when

- access to the permanent establishments of a subsidiary is difficult or impossible for the component auditor or the group audit team,
- Accounting staff of the component are no longer available or are no longer available to a sufficient extent to provide information and generate evaluations from the IT system, or
- designated component auditors are no longer available, or they no longer have sufficient personnel or other resources available.

If the problems are rooted in the accounting system of the component, it must first be considered whether the parent company may not be able to obtain the information required for the preparation of the consolidated financial statements without disproportionately high costs or unreasonable delays. In this case, from the point of view of a parent company that prepares consolidated financial statements in accordance with the German Commercial Code (HGB), a waiver of the consolidation of the respective subsidiary in the consolidated financial statements can be considered (see question 3.1.2.).

In all other cases, as part of the audit planning, the group auditor must determine how to deal with any aforementioned problems in obtaining audit evidence. In part, these problems can possibly be countered by the component auditor or the group audit team performing remote audit procedures (see in detail on the possibilities and limits of remote audit procedures the IDW's Technical Guidance on the Impact of the Corona Virus on Accounting and Auditing, Part 3, 5th Update of April 2021, esp. question 3.3.1. and Annex 1 (available at: https://www.idw.de/idw/themen-und-branchen/coronavirus)). In principle, the postponement of audit procedures can also be considered if there is a reasonable expectation that the access and resource problems will be solved within a reasonable period of time.

Furthermore - if also necessary in addition to performing remote audit procedures - the group audit team may consider whether it is possible to change the planned audit procedures in relation to the financial information of a component, e.g., performing substantive audit procedures (remotely if necessary) instead of performing control tests on which the group audit team originally intended to rely. If component auditors are no longer available to the extent necessary, the group audit team must reassess its own involvement in the risk assessment and the performance of audit procedures on the component's financial information (see *IDW PS 320 (Revised)*, para. 28 et seq.; see also question 5.4.2.).

The need to change the audit approach may also arise when obtaining confirmations from third parties (external confirmations) as evidence of certain matters reflected in the reporting package. For example, it may not be possible to obtain bank confirmations from certain banks located in Russia, or the reliability of the confirmations may be questioned. In these cases, the group audit team must decide, based on its understanding of the component and the component auditor, whether it is necessary to perform alternative audit procedures, taking into account the risk assessment for the consolidated financial statements (see *IDW PS 302*

(Revised), para. 24; ISA [DE] 330, paras. 19, 27). If this is considered necessary, the component auditor must be given appropriate alternative instructions, or the group audit team must perform the alternative audit procedures itself.

If the group auditor is unable to obtain sufficient appropriate audit evidence for material representations in the financial information of a subsidiary located in Ukraine, Russia or Belarus, the auditor must assess the effects on the audit opinions on the consolidated financial statements and group management report (see *IDW PS 320 (Revised)*, para. 42; ISA [DE] 600, para. 44).

Question 5.4.2: From the perspective of the group auditor, what should be considered if a component auditor based in Russia or Belarus is no longer a member of the group auditor's network?

Leaving the network regularly results, among other things, in the component auditor no longer being able to draw on professional and technological resources of the network, no longer being involved in network-wide quality assurance measures and no longer being subject to the network's quality assurance rules, and it can no longer be assumed that the component auditor applies the same audit methodology as the group auditor. As a result, the scope of the audit procedures to obtain an understanding of the component auditor will regularly increase (see *IDW PS 320 (Revised)*, paragraph 16 and A17; ISA [DE] 600, paragraph 19 and A33 et seq.). This concerns e.g., the following aspects:

- whether the component auditor complies with the professional duties relevant to the audit of the consolidated financial statements, in particular independence and impartiality
- whether the component auditor has sufficient professional competence
- whether the group audit team can be involved in the work of the component auditor to the extent required by *IDW PS 320 (Revised)* or ISA [DE] 600.

Due to the current political situation in Russia and Belarus, there may be concerns as to whether component auditors are under undue pressure and, as a result, their independence and objectivity may be compromised. It may also be questionable whether component auditors, shortly after leaving an auditor network, already have other human, professional and technological resources as well as quality management in place to continue to perform the audit competently. It will therefore often not be sufficient to obtain written confirmations from the component auditor; instead, further audit procedures will be necessary (see *IDW PS 320 (Revised)*, para. A22; ISA [DE] 600, para. A35).

The group audit team must not use the work of the relevant component auditors or request the relevant component auditors to perform work in relation to components if serious concerns remain in relation to the above aspects. In this case, the group audit team must obtain sufficient appropriate audit evidence on the accounting information of the components without relying

on the work of the relevant component auditors (see *IDW PS 320 (Revised)*, para. 7; ISA [DE] 600, para. 20). This applies in particular to concerns about independence. The fact that a component auditor is not independent cannot be compensated for by the group audit team extending its involvement in the component auditor's work or performing further audit procedures on the component's accounting information itself. In contrast, less serious concerns about the professional competence of a component auditor (e.g., due to the not yet fully compensated loss of certain professional or technological resources of the network) can, if necessary, be compensated by the group audit team being involved to a greater extent in the work of the component auditor or performing additional audit procedures of its own (see *IDW PS 320 (Revised)*, paragraph A21).

5.5. Reporting on material uncertainties related to events or conditions that may cast significant doubts on the entity's ability to continue as going concern and on "facts impairing the entity's development"

Question 5.5.1: In which cases must the auditor's report include a reference to a material uncertainty?

A "material uncertainty" exists if the use of going concern basis of accounting is appropriate but, notwithstanding this, there are material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. This is the case if the entity may not be able to realize its assets and settle its debts in the ordinary course of business (IDW AuS 270 (Revised), paras. 23, 24 lit. b). If, for example, reorganization measures necessary for the continuation of the company's activities have not yet been initiated at the time of issuing the auditor's report, but are planned, and if their realization is uncertain, this is an indication of the existence of a material uncertainty.

If there is a material uncertainty, appropriate information to the users of the financial statements is required in the financial statements and – when relevant – in the management report (see question 2. 5.). In this case, the auditor must include a corresponding reference in the auditor's report (separate section with the heading "Material uncertainty related going concern"; see Article 322 para. 2 sentences 3 and 4 HGB as well as IDW AuS 270 (Revised), para. 29)**?**

Question 5.5.2.: Under which conditions must the effects of the current war induced events be qualified as "facts impairing development"?

Pursuant to Article 321 para. 1 sentence 3 HGB, the auditor must report in the long-form audit report, in addition to material uncertainties, on facts ascertained during the performance of the audit which materially impair the development of the audited entity. Facts impairing development will regularly precede a material uncertainty. However, they must be facts that cause the entity to be in more than just a strained financial situation. These might relate to

facts such as a “break” from central, previously positive trends, a strong decline in incoming orders, a strong increase in procurement prices, the loss of important sales markets or sanctions against significant business partners, which have serious effects on the business activity or profitability, but which do not in the foreseeable future give rise to risks that the entity will cease operations. It will not always be possible to make a clear distinction between facts that impair development and a material uncertainty and so this must always be assessed on the basis of the circumstances of the individual case.

For the differences in the auditor's reporting on facts impairing development compared to the reporting on a material uncertainty (including the differences in the presentation in the financial statements), see the IDW's Technical Guidance on the impact of the spread of coronavirus on financial statements and their audit, Part 3, Update No. 5 April 2021 (available at: https://www.idw.de/idw themen-und-branchen/coronavirus).

5.6. Reporting on Key Audit Matters

<u>Question 5.6.1.:</u>Can the impact of current war induced events be significant in reporting Key Audit Matters (KAM) in the auditor’s report?

If IDW AuS 401 “Communication of Key Audit Matters in the Auditor's Report” is applicable to the audit of the financial statements, the current war induced events may give rise to a key audit matter (KAM) to be reported in the auditor's report. IDW AuS 401, para. 9, defines KAMs as those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements for the current period. KAM are selected from matters discussed with those charged with governance (see section 5.9.). This includes the "most significant assessed risks of material misstatement", which are selected in accordance with Article 10 para. 2 lit. c of the EU-Audit Regulation and must be described in the auditor’s report to support the audit opinion.

In order to determine the KAM, it is first necessary to determine those matters discussed with those charged with governance which required significant auditor attention in performing the audit (see IDW AuS 401, para. 12 et seq.). The determination of these matters and the selection of those matters that were of most significant in the audit may have been influenced by the effects of the Ukraine war. For example, consideration should be given to the following:

- *Identified* events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The assessment of whether the use of going concern basis of accounting is appropriate and whether there is a material uncertainty may be subject to a high degree of uncertainty for entities severely affected by the impact of the war induced events. This may also result in a higher risk assessment by the auditor with regard to the appropriateness of maintaining the use of going concern basis of accounting or the appropriateness of disclosures on material uncertainties, which may

indicate the existence of a KAM (see. *IDW AuS 401*, para. 12a; on the consequences for the auditor's report if the material uncertainty represents a "highly significant assessed risk of material misstatement" within the meaning of Article 10 para. 2 lit. c EU-APrVO, see *IDW AuS 270 (Revised) (10.2021)*, paragraph 35 and A45 et seq.). This is also already relevant for audits of financial statements prepared as at 31 December 2021.

- *Problems in obtaining sufficient appropriate audit evidence*: War-related circumstances can lead to problems in obtaining sufficient appropriate audit evidence, particularly in the case of audits of consolidated financial statements (see section. 5.4.), but also in the case of audits of annual financial statements (e.g., of branches or affiliated companies in Ukraine, Russia or Belarus), may lead to problems in performing audit procedures and obtaining relevant and reliable evidence as a basis for the audit opinion (see *IDW PS 401*, paragraph A30). This may also be relevant for audits of financial statements prepared for 31 December 2021.
- *Certain events or transactions that have a significant impact on the financial statements*: The impact of war may include developments that affect multiple financial statement line items in different ways and/or result in unusual or non-recurring transactions (e.g., new impairments of non-financial or financial assets or deconsolidation of operations).
- *High estimation uncertainties*: KAM can also relate to estimated values that are subject to high estimation uncertainty due to the dynamic development and unclear consequences of the war events. This applies even if there is no significant risk in this respect. Such estimated values are, among other things, highly dependent on the judgement of the executive directors, often concern the most complex areas of the financial statements and may therefore require the involvement of both an expert of the executive directors and an expert working for the auditor (see *IDW PS 401*, paragraph A26).

5.7. Inclusion of an emphasis of matter paragraph relating to the war induced events in the auditor’s report

<u>Question 5.7.1.</u>: Under what conditions can an emphasis of matter paragraph be included in the auditor's report? When shall an emphasis of matter paragraph not be included??

IDW AuS 406, para. 10, regulates the requirements for including an emphasis of matter paragraph in the auditor's report. Frequent use of an emphasis of matter paragraph may reduce the effectiveness of such communications by the auditor. Therefore, as a general rule, the auditor must only include an emphasis of matter paragraph in the auditor's report if he considers it necessary to draw the users’ attention to a matter presented or disclosed in the financial statements, the management report or in other material subject to the audit which, in

his opinion, is of such significance that they are of fundamental importance to users' understanding of the subject matter of the audit.

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

- because of the specific circumstances, the audit opinion has to be modified pursuant to IDW AuS 405, e.g., because the management of the audited entity has not adequately presented the effects of current events in the financial statements and management report
- because of the specific circumstances a reference to a material uncertainty related to going concern (going concern risks) is required in accordance with IDW AuS 270 (Revised) (see section 5.5.), or
- the matter has been identified as a key audit matter to be reported in the auditor's report in accordance with IDW AuS 401 (see section 5.6.).

Furthermore, an emphasis of matter paragraph may not be included if the matter relates to another matter subject to the audit that is only to be reported on within the long-form audit report, e.g., the results of the audit of the risk early warning system pursuant to Article 317 para. 4 HGB.

As to whether, or in which constellations, the inclusion of an emphasis of matter paragraph in connection with the current war induced events can be considered, see the explanations on question 5.7.2.

Question 5.7.2.: In which cases may it be appropriate to include an emphasis of matter paragraph relating to the current war induced events?

IDW AuS 406, para. A8, gives examples of where the auditor may consider it necessary to include an emphasis of matter paragraph, such as a significant event that occurred between the reporting date and the date of the auditor's report or a catastrophic event that has had or continues to have a significant effect on the financial position or performance of the entity

When auditing financial statements and management reports prepared as at 31 December 2021, the auditor may consider an emphasis of matter paragraph in connection with the current war induced events necessary, in particular, if the information provided in this regard in the report on subsequent events and the presentations in the forecast report and risk report within the management report are of fundamental importance for the understanding of the financial statements and the management report (see also IDW AuS 406 (Revised), Annexes 1 and 2). This applies all the more if the future effects on the net assets, financial position and financial

performance depend heavily on the further course of the war and the reactions thereto and therefore considerable uncertainties remain

Even when there is a departure from the going concern accounting principle, the auditor may consider it appropriate to draw the attention of the addressees to this fact (see also IDW AuS 270 (Revised), para. A33 and Example 5 of Annex 1 to IDW AuS 270 (Revised)).

The effects of the outbreak of war are to be processed in the accounting for reporting dates after 24.02.2022 (see Chapters **Fehler! Verweisquelle konnte nicht gefunden werden.**. and 4.). The report on subsequent events as a "corrective" is therefore often no longer of the same fundamental importance in this context as it may be for the reporting date 31.12.2021. Emphasis of matter paragraphs should therefore only be used within narrow limits (for selected examples in connection with the effects of the Corona pandemic, see the IDW's Technical Guidance on the effects of the Corona virus on accounting and its audit, Part 3, 5th update of April 2021, esp. question 3.7.4. (available at: https://www.idw.de/idw/themen-und-branchen/coronavirus).

5.8. Reporting on sanctions offences (breaches)

Question 5.8.1: How should the auditor report on identified breaches of EU sanctions?

Pursuant to Article 321 (1) sentence 3 HGB, the auditor must report in the long-form audit report, among other things, on severe violations of law and regulations found during the performance of the audit that do not have a direct effect on the financial statements, i.e. not relate to the provisions applicable to the preparation of the annual financial statements or management report, including the principles of proper accounting ("other violations of the law" as defined by *IDW PS 210*, paragraph 7). The statutory provisions covered by Article 321 (1) sentence 3 HGB also include the EU regulations on which the sanctions against Russia and Belarus are based (for further information on the EU sanctions, see question 6.2.1.).

Violations of EU sanctions constitute criminal offences or administrative offences (Articles 18, 19 Foreign Trade and Payment Act (Außenwirtschaftsgesetz, AWG), Article 82 Foreign Trade and Payment Ordinance (Außenwirtschaftsverordnung, AWV; see question 6.3.1.). The resulting risk for the entity as well as other conceivable risks associated with a breach of a sanction, such as reputational risks, as well as the significance of the relevant EU legal norms, which must be classified as high against the backdrop of the war, indicate overall that sanction breaches are to be assessed as serious within the meaning of Article 321 para. 1 sentence 3 HGB (on the criteria see *IDW PS 450 (Revised), para.* 49). It is irrelevant for the initiation of the reporting obligation whether the violations are intentional or unintentional.

Moreover, it is sufficient for the reporting obligation if the facts that have come to the attention of the auditor indicate a breach of sanctions (see Article 321 (1) sentence 3 HGB: "indicate"). It is not the auditor's responsibility to clarify cases of doubt conclusively. Regarding the

understanding of the sanctions relevant for the entity to be audited, including the relevant internal controls of the entity, which must nevertheless be obtained within the scope of the audit procedures for risk assessment, see question 5.1.2.

Auditors of public interest entities, if they have reasonable grounds to suspect that sanctions breaches may occur or have occurred, must also comply with Article 7 EU-Audit Regulation (Regulation (EU) No 537/2014). According to this article, the auditor must inform the authority responsible for investigating the violation if the entity does not adequately investigate the matter after the auditor has informed the entity (see in detail IDW Position Paper on Doubtful Issues in EU Regulation, 6th supplemented edition, section 14.2., available at https://www.idw.de/idw/medien/idw-positionspapiere). In principle, according to Article 323 (5) HGB, reports must be made to the BaFin [Bundesanstalt für Finanzdienstleistungsaufsicht German Federal Financial Supervisory Authority], and in the case of suspicion of a criminal offence or misdemeanor also to the respective authority responsible for prosecution (Article 323 (5) HGB), i.e. in the case of a criminal offence to the public prosecutor's office responsible for criminal prosecution and in the case of a misdemeanor to the responsible administrative authority.

For provisions for liabilities for an impending administrative penalty or fine, see question 3.4.1.

5.9. Communication with those charged with governance

<u>Question 5.9.1.:</u>Which aspects of the effects of the Ukraine war does the auditor need to communicate with those charged with governance?

The auditor's responsibilities to communicate with those charged with governance depend on the significance of the current war induced events for the entity's business. The matters to be communicated may include, for example, the following:

- Information on impacts on the planned scope and timing of the audit, e.g., if new events occur shortly before the planned reporting schedule that have possible impacts on the report on subsequent events and the presentation in the management report (see IDW AuS 470 (Revised), paras. 20 and A16 et seq.).
- Reporting on significant problems encountered in obtaining audit evidence, especially if the entity operates in a war zone or in Russia/Belarus (see IDW AuS 470 (Revised), paras. 21b and A26); if there is a limitation on the scope of the audit s which, according to IDW AuS 405, leads to a modification of the audit opinion on the financial statements in the auditor's report (e.g., if the reporting package of a significant component cannot be audited), this must be mentioned (see IDW AuS 470 (Revised), para. 21d) *(also concerns modifications due to objections*).

- Exchange of information on events or circumstances identified as induced by the war that could raise significant doubts about the entity's ability to continue as a going concern (see IDW AuS 270 (Revised), para. 34)).
- For audits of public interest entities: Notification of identified or suspected material breaches of sanctions including the request to investigate the facts and to take appropriate measures to deal with them and to prevent a repetition of breaches or information on the corresponding request issued to the executive directors (see Article 7 EU-Audit Regulation).
- For audits of public interest entities: Discussion of those effects of the war induced events which are to be regarded as matters to be treated as key audit matters (KAM) from the point of view of the auditor (see section 5.6.) (see IDW AuS 401, para. 20; IDW AuS 470 (Revised), paras. 21d and A28).
- Discussion of the intention to an emphasize separately in the auditor's report a fact presented in the financial statements or management report in connection with the war induced events (see section 5.7.) (see IDW AuS 406, para. 15; IDW AuS 470 (Revised), paras. 21d and A28).
- Discussion of war events as a significant source of estimation uncertainty if this is a significant qualitative aspect of the accounting practice of the entity concerned (see *IDW AuS 470 (Revised)*, para. 21a).

5.10. Responsibilities after the date of the auditor’s report

Question 5.10.1: How should the auditor deal with war induced events occurring after the date of the auditor’s report if there is evidence that they have a material effect on the audited entity?

After the date of the auditor’s report, the auditor is generally not obliged to perform further audit procedures on the audited annual financial statements and, when applicable, the management report (see IDW AuS 203 (Revised), para. 18 et seq.; ISA [DE] 560, paras. 10 and 14). If, however, there is a not inconsiderable period of time between the date of the auditor's report and its issuance, or if the occurrence of significant events is to be expected even in the case of a shorter period of time, the auditor must clarify with the entity’s management before the issuance of the auditor's report whether events and developments in the meantime affect the statement made in the auditor's report (see *IDW AuS 203* (Revised), *para.* 18 et seq.).

The further developments of the events of the war after the date of the auditor's report do not lead to the conclusion that the financial statements and/or the management report would have been inaccurate at the date of the auditor's report. This also applies if these developments include adjusting events that did not yet exist at the date of the auditor's report or if they are new non-adjusting events, which are “event of special significance” and therefore would have

to be reported in the report on subsequent events and, if applicable, would influence the forecast report and opportunity/risk report within the management report. Therefore, this is not a reason to withdraw the auditor's report.

However, in the event of circumstances coming to the auditor's attention, during the period in which to the auditor's knowledge the financial statements have not yet been approved and established (e.g. by the supervisory board, which may be of very high significance for the audited entity, it seems appropriate that the auditor would draw to the attention of the corporate bodies responsible for the preparation (management board) and approval (e.g. supervisory board) of the financial statements their respective responsibilities for assessing the need to amend the financial statements (see also question 2. 7.).

If the corporate bodies decide to amend the financial statements and/or the management report, these must be audited by way of a supplementary audit pursuant to Article 316 para. 3 sentences 1 and 2 HGB to the extent required by the amendments. As a rule, the auditor is not obliged to perform more extensive audit procedures within the scope of the supplementary audit. The situation is different if the effects of war induced events that have occurred since the original date of the auditor's report contain indications that the going concern assumption is no longer justified or that there is a material uncertainty in connection with the going concern assumption. In this case, the auditor must update his evaluation of the appropriateness of the use of going concern as the basis of accounting, including the assessment of appropriate disclosures in the financial statements when a material uncertainty exists, as part of the supplementary audit (see the minutes of the 234th HFA meeting, FN-IDW 2/2014, p. 198).

If the corporate bodies - notwithstanding the auditor's reference to their responsibilities - decide not to amend the prepared and audited financial statements and/or management report before the financial statements are adopted, even though it can be assumed that the duties of the corporate bodies would require this against the background of events that have occurred in the meantime (see question 2.7.), this does not constitute grounds for revoking the auditor's report. The violation of the duties of the corporate bodies does not change the fact that the prerequisites for the issuance of the auditor's report existed on the date of the auditor's report at which point the relevant war events had not yet occurred.

5.11. Other aspects

Question 5.11.1: Is it to be expected that how the audit has dealt with the effects of the Ukraine war will increasingly be the subject of external inspections?

In March 2022, the Auditor Oversight Authority (APAS) expanded its 2022 work program with regard to the effects of the war in Ukraine (available at https://www.apasbafa.bund.de/APAS/DE/Publikationen/Arbeitsprogramme/arbeitsprogramme_node.html). According to this, APAS will deal in inspections with the audit firms' risk assessments of the effects of the Ukraine war and the measures derived from this for the

quality assurance systems as well as successively with individual audits of public interest entities exposed to particular risks from the Ukraine war.

It can also be assumed that, in the case of a corresponding client structure (e.g., group audits of companies with business activities in Ukraine, Russia or Belarus), the appropriateness and effectiveness of the firm's responses to any risks to quality resulting from the war will also be reviewed as part of the external quality control.

6. Impact of sanctions on contractual relations

6.1. Effectiveness of contracts

Question 6.1.1.:Can new contracts that are in breach of EU sanctions be concluded effectively?

No, new contracts that are in breach of EU sanctions already issued are void (Articles 134, 139 BGB [Bürgerliches Gesetzbuch: German Civil Code]. According to Article 134 BGB, a legal transaction that is in breach of legal prohibition is void. The EU sanctions imposed as of 23 February 2022 by amending or extending Regulations (EU) No. 269/2014 and No. 833/2014 apply as direct law in all EU member states. A sanction imposed by means of an EU Regulation is therefore a prohibitory law within the meaning of Article 134 of the German Civil Code. Circumvention transactions are also covered.

Question 6.1.2: Will existing contracts remain effective in the event of a breach of EU sanctions?

Yes, contracts already existing remain effective in principle. In order to be void, the contract must be in breach of a prohibition law at the time the contract is concluded. In principle, EU sanctions do not apply retroactively. Retroactive effect can only be considered in exceptional cases. Insofar as the contract has not yet been fully settled, the old contract clauses or settlement periods for contracts concluded before 26 February 2022 must be observed.

Question 6.1.3.: May the auditor resign from the statutory audit mandate?

In principle, no. An effective audit engagement may only be terminated by the statutory auditor for good cause within the narrow limits of Article 318 para. 6 sentence 1 HGB. However, if by continuing the audit or issuing the auditor's report the auditor would be in breach of EU sanctions, this would probably constitute good cause within the meaning of Article 318 para. 6

sentence 1 HGB. On the other hand, any threat of loss of reputation or image should not be a justifiable cause for resignation.

<u>Question 6.1.4.:</u> May a German public auditor resign from or terminate engagements outside the statutory audit?

In principle, yes. Depending on whether the professional work outside the statutory audit is a contract for work and labor or a contract for services, the respective civil law rules on termination apply.

Since the service provided by a German public auditor generally constitute services of a higher nature based on a special relationship of trust, termination is possible under Article 627 (1) BGB. However, it should be noted that such a termination must not be untimely (Article 627 (2) sentence 2 BGB), otherwise the German public auditor will be liable for damages (Article 627 (2) sentence 2 BGB). This would be the case if the termination takes place at a time when the client is unable to obtain the necessary services of another party - e.g. shortly before the expiry of a (statutory) deadline. However, insofar as the German public auditor would be in breach of EU sanctions by continuing the engagement or providing the service, this would likely constitute good cause under Article 627 (2) BGB, which would also justify a resignation or termination without notice.

Insofar as the law on contracts for work and services is relevant, it also applies here that, insofar as the German public auditor would be in breach of EU sanctions through the continuation of the engagement or the creation and delivery of the work, he is likely to be entitled to terminate the engagement for cause pursuant to Article 648a BGB.

In addition, the general law on breach of contract applies (see question 6.1.5.). With regard to payments of damages, it should be noted that these are covered by the prohibition of performance under Article 10 of Regulation (EU) No 833/2014.

<u>Question 6.1.5.:</u> Are there any other possibilities for the debtor to withdraw from the contract?

If there is a statutory prohibition of performance as a result of a sanction, rescission pursuant to Article 313 BGB ("interference with the basis of the transaction") may be considered. An interference with the basis of the contract exists if circumstances which have become the basis for the contract have changed significantly after the conclusion of the contract and the parties would not have concluded the contract or would have concluded it with different content if they had been aware of these circumstances. In the case of continuing obligations, an extraordinary right of termination for good cause (Article 314 BGB) occurs rather than a withdrawal.

Further possibilities for withdrawal may arise in individual cases from special contractual provisions, e.g., so-called *force majeure clauses* ("force *majeure*") or hardship provisions.

Whether these cover matters subject to legal sanctions has to be determined in the individual case.

Question 6.1.6: Does the debtor have a right to refuse performance?

Insofar as the contract is effective, the debtor may have a right to refuse performance due to impossibility pursuant to Article 275 (1) BGB if the performance would represent a breach of EU sanctions. In this case, there is likely to be a legal impossibility of performance within the meaning of Article 275 (1) BGB. In this case, the obligation to perform or pay lapses by dint of the operation of law.

Insofar as the performance does not cause a breach of EU sanctions, there is still an obligation to perform or pay despite the exclusion of particular Russian banks from the SWIFT payment services system. If necessary, the party obligated to make the down payment or advance payment may, however, invoke the plea of uncertainty pursuant to Article 321 of the German Civil Code (BGB).

Moreover, with regard to other cases of impossibility (e.g., in the case of physical impossibility of performance due to destroyed infrastructure, etc.), it should be noted that for a refusal to perform pursuant to Article 275 (1) BGB, there must be a permanent, i.e. not merely temporary, non-performance. This may be difficult to predict in the case of armed conflicts.

Question 6.1.7.: What happens to the consideration if the debtor refuses performance?

If the debtor does not have to perform according to Article 275 subsection 1 BGB, the claim for consideration (Article 275 subsection 4 in conjunction with Article 326 subsection 1 BGB) lapses. Any consideration already paid must be returned (Article 275 (4) in conjunction with Article 326 (4) BGB). However, the prohibition of fulfilment according to Article 11 of Regulation (EU) No. 833/2014 and Article 11 of Regulation (EU) No. 269/2014 must be observed, which means that repayment claims may not be fulfilled.

The creditor is also entitled to rescind the contract (Article 275(4) in conjunction with Article 326(5) of the German Civil Code) and may, under certain circumstances, assert claims for damages against the debtor (Article 275(4) in conjunction with Article 280 of the German Civil Code). With regard to payments of damages, it should be noted that these are covered by the prohibition of performance under Article 10 of Regulation (EU) No. 833/2014.

Question 6.1.8: What is the provision ban (Article 2(2) of Regulation (EU) No 269/2014)?

The EU sanctions pursue different objectives, such as the freezing of funds, the transfer of funds, the making available of economic resources or the import or export of particular economic goods or commodities. Pursuant to Article 2(1) of Regulation (EU) No 269/2014, all funds and economic resources belonging to natural and legal persons, entities and bodies listed in Annex I to this Regulation shall be "frozen". In addition, the "stand-by obligation"

(Article 2(2) of Regulation (EU) No 269/2014), which is generally binding in all EU Member States, applies. The stand-by ban is a personal measure. In accordance with the prohibition of making available pursuant to Article 2 (2) of Regulation (EU) No 269/2014, no funds or economic resources may be made available, directly or indirectly, to, or for the benefit of, the natural or legal persons, entities or bodies listed in Annex I of that Regulation and the natural or legal persons, entities or bodies associated with them.

With the implementing regulations (EU) 2022/260 and 2022/261 of 23 February 2022, 2022/330 and 2022/332 of 25 February 2022, 2022/336 of 28 February 2022 and 2022/353 of 2 March 2022, the ban on making available, which was already issued in 2014 in the wake of the annexation of Crimea, has now been extended to a larger group of persons following Russia's attack on Ukraine. As the conflict is a dynamic process, it can be assumed that the existing EU sanctions will be continuously revised - i.e., further tightened if necessary - depending on the crisis situation.

Question 6.1.9.: What is to be understood by "funds" and "economic resources" within the meaning of Regulation (EU) No 269/2014?

"Funds" within the meaning of Article 2(2) of Regulation (EU) No 269/2014 are financial assets and benefits of every nature, esp. cash, cheques, claims on money, bills of exchange, money orders and other payment instruments, deposits with financial institutions or other entities, balances on accounts, claims for payment and securitized receivables, publicly and privately traded securities and debt instruments including stocks and shares, certificates representing securities, bonds, promissory notes, warrants, debentures and derivatives, interest income, dividends and other income or appreciation on assets, loans, rights of set-off, guarantees, performance bonds and other financial claims, letters of credit, bills of lading, instruments of transfer and documents evidencing interests in fund property or other financial resources.

"Economic resources" within the meaning of Article 2(2) of Regulation (EU) No 269/2014 are assets of every nature, whether tangible or intangible, movable or immovable, which are not funds but may be used to acquire funds, goods or services. This includes, in particular, (trade) goods.

Question 6.1.10.: What is to be understood by "indirect provision" within the meaning of Regulation (EU) No 269/2014?

“Indirect provision" occurs if the non-listed addressee is more than 50% owned or otherwise controlled by a listed entity. Such control may exist, for example, through the legal or de facto power to appoint or remove the majority of the members of a management or supervisory

body, but this determination always requires a case-by-case assessment taking into account all the circumstances of the individual case.

6.2. Further information

Question 6.2.1: Where can I get more information on EU sanctions ?

Initial information can be found on the respective websites of the Deutsche Bundesbank (https://www.bundesbank.de/de/service/finanzsanktionen/sanktionsregimes/russland-ukraine--610842) and BAFA (https://www.bafa.de/DE/Aussenwirtschaft/Ausfuhrkontrolle/Embargos/Russland/russland_node.html). The Deutsche Bundesbank is the competent oversight authority for financial sanctions, the BAFA for foreign trade.

Further information can be found in the FAQs of the BMWK (https://www.bmwi.de/Redaktion/DE/FAQ/Sanktionen-Russland/faq-russland-sanktionen.html) and the Deutsche Bundesbank (https://www.bundesbank.de/de/startseite/haeufig-gestellte-fragen-zum-thema-finanzsanktionen-886614), among others.

The BAFA and the Deutsche Bundesbank have also established hotlines for questions of interpretation and application (https://www.bafa.de/DE/Aussenwirtschaft/Ausfuhrkontrolle/Embargos/Russland/russland_node.html; https://www.bundesbank.de/de/service/finanzsanktionen/sanktionsregimes/ukraine-russland-610842).

6.3. Legal consequences of a breach

Question 6.3.1.: Will a breach of EU sanctions be penalized?

Yes, breaches of EU sanctions constitute criminal offences or civil law offences and can be punished with prison sentences of up to five years or fines of up to 500,000 euros (Articles 18, 19 AWG; Article 82 AWV).

German public auditors who have professional contact with natural or legal persons or entities or organizations from Russia should check on a case-by-case basis whether services are being provided that are now prohibited and whether these concern persons or entities that are on the respective current EU sanctions' lists.

When there are factual indications suggesting that a matter may fall within the scope of EU sanctions, it is strongly recommended to seek legal advice (including external advice if necessary). This also applies to any sanction imposed pursuant to US law.