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COVID-19: Implications on Financial Statements

The recent outbreak of Covid-19 and the subsequent measures that have been implemented (and will be implemented over the very next days) pose some challenges for entities when preparing their financial statements. Indeed, as recommended by the European Securities and Markets Authority (“**ESMA**”), entities should assess whether, and to what extent, the outbreak of Covid-19 might affect their business activities, financial situation and economic performance in their 2019 year-end financial report.

Given the unpredictability of the outbreak’s economic impact, a one-size-fits-all approach for the disclosure would not be appropriate. Each company should indeed carefully evaluate whether the outbreak of the disease might change the information presented in its financial statements, no matter if such financial statements have already been approved by the board of directors.

Notwithstanding the above, there are certain accounting principles that could help entities to perform their evaluations on the economic impact of Covid-19 when preparing financial statements.

First of all, both IAS/IFRS Standards and Italian Gaap require entities to take into account the events, favorable or unfavorable, that occur between the end of the reporting period and the date when the financial statements are authorized for issue (see IAS 10 and OIC 29 for entities which adopt Italian Gaap).

The spread of Covid-19 definitely falls within the scope of these accounting principles. Entities should thus evaluate whether the impact of such outbreak on business operations, assets and liabilities might be defined as an “adjusting event”, which requires the entity to adjust the amounts recognized in its financial statements, or as a non “adjusting event”. Should an entity conclude that neither the outbreak of Covid-19 nor the measures taken by Governments are adjusting events, but the impacts of the same are material, the entity is required to disclose the nature of such events, and to estimate their financial effects (if practicable)[(1)].

When evaluating the potential impact of an event occurred after the reporting period (*i.e.* the outbreak of Covid-19) an entity should also assess whether this event might have an impact on its ability to continue as a going concern, taking into account all available information about the future for a period which is at least, but not limited to, twelve months from the end of the reporting period (see IAS 1 and Article 2423-*bis*, par. 1, of the Italian Civil Code). When addressing this evaluation, an entity shall take into account all available information, including the nature and the supposed timeline of the measures taken to fight the outbreak, as well as the characteristics of the specific business and marketplace.

Other reporting issues which could recommend that entities evaluate the impact of the outbreak are, inter alia, Financial Instruments (IFRS 9) and Impairment Test (IAS 36), giving that both these accounting principles require to evaluate forecasted cash flows based on certain assumptions. The same applies also to entities that prepare their financial statements according to the so called Italian Gaap; indeed, among these principles, OIC 9 (“*Svalutazione per perdite durevoli di valore delle immobilizzazioni materiali e immateriali*”) as well as OIC 19 (“*Debiti*”) require entities to evaluate, inter alia, future cash flows in order to figure out the carrying amount of assets and liabilities.

More generally, IAS/IFRS Standards (IAS 1) and Italian Gaap (OIC 29) require disclosure of information about assumptions concerning the future and other sources of uncertainty which have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, providing that if it is impracticable for an entity to disclose the potential impact of an assumption, a source of uncertainty or a future event, the entity shall however disclose that a material adjustment might be required within the next financial year. Therefore, entities shall consider whether the outbreak of the disease might impair or change the assumptions and the sources of uncertainty presented in financial statements, increasing risks, and thus provide additional disclosure to enable users of financial statements to understand the effects of such outbreak.

In any event, since not all entities will be equally affected by the outbreak of Covid-19, the evaluations required, the conclusion reached and the subsequently impacts on the financial statements will hinge upon and depend on the characteristics of the entity in each case. Nevertheless, as the outbreak continues to progress and evolve, entities should perform an “ongoing assessment” in order to evaluate the information disclosed up to the very date on which financial statements are issued.

[1] Similarly, OIC 29 states that events, which do not trigger for an adjustment of the amounts recognized in financial statements, should in any case be disclosed in the notes, in order to not jeopardize the evaluations made by users of financial statements.

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