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Expected effects of the Covid-19 pandemic on the IFRS financial statements for the financial year 2020

In the opposite to the financial year 2019, the Covid-19 pandemic will have an effect on the financial statements for the year 2020. The article shows the expected effects of the Covid-19 pandemic on the financial statements according to IFRS, from a German and Swedish perspective. The most probable occurring effects on the balance sheet are asset impairments on non-current assets, recognised expected credit losses on financial assets, asset impairments on inventories and provisions for onerous contracts. Beside the asset impairment expenses, profit and losses from discontinued operations may be disclosed in the statement of profit or loss and other comprehensive income.

1 INTRODUCTION

Sudden changes can occur that affects companies more or less dramatically, for example the Covid-19 pandemic. This may both affect the earnings of the companies as well as the book values of their assets, two key accounting measures.[1] Financial reporting is important for economic decision making. For rational decision making it is important with sufficient, appropriate and relevant financial information.[2] The financial statement users put their trust in the accountants that they can cover the effects of Covid-19.[3] Against this backdrop it is interesting to analyse the possible effects of the Covid-19 pandemic on the financial statements for the financial year of 2020.

The IFRS financial statements of the financial year 2019 were in general not influenced by the economic effects of the Covid-19 pandemic. On the

1 Bepari, M.K. (2015), "Relative and incremental value relevance of book value and earnings during the global financial crisis", International Journal of Commerce and Management, Vol. 25 No. 4, pp. 531–556.

2 Gkouma, O., Filos, F. and Chytis E (2018) Financial crisis and corporate failure: The going concern assumption Findings from Athens stock exchange, Journal of Risk and Control, Vol. 5 No. 1, 141–170.

3 Nichita, M., Paunescu, M and Calu, M. A. (2020) Financial Reporting for Entities Applying IFRS, in the Context of the Corona Crisis, CECCAR Business Review, Vol. 1 No. 5, 13–23.

perspective of the end of the reporting period (31/12/2019), the Covid-19 pandemic was classified for most by the companies as a non-adjusting event after the reporting period and was only presented in the notes to the financial statements.[4] Despite this, when preparing the financial statements of the financial year 2019 the management had to assess the entity's ability to continue as a going concern.[5] Therefore, all available information about the future had to be taken into account[6], for at least 12 months from the end of the financial year 2019.[7] When the analysis of the assessed future development performed by the management did not support the going concern assumption, the financial statements for the financial year 2019 had to be prepared on a liquidation[8] and not on a going concern basis.[9] Furthermore, according to IAS 1.25 sent. 3 the fact that significant uncertainties regarding the going concern assumption existed at the end of the financial year 2019 had to be disclosed in the notes accompanying the financial statements for 2019.[10] In addition, the Covid-19 pandemic had an effect on the management reports of the financial year 2019[11], especially on the entity's likely future development[12] and the therewith related risks and opportunities reporting.[13] In contrast to this, the Covid-19 pandemic is an event occurring during the (financial) year 2020 and has to be reflected in the financial statements for the financial year 2020. In the statement of cash flows, only cash flows have to be depicted and the statement of changes in equity shows the development of the single components of equity during a reporting period. The following analysis focuses on the effects of the

4 See IAS 10.21 f.

5 See IAS 1.25 sent. 1.

6 See Sterling, R. R. (1968), The Going Concern – An Examination, The Accounting Review, Vol. 43 No. 3, 1968, pp. 481–502, here p. 483.

7 See IAS 1.26 sent. 1.

8 See Sterling, R. R. (1968) (FN. 6), p. 482.

9 See IAS 1.25 sent. 4.

10 See Gkouma, O., Filos, F. and Chytis E (2018), (FN. 2), p. 142 regarding the unwillingness of management to disclose such uncertainties that could raise doubt on the entity's going concern.

11 From the perspective of the IFRS accounting, the management reporting or management commentary is voluntarily. See IFRS. Mananagement Commentary.

12 See article 19 sect. 2 let. a) of the EU directive 2013/34/EU.

13 Compare for an empirical research Kirsch, H. (2020), Auswirkungen der Corona-Pandemie in den Geschäftsberichten der DAX 30-Unternehmen für das am 31.12.2019 endende Geschäftsjahr, PiR (Praxis der internationalen Rechnungslegung), 2020, Vol. 16, No. 6, pp. 217–221, here pp. 220 f.

Covid-19 pandemic on the balance sheet[14], the statement of profit or loss and other comprehensive income and the notes according to IFRS.

2 PURPOSE AND DISPOSITION

The purpose of this article is to analyse in what way the Covid-19 pandemic will have effect on the financial statements for the financial year of 2020 or equivalent. The scope of the article has been limited to a number of material accounting issues, which will raise questions regarding the setting-up of the financial statements due to the pandemic. The accounting issues chosen for the article concerns both the balance sheet and the comprehensive income, especially the profit/loss-calculation.

The article relies on a discussion regarding the possible effects on the accounting for specifically chosen assets, debts, income or expenses. The approach is therefore qualitative. An empirical and quantitative study of financial statements would be another feasible approach, but is not possible to perform at the time of writing this article, since the vast majority of listed companies has not yet published their financial statements for 2020.

The main source of material used in this study are the internationally accepted accounting standards IAS/IFRS. Listed companies in the European Union and most other countries around the world are obliged to follow these standards when setting-up their consolidated financial statements. The accounting issues that most companies in different countries are facing are therefore most likely similar. It is not feasible to identify all, or even the majority, of the accounting issues that may arise caused by the Covid-19 pandemic in the framework of this article. Instead, some accounting issues have been chosen which are intended to give a broad picture of the possible aspects.

As an introduction, effects of the Covid-19 pandemic on the applicable accounting policies are discussed, especially the principle of going concern. A major part of the article is devoted to expected effects on the balance sheet. Firstly, a number of assets, both tangible and financial, are analysed regarding these effects. The assets that have been chosen for this study are intangible assets, financial assets, investments in associates and joint ventures, inventories and work in progress and other receivables. Further, the impact on the balance sheet regarding debts and deferred

14 In the following, the term "balance sheet" is used instead of the equivalent term "statement of financial position" (IAS 1.10 a).

taxes are analysed. Later in the article, different types of income and expenses are discussed regarding the expected effects on the statement of profit or loss. The last part of the article is devoted to expected effects on disclosures. The disclosures have an important role, since the companies have an obligation to inform about potential future risks that may affect them. The article is ended with a summary.

3 EFFECTS ON THE APPLICABLE ACCOUNTING POLICIES

In the course of the preparations of the IFRS financial statements it has to be examined which accounting policies have to be applied. Due to the economic effects of the Covid-19 pandemic this includes an assessment of the entity's ability to continue as a going concern. According to IAS 1.26, management takes into account all available information about the future, at least for twelve months after the end of the reporting period. In this context, the German institute of auditors (IDW[15]) points out that for the forecasts also concrete and reliable statements by (federal or state) governments have to be taken into account, even if the necessary legal steps are still pending at the point in time the setting-up of the financial statements is finished and the auditor's certificate is issued as far their implementation can be expected.[16] In the case that management's assessment does not support the assumption of going concern the accounting policies used for preparing the financial statements must reflect this changed assumption. Furthermore, the entity has to disclose this fact, together with the basis on which the financial statements have been prepared and the reason why the entity is not regarded as a going concern.[17] In contrast, it is not allowed to change the applied IFRS accounting policies only due to a change in the economic circumstances caused by the spread of the coronavirus. According to IAS 8.14, a change in the accounting policies takes place only if such a change is required by a new or revised IFRS, or it results in financial statements providing reliable and more relevant information about the entity's transactions, accountable events and other conditions.

15 This abbreviation stands for "Institut der Wirtschaftsprüfer" which has its headquarters in Düsseldorf, Germany.

16 See IDW, Effects of the spread of the corona-virus on the financial statements as of 31.12.2019 and their audit, 27.3.2020, part 2, section 2 (retrieved on 12.01.2021 from https://www.idw.de/blob/122914/8b4b3722606c025e741eb7ac59988ded/down-corona-idw-fachlhinw-relepruefung-teil1u2englisch-data.pdf).

17 See IAS 1.25 sent. 4.

4 EXPECTED EFFECTS ON PARTICULAR ITEMS OF THE BALANCE SHEET

4.1 Assets

4.1.1 Intangible assets including goodwill and property, plant and equipment

The rules for recognising impairment of an asset according to IAS 36 have to be applied on all kinds of intangible assets (IAS 38 and IFRS 3), on property, plant, and equipment (IAS 16), including the right-of-use assets resulting from leases (IFRS 16)[18], and on investment property (IAS 40) measured at cost[19]. In this context, two groups of assets can be distinguished:

– goodwill and the intangible assets with an indefinite useful life, and
– all other assets mentioned before.

For the first-mentioned group of assets the entity has to perform an annual asset impairment test even if there is no indication for an asset impairment[20] as no amortisations are recognised on these assets.[21] Only under quite particular conditions[22] when the recognition of an asset impairment on goodwill seems to be very unlikely the entity is exempted from performing the regular annual asset impairment test. Due to the significant economic effects of the Covid-19 pandemic, the prerequisites for a waiver of the annual asset impairment test of goodwill are fulfilled only in such rare cases in which the last performed asset impairment test shows a significant excess of the recoverable amount of the cash-generating unit including the goodwill over its carrying amount. Therefore, even in the case of a current material decrease of the recoverable amount of the cash-generating unit the recoverable amount is still probably higher than its carrying amount.

For all other assets the entity has to check if there is any indication that the asset may be impaired, as only in the case that at least one asset impairment indicator is existing an asset impairment test has to be performed. IAS 36.12 provides a non-exhaustive list of asset indicators from external

18 See IFRS 16.33.

19 The application of IAS 36 is excluded for investment property measured at fair value, compare IAS 36. 2 f).

20 See IAS 36.90 and IAS 38.108 a).

21 See e.g. IAS 38.107.

22 Therefore all of the criteria mentioned under IAS 36.99 must be satisfied.

and internal information sources. Due to economic effects of the Covid-19 pandemic it may even be possible that several of the listed asset impairment indicators mentioned in IAS 36.12 are satisfied.[23] Except for the increase of market interest rates[24], all other external impairment indicators (esp. significant changes with an adverse effect on the entity in the market or economic environment, excess of the carrying amount of the net assets over its market capitalisation) may arise as a consequence of the economic effects of the Covid-19 pandemic. Furthermore, internal sources of information, like significant changes in the manner, in which an asset is used or expected to be used, or a deterioration of the expected economic benefits from an asset or a cash-generating unit may also indicate an asset impairment. Nonetheless, it has to be pointed out, that the Covid-19 induced occurrence of one or more asset impairment indicators is highly dependent on the business sectors in which the entity is engaged. Therefore, the existence of asset impairment indicators, which involves some discretion, has to be examined carefully in all potential relevant cases.[25]

If at least one asset impairment indicator for an asset or a cash-generating unit is existing, in the next step the entity has to determine its recoverable amount.[26] Therefore, the two components of the recoverable amount, the fair value less costs of disposal and the value in use, have to be estimated. The fair value less costs of disposal, which is defined as an exit price[27], may also be reduced if other market participants are only willing to pay a lower price due to the restricted possibilities of generating cash flows from the use of that asset. Therefrom, the extent to which the single business sectors are affected by the economic effects of the Covid-19 pandemic is most probably also reflected in the fair values of assets typical for these business branches.

For determining the value in use, the expected future cash flows derived from the asset or the cash-generating unit are discounted with an interest rate reflecting the uncertainties of future cash flows from that asset (or

23 Also *IDW*, (FN. 16), part 2, section 4 "Impairment of assets according to IAS 36".

24 See IAS 36.12 c).

25 Compare Rinker, C. (2020), Mögliche Auswirkungen des Ausbruchs des Corona-Virus auf den IFRS-Abschluss und den Lagebericht – Überblick über wesentliche Themen bei der Abschlusserstellung, PiR (Praxis der internationalen Rechnungslegung), 2020, Vol. 16, No. 5, pp. 167–173, here p. 169.

26 According to IAS 36.6, the recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

27 See IFRS 13.9 i.V.m 13.24.

cash-generating unit).[28] The effects of the Covid-19 pandemic will in many cases affect the estimations of future cash flows and mostly reduce them. Nevertheless, the calculation of the value in use must always reflect the current expectation as of the end of the reporting period. Therefore, despite the uncertainties about the expectations of future cash flows a "freeze" of these estimations at pre-covid-19 period amounts is not appropriate. "A high degree of uncertainties in an entity's operating environment is likely to result in more frequent changes in management's expectations about the future."[29] Furthermore, the increased uncertainties induced by the Covid-19 pandemic will probably increase the interest rate used for discounting the future cash flows[30] and finally result in a lower value in use. Notwithstanding the above-mentioned analysis, if immediately before the Covid-19 pandemic influenced the future cash flows an (unrecognised) "headroom" existed,[31] a reduction of the recoverable amount of the cash-generating unit is allocated to the headroom and has not an immediate effect on the goodwill. Therefore, under this condition an asset impairment loss on acquired goodwill is recognised only when that headroom is reduced to zero.[32]

If property, plant and equipment and, under rare circumstances, intangible assets[33] are measured at revalued amounts an update of the fair value is dependent on the volatility of changes in fair value. In the case of insignificant changes in fair value[34] it may be sufficient to determine the fair value for the assets subject to an revaluation only every three or five years.[35]

28 See IAS 36.55 and in addition IAS 36.30 d).

29 See IASB, Applying IFRS-Standard in 2020 – impact of covid 19, Oct. 2020, p. 2 (retrieved on 12.01.2021 from https://cdn.ifrs.org/-/media/feature/news/2020/inbrief-covid19-oct2020.pdf?la=en).

30 Also the IDW is expecting such a change. See *IDW*, (FN. 16), part 2, section 4 "Impairment of assets according to IAS 36".

31 According to DP/2020/1. Chap. 1.9 an (unrecognised) headroom is defined as the positive difference by which the recoverable amount of a cash-generating unit exceeds the carrying amount of its recognised assets (including a capitalised goodwill).

32 See DP/2020/1. Chap. 3.35 and Zimmermann, J./Hölzer, M./Luthardt, U. (2021), Der IASB in der Falle des Impairment-Only-Approach?, KOR (Zeitschrift für internationale und kapitalmarktorientierte Rechnungslegung) 2021, Vol. 21, No. 3, pp. 101–106, here p. 104.

33 Prerequisite of applying the revaluation model on the measurement of intangibles is that their fair value is measured by reference to an active market (see IAS 38.75 sent. 2).

34 See IAS 16.34 sent. 3 and IAS 38.79 sent. 3.

35 Between the revaluation dates the fair values of depreciable assets are updated by depreciations from the latest fair value (see Runesson, E./Samani, N./Marton, J., Financial Accounting Theory – An Accounting Quality Approach, Lund 2018, p. 263).

Under the present circumstances the conditions for an update of the fair value of the revalued assets only in a few years cycle will probably not be fulfilled. Therefore, even if there is no indication for an asset impairment, the fair value of assets subject to revaluation has to be determined and used for revaluation. Even if such an update of the fair value of the revalued assets does not trigger an asset impairment loss recognised in the statement of profit or loss (p/l-statement), it may be possible that a loss from revaluation is recognised in the other comprehensive income, if there is any credit balance existing in the revaluation surplus in respect to that asset.

4.1.2 Financial assets and hedge accounting

The Covid-19 pandemic may affect the amount of the recognised expected credit losses[36] and the fair value of financial assets. Schedule 1 shows the relevant effects for the different kinds of financial assets:

	financial assets measured at amortised cost	financial assets measured at fair value through other comprehensive income	financial assets measured at fair value through profit or loss	investments in equity instruments not held for trading purposes
expected credit losses (gains) (recognised in profit/loss)	X	X		
fair value changes (recognised in profit/loss)			X	
fair value changes (recognised in other comprehensive income)		X		X

Schedule 1: Types of effects on the comprehensive income for the different kinds of financial assets

36 See IFRS 9. chap. 5.5.1.

The economic effects of the Covid-19 pandemic could also cause an increase of the expected credit losses or the occurrence of impairments for financial assets measured at amortised cost (AC) and financial assets measured at fair value through other comprehensive income (FVtOCI). With regard to the expected credit losses, the entity has at first to assess if the expected credit risk of the single financial assets (measured at AC or FVtOCI) have increased significantly since initial recognition. In this case, the loss allowance for the non-credit-impaired financial assets must be changed from the loss allowance at the amount equal to the 12-month expected credit loss[37] to the loss allowance equal to the amount of expected credit losses until the maturity of the financial assets (Lifetime expected credit losses[38]). Therefore, the loss allowance for expected credit losses is not only affected by the annual update of the credit risk but in addition by a change in the method of calculating the loss allowance for the credit risk.[39] For the calculation of the loss, allowance for the financial assets subject to the expected credit loss model an entity shall use all reasonable and supportable information that is available at the end of the reporting period to an entity without undue cost or effort when applying IFRS 9.[40] In this context, the ESMA points out that the presumption of IFRS 9. chap. 5.5.11 sent. 2 that a significant increase in credit risk since initial recognition has happened when contractual payments are more than 30 days past due is rebuttable[41]. Similarly, the IASB states that it is not sufficient to rely "on some mechanistic criterion (for example, treating payment holidays as automatic evidence of a significant increase in credit risk) to determine"[42] a significant increase in the credit risk and in the consequence to change the expected credit loss model for such financial assets. In addition, the effect of most probably implemented public measures on the credit risk has to be considered.[43]

37 See IFRS 9. chap. 5.5.5.

38 See IFRS 9. chap. 5.5.3.

39 The IASB, (FN. 29), p. 3 expects also this Covid-19 pandemic driven measurement effect.

40 Compare IASB, (FN. 29), p. 3.

41 See IFRS 9. App. B 5.5. 20 and compare ESMA, Public Statement: "Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9", p. 3 (retrieved on 12.01.2021 from https://www.esma.europa.eu/sites/default/files/library/esma32-63-951_statement_on_ifrs_9_implications_of_covid-19_related_support_measures.pdf).

42 See IASB, (FN. 29), p. 3.

43 See also chapter 3.

If a financial asset becomes credit-impaired due to the economic effects of the Covid-19 pandemic the loss allowance on that financial asset has to be calculated at an amount equal to the lifetime expected credit losses. Moreover, the effective interest rate shall be applied to the amortised cost of that financial asset in subsequent reporting periods.[44]

Besides these above-mentioned effects on the p/l-statement which only arise from financial assets measured at AC or for those measured at FVtOCI, effects on the comprehensive income from the fair value measurement have to be recognised for all financial assets except for financial assets measured at AC. But only in the case of financial assets measured at fair value through profit or loss (FVtPL) the fair value changes have to be recognised immediately in the p/l-statement. The cumulative fair value adjustments of the financial assets measured at FVtOCI recorded in the other comprehensive income during the holding period of these assets have to be reclassified and recognised in the p/l-statement when the financial asset is sold or reclassified[45], or otherwise derecognised. In contrast to this, all fair value changes from investments in equity instruments not held for trading purposes are never subsequently transferred to profit or loss. The same also applies for the gain or loss from sale or other derecognition of these equity instruments.[46]

A Covid-19 pandemic induced reclassification of financial assets from one to another category of financial assets shown under schedule 1[47] arises only in rare circumstances as at initial recognition the financial assets (of a portfolio) are classified on the basis of the business model under which these financial assets are managed and on the characteristics of their contractual terms.[48] According to IFRS 9. App. B. 4.1.3A, even if the entity sells financial assets when there is an increase in the assets' credit risk the business model for financial assets measured at AC is not breached. This has to be applicable analogous for a higher sales volume of financial assets

44 See IFRS 9. chap. 5.4.1 b).

45 See IFRS 9. chap. 5.7.10.

46 See IFRS 9. chap. 5.7.1 b) and in addition IFRS 9. App. B 5.7.1.

47 As at initial recognition the attribution of equity instruments to the category "investments in equity instruments not held for trading purposes" is irrevocable (see IFRS 9. chap. 5.7.5) a reclassification of these equity instruments in another category is precluded at all.

48 Compare IDW, Fachlicher Hinweis, part 3 (2. Update vom Dez. 2020) from 2020, Dec., 21, Frage 2.3.2 (retrieved on 12.01.2021 from https://www.idw.de/blob/124230/6afeb03649d278b-7c97bcd01976e90ea/down-corona-idw-fachlhinw-relepruefung-teil3-update2-data.pdf).

measured at FVtOCI as the business model for these financial assets allows already under normal circumstances greater frequency and higher sales volumes.[49]

The Covid-19 pandemic may also affect the hedge accounting. In the case that the hedged item is a forecast transaction at the end of the reporting period the entity has to assess if the transaction is still highly probable.[50] A postponement of the forecast transaction by a short period of time might be justifiable and does not induce a discontinuation of the hedge accounting.[51] Otherwise it has to be distinguished if the transaction is still expected to occur in the future (but not highly probable) or not. In the first-mentioned case the amount which has already been recognised in the other comprehensive income and accumulated in the cash flow hedge reserve shall be retained in equity, otherwise the amount accumulated in the cash flow reserve shall immediately be reclassified to profit or loss.[52] The hedging instrument, which has formed a part of the hedging relationship until the discontinuation of the hedge relationship takes place, is subsequently classified according to the general rules on a stand-alone basis. Normally, the hedging instrument is a financial derivative and therefore classified as a financial asset measured at FVtPL.

4.1.3 Investments in associates and joint ventures

Due to the economic effects of the Covid-19 pandemic it may be possible that an objective evidence of an impairment of the net investment in the associate or joint venture arises.[53] Under this condition the entire net investment in the affected associate or joint venture has to be tested for an impairment. The net investment in the associate or joint venture does not only include the carrying amount of the interests in the associate or joint venture determined by using the equity method but also any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. A long-term interest qualifies as part of the net investment in the associate or joint venture if its settlement is neither planned nor likely to occur in the foreseeable future[54] (e.g. long-term

49 See IFRS 9. App. B 4.1.4B.

50 See IFRS 9. chap. 6.3.1 in combination with 6.3.3.

51 See IDW RS HFA 48, IDW-Life 2017, p. 694.

52 See IFRS 9. chap. 6.5.12 a) and b) and in addition IDW, (FN. 48), Frage 2.3.5.

53 See IAS 28.40 in combination with 28.41A–C.

54 See IAS 28.38.

loans, participating certificates). The asset impairment test according to IAS 36 for investments in associates and joint ventures compares the recoverable amount of the entire net investment in the associate or joint venture as a single asset with its carrying amount.[55] Any impairment loss has to be recognised in the profit or loss without any allocation to the assets included in the net investment in the associate or joint venture.[56]

4.1.4 Inventories and work in progress

The measurement of the inventories for which IAS 2 has to be applied and also the measurement of the work in progress which are in the scope of IFRS 15 (contracts with customers) can also be affected by the Covid-19 pandemic.

For the measurement of the finished and semifinished products belonging to the inventories according to IAS 2 it has to be pointed out that the fixed production overhead costs have to be allocated based on the normal capacity of the production facilities.[57] If in the financial year of 2020 due to Covid-19 pandemic induced shutdowns the actual capacity utilization is significant lower than the normal capacity utilization only the fixed overheads are allowed to be included in the costs of conversion which would have be incurred under a normal capacity utilization.[58] The fixed overheads which could not be allocated to the products have to be recognised immediately as expenses in profit or loss.

Furthermore, the finished and semifinished products which are in the stock at the end of the financial year 2020 are subject to the asset impairment test for inventories. The net realisable value of these inventories may be decreased due to a Covid-19 pandemic caused lower demand for the sales products of the entity, e.g. from refining industries or from the consumers. If at the end of the reporting period the net realisable value of an item of inventory is lower than its cost this inventory has to be written down and an asset impairment has to be recorded in profit or loss.[59] Also, materials and other supplies are subject to an asset impairment if either the net realisable value retrograde derived from the sales price of the finished product for which the materials are consumed or the replacement cost of

55 See IAS 28.42 sent. 2.

56 See IAS 28.42 sent. 3.

57 See IAS 2.13 sent. 1.

58 See IAS 2.13 sent. 4.

59 See IAS 2.9.

the materials on the markets on which the entity usually purchases these materials[60] is below the cost.

The work in progress in the scope of IFRS 15 could also be affected by the Covid-19 pandemic when after the contract inception significant changes regarding the criteria that are necessary for meeting the requirements of a contract with a customer[61] occur.[62] For example, this is the case when at a date after contract inception it is probable that the consideration to which the entity is entitled in exchange for goods or services could not be collected from the customer, e.g. due to a significant deterioration of the solvency of the customer.[63] When such an event happens, at this point in time the entity has to reassess the sales recognition and eventually to correct the recognised net sales and the corresponding contract assets and contract liabilities (i.e. work in progress already not approved by the customer less any received advance payments).[64]

4.1.5 Other receivables

If the entity has taken out a business interruption insurance, which covers the lost profits or the incurred expenses during a Covid-19 pandemic induced business interruption (i.e. shutdown) it has to capitalise another receivable for all such insurance claims not paid until the end of the financial year 2020. If due to the conditions of the business interruption insurance it is doubtful that the insurance covers the lost profits or the incurred expenses during a pandemic induced shutdown (e.g. application of a "force majeure" clause) a receivable is only capitalised when it becomes virtually certain that an inflow of economic benefits will arise.[65] Otherwise a contingent asset is arising which has only to be reported in the notes when an inflow of economic benefit is probable.[66] Furthermore, at the end of the financial year 2020 the entity has also to recognise for any outstanding claim on governmental support payments in the context with the Covid-19 pan-

60 According to IAS 2.32, the replacement cost of the materials can only be used as a substitute for the retrograde determined net realisable value when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value.

61 See IFRS 15.9.

62 See for example(s) IFRS 15.13–15.16.

63 See IFRS 15.56 and similar IDW, (FN. 16), part 2, section 4 "revenue recognition".

64 Similar IDW, (FN. 16), part 2, section 4 "revenue recognition".

65 See IAS 37.35 sent. 2.

66 See IAS 37.89 and in addition Rinker, C. (2020), (FN. 25), here p. 170.

demic, e.g. compensation for the losses of a shutdown, receivable if it is virtually certain that this claim will be paid.

4.2 Debts

Provisions for restructuring obligations or for onerous contracts could also be triggered by the Covid-19 pandemic. Prerequisite for recognising a provision for a restructuring obligation is that a constructive obligation arises. Therefore, a detailed formal plan for the restructuring with the elements mentioned in IAS 37.72 must exist. A mere restructuring decision taken by management prior to the balance sheet date does not give rise to a constructive obligation. Therefore, in this situation a provision for restructuring could not be recognised in the balance sheet.[67] If the conditions for a restructuring obligation are met, for measuring the obligations against employees the regulations of IAS 19 apply.[68]

Due to the economic effects of the Covid-19 pandemic provisions for onerous contracts according to IAS 37.66–69 may have to be recognised. Necessary for recognising such a provision is that the unavoidable costs of meeting the obligations under that contract (i.e. the lower of the cost of fulfilling the contract and any compensation or penalty arising from failure to fulfil it) exceed the economic benefits expected to be received under it (or zero in the case of failure to fulfil the contract).[69] For example, a provision for an onerous contract has to be recognised if the entity has agreed on a long-term supply contract over a certain amount of materials (e.g. crude oil) and at the end of the reporting period the price for that material decreased. If the entity does not have the possibility to cancel the contract about the amount not delivered under this contract (outstanding amount) for a lower compensation or penalty payment, the provision is calculated at the end of the reporting period as the amount that equals the price difference between the contracted supply price and the current price at the end of the reporting period times the outstanding amount as of this date.[70] In particular cases, also sales contracts may become onerous if the spread of the coronavirus causes interruptions in the supply chain (e.g. failure of suppliers offering favourable conditions).

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67 See IDW, (FN. 16), part 2, section 4 "provisions".

68 See also IDW, (FN. 16), part 2, section 4 "provisions".

69 See IAS 37.68.

70 If the outstanding amount is sufficient to meet the entity's demands for more than one year, the long-term obligation has to be discounted (see IAS 37.45).

Normally, financial liabilities are measured at amortised cost, using the effective interest method.[71] If the contractual cash flows of these financial liabilities are not renegotiated or modified due to the Covid-19 pandemic, no measurement effects on these have to be recorded.[72] In the case that the entity does not meet the financial covenants agreed in the credit or loan terms, the lender is able to call the financial liability immediately. Under these circumstances, a non-current financial liability must be reclassified as current.[73]

4.3 Deferred taxes

Deferred taxes from temporary differences could arise from possible Covid-19 pandemic induced effects on assets and debts shown under chapter IV. 1 and IV. 2 if the therewith linked expenses or losses are not included in the taxable profit of the same reporting period. Therefore, the arising of deferred taxes from temporary differences is dependent on the regulations of the prevailing national tax law. For example, if the tax law restricts the deduction of asset impairments for taxable purposes on permanent asset impairments deferred tax assets arise for all non-permanent asset impairments recorded on intangibles, property, plant and equipment, financial assets including loss allowances according to the expected credit loss model and inventories in the IFRS financial statements.[74] Deferred tax assets arise also if the applicable tax law prohibits the recognition of provisions for onerous contracts. Furthermore, deferred tax liabilities are reduced corresponding to the decrease of fair value adjustments on financial instruments measured at fair value or losses from the revaluation of property, plant and equipment or intangibles subject to revaluation.

Moreover, deferred tax assets may be recognised for tax losses in the financial year 2020 if these are carried forward and will be available against future taxable profits. Nevertheless, both the recognition of deferred tax assets for deductible temporary differences and for the carry forward of unused tax losses is dependent on the condition that it is probable that future taxable profit will be available against which the deductible tempo-

71 Vgl. IFRS 9. chap. 4.2.1.

72 See in addition IFRS 9. chap. 3.3.2 f.

73 See IAS 1.69 and additionally IDW, (FN. 16), part 2, section 4 “financial instruments”.

74 None of the relevant IAS/IFRS requires a permanent decrease in the recoverable amount or net realisable value as a condition for recognising an asset impairment or a permanent increase of the credit risk of the financial assets.

rary differences or the unused tax losses can be utilised.[75] Although IAS 12 does not specify a defined time horizon in which the deductible temporary differences or the tax losses have to be utilised, nevertheless IAS 12.24 and 12.34 require some kind of evidence that the entity will have available sufficient taxable profit or taxable temporary differences in the future. Regularly, such an evidence may be demonstrated by a current business planning including an earnings planning.[76] This business planning must be consistent to the assumptions made by management in the context of the impairment test in accordance with IAS 36.[77] The review of the forecast of the expected future taxable profit at the end of the financial year 2020 may not only result in a renunciation of capitalising additional deferred tax assets for incurred tax losses or arising deductible temporary differences during this financial year, but also in a reduction of the deferred tax assets which still existed at the beginning of the financial year 2020.[78]

The direction and the extent of the total effect on the deferred taxes resulting from the different and partly opposite effects on the deferred tax assets and deferred tax liabilities triggered by the Covid-19 pandemic could not be predicted and is largely dependent on the individual economic characteristics and conditions of the entity. Especially the significance and duration of the economic effects of the Covid-19 pandemic on the present and future taxable profits, time horizon of the earnings planning, existence of a deferred tax asset or a deferred tax liability at the beginning of the financial year 2020 and the change of the net deferred taxes from temporary differences by additional arising deductible differences or by reversing taxable differences, will influence the total effects.

5 EXPECTED EFFECTS ON THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

At first, it has to be pointed out, that in the p/l-statement and its items the Covid-19 pandemic induced measurement adjustments are reflected. Especially the following items of the p/l-statement are affected:

75 See IAS 12.24 and 12.34.

76 See Kirsch, H., Einführung in die internationale Rechnungslegung nach IFRS, 12. ed., Herne 2019, p. 203 f.

77 See IDW, (FN. 16), part 2, section 4 “income taxes”.

78 Compare IAS 12.56 and similar IDW, (FN. 16), part 2, section 4 “income taxes”.

item of the p/l-statement (IAS 1.82 in combination with IAS 1.102)	**Effects on items of the p/l-statement due to the Covid-19 pandemic**
net sales	adjustments of the transaction price if the criteria for a contract with customer change significantly after the inception of the contract (chapter 4.1.4)
other income	received compensation payments from business interruption insurance or received governmental support payments or corresponding capitalised claims (chapter 4.1.5)
gains and losses arising from the derecognition of financial assets measured at AC	(gains) losses on increased sales volumes of financial assets measured at AC due to a significant increase in their credit risk (chapter 4.1.2)
impairment losses according to IFRS 9. chap. 5.5	increase of the loss allowance for financial assets measured at AC and for financial assets measured at FVtOCI (chapter 4.1.2)
other financial gains/losses	(gains and) losses of the fair value changes of financial assets measured at FVtPL (chapter 4.1.2)
asset impairment expenses	asset impairment expenses on goodwill, intangible assets, property, plant and equipment, right-of-use assets, investment property, and investments within the scope of IAS 36 if not otherwise disclosed (chapter 4.1.2 and 4.1.3)
material expenses	– unallocated overheads (chapter IV 1. d), – write-drown of materials and other supplies (chapter 4.1.4)
employee benefit expenses	recognition of restructuring obligations, as far as the obligations refer to obligations against employees (chapter 4.2)
other expenses	– recognition of restructuring obligations, except of obligationsagainst employees (chapter 4.2), – expenses for onerous contracts (chapter 4.2), – write-down of finished and semifinished products (chapter 4.1.4)

Schedule 2: Items of the p/l-statement particularly affected by the Covid-19 pandemic

Furthermore, if the economic consequences of the Covid-19 pandemic result in the management's decision to discontinue a business operation and all the other requirements for a discontinued operation are satisfied[79], all income and expense items attributable to this operation have to be reclassified retrospectively (starting with the first reporting period presented in the IFRS financial statements) to the special p/l-statement item "amount of profit or loss for the total of discontinued operations" according to IAS 1.82 ea)[80].

Finally, not only the p/l-statement but also the other comprehensive income section with both its subsections may be affected by the economic effects of the Covid-19 pandemic.[81] In the "other comprehensive income that will not be reclassified subsequently to profit or loss" are losses from the fair value measurement of all investments in equity instruments not held for trading purposes and losses from the revaluation of property, plant and equipment and intangibles to the extent of any revaluation surplus for these assets recorded.[82] The fair value changes of the financial assets measured at FVtOCI have to be recognised in the "other comprehensive income that will be reclassified subsequently to profit or loss when specific conditions are met". Moreover, if these financial assets are sold or the hedge accounting of forecast transactions is discontinued when it is not more expected that the hedged items will occur[83] the cumulative fair value adjustments resp. the cash flow reserve are reversed by the other comprehensive income that will be reclassified subsequently to profit or loss when specific conditions are met and reclassified to p/l.[84]

6 DISCLOSURES IN THE NOTES

Disclosures are very important for the interested parties. Thus, consequences of the Covid-19 pandemic should be reflected in the different disclosures in the financial reporting, especially in the notes.

Even if the going concern assumption for setting-up the financial statements of an entity is not rebutted and therefore the financial statements of this entity are prepared based on going concern[85], nevertheless this entity

79 See IFRS 5.32.

80 Compare IFRS 5.33 a) and b) for further disclosure information.

81 See IAS 1.82A a) (i) and (ii).

82 See IAS 16.40 sent. 2 and IAS 38.86 sent. 2.

83 Compare chapter 4.1.2.

84 See IFRS 9. chap. 5.7.10 and IFRS 9. chap. 6.5.12 b) in combination with chap. 6.5.2. b).

85 See chapter 3.

shall disclose material uncertainties related to events or conditions that may cast significant doubt upon its ability to continue as a going concern.[86]

According to IAS 1. 125 companies must inform about potential future risks that may affect the reported values of assets and debts in the balance sheet for the next coming financial years. The information must also include how much the value will be affected. The assets and debts included above will be affected even though we do not yet know to what extent. Companies must in each case disclose information about expected effects. Several possible effects have been recognised in this article, all of which must be reflected in the disclosures.

Decreased demand for certain products may lead to reduced profits, but may also affect the price of the inventories. The risk for defaults will also increase. Another possible effect is that the demand for office buildings and retail stores may be affected because of different shopping habits and more employees working at home. That will affect future cash flows for the real estate companies which may substantially affect the values of investment properties in the balance sheet. Expectedly this kind of information should be included in the notes concerning investment properties. Similar disclosures are regulated in IFRS 13, which states that important assumptions made must be disclosed.

Goodwill is another asset that often is regarded to include future expectations. An impairment test must normally be conducted each year. This is also an asset that may be affected by the economic effects of the Covid-19 pandemic.[87] Important to notice is that the Covid-19 pandemic may affect financial stability in economies which in turn may affect the interest rates in one way or another.[88] When estimating fair values using level-3 inputs, the interest rate is very important. Small changes in interest rate will have dramatic impact on both reported values in the balance sheet as well as on reported income when the values are high. This is an important information to include in the notes. Deferred taxes, especially deferred tax assets from carry forward of unused tax losses, are another example for the high dependency of the value of an asset from future expectations. Finally, it has to be noticed that the requirements of providing the above-mentioned information is not necessary if the assets are assessed to fair value and the

86 See IAS 1.25 sent. 3.

87 See chapter 4.1.1.

88 See also chapter 4.1.1.

price is based on active market prices, according to IAS 1.128. But in most cases for goodwill and investment properties, that is not the case.

Regarding the financial debts, companies are supposed to inform about the liquidity risk according to IFRS 7.39. Furthermore, according to 7.40 f. entities have to conduct a sensitivity analysis regarding the market risks of their debts, which includes also an analysis of the impact of changing interest rates for example. Interest rates may be affected by the effects of the Covid-19 pandemic. Therefore, it is important to disclose how this affects the profit and loss accounts. The examples above illustrate certain areas where the disclosures may be an extra challenge. All together disclosures about expected effects of the Covid-19 pandemic are important in order to provide the investors and other interested parties with as relevant information as possible. Thus, we should expect this to be reflected in the disclosures of the forthcoming annual reports.

7 SUMMARY

The Covid-19 pandemic has caused problems for many companies and will have both short term as well as long term effects for companies. The effects may be due to different reasons like for example changes of interest rates, changed demand to products, increased costs or changes in behaviour and habits of people in general. The aim of this article is to focus on possible effects on the financial statements.

To assess the ability to continue as a going concern or not is a first step. Also, if the going concern assumption is retained, the Covid-19 pandemic may affect the future expectations of the business which in turn may affect the future cash flows in different ways. This is a somewhat new situation which requires useful information to the interested parties in order to provide them with relevant information. Therefore, this must be reflected in the disclosures especially concerning the entity's future development and the therewith-related risks and opportunities. Decreased demand for certain products may lead to reduced profits, but may also affect the price of the inventories. The risk for defaults will also increase. This article indicates though that maybe the most important consequence are changes in future expected cash flows. For intangible and financial assets as well as for many tangible assets, future cash flows makes the basis for assessing the fair value. Changes in future assumptions may substantially affect both the balance sheet as well as the income statement. It is reasonable to expect the companies to reflect this in one way or another. Furthermore, this should thoroughly be regarded in disclosures.

The contribution of this article is two-folded. Firstly, a number of potential effects on the balance sheet and the income statement have been identified. This may be helpful for both companies and interested parties to be attentive too. Secondly, this highlights the requirements of the IFRS when it comes to reflect rapid changes and potential future risks. In this context it should be pointed out that investigating the factual effects of the Covid-19 pandemic on the financial statements for the financial year 2020 may provide some empirical evidence regarding the current discussion about the unrecognised headroom and the proper goodwill accounting raised in the DP/2020/1.

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