

Financial Statements as at 31 December 2019

Companies completing their financial statements as at 31 December 2019 must assess how COVID-19 can impact both the results being approved and the information they are to communicate regarding the facts following the fiscal year closure in the explanatory note to the financial statements and in the management report.

The Italian accounting principle (OIC 29) divides the "facts that took place after the end of the financial year" into three categories:

- (i) subsequent facts that must be incorporated in the budget values;
- (ii) subsequent facts that should not be reflected in the budget values;
- (iii) subsequent facts that may affect the going concern status.

As for the first two cases, the legal basis of responsibility is awareness or not of the event (which then manifested itself) before the fiscal year closure.

If the event is known before the end of the financial year, apart from derogating from the general principle of prudence for the formation of the financial statements, it must be taken into account when determining the operating result and the equity.

If the effect of the event becomes known after the end of the financial year, it should only be included in the explanatory note to the financial statements, but it does not imply a change in the balance sheet figures as it was not known or foreseeable before the end of the financial year.

The situation is different when directors consider the ongoing concern status, i.e. the company's ability to continue to constitute a functioning economic complex intended for the production of income for a future period of at least 12 months from the balance sheet date, adversely affected (Article 2423-*bis*(1)(1) of the Italian Civil Code).

If this were to happen irreversibly, it would be necessary to take this into account and modify the principles of drafting of the financial statements with the need to accurately describe the new accounting policies in the explanatory note.

All of the above will significantly impact the Equity in the Financial Statement at 31 December 2019.

Timelines for Approval of the Financial Statements

In this period of great uncertainty, special attention must be paid to the timing of the general meeting for the approval of the financial statements.

If the directors can reasonably assume that they do not have to change the figures in the accounts as at 31 December 2019 (if not in the rare cases of lack of the ongoing concern), they must, however, according to the law, highlight the facts that occur up to the date of drafting of the financial statements and, if they have a significant impact, also the events that occur between the date of drafting of the financial statements and the date of their approval by the general meeting, modifying the draft financial statements (already prepared) (Italian Accounting Principle 29(62)), at least in the section relating to the explanatory note.

Therefore, administrators are required to be able to analyze the economic and financial effects that COVID-19 will have on the 2020 management, which is far from easy.

It will therefore be reasonable to postpone the approval of the draft financial statements by the directors, in order to obtain the information and forecasts necessary for the formation of the explanatory note and the management report and, if possible, have a more defined picture of the crisis.

Article 106 of the new Law Decree (*Cura Italia*) contemplates:

1. general deferral of the general meeting for the approval of the financial statements as at 31 December 2019 until 29 June 2020;
2. general meetings, ordinary or extraordinary, of SpA and Srl companies can be also held by means of telecommunications that guarantee the identification of the participants, their participation and the exercise of the right to vote, without, in any case, the need for them to be in the same place;

3. for Srl companies, the expression of the vote occurs by written consultation or by express written consent. These simplifications are contingent at the time of emergency and therefore apply to general meetings convened by 31 July 2020 or, if later, by the date until which the state of emergency related to the health risk associated with the onset of the COVID-19 outbreak is in force.

Financial Statements Disclosure

Explanatory Note

The Italian Civil Code provides that the nature and financial, financial and economic effect of the important events that occur after the end of the financial year are indicated in the explanatory note.

It is therefore obligatory to show the effects that COVID-19 is *likely* to have on the company's economic and financial situation.

Particular attention should be given to prospective flows of liquidity, a key element, together with ongoing concern basis, in order to avert the business crisis.

According to the national accounting principles "facts are considered relevant if, whether or not they require changes in the financial statement figures, they influence the situation represented in the financial statements and are of such importance that failure to communicate them could adversely affect the possibility of the recipients of the corporate information to make correct assessments and appropriate decisions. In the illustration of the event occurred, an estimate of the effect on the company's equity/financial position or the reasons why the effect cannot be determined are provided."

For those who draw up the financial statements in an extended form, the information contained in the explanatory note must be detailed in the management report in the "Predictable Evolution of Management" section.

Management Report

The management report will have to provide details of the effects that COVID-19 has on business management with particular focus on the:

- (i) general trend;
- (ii) risks the company is subject to;
- (iii) evolution of business in 2020.

This concerns the analysis of the prospective aspects, performed taking into account assumptions of hypotheses and scenarios as well as assessment of management (new) risks that will need to be properly considered in the company's planning and programming tools (budgets, industrial plans, period situations, treasury plans) for the future.

It will be necessary to integrate and expand the information already present in the explanatory note by illustrating the actions/operations that are intended for implementation to rebalance the economic and financial situation.

A well prepared and detailed Management report will promote transparency of information and reduce the so-called "information asymmetry," allowing the company to be better valued and therefore, improve its corporate reputation in general.

The information contained in this circular is presented for information purposes only and does not refer to any particular specific situation, therefore it may not contain all the elements necessary for making operational decisions. It does not constitute legal or tax advice.