# Exploring the receptivity to accounting regulation change: what information is being disclosed in Italian Management's Reports?

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**ABSTRACT**

This paper is aimed at investigating how regulatory change affects corporate disclosure. In particular, an analysis of the information disclosed in the Management's Reports prepared by Italian listed companies is conducted. The Italian context is interesting because the 2007 reform has extended the contents to be included in Management's Reports. Companies have to disclose information pertaining to risks and uncertainties, performance indicators, environment and personnel. These new requirements do not only lead to an increase of the information to be disclosed, but also to a change in the nature of the information made available. In addition to the more traditional financial information, also social, environmental and strategic information must be provided. The content analysis conducted on the 2008 financial year Management's Reports compiled by the major Italian listed companies allows for formulating reflections on the receptivity to regulatory change. Research findings suggest that only few companies have been receptive to the reform.

**Key words:** Accounting regulation change, Corporate disclosure, Receptivity, Management's Report, Italian listed companies

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## 1. INTRODUCTION

European listed companies perceive increasing pressures to improve corporate disclosure. The need to integrate the financial information disclosed in Financial statements has stimulated the European and national legislators, and the International Accounting Standards Board (IASB) to regulate the contents of the Management's Report – also known as Management's Discussion and Analysis (MD&A) or Operating and Financial Review (OFR). This document is relevant in both the professional and academic arenas as it presents management's view on a company's financial situation and financial performance with three perspectives: present, past and future developments. Therefore, the information provided is very important as it is the result of managers' willingness to disclose (or not) additional information, whose quantity and quality may be very sensitive to the company itself and the users.

This paper is aimed at contributing to the debates on corporate disclosure by studying the impact of regulatory change on Management's Reports prepared by the major companies listed on the Italian Stock Exchange (Borsa Italiana SpA). The explanations are based on institutional theory which provides an understanding of organizational reactions to pressures to conformity (receptivity versus resistance to regulatory change).

The Italian context provides a fertile soil for research because of two reasons. First of all, the Italian and European legislators have intervened on several occasions to regulate the contents of the Management's Report. Thus, it is interesting to investigate the reform introduced by the 2007 Italian law that, by adopting the European Accounting Modernization Directive 51/2003/CE, has expanded the contents to be included in Management's Reports. Management is now explicitly required to disclose company's risks and uncertainties, financial and non financial performance indicators, environmental and personnel information. Second, interest in Management's Report was also demonstrated by the International Accounting Standards Board (IASB), the international standards setter whose standards (IAS/IFRS) must be adopted by European Union (EU) listed companies. In December 2010, the IASB has published the "IFRS Practice Statement Management Commentary" (henceforth, Practice Statement), which is not a binding international accounting standard, but provides a general framework that can be adopted by managers as guidance for the presentation of useful Management's Reports.

This paper presents the results of an empirical research based on the content analysis of the Management's Reports prepared by the major companies – in terms of market capitalization – listed on the Italian Stock Exchange whose stocks are included in the FTSE MIB 40 Index. The analysis is conducted on the 2008 financial year Management's Reports because it is the first year in which the new requirements had to be implemented. The content analysis of Management's Reports assesses whether, and how, the managers have disclosed information pertaining to the new requirements.

The research results allow for formulating some reflections on the impact of regulatory change on Italian Management's Reports and enable the answering of the following research questions: When preparing Management's Reports, have the new requirements been taken into account? If so, how? In essence, have the companies been receptive to the reform?

The remainder of this paper is structured as follows. First, the theoretical background of our research is explained (section 2). Then, the contents of the Management's Report in the Italian context, as modified by the 2007 reform, are described (section 3), followed by an explanation of the research methodology used for conducting our study (section 4). Thereafter, an analysis of the research findings is provided (section 5). Finally, we answer our research questions by discussing the main results of our study and highlight the limitations and future developments of this paper (section 6).

## 2. THEORETICAL BACKGROUND

The relevance and role of accounting and corporate disclosure are widely debated in academic and professional literature. Through the preparation and publication of Financial statements, companies should be able to disclose the information that meets their stakeholders' financial and non-financial expectations (Unerman, 2000; Di Pietra, 2005; Leuz et al., 2004; Burchell et al., 1980; Hopwood, 1983; Roberts & Scapens, 1985). Listed companies need to complement and supplement information published in financial statements with other documents, such as the Management's Report.

Because of the informative power of Financial statements, reporting activities need to be governed by rules. Accounting rules are necessary to avoid market failures, provoked by the publication of false and misleading information, to guarantee the credibility of Financial statements and to facilitate comparability of information disclosed by different companies (Flower, 1999). Accounting rules are created, and also change over time, in order to consider the evolution of the outer and inner contexts of a company (March et al., 2003). According to Pettigrew (1987), the outer context refers to the social, economic, political, and competitive environment in which a company operates, while the inner context refers to the structure, corporate culture, and political context within the company.

On the one hand, the internationalization of economic activities and the integration of capital markets have raised the need to prepare reliable and comparable financial information, not only within a given country but also in the international sphere. On the other hand, the need to meet the expectations of different categories of stakeholders has increased the need for accounting rules and caused a gradual change in the national accounting regulation model and, consequently, has impacted on companies' reporting activities (Di Pietra, 2002; Flower & Lefebvre, 1997; Flower & Ebbers, 2002; McLeay, 1999; McLeay & Riccaboni, 2000; West, 2003). The "globalised" social-economic context has limited the effects of national regulation, strengthening and legitimizing the role of international accounting standards. Consequently, when preparing Financial statements, each company cannot only comply with national accounting rules, but has to take into account also the international accounting standards.

The topic of changes in corporate disclosure is especially relevant in the European context. Over the years, the European Commission has issued Directives and Regulations aimed at stimulating an accounting harmonisation process. With Regulation n. 1606 of 2002, the European Commission recognised the IASB as the reference standard setter, forcing the companies listed within the EU markets to apply the IASB standards (IAS/IFRS) for the preparation of their consolidated Financial statements (Camfferman & Zeff, 2007; Tamm Hallström, 2004).

In essence, European companies have to comply with national and EU accounting rules. A reform of accounting rules currently in use affects companies behaviours as the convergence towards the adoption of new accounting rules asks for a (more or less radical) change in their accounting practices and routines.

According to the theoretical approach proposed by Greenwood & Hinings (1996), a radical change occurs when a company (or a group of companies) moves to the use of accounting rules that are completely different from those in use. On the contrary, convergent changes consist of slight transformation of the accounting rules adopted by a company.

In general, a radical change occurs when an interaction between exogenous and endogenous factors takes place. The exogenous factors are the market and the institutional contexts, while the endogenous factors are the dissatisfaction of internal stakeholders, their commitment to change, power dependencies and capacity for action (Greenwood & Hinings, 1996). Without an appropriate interplay of those factors, which allows for a certain degree of receptivity and permeability to change, a desired or imposed radical change may ultimately result in a convergent change (Lapsley & Pettigrew, 1994; Pettigrew, 1987).

That is, EU and national government's ability and power (institutional pressures) to impose the adoption of new accounting rules is not sufficient to ensure an immediate and total convergence. Conformity to accounting regulation reforms also depends on the reactions of the companies (Phillips et al., 2000). According to DiMaggio & Powell (1983), institutional pressures towards convergence lead, over time, the companies to follow isomorphic behaviours as each company tends to resemble the others. This attitude is not always due to reasons of economic rationality, but is also driven by the need to gain operational and social legitimacy.

Kondra and Hinings (1998), disagreeing with the focus on isomorphic processes leading to conformity, argue that there may be organizations that do not conform and deviate from the behaviours of other companies. Each company can enact a range of strategic and tactical reactions as response to institutional pressures toward conformity. These may vary from total conformity to (more or less active forms of) resistance to change (Oliver, 1991). The most hostile reaction to change may depend on the difficulty that companies face in converging towards the adoption of new accounting rules. Accounting practices adopted may in fact be difficult to change especially if the change requires a substantial transformation of the routines currently in use (Burns & Scapens, 2000). In this sense, the diffusion and adoption of new accounting rules must be preceded by their theorization, the process by which innovations achieve legitimacy and are considered more appropriate than existing practices (Greenwood et al., 2002).

To conclude, a transformation of the regulatory framework, such as a reform of the contents to be disclosed in the Management's Report, impacts on the companies that have to comply with the new accounting rules. In order to understand the impact of regulatory change on the Management's Reports prepared by Italian listed companies, the next section describes the contents of the Management's Report in the Italian context, as modified by the 2007 reform.

## 3. THE RECENT CHANGE IN THE ITALIAN REGULATORY FRAMEWORK

As highlighted in the previous section, the internationalization and globalization of economic activities have influenced corporate disclosure. The Management's Report, the document which integrates the information disclosed in the Financial statement, has assumed a crucial importance in the national and international scenario. This report may have a considerable informative power as it should include both financial and non-financial information that presents management's view on a company's financial situation and financial performance. Therefore, the information communicated to the market is very important as it is the result of managers' willingness to disclose (or not) information, whose quantity and quality may be very sensitive, with respect to the mandatory or optional requirements of the regulatory framework (Barron et al., 1999; Beretta & Bozzolan, 2004; Pava & Epstein, 1993; Penno, 1997).

A proof of the value attributed to the Management's Report is the fact that the Italian and European legislators intervened, on several occasions, to regulate its contents. Interest in this document was also shown by the IASB, which has recently published the "IFRS Practice Statement Management Commentary" (henceforth, Practice Statement) aimed at providing management with a general framework for the presentation of useful Management's Report (IASB, 2010).

In Italy, the contents of the Management's Report are disciplined by Article 2428 of the Civil Code: "Management's Report (in Italian: *Relazione sulla gestione*)", which was amended over time in order to comply with the requirements of EU Directives (see, for example, the Accounting Modernization Directive 51/2003/CE).

Specifically, the Italian legislator, in reforming Article 2428 of the Civil Code with legislative decree 2 February 2007, n. 32, expanded the contents of the Management's Report, introducing substantial innovations with respect to the past. The Article's text is presented below, showing in italics the parts added by the 2007 reform.

Subsection 1 states: "The financial statement must be accompanied by a Management's Report *containing an exhaustive, balanced and trustworthy analysis of the company situation, and management trend and results*, in its whole and in the various sectors in which it operates, with particular attention to the costs, revenues and investments, *as well as a description of the key risks and uncertainties to which the company is exposed*".

Subsection 2 states "*the analysis in the first subsection is consistent with the dimension and the complexity of the company's business and contains the financial and* *non-financial performance indicators pertinent to the specific company activity, including information pertaining to the environment and personnel. The analysis contains, where timely, references to the amounts reported in the financial statement and supplementary explanations on them*".

Subsection 3 highlights the information in the Management's Report: "In every case, the report should contain:

1. research and development activities;
2. transactions with controlled (subsidiary), affiliated and controlling (parent) companies;
3. the number and nominal value of both its own shares and the stock or shares of controlling companies possessed by the company, also through a trustee company or nominee, with an indication of corresponding capital share;
4. the number and nominal value of its own shares, as well as the stock or shares of controlling companies bought or transferred by the company, in the course of the financial year, also through a trustee company or nominee, with an indication of the corresponding capital share, of the amounts and motives for the purchases and transfers;
5. the significant events occurring after the year-end close;
6. the foreseeable evolution of management;

*6-bis. with regard to the use by the company of financial instruments, if they are significant for the evaluation of the financial situation of the company and of its income (loss) for the year:*

*a. the objectives and policies of the company for managing financial risks, including the hedging policy for each main category of operations;*

*b. the exposure of the company to price, credit, liquidity and variation in cash flow risks*".

Subsection 4 was repealed in 2007 and is therefore not being studied in this paper.

Finally, subsection 5 prescribes that the Management's Report has to contain a list of the sub-offices of the company.

A detailed interpretation on the compilation procedures of the "new Management's Report" was supplied by the National Board of Chartered Accountants (in Italian: *Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili* – CNDCEC, 2009a). The CNDCEC also addressed the issue of information on the environment and personnel that have to be mandatory and voluntarily disclosed in Management's Reports (CNDCEC, 2009b).

In summary, in the pursuit of full transparency of information (disclosure), the Management's Report of joint-stock companies – besides the traditional information regarding costs, revenues and investments – must include, starting with the 2008 financial year, information relating to risks and uncertainties, as well as the financial and non-financial performance indicators and information relating to the environment and personnel. This innovation does not only deal with a broadening of the quantity of the information to supply. It asks for a variation in the nature of the information disclosed in Management's Reports: besides financial information, there must be information of a social, environmental and strategic nature. This represents an enhancement with respect to the past, in which the prescribed regulation was too generic and the academic and professional interpretations did not allow for resolution of doubts regarding the contents of Management's Reports and their degree of depth (Bagnoli, 2003, pp. 37-38, 91-93).

The following table highlights the key contents of the Management's Report, in the order prescribed by the Italian regulations (Table 1).

Table 1 – Contents of Management's Report according to Italian new regulatory framework

| |
|---|
| An analysis of the company situation and of management trend and results, in its whole and in the various sectors in which it operates, with particular attention to costs, revenues and investments |
| Risks and uncertainties to which the company is exposed |
| Financial and non-financial performance indicators |
| Information relating to the environment |
| Information relating to personnel |
| The Management's Report must contain:<br>1. Research and Development activities<br>2. Transactions with controlled, affiliated and controlling companies<br>3. The number and nominal value of both its own shares and the stock or shares of controlling companies possessed by the company<br>4. The number and nominal value of its own shares, as well as the stock or shares of controlling companies bought or transferred by the company, in the course of the financial year<br>5. Significant events occurring after the year-end close<br>6. Foreseeable evolution of management<br>6-bis. With regard to the use by the company of financial instruments:<br>a. the objectives and policies for managing financial risks<br>b. company exposure to price, credit, liquidity and variation in cash flow risks |
| The list of company's sub-offices |

It is also worth mentioning the main features of IASB's Practice Statement. The Practice Statement is not a binding accounting standard; it presents a framework whose objective is to assist management in presenting useful Management's Reports that relate to financial statements that have been prepared in compliance with IAS/IFRS. Management's Reports prepared in accordance with this framework can provide users of financial statements with integrated historical and prospective commentary on the company's financial position, financial performance and cash flows, as it explains management's view not only about what has happened, but also why it has happened and what the implications are for the company's future (IASB, 2010, pp. 7-8).

Moreover, in developing its Management's Report, management should present information that provides its view of the company's performance, position and progress, and supplements and complements information presented in the Financial statement (IASB, 2010, pp. 8-10).

On the one hand, the Practice Statement does not postulate specific form and content of Management's Report asserting that they will vary between companies, reflecting the nature of their business, the strategies adopted by management and the regulatory environment in which they operate. On the other hand, the Practice Statement indicates the elements that useful Management's Report should include, which are stated below:

- the nature of the business,
- management's objectives and strategies for meeting those objectives, in order to enable users to understand the priorities for action and the resources that must be managed to deliver results,
- the company's most significant financial and non-financial resources; strategic, commercial, operational and financial risks; and relationships with stakeholders,
- the results of operations and prospects, describing the company's financial and non-financial performance and the extent to which that performance may be indicative of future performance,
- the critical performance measures and indicators (both financial and non-financial) that management uses to evaluate the company's performance against stated objectives (IASB, 2010, pp. 11-16).

To conclude, the new requirements introduced by the Italian legislator are quite in line with the main issues of the IASB's Practice Statement. It is even possible to affirm that the Italian regulatory framework is – to some extent – ahead of the IASB's framework because of the inclusion of environmental and personnel matters (which are lacking in the Practice Statement). In this sense, the Italian Accounting Standards Setter (in Italian: *Organismo Italiano di Contabilità* – OIC), in the comment letter to the Exposure Draft Management Commentary ED/2009/6, declared that the IASB should deal with more significant and urgent projects instead of preparing a guidance on Management's Reports, since this document has a precise discipline in the EU sphere and also in Italy (OIC, 2010).

However, IASB's Practice Statement asks the companies to disclose the management objectives and the strategies for reaching these objectives, in order to enable the users of Management's Reports to understand company's priorities. This issue is not explicitly considered in the Italian new regulatory framework.

After having highlighted the new requirements that Italian companies have to take into account when preparing Management's Reports, the next section describes the research methodology adopted for conducting our study.

## 4. RESEARCH METHODOLOGY

The methodology employed in conducting this research project is based on a literature review and an empirical investigation. After having carried out a review of the national and international literature on changes in European accounting regulation and the Management's Report, we have realized a quantitative content analysis of the Management's Reports compiled by the major companies – in terms of market capitalization – listed on the Italian Stock Exchange (Borsa Italiana SpA).

The empirical research consisted of three stages. The first stage was devoted to the sampling process and the selection and collection of the documents to be analysed, which according to Weber (1990) are crucial when carrying out content analysis studies. We proceeded as follows. First, we identified the 40 joint stock companies whose stocks were traded on the FTSE MIB 40 Index and excluded 13 companies operating in the Finance sector (banks, insurance, financial services) because they are subject to another specific disclosure discipline.

The 27 remaining companies were active in the following sectors: Consumer Goods (7 companies), Industrials (8 companies), Basic Materials (1 company), Consumer Services (3 companies), Utilities (4 companies), Oil & Gas (2 companies), Technology (1 company) and Telecommunications (1 company). Second, we selected and collected the documents to be analysed. The Management's Report (or annual report if the Management's Report was included and not separately presented) – in PDF format – of each company was found online on the Borsa Italiana SpA web site, using the link to the document archive of each company. We downloaded the Management's Reports pertaining to the 2008 financial year given that it was the first year of implementation of the reform.

Third, further companies were excluded from the sample for different reasons. For Tenaris, operating in the Basic Materials sector, the Management's Report was not available on the Borsa Italiana SpA web site; it was directly downloaded from the company's internet site. Different from all the other Management's Reports, which were written in Italian, Tenaris' was prepared in the English language. Consequently, the Tenaris' Management's Report was not maintained in the sample as language differences could affect the results of the content analysis. For STMicroelectronics, active in the Technology sector, the Management's Report was not available on the Borsa Italiana SpA web site, or on the company's internet site. Finally, Geox

(Consumer Goods sector) was not included in the analysis because in the 2008 annual report, the diction of the Management's Report was not included (even if the annual report comprises many paragraphs containing information attributable to a Management's Report). All in all, the sample for 2008 was composed of 24 Management's Reports. Table 2 illustrates the sampling process just described, reporting the name of each of the 40 companies included in the FTSE MIB 40 Index (Borsa Italiana SpA), highlighting the sector in which it operates and if it was included in the sample for 2008.

The second stage was dedicated to the content analysis. Content analysis is an empirical research tool that can be used to reach additional understanding of corporate disclosure contents and practices. It may be carried out by using different methods (see, among others, Weber 1990 and Unerman, 2000). We adopted a quantitative content analysis by calculating the space (number of words) of specific issues disclosed in the selected Management's Reports. These investigation and calculations were carried out because, as also argued by Unerman (2000), a key assumption underlying quantitative content analysis is that the number of words devoted to an issue may provide indications about which issues have received greater importance when preparing the Management's Report.

To be precise, the analysis of the Management's Reports was carried out by compiling a short report for each of the companies included in the sample. Every short report contains two types of information. The first type of information consists of general information relevant to the company at December 12, 2008: the sector in which it operates, the size (capitalization, sales, capital invested number employees), the shareholders' composition (to evaluate if there are foreign members in the ownership), the geographic location of company's offices, listed markets, the language used to prepare the Management's Report (and annual report). The second type of information relates to specific information which was searched in each of the 24 Management's Report in order to answer the following questions:

- Does the Management's Report constitute a document attached to or internal to the annual report?
- Are all the new requirements dealt with? Hypothesizing that the examined document does not contain all the prescribed issues, what are the issues that were excluded?
- How much space is dedicated to the new requirements in terms of the number of paragraphs, number of words and the number of words divided by the total number of words in the entire Management's Report?

In order to make such calculations, the PDF text was extracted with A-PDF text extractor program and transformed in a word document, enabling us to select text parts and to count the number of words dedicated to specific issues.

Table 2 – Sample for 2008 financial year

| | COMPANY | SECTOR | SAMPLE |
|---|---|---|---|
| 1 | A2A | Utilities | **X** |
| 2 | Ansaldo STS | Industrials (industrial goods & services) | **X** |
| 3 | Atlantia | Industrials (industrial goods & services) | **X** |
| 4 | Autogrill | Consumer Services (travel & leisure) | **X** |
| 5 | Azimut | Financials (financial services) | |
| 6 | Banco Popolare | Financials (banks) | |
| 7 | Banca MPS | Financials (banks) | |
| 8 | Banca Popolare di Milano | Financials (banks) | |
| 9 | Bulgari | Consumer Goods (personal & household goods) | **X** |
| 10 | Buzzi Unicem | Industrials (construction & materials) | **X** |
| 11 | Campari | Consumer Goods (food & beverage) | **X** |
| 12 | CIR | Industrials (industrial goods & services) | **X** |
| 13 | Enel | Utilities | **X** |
| 14 | Eni | Oil & Gas | **X** |
| 15 | Exor | Financials (financial services) | |
| 16 | Fiat Group | Consumer Goods (automobiles & parts) | **X** |
| 17 | Finmeccanica | Industrials (industrial goods & services) | **X** |
| 18 | Fondiaria Sai | Financials (insurance) | |
| 19 | Generali Assicurazioni | Financials (insurance) | |
| 20 | Geox | Consumer Goods (personal & household goods) | |
| 21 | Impregilo | Industrials (construction & materials) | **X** |
| 22 | Intesa SanPaolo | Financials (banks) | |
| 23 | Italcementi | Industrials (construction & materials) | **X** |
| 24 | Lottomatica | Consumer Services (travel & leisure) | **X** |
| 25 | Luxottica | Consumer Goods (personal & household goods) | **X** |
| 26 | Mediaset | Consumer Services (media) | **X** |
| 27 | Mediobanca | Financials (banks) | |
| 28 | Mediolanum | Financials (insurance) | |
| 29 | Parmalat | Consumer Goods (food & beverage) | **X** |
| 30 | Pirelli & C. | Consumer Goods (automobiles & parts) | **X** |
| 31 | Prysmian | Industrials (industrial goods & services) | **X** |
| 32 | Saipem | Oil & Gas | **X** |
| 33 | Snam rete gas | Utilities | **X** |
| 34 | Stmicrolectronics | Technology | |
| 35 | Telecom Italia | Telecommunications | **X** |
| 36 | Tenaris | Basic Materials (basic resources) | |
| 37 | Terna | Utilities | **X** |
| 38 | Ubi Banca | Financials (banks) | |
| 39 | Unicredit | Financials (banks) | |
| 40 | Unipol | Financials (insurance) | |

During the third and last stage we analysed and compared the short reports. In particular, comparing the short reports compiled for each company, it is possible to understand if the order and space dedicated to the various issues were just a purely formal fulfilment of the regulation, or if the company management really tried to disclose valuable information relevant to complete the information presented in the financial statement. In substance, the content analysis of Management's Report is also of a qualitative nature and is aimed at understanding the degree of receptivity of the company to the regulatory change.

The next section discusses the key results that emerged from the comparison of the short reports compiled for each of the selected Management's Reports.

## 5. FINDINGS

From the analysis of the 24 Management's Reports of the companies listed on the FTSE MIB 40 Index, managed by Borsa Italiana SpA, the following considerations can be expressed.

In almost all of the cases the Management's Report is included inside the annual report. Only for A2A, operating in the Utilities sector, the Management's Report has been prepared separately and attached to the annual report.

The length of the documents examined (the total number of words making up each Management's Report) varies from a minimum of 4,272 words (Eni: Oil & Gas) to a maximum of 57,432 words (Enel: Utilities), while the average length is 28,372 words. We have noticed that the total number of the words included in the Management's Report of Eni (Oil & Gas) is few because of a possible form inaccuracy. In fact, reading the index of Eni's consolidated financial statement, it is clear that the latter includes several paragraphs containing information attributable to the Management's Report. However, our position in this respect has been neutral, meaning that we have only focused our attention on the text included in the Management's Report.

Table 3 shows the company name, the sector in which it operates, and their classification in terms of length of their Management's Report.

Table 3 – Length of Management's Report

| Number of words | Company | Sector |
|---|---|---|
| less than 10,000 | Bulgari | Consumer Goods (personal & household goods) |
| | Eni | Oil & Gas |
| between 10,001 and 20,000 | Ansaldo STS | Industrials (industrial goods & services) |
| | Buzzi Unicem | Industrials (construction & materials) |
| | Campari | Consumer Goods (food & beverage) |
| | CIR | Industrials (industrial goods & services) |
| | Italcementi | Industrials (construction & materials) |
| | Lottomatica | Consumer Services (travel & leisure) |
| | Luxottica | Consumer Goods (personal & household goods) |
| between 20,001 and 30,000 | Autogrill | Consumer Services (travel & leisure) |
| | Pirelli | Consumer Goods (automobiles & parts) |
| between 30,001 and 40,000 | A2A | Utilities |
| | Atlantia | Industrials (industrial goods & services) |
| | Impregilo | Industrials (construction & materials) |
| | Mediaset | Consumer Services (media) |
| | Parmalat | Consumer Goods (food & beverage) |
| | Prysmian | Industrials (industrial goods & services) |
| | Terna | Utilities |
| between 40,001 and 50,000 | Fiat | Consumer Goods (automobiles & parts) |
| | Saipem | Oil & Gas |
| | Telecom Italia | Telecommunications |
| more than 50,001 | Enel | Utilities |
| | Finmeccanica | Industrials (industrial goods & services) |
| | Snam rete gas | Utilities |

Table 3 demonstrates that about one-third of the companies has prepared a Management's Report consisting of a number of words between 10,001 and 20,000 words, and about one-third between 30,001 and 40,000 words. The other companies belong to different classes of length.

Regarding the contents of the Management's Report, the issues required by Article 2428 (as identified in Table 2) are not always totally dealt with. In the majority of the cases, the issues excluded are:

–The list of the sub-offices: in 21 out of 24 cases, there is no cross-reference made to other documents, and the reason for such a gap is not included; in substance, isn't there any sub-office or are sub-offices individualized in the consolidated Financial statement?

−The details related to own shares possessed and bought/transferred are lacking in 14 out of 24 cases; in fact, in more than half of the documents examined, only its own shares possessed is indicated, without specification of the number of shares acquired and/or sold and the related nominal value.

−The relationships with related parties (11 out of 24 cases): in some cases, the Management's Report has an explicit cross-reference to the consolidated Financial statement; in other cases, it is dealt with in the consolidated Financial statement as it was listed in the index. Sometimes, there is no reference at all to the issue.

−In 10 of 24 cases, the management of and exposure to financial risks are completely absent or treated in a partial manner.

−Environmental information is absent in 9 of 24 cases.

The following issues are excluded in a less systematic manner: risks and uncertainties to which a company is exposed, information regarding personnel, research and development activities, foreseeable evolution of management and the significant events occurring after the year-end close.

In some cases, the issues excluded in the Management's Report are dealt with in the annual report. We could deduce it from reading the Management's Report, because it makes a specific cross-reference to the annual report or to another document, or from reading the index of contents of the Financial statement. In other cases, it was not possible to assess if the issues excluded are dealt with in other documents.

Finally, 14 of the 24 Management's Reports have up to a maximum of three issues excluded, while the remaining documents have greater gaps (of information). Returning to the most complete documents, in terms of number of issues dealt with, the A2A (Utilities) Management's Report has only omitted the relationships with related parties, referring the reader to the consolidated Financial statement, while Terna's (Utilities) has only omitted the list of sub-offices. Following, in terms of completeness, are Atlantia (Industrials – industrial goods & services), Autogrill (Consumer Services – travel & leisure), Fiat (Consumer Goods – automobiles & parts), Finmeccanica (Industrials – industrial goods & services), Impregilo (Industrials – construction & materials), Italcementi (Industrials – construction & materials), Luxottica (Consumer Goods – personal & household goods), Parmalat (Consumer Goods – food & beverage; even if the absence of environmental information is astonishing), Prysmian (Industrials – industrial goods and services), Saipem (Oil & Gas), Snam rete gas (Utilities) and Telecom Italia (Telecommunications). The Management's Reports that have the highest number of issues excluded are those of Eni (Oil & Gas) and Lottomatica (Consumer Services – travel & leisure). To be more precise, in the case of Eni, it is evident that most of the issues excluded are dealt with in the consolidated Financial statement, while in the case of Lottomatica it is not possible to determine if the missing issues are included in the consolidated Financial statement. Table 4 shows the most excluded issues in the analysed Management's Report.

Table 4 – Most excluded content of Management's Report

| **Most excluded content** |
|---|
| – List of sub-offices<br>– Details on own shares possessed and bought/sold<br>– Transactions with related parties<br>– Exposure to and management of financial risks<br>– Environmental information |

Moreover, in different Management's Reports, multiple issues are dealt with in the same paragraph. The most popular format is to introduce the issues in a paragraph entitled "Other Information", in which issues required by the regulation are discussed. The issues most frequently discussed in such a paragraph are: the number and nominal value of company's own shares (possessed and bought/transferred), relationships with related parties and the list of sub-offices. In some cases, research and development activities, as well as financial risks, are also discussed.

As regards the new requirements introduced by the 2007 regulatory change, the following can be presented.

The new regulatory framework requires companies to describe the *risks and uncertainties* to which they are exposed. In the majority of the documents analysed, the risks and uncertainties are treated in a generic manner, without really clarifying the degree of exposure to the risks and the policies for managing them. In some cases, only a general definition of the risks is supplied. Only in Finmeccanica's Management's Report (Industrials – industrial goods & services), is there a clear separation between the type of risk to which the company is exposed and the actions taken to face each risk. The percentage of words dedicated to the risks and uncertainties to (divided by) the total number of words in the Management's Report fluctuates between a minimum percentage of 0.8% (Atlantia: Industrials – industrial goods & services) and a high of 20.8% (Bulgari: Consumer Goods – personal & household goods), with an average value of the whole sample of 5.3%. In almost all of the Management's Reports in which the risks and uncertainties are discussed, there exists a specific paragraph on the issue; however, in the case of A2A (Utilities), the risks and uncertainties are introduced in a sub-paragraph inside of the paragraph entitled "Other Information". In the case of Atlantia (Industrials – industrial goods & services), the risks and uncertainties are dealt with in a paragraph that also deals with the foreseeable evolution of management, while in Telecom Italia's (Telecommunications) Management's Report, the risks and uncertainties are dealt with in 4 sub-paragraphs placed in the paragraph on the "Foreseeable evolution of management".

In the majority of the Management's Reports analysed, the issues of exposure to and management of *financial risks* are both dealt with in the paragraph on risks and uncertainties, but the risks are not always clarified and we had to identify them in order to determine the number of words devoted to those issues. The percentage of words dedicated to the financial risks to (divided by) the total number of words of the Management's Report varies between a minimum percentage of 0.3% (Impregilo: Industrials – construction & materials) and a high of 6.8% (Bulgari: Consumer Goods – personal & household goods), with an average value of the whole sample of 1.5%. In general, cross-reference is made to the consolidated Financial statement for a more detailed discussion of these issues.

Another innovative point with respect to the past is the insertion of *financial and non-financial indicators* in order to better understand the company situation, and management trend and results. In this regard, the analysis has highlighted that not many indicators are adopted and are not present in all of the Management's Reports analysed. Indicators are mainly located in the paragraphs discussing the management trend and results. Thus, in almost all the cases, it is not possible to determine the exact number of the words relating to the performance indicators. On the one hand, some items and margins (like cost and revenues, Ebitda, Ebit, capital invested and net financial position) are mainly presented and discussed, but the only financial indicators found (not in every Management's Report) are ROI, ROE, ROS and gearing & leverage. Only in the Management's Reports of two companies operating the Industry sector – industrial goods & services (Ansaldo STS and Finmeccanica) is EVA indicated. On the other hand, non-financial indicators are not clearly identified and discussed, meaning that users have to eventually identify and interpret them. Finally, in the Management's Reports examined, there is hardly never a specific paragraph that listed and explained the performance indicators. In 7 of the 24 cases, there is a paragraph or table related to the performance indicators, but the percentage of words to (divided by) the total number of words in the Management's Report is very low, with values between 0.4% (Italcementi: Industrials – construction & materials; Snam rete gas: Utilities; Telecom Italia: Telecommunications) and 2.4% (Saipem: Oil & Gas), with an average value of the whole sample of 0.5%.

Regarding *environmental information*, the empirical analysis has highlighted that in the Management's Report of Atlantia (Industrials – industrial goods & services), Bulgari (Consumer Goods – personal & household goods), Campari (Consumer Goods – food & beverage), CIR (Industrials – industrial goods & services), Enel (Utilities), Lottomatica (Consumer Services – travel & leisure), Parmalat (Consumer Goods – food & beverage) and Pirelli (Consumer Goods – automobiles & parts), no reference is made to environmental information either in a cross-reference to the consolidated financial statement, or any other document. The Management's Report of Fiat (Consumer Goods – automobiles & parts), even though it does not supply environmental information, refers readers to the Sustainability Report. When the Management's Report supplies the environmental information, in the majority of the cases, a specific paragraph on the issue is included. However, in some cases, the environmental matters are incorporated in the paragraphs on "Corporate Social Responsibility (CSR)", "Health, Safety, Environment" or "Sustainable Development". The percentage of words dedicated to the environment to (divided by) the total number of words in the Management's Report varies between 0.3% (Terna: Utilities) and 6.6% (Impregilo: Industrials – construction & materials), with an average value of the whole sample of 1.9%.

Regarding the *information on personnel*, the empirical analysis has shown that in almost all the Management's Reports, there is at least one paragraph (or sub-paragraph) dedicated to this issue. Only in 3 of the 24 documents analysed, there is no reference to the issue (Campari: Consumer Goods – food & beverage; CIR: Industrials – industrial goods & services; Lottomatica: Consumer Services – travel & leisure). The percentage of words dedicated to the information on personnel to (divided by) the total number of words in the Management's Report varies between a minimum of 0.5% (Pirelli – Consumer Goods: automobiles & parts) and a maximum of 14.6% (Finmeccanica – Industrials: industrial goods & services), with an average of the whole sample of 5.6%. Not all the documents analysed supply complete information on Human Resources and only indicate the total number of employees and training activities, without specifying the number of those dying in job-related activities, serious accidents, etc.

Table 5 summarizes the main research findings pertaining to the new requirements introduced by the 2007 regulatory change.

Table 5 – Research findings

| **ISSUE**<br>Number of words /<br>Tot. number of words in MR | **Min (%)** | **Max (%)** | **Average (%)** |
|---|---|---|---|
| Risks & uncertainties | 0.8 | 20.8 | **5.3** |
| Financial risks | 0.3 | 6.8 | **1.5** |
| Financial & non-financial performance indicators | 0.4 | 2.4 | **0.5** |
| Environment | 0.3 | 6.6 | **1.9** |
| Personnel | 0.5 | 14.6 | **5.6** |

From the empirical investigation, it emerged that there is not a precise correspondence between completeness (quantity of issues dealt with) and the number of words dedicated to the issues dealt with. For example, A2A (Utilities) has prepared the most complete Management's Report (omitting just one issue), but the percentage of information on personnel is very low (0.6%) – near the minimum – and that related to risks and uncertainties is 4.1% – below the average. In the same way, Terna's (Utilities) Management Report, although omitting only one issue, has disclosed a percentage of words dedicated to the innovative issues below the average of the sample. Similar reflections can also be proposed for other companies' Management's Report.

Moreover, there is not a precise correspondence between the total number of words in the Management's Reports and the number of words dedicated to the issues dealt with. For example, Bulgari (Consumer Goods – personal & household goods) has prepared a Management's Report that is among the briefest but that has the highest percentage of words dedicated to risks and uncertainties.

This result is explainable by the fact that in the document, many issues are omitted. Finmeccanica (Industrials – industrial goods & services) and Snam rete gas (Utilities) have prepared a Management's Report that surpassed 50,000 words but that have a percentage of words relative to risks and uncertainties of 4.2%, which is quite inferior with respect to that of Bulgari and is below the average. Finally, Enel (Utilities), having the longest Management's Report (in terms of number of words), has dedicated just 2.7% of the words to risks and uncertainties and has a surprising absence of any environmental information.

From the aforementioned considerations, it is evident that the issues prescribed by the Italian new regulatory framework are not always present in the Management's Reports prepared by the major Italian listed companies.

Moreover, the order in which they are presented does not perfectly correspond with that prescribed by the Civil Code. The managers have given priority to some issues, rather than the others, as with Autogrill (Consumer Services – travel & leisure) and Bulgari (Consumer Goods – personal & household goods) that, before commenting on the management trend and results, discuss risks and uncertainties, using a percentage of words equal to 8.3% and 20.8%, respectively – both above the sample average of 5.3%.

Nevertheless, it is not possible not state that the order followed is always an indication of the importance attributed to an issue in terms of the space it occupied in the Management's Report. For example, in the document prepared by Parmalat (Consumer Goods – food & beverage) the information on personnel is the second issue discussed, but the percentage of words is 1.8% (well below the average). Fiat's (Consumer Goods – automobiles & parts) Management's Report discusses the risks and uncertainties before the management trend and results, but has a percentage of words of

5.2%, very close to the sample average. To the contrary, the Management's Report of Luxottica (Consumer Goods – personal & household goods) discusses the risks and uncertainties at the end of the document and has a percentage of words of 15.5%, well above the average.

The next section answers the research questions set in the first section by discussing the findings that emerged from the field analysis and the changes in disclosure that followed the innovations introduced by the regulation. It also highlights the limitations and the future developments of this paper.

## 6. DISCUSSION AND CONCLUSIONS

The results of the analysis reported in the previous section highlight that the innovative issues introduced by the national regulation, which reflects the requirements of the European Community Accounting Directives, are not suitably dealt with in the 2008 Management's Reports of the 24 sample companies listed on the FTSE MIB 40 Index (managed by Borsa Italiana SpA).

Risks and uncertainties have received, on average, a space of 5.3% of words. In most cases, their treatment is not fully in line with what is wished for by the CNDCEC (2009a). In some Management's Reports, risks and uncertainties are even not discussed. Additionally, the financial risks are not always treated in a complete manner. Regarding the employment of performance indicators, in order to integrate the information on the company situation and the management trend and results, in many cases only Ebitda and Ebit, capital invested, net financial position and few other indicators are properly discussed.

Further indicators like ROE, ROI and ROS – when disclosed – are mostly calculated but do not ever receive specific comments. Regarding the information relating to environment and personnel, the picture is not totally satisfactory as well. In many of the Management's Reports these issues are not dealt with or are treated in a partial manner, disregarding what expected by the CNDCEC (2009b).

Considering only the innovative issues introduced by the reform, namely: risks and uncertainties, financial risks, performance indicators, environment and personnel, it is possible to classify each company into three categories of receptiveness to reform ("receptive", "partially receptive", "not receptive") based on the completeness of their Management's Report.

Companies are classified as "receptive" if their Management's Report receives a total score of 4 or 4.5 or 5 points; "partially receptive" if their Management's Report receives a total score ranging from 2 to 3.5 points; "not receptive" if their Management's Report receives a total score ranging from 0 to 1.5 points.

The criterion for scoring is as follows. As regards the four innovative issues: risks and uncertainties, financial risks, environment and personnel, 1 point is assigned to each issue if it has received a percentage of words equal or above the sample average, 0.5 point if it was dedicated a percentage of words below the sample average, 0 points if the issue is not treated in the Management's Report.

With regard to performance indicators, since the regulatory framework does not establish a minimum number of indicators to be disclosed in the Management's Report, and taking into account the findings of the investigation reported in the previous section, the following scoring criterion has been adopted.

If the Management's Report only discloses indicators such as Ebitda and Ebit, capital invested and net financial position, it was assigned a score of 0 points, because those indicators result from a reclassification of the Financial statement and are presented to generally discuss management trend and results.

If the Management's Report discloses more indicators than just Ebitda and Ebit, capital invested and net financial position, it received a score of 0.5 point. If the Management's Report discloses more indicators than those listed above and also presents a specific paragraph or table which clearly identifies performance indicators, it was assigned a score of 1 point.

The total score assigned to each Management's Report is calculated by adding the points allocated to each innovative issue. That score has been considered to classify each company in one of three categories of compliance with the new regulatory framework.

The categories of compliance can be considered as a measure of the receptivity to the regulatory change and are distinguished in high, partial and low. Table 6 shows the results of such classification.

Table 6 – Categories of compliance

| CATEGORY | COMPANY | SECTOR |
|---|---|---|
| *High* | Finmeccanica | Industrials (industrial goods & services) |
| | Mediaset | Consumer Services (media) |
| | Prysmian | Industrials (industrial goods & services) |
| | Saipem | Oil & Gas |
| | Telecom Italia | Telecommunications |
| *Partial* | A2A | Utilities |
| | Ansaldo STS | Industrials (industrial goods & services) |
| | Autogrill | Consumer Services (travel & leisure) |
| | Bulgari | Consumer Goods (personal & household goods) |
| | Buzzi Unicem | Industrials (construction & materials) |
| | CIR | Industrials (industrial goods & services) |
| | Enel | Utilities |
| | Fiat | Consumer Goods (automobiles & parts) |
| | Impregilo | Industrials (construction & materials) |
| | Italcementi | Industrials (construction & materials) |
| | Luxottica | Consumer Goods (personal & household goods) |
| | Parmalat | Consumer Goods (food & beverage) |
| | Pirelli | Consumer Goods (automobiles & parts) |
| | Snam rete gas | Utilities |
| | Terna | Utilities |
| *Low* | Atlantia | Industrials (industrial goods & services) |
| | Campari | Consumer Goods (food & beverage) |
| | Eni | Oil & Gas |
| | Lottomatica | Consumer Services (travel & leisure) |

In substance, on the basis of the findings resulting from our research, it can be stated that the companies studied are not very receptive to the changes set by the 2007 reform. There are very few Management's Reports that respect the normative requirements and present almost all the innovative contents. Moreover, even if the innovative issues are disclosed the quality of the information provide is debatable. Therefore, as our theoretical framework suggest, the reform of the regulatory framework may have introduced some pressures towards the disclosure of additional information in Management Report, but the changes in corporate disclosures may reflect a "for show" rather than a substantial change.

With respect to IASB's IFRS Practice Statement Management Commentary, the Management's Reports analysed in this paper are also not totally in line with the contents of the framework published by the IASB (given that they do not respect all the requirements of Article 2428 of the Civil Code). We agree with the IASB's decision that it is better to provide a framework for the presentation of Management's Report instead of a compulsory international accounting standard. The Management's Report is a document which is difficult to standardize because it presents the view of the management of a company in a precise moment. A standardization of the Management's Report can reduce its informative power. Nevertheless, it is important to consider the IASB's Practice Statement Management even if it is not a binding standard and a company is not mandatorily required to comply with it to be able to assert compliance with IAS/IFRS. It seems interesting to investigate if companies listed on the Italian Stock Exchange will voluntarily comply with this framework and to study how the companies behave in regard to disclosure of the issues related to the management objectives and the strategies for reaching these objectives. The communication of these issues requires the managers, besides supplying information on the past and the present, also to disclose specific information on the company's future. This requirement constitutes a considerable challenge, considering that the Italian context was, for a long time, characterized by management discretion.

The results of our analysis on the Italian context appear to be consistent with the characteristics of the national accounting regulation model (Di Pietra et al., 2000, pp. 59-78). Listed companies are operating within a system in which political forces and legal constraints are relevant. That is, when preparing their Financial statements and, in particular, their Management's Report, companies follow a "formal compliance" of the rules. The political and legal system operating within the Italian accounting regulation model is the ground supporting a typical attitude of Italian companies complying with new accounting rules: what it is not strictly required is not necessarily disclosed in annual reports and what it is not explicitly forbidden could be done. Assuming the opposite perspective this implies that Italian companies in preparing their Financial statements are used to resist the changes or are typically not so receptive (Di Pietra, 2011, pp. 230-257; see also Delvaille et al., 2005, pp. 139-164).

To be able to make a more reliable judgment on companies' receptivity to regulatory change, it is necessary to conduct a broader space-temporal analysis. A limitation of the current paper is that the Management's Reports from only one financial year were examined. The documents analysed are from the financial year ending 31 December 2008, as it is the first year in which the new requirements had to be implemented. It would be interesting to also examine the Management's Reports from financial year 2007, the year that precedes the implementation of the reform requirements, as well as financial year 2009, so as to formulate more complete considerations.

Another limitation of the current paper is that the sample of analysis is composed of companies operating in different sectors (with the exclusion of those operating in the Finance sector). A solution could be to create specific samples, with the aim of better understanding the disclosure behaviours of companies operating in the same sector.

In conclusion, the topic discussed in the present paper offers a starting point for reflections and stimulates further research to contribute to the scientific debate on Management's Report and on corporate disclosure.

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