Chapter 12
IASB ED Management Commentary Versus European Regulation: The Impact on Management's Reports of Companies Listed on Italian Stock Exchange

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Abstract This chapter aims to investigate how regulatory change affects corporate disclosure. The explanations are based on institutional theory which provides an understanding of how organizations may react to a change in the regulatory framework. By conducting a content analysis, the chapter focuses on the information disclosed in the Management's Reports prepared by the major Italian listed companies after the enactment of the 2007 law. This law extended companies' disclosure obligations since management has to disclose information pertaining to risks and uncertainties, performance indicators, environment, and personnel. The new requirements not only lead to an increase in the information to be disclosed, but also to a change in the nature of the disclosed information. In addition to the more traditional financial information, also social, environmental, and strategic information should be provided. The main results of the content analysis allow to formulate some tentative reflections on companies' receptivity to the 2007 regulatory change.

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12.1 Introduction

Corporate disclosure is debated in professional and academic arenas as the right of stakeholders to be informed has highlighted the limitations of traditional financial information provided by annual reports (Beattie 2000). Management should disclose additional information which enables the users of annual reports to better understand and interpret companies' performance (Beattie et al. 2004). Consequently, the supplementing information published in the Management's Report—also called Management's Discussion and Analysis (MD&A) or Operating and Financial Review (OFR)—plays an important role in the overall disclosure package (Clarkson et al. 1999). This report should present management's view on a company's situation with three perspectives: present, past, and future developments. Therefore, the information provided is important as it is the result of managers' willingness (or obligation) to disclose information, which may be sensitive to the company itself and to the users.

This chapter is aimed at contributing to the aforementioned topics by studying the impact of the 2007 regulatory change on Management's Reports compiled 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 how organizations may react to a change in the regulatory framework.

The research is relevant for two reasons. First of all, the Italian and EU legislators intervened on several occasions to determine the contents of the Management's Report. Thus, it is interesting to investigate the change introduced by the 2007 Italian law that, by adopting the European Directive 51/2003/CE, has expanded the contents to be included in Management's Reports. For instance, managers are now explicitly required to disclose information on company's risks, financial and non-financial performance indicators, and environmental and personnel information (Sottoriva 2007). Second, interest in Management's Report was also demonstrated by the International Accounting Standards Board (IASB), the international standards setter that in June 2009 published the Exposure Draft (ED) Management Commentary ED/2009/6 (IASB 2009). This ED is not a binding international accounting standard, but includes a general framework that can be used by managers as guidance for the preparation and presentation of decision-useful Management's Reports.

In trying to better understand the "disclosure pressures" perceived by companies, the chapter presents a comparison between the contents of the Management's Report required by the Italian regulatory framework, as changed in 2007, and those included in the IASB's ED, identifying similarities and differences.

The chapter also presents the first results of an empirical research on the disclosures of the major companies listed on the Italian Stock Exchange whose stocks are included in the FTSE MIB 40 Index. The empirical research is conducted through a content analysis of the 2008 Management's Reports because it is the first financial year in which the new requirements had to be implemented. The content analysis is aimed at assessing the general level of completeness of the selected

Management's Reports and understanding whether, and how, management disclosed information in compliance with the new requirements. All in all, the research results allow for formulating some tentative reflections on the impact of the 2007 regulatory change on Management's Reports and if managers have been receptive to it.

The remainder of this chapter is structured as follows. First, the theoretical background of the study is presented (Sect. 12.2). Then, a comparison between the contents of the Management's Report required by Italian regulatory framework, as modified in 2007, and those included in the IASB's ED is provided (Sect. 12.3). Thereafter, the research methodology followed for conducting the empirical research is explained (Sect. 12.4) and the main findings of the content analysis are depicted (Sect. 12.5). The final section discusses the main results of this study and highlights the limitations and future developments of this chapter (Sect. 12.6).

12.2 Theoretical Background

The relevance and role of accounting and corporate disclosure are widely debated in the academic and professional literature. Through the compiling and publication of annual reports, the company should be able to disclose the information that meets all stakeholders' information needs (Catturi 1997; Di Pietra 2005; Leuz et al. 2004; Burchell et al. 1980; Hopwood 1983; Roberts and Scapens 1985). In this sense, traditional financial information should be complemented and supplemented with the additional disclosures included in the Management's Report (Clarkson et al. 1999).

Because of the informative power of corporate disclosures, 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 annual reports and to facilitate comparability of information disclosed by different companies (Flower 1999). Accounting rules are created and change over time in order to consider the evolution of the outer and inner contexts of a company (March et al. 2003). 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 (Pettigrew 1987).

The internationalization of economic activities and the integration of capital markets have impacted on companies' reporting activities. On the one hand, companies need to prepare reliable and comparable annual reports, not only within a given country but also in the international sphere. On the other hand, companies also need to meet the expectations of different categories of stakeholders by disclosing both financial and non-financial information (Di Pietra 2002; Flower and Lefebvre 1997; Flower and Ebbers 2002; McLeay 1999; McLeay and Riccaboni 2000; West 2003). The "globalized" social-economic context has limited the effects of national regulation, strengthening and legitimizing the role of international accounting standards. Consequently, when compiling its annual report, each company can not 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 harmonization process. With Regulation n. 1606 of 2002, the European Commission recognized the IASB as the reference standard setter, obliging the companies listed within the European Union markets to apply the IAS/IFRS for the preparation of their consolidated annual reports (Camfferman and Zeff 2007; Tamm Hallström 2004).

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

Applying the theoretical approach proposed by Greenwood and Hinings (1996), a radical change occurs when a company 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 and 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 and Pettigrew 1994; Pettigrew 1987). In other words, the transition toward the use of new rules and, consequently, a change in disclosure behaviors are not only dictated by a regulatory framework change; they also depend on the decisions made by each company.

That is, European Union 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 change also depends on the reactions of the companies (Phillips et al. 2000). According to DiMaggio and Powell (1983), institutional pressures toward convergence lead, over time, the companies to follow isomorphic behaviors as each company tends to resemble the others. This attitude might not be due to reasons of economic rationality, but could be 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 behaviors 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 toward the adoption of new accounting rules. Accounting practices may in fact be difficult to change especially if the change requires a substantial transformation of the routines currently in use (Burns and Scapens 2000). In this sense, the diffusion and adoption of new 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 an extension of the contents to be disclosed in the Management's Report, impacts on the companies that have to comply with the new rules. However, the results of such transformation are not certain because of companies' possible deviating reactions.

After having highlighted how a change in the regulatory framework might impact on the preparation of Management's Reports, the next section identifies similarities and differences between the main issues of the IASB's ED the contents of the Management's Report in the Italian regulatory framework, as modified in 2007.

12.3 IASB's Exposure Draft Management Commentary Versus Italian's Regulatory Framework

As highlighted in the previous section, the internationalization and globalization of economic activities have influenced the level and extent of corporate disclosures. The Management's Report, the document which integrates the information disclosed in financial statements, should present management's view on a company's present and past situation as well as future developments. Therefore, the information provided is the result of managers' disclosure behaviors, whose quantity and quality may be sensitive and depending on the mandatory or optional requirements of the regulatory framework (Barron et al. 1999; Beretta and Bozzolan 2004; Pava and Epstein 1993; Penno 1997).

A proof of the value attributed to the Management's Report is that the Italian and European legislators intervened, on several occasions, to establish its contents. Interest in this document was also shown by the IASB, which in June of 2009 published the "Exposure Draft Management Commentary ED/2009/6" proposing a general framework for the preparation and presentation of the Management's Report (IASB 2009).

According to IASB's ED, Management's Report can be an important element of companies' communication with the capital markets, supplementing as well as complementing the financial statements. It provides a context within which to interpret the financial position, financial performance, and cash flows of an entity. It also provides an opportunity to understand management's objectives and its strategies for achieving those objectives. Users of financial reports in their capacity as capital providers use the information provided in Management's Report as a tool for evaluating an entity's prospects and its general risks, as well as the success of management's strategies for achieving its stated objectives (IASB 2009, p. 4).

The IASB's ED is not a binding accounting standard; it proposes a framework for the preparation and presentation of Management Commentary to accompany financial statements prepared in compliance with IAS/IFRS. This framework is intended to assist management in preparing decision-useful Management's Reports. According to the IASB, Management's Reports prepared in accordance with this framework can provide users of the financial statements with historical and prospective commentary on the entity's financial position, financial performance, and cash flows, as it explains management's view on not only what has happened, but also why management believes it has happened and what management believes the implications are for the entity's future (IASB 2009, pp. 7, 9).

According to IASB's ED, when compiling Management's Report, management should include information which is useful for the needs of existing and potential capital providers, as the primary "users" of financial statements. As for the "time frame," the framework explicitly states that Management's Report should communicate information explaining not only the present, but also the past and future performance, position, and development of an entity (IASB 2009, p. 8).

Moreover, management should consider the following "principles" that underpin decision-useful Management's Report, which:

a. provides management's view of the entity's performance, position, and development;
b. supplements and complements information presented in the financial statements; and
c. has an orientation to the future (IASB 2009, pp. 9–11).

On the one hand, the framework does not indicate a specific form for the "presentation" of Management's Report. It will vary between entities, reflecting the nature of their business, the strategies adopted by management and the regulatory environment in which they operate. On the other hand, the framework indicates the "content elements" of decision-useful Management's Report, which are stated below:

1. the nature of the business, discussing (a) the industries in which the entity operates, (b) the entity's main markets and competitive position within those markets, (c) significant features of the legal, regulatory and macro-economic environment that influence the entity and the markets in which the entity operates, (d) the entity's main products and services, business processes and distribution methods, and (e) the entity's structure and its economic model;
2. 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;
3. the entity's most significant (financial and non-financial) resources, (strategic, commercial, operational, and financial) risks and relationships with

stakeholders; how those resources, risks, and relationships affect the entity's long-term value and are managed;
4. the results of operations and prospects, describing (a) the entity's financial and non-financial performance, (b) the extent to which that performance may be indicative of future performance, and (c) management's assessment of the entity's prospects; and
5. the critical performance measures and indicators (both financial and non-financial) that management uses to evaluate the entity's performance against stated objectives (IASB 2009, pp. 12–16).

Table 12.1 summarizes the main contents of Management's Report according to IASB's ED.

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 (for example, the Accounting Modernization Directive 51/2003/CE).

In revising Article 2428 of the Civil Code with the 2007 law, the Italian legislator expanded the contents of the Management's Report by introducing substantial innovations with respect to the past (Sottoriva 2007). The Article's text is presented below, showing *in italics the parts added by the 2007 law*.

> 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.*
>
> *The analysis above 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.*
>
> In every case, the report should contain:
>
> 1. research and development activities;
> 2. transactions with controlled (subsidiary), affiliated and controlling (parent) companies;

Table 12.1 Contents of management's report according to IASB's ED

The nature of the business
Management objectives and strategies
The most significant company resources
Strategic, commercial, operational, and financial risks
The most significant business relationships
Management activity results
Future prospects
Performance measures and indicators

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 likely 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.

Finally, 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 Professional and Chartered Accountants (CNDCEC 2009a). The National Board of Professional and Chartered Accountants (CNDCEC) also addressed the information on the environment and personnel that should be disclosed (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—should include, starting with the financial year ending December 31, 2008, risks and uncertainties, as well as financial and non-financial performance indicators and information relating to the environment and personnel (Sottoriva 2007). The new requirements do not only deal with a broadening of the quantity of the information to supply. There is also a variation in the nature of the information to be disclosed: besides financial information, Management's Reports should include information of a social, environmental, and strategic nature. This is an enhancement with respect to the past, in which—as stated by Bagnoli (2003)—regulation was too generic and the academic and professional interpretations did not solve doubts regarding the contents of Management's Reports and their degree of depth (Bagnoli 2003, pp. 37–38, 91–93).

Table 12.2 highlights the key contents of the Management's Report according to the Italian regulations, as modified in 2007.

On the one hand, by comparing the innovations introduced by the Italian legislator with the main issues of the IASB's ED, it is possible to affirm that the Italian regulatory framework is—to some extent—ahead of the IASB project because of the explicit inclusion of environment and personnel matters (which are lacking in the ED/2009/6). In this sense, the Italian Accounting Setter (in Italian: *Organismo Italiano di Contabilità*—OIC), in the comment letter to the ED, declared that the IASB should deal with more significant and urgent projects

Table 12.2 Contents of Management's Report according to Article 2428 of the civil code

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
A description of the risks and uncertainties
Financial and non-financial performance indicators
Information relating to the environment
Information relating to personnel
The Management's Report must contain: 1. Research and Development activities 2. Transactions with controlled, affiliated, and controlling 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. Significant events occurring after the year-end close 6. Likely evolution of management
6-bis. With regard to the use by the company of financial instruments: a. The objectives and policies for managing financial risk b. Company exposure to price, credit, liquidity, and variation in cash flow risks
The list of company's sub-offices

instead of preparing a guidance on Management's Reports, since this document has a precise discipline in the European Union and also in Italy (OIC 2010).

On the other hand, IASB's ED explicitly 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. Such requirement is not explicitly mentioned in Article 2428 of the Italian Civil Code.

After having highlighted similarities and differences between the contents of Management's Report according to the IASB's ED and the Italian regulatory framework, as modified in 2007, the following section describes the research methodology adopted for conducting this research.

12.4 Research Methodology

The methodology employed in conducting the study presented in this chapter is based on a literature review and an empirical research. After carrying out a review of the national and international literature on changes in accounting regulation and the Management's Report, a 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) was executed.

In particular, the sample is composed of Management's Reports prepared by the joint-stock companies whose stocks are included in the FTSE MIB 40 Index. From 40 companies identified, the 13 companies afferent to the finance sector (banks, insurance, financial services) were excluded as they are subject to another specific disclosure discipline. The 27 remaining companies work in the following sectors: Consumer Goods (7 companies), Industrials (8 companies), Basic Materials (1 company), Consumer Services (3 companies), Utilities (4 companies), Oil and Gas (2 companies), Technology (1 company), and Telecommunications (1 company).

The Management's Report of each company was found online on the Borsa Italiana SpA web site, using the link to the document archive of each company. Tenaris' Management's Report was not available on the Borsa Italiana SpA web site; it was directly downloaded from the company's Internet site. Instead, STMicroelectronics was excluded because its 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 sample because the 2008 consolidated annual report did not include the diction of the Management's Report (even if the consolidated annual report comprises many paragraphs containing information attributable to a Management's Report). In this respect, the researchers have been neutral, focusing only the text explicitly included in the Management's Report.

All in all, the sample is composed of 25 Management's Reports.

Table 12.3 illustrates the sampling process described above, reporting the name of each of the 40 companies included in the FTSE MIB 40 Index (Borsa Italiana SpA), the sector in which it operates and if it was included in the sample.

The content analysis was conducted on the 2008 financial year Management's Reports because it is the first year of application of the new discipline. Specifically, for each company of the sample, a short note was written containing two types of information. The first type of information consists of general information on the company: the dimension (capitalization, sales, capital invested, number employees), the composition of shareholding (to evaluate if there are foreign members in the ownership), the geographic location of company's offices, the sector in which it operates, listed markets, the language used to compile the Management's Report (and financial statement). Instead, the second type relates to specific information which was searched in the Management's Reports. The content analysis was performed in two steps. The first step consisted of a check list aimed at investigating if:

- the Management's Report is a separate document or internal to the annual report for the year ending 31/12/2008;
- all the issues required by Article 2428 of the Civil Code are dealt with. This type of investigation provides an understanding of the general level of completeness of the selected documents;

Table 12.3 Sampling process

Company	Sector	Sample
A2A	Utilities	X
Ansaldo STS	Industrials (industrial goods and services)	X
Atlantia	Industrials (industrial goods and services)	X
Autogrill	Consumer Services (travel and leisure)	X
Azimut	Financials (financial services)	
Banco Popolare	Financials (banks)	
Banca MPS	Financials (banks)	
Banca Popolare di Milano	Financials (banks)	
Bulgari	Consumer goods (personal and household goods)	X
Buzzi Unicem	Industrials (construction and materials)	X
Campari	Consumer goods (food and beverage)	X
CIR	Industrials (industrial goods and services)	X
Enel	Utilities	X
Eni	Oil and gas	X
Exor	Financials (financial services)	
Fiat Group	Consumer goods (automobiles and parts)	X
Finmeccanica	Industrials (industrial goods and services)	X
Fondiaria Sai	Financials (insurance)	
Generali Assicurazioni	Financials (insurance)	
Geox	Consumer goods (personal and household goods)	
Impregilo	Industrials (construction and materials)	X
Intesa SanPaolo	Financials (banks)	
Italcementi	Industrials (construction and materials)	X
Lottomatica	Consumer services (travel and leisure)	X
Luxottica	Consumer goods (personal and household goods)	X
Mediaset	Consumer services (media)	X
Mediobanca	Financials (banks)	
Mediolanum	Financials (insurance)	
Parmalat	Consumer goods (food and beverage)	X
Pirelli and C.	Consumer goods (automobiles and parts)	X
Prysmian	Industrials (industrial goods and services)	X
Saipem	Oil and gas	X
Snam rete gas	Utilities	X
Stmicrolectronics	Technology	
Telecom Italia	Telecommunications	X
Tenaris	Basic materials (basic resources)	X
Terna	Utilities	X
Ubi Banca	Financials (banks)	
Unicredit	Financials (banks)	
Unipol	Financials (insurance)	

- the order established by Article 2428 of the Civil Code is respected. This type of investigation might highlight what choices have been made by managers when compiling the Management's Report.

The second step of the content analysis was dedicated to counting the space dedicated to the innovative issues (introduced in 2007) in terms of number of paragraphs, number of words, and density (the number of words devoted to each innovative issue divided by the total number of words in the entire Management's Report). Similar calculations were carried out as the space devoted to an issue may indicate which issues have received greater importance when compiling the Management's Report (Bagnoli 2009; Unerman 2000). In order to make these calculations, the PDF text was extracted with A-PDF text extractor program and transformed in a word document, enabling to select text parts and to count the number of words dedicated to specific issues.

The following section discusses the key findings that emerged from the content analysis of the Management's Reports included in the sample.

12.5 Findings

From the content analysis of the 25 Management's Reports of the companies listed on the FTSE MIB 40 Index (Borsa Italian SpA), the following considerations can be expressed. In 24 out of 25 cases the Management's Report was included in the consolidated annual report. Only one company, operating in the Utilities sector, prepared its Management's Report as a separate document.

The length of the documents examined (the total number of words) varied from a minimum of 4.272 words to a maximum of 57.432 words, while the average length is 27.912 words. Table 12.4 shows how many companies (and their respective sector) fall in different classes of Management's Reports' length (number of words).

Table 12.4 shows that about one-third of the companies has compiled 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 have other classes of length.

Regarding the general level of completeness of the Management's Reports, the issues required by Article 2428 (as identified in Table 12.2) are not always totally dealt with. In the majority of the cases, the issues excluded are:

- The list of the sub-offices: in 22 out of 25 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 somewhere else?
- The details related to own shares possessed and bought/transferred are lacking in 15 out of 25 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 25 cases): in some cases, the Management's Report has an explicit cross-reference to the notes to financial statements; in other cases, it was possible to understand that the missing issue is

Table 12.4 Length of Management's Report

Number of words	No. of companies	Sector
Less than 10,000	1	Consumer goods (personal and household goods)
	1	Oil and gas
Between 10,001 and 20,000	1	Basic materials (basic resources)
	1	Consumer goods (food and beverage)
	1	Consumer goods (personal and household goods)
	1	Consumer services (travel and leisure)
	2	Industrials (construction and materials)
	2	Industrials (industrial goods and services)
Between 20,001 and 30,000	1	Consumer goods (automobiles and parts)
	1	Consumer services (travel and leisure)
Between 30,001 and 40,000	1	Consumer goods (food and beverage)
	1	Consumer services (media)
	1	Industrials (construction and materials)
	2	Industrials (industrial goods and services)
	2	Utilities
Between 40,001 and 50,000	1	Consumer goods (automobiles and parts)
	1	Oil and gas
	1	Telecommunications
More than 50,001	1	Industrials (industrial goods and services)
	2	Utilities

dealt with in the consolidated annual report as it is listed in its index. Sometimes, there is no reference at all to the missing issue.

- In 11 of 25 cases, the management of and exposure to financial risks are completely absent or treated in a partial manner with a cross-reference to the notes to financial statements.
- Environmental information is absent in 8 of 25 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, likely evolution of management, and the significant events occurring after the year-end close.

- Finally, 14 of the 25 Management's Reports have up to a maximum of three issues excluded, while the remaining documents have greater gaps of information.

In some cases, the issues excluded in the Management's Report are dealt with in the consolidated annual report. It was possible to understand it from reading the Management's Report, because it makes a specific cross-reference to the consolidated annual report or to another document, or from reading the index of contents of the consolidated annual report. In other cases, it was not possible to determine if the issues excluded were dealt with in other documents.

Regarding the order in which the issues are presented in the selected Management's Reports, is it possible to state that the order indicated in Article 2428 (as identified in Table 12.2) is not ever totally respected. In the majority of the Management's Reports, the company's situation, and management trend and results, are the initial issues dealt with. However, there is no substantial uniformity in the order of the issues dealt with in the 25 documents analyzed, showing diverging presentation patterns.

Moreover, in different Management's Reports, multiple issues are dealt with in the same paragraph. The most popular format is to discuss some of the issues required by the regulation in a paragraph entitled "Other Information." The issues most frequently disclosed 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 innovative issues introduced in 2007, the following picture can be portrayed.

Article 2428 of the Civil Code requires companies to describe the *risks and uncertainties* to which they are exposed. In the majority of the documents analyzed, 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. The density of words dedicated to the risks and uncertainties fluctuates between a minimum percentage of 0.8 % and a high of 20.8 %, with an average value of the whole sample of 6 %. 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 one case the risks and uncertainties are introduced in a sub-paragraph inside the "Other Information" paragraph. In the other two cases, the risks and uncertainties are dealt with in a paragraph that also deals with the likely evolution of management.

In the majority of the Management's Reports analyzed, 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 the researchers had to identify them in order to determine the number of words devoted to those issues. The density of words dedicated to the financial risks varies between a minimum percentage of 0.6 % and a high of 6.8 %, with an average value of the whole sample of 1.4 %. In general, cross-reference is made to the notes to financial statements for a detailed discussion of these issues.

Another innovation 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 selected Management's Reports. 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 performance indicators. On the one hand, some items and margins (like cost and revenues, Ebitda, Ebit, capital invested, and net financial position) are presented and discussed, but the only other financial indicators found (not in every Management's Report) are ROI, ROE, ROS, and gearing and leverage. Only in the Management's Reports of two companies 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 ever a specific paragraph that listed and explained the performance indicators. In 7 of the 25 cases, there is a paragraph or table related to performance indicators. This implies that the density of words is biased downwards, with values between 0.4 and 2.4 %. The average value of the whole sample is only 0.3 %.

Regarding *environmental information*, the empirical analysis has highlighted that in one-third of the selected Management's Reports no reference is made to environmental information either in a cross-reference to the consolidated annual report, or any other document. The Management's Report of one company, even though it does not supply deep environmental information, refers readers to the Sustainability Report. When the Management's Report discloses 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 density of words dedicated to the environment varies between 0.3 and 6.6 %, with an average value of the whole sample of 1.8 %.

Regarding the *information on personnel*, the empirical analysis shows 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 25 documents analyzed, there is no reference to that issue. In some Management's Reports, the information on personnel is spread in different paragraphs, such as—for instance—"Health, Safety and Environment." The density of words dedicated to personnel varies between a minimum percentage of 0.5 % and a maximum of 14.6 %, with an average of the whole sample of 4.7 %. Not all the documents analyzed supply complete information on personnel 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 12.5 summarizes the main research findings pertaining to the new requirements introduced by the 2007 regulatory change.

From the empirical investigation, it emerged that there is no precise correspondence between completeness (quantity of issues dealt with) and the density of words dedicated to the issues dealt with. For example, one of the most complete Management's Reports (omitting just one issue) presents percentages of information on risk and uncertainties and on personnel that are, respectively, below the average and next to the minimum.

Moreover, there is no precise correspondence between the total length of the Management's Reports and the density of words dedicated to the issues dealt with. For example, the Management's Report that is among the briefest has the highest density of words dedicated to risks and uncertainties. Also, the longest

Table 12.5 Findings: average density of innovative issues

Innovative issue	Average density (%)
Risks and uncertainties	6.0
Financial risks	1.4
Financial and non-financial performance indicators	0.3
Environment	1.8
Personnel	4.7

Management's Reports have a density of words relative to risks and uncertainties which is quite lower than the maximum.

From the aforementioned considerations, it is evident that the issues prescribed by Article 2428 of the Civil Code are not always present, or dealt with in a complete manner, in the Management's Reports compiled by the major companies listed on the Italian Stock Exchange (Borsa Italiana SpA). Moreover, the order in which they are presented does not perfectly correspond with that indicated by the Civil Code. It is not possible to 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 one Management's Report the information on personnel is the second issue discussed, but the density of words is well below the average. Two other documents discuss the risks and uncertainties before the management trend and results, but have a percentage of words which is below the sample average. On the contrary, the Management's Report that discusses the risks and uncertainties at the end of the document has a density of words well above the average. This evidence highlights that companies have different presentation behaviors.

The following section discusses the findings that emerged from the content analysis. It also highlights the limitations and the future developments of this.

12.6 Discussion and Conclusions

The findings concerning the general level of completeness of the selected 25 Management's Reports seem to be quite in line with the results found by Bagnoli in 2003. The author claims that many Italian companies do not pursue full transparency and avoid disclosing some information. Specifically, many companies do not disclose present and future-oriented information, but only disclose superficial information on their personnel, research, and development activities (without telling the outcomes of such activities), no or partial information on the number and nominal value of own shares, as well as the stock or shares of controlling companies, bought, or sold during the year (Bagnoli 2003, pp. 250–271).

The results from the content analysis also reveal that the innovative issues introduced by the 2007 Italian law, which reflects the requirements of the

European Community Accounting Directives, are not always suitably dealt with in the selected Management's Reports.

Risks and uncertainties have received, on average, a density of words of 6 %. In most cases, their treatment is not fully in line with what was wished for by the CNDCEC. In some Management's Reports, risks and uncertainties are not discussed at all. 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 personnel and environment, 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 is expected by the CNDCEC.

The Management's Reports analyzed in this chapter are also not in line with the contents of IASB's ED. It becomes interesting to follow IASB's progress with the ED and to understand which role it may play on the preparation of Management's Reports (given that it is not a binding accounting standard). If the IASB approves a final version, it might be challenging when it comes to disclosing management objectives and the strategies for reaching these objectives. The communication of these issues requires that the managers, besides supplying information on past and present events, also communicate specific information on the company's future. This requirement is a considerable challenge, considering that the Italian context was, and still is, characterized by management discretion and avoidance of full transparency (Bagnoli 2003).

The findings suggest that the companies included in the sample were not very receptive to the changes set by the 2007 law. There are very few Management's Reports that respect the normative requirements and present almost all the expected contents. This also means, in accordance with the theoretical section, that companies have not shown an immediate convergence toward the new disclosure rules. This room for deviating behaviors can be explained by the Italian long lasting reluctance to disclose sensitive information, but might also be related to type of pressures exerted by legislators and standard setters. To what extent are companies' disclosure behaviors compelled by the regulatory framework?

All in all, to be able to make a reliable judgment on companies' receptivity to regulatory change, it is desirable to conduct a broader space-temporal analysis. A limitation of this is that the Management's Reports from only one financial year were examined. The documents analyzed are from the financial year ending December, 31st, 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 new requirements, as well as financial year 2009, so as to formulate more complete considerations.

Another limitation of the current is that the sample is composed of companies operating in different sectors (with the exclusion of those operating in the Finance sector). An option could be to create specific subsamples, with the aim of better understanding the disclosure behaviors of companies operating in the same sector.

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

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