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## When the financial statements are definitive the Italian case

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### Abstract

In this article, the question arises as to when a balance sheet can be defined as definitive is certain. Undoubtedly, observance of the postulates of truthfulness, fairness and clarity is the first step toward drawing up a legitimate and legally valid balance sheet. This, however, does not guarantee that the financial statements are certain and definitive because, at any time, a shareholder or third party may challenge the financial statements drawn up even though they observe the postulates of clarity, truthfulness and correctness. The balance sheet will become final and inevitable when no one can challenge the resolution approving that document. This article will highlight the evolution that has taken place in Italy concerning this issue.

**Keywords:** Financial statement, financial statement challenge, understandability, truthfulness, fairness, financial statement postulates

### Introduction

Regardless of the legislation governing this structured document, it must always draw up the financial statement must always be drawn up by applying three fundamental postulates, the failure to observe which, in every country in the world, leads to an illegitimate financial statement. Each legislation understands the overall document to consist of different elements. Countries like Italy consider the cash flow report a document part of the financial statement. Others think it to be only an accessory and voluntary information that companies may not even communicate externally. All countries, however, regardless of the structure of the financial statement in force, indicate clarity, truthfulness and fairness as postulates of the financial statement. Italy indicates these postulates in Article 2423 of the Civil Code. It should be noted how, in some countries, truthfulness and fairness identify a single postulate defined, generically, as truthfulness but which, in reality, also includes what, in Italy, we define as fairness.

Without the observance of these postulates, the financial statement cannot be considered valid and legitimate in any country.

### Understandability

The Italian national accounting standards OIC (Organismo Italiano Contabilità) deal with this issue very concisely, limiting themselves to stating that the financial statement must be understandable and must therefore be analytical and accompanied by explanatory notes that facilitate comprehension and intelligibility of the schematic accounting symbology. However, the information provided must not be excessive and superfluous (OIC Principle No. 11 Financial Statement - Purpose and Postulates).

The relevance, not only theoretical and academic but pragmatic and relevant in judicial matters, obliges us to go into the concept of clarity in more detail.

From the above, it can be understood how this postulate pertains to a problem of form and not substance. Clear' communication does not imply correct and truthful information but only identifies a flow of information intelligible to the addressees.

Information is clear when the user can fully understand the message addressed to him.

Concerning this, we like to recall how at the end of the 1960s, communication studies underwent a real scientific revolution, in the Kuhnian sense of the term.

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In 1971, Watzlavich, together with some of his colleagues, after carrying out an in-depth analysis on the subject in question, concluded that one could not communicate. This assertion created a profound break with the previously developed studies; the definitions of communication that had been formalised in the 1940s and 1950s, although they revealed a remarkable evolutionary process, had never specifically emphasised this particular aspect of human behaviour. Watzlavich, on the other hand, analysed the consequences of what one might call the 'passive behaviour' of an individual and came to affirm that every individual, regardless of whether or not he or she sets himself or herself the goal of sending messages to third parties, communicates with the outside world by simply adopting or not adopting a certain behaviour. Watzlavich's axiom derives the need for each individual to formulate a true and proper communication strategy. Only by acting in this way are subjects able to programme, and thus keep under control, the messages that they voluntarily or involuntarily continuously send to the outside world.

It is understandable how such statements, having considerable relevance in every field of human endeavour, also acquire particular importance in the corporate world. Therefore, every company, whether it implements a specific communication policy or no communication at all, disseminates information. If this is not optimally planned, the news and communication that will be, in any case, intended for third parties will be a chaotic vision of the company and, unequivocally, will provide the outside world with a bad image of the company.

Therefore, it is in the company's interest to plan its communication activities since this is the only way the company avoids the danger of sending unfavourable messages to third parties, perhaps unwittingly. As has been emphasised in the preceding pages, the primary corporate communication tool is the financial statement, a document concerning all the general considerations that can be made about any reticent and/or passive conduct of the company that is not explicitly connected economic-financial and asset communication apply.

In the writer's opinion, the postulate of clarity, also understood in purely civil law terms, cannot disregard specific primary considerations regarding the so-called intelligibility of the financial statement.

The judgement on the observance of the postulate of the understandability of the financial statement cannot disregard two specific orders of considerations:

- a) to inform means to send, using appropriate tools, messages to the outside world
- b) informing also means not losing sight of the actual reception capacity of the user to whom the message is sent.

In the context of corporate reporting, the problem of the correct reception of the message contained in the financial statement assumes particularly relevant importance since accounting is not only a semiotic system which, being composed of signs, is in itself complex to interpret, but it is also a system characterised by particular features that make the work of those who must understand the messages contained in such a document even more difficult.

The main problems that a person faces when trying to

understand the set of signs in the financial statement are therefore connected to the interpretation of the symbols in the document.

### **These problems can be traced back to three different cases**

- 1) In financial statements, expressions are often used that are typical of everyday language. This circumstance, on the one hand, can sometimes simplify the task of those who have to interpret those signs; on the other hand, it can create considerable problems since, in many cases, it happens that the accounting symbols - although using terms that are typical of the spoken language - use such terms with meanings that are also profoundly different from the purposes in which they are accepted in ordinary language. In such a situation, it may lead the interpreter to attribute the accounting symbol to the meaning commonly accepted in ordinary language, with the possibility of falling into misunderstandings, even macroscopic ones, of interpretation;
- 2) many accounting terms do not find immediate correspondence in ordinary language. In other words, the person who has to understand the financial statement finds himself faced not only with phrases that could mislead him, since their accounting meaning is different from the one generally attributed to those terms in ordinary language but also with purely technical accounting entries which, not being directly translatable into ordinary language, are in practice incomprehensible to a non-expert reader.
- 3) Finally, identical symbols often designate different objects or vice versa, while other signs refer to similar phenomena. If one then adds to this the observation that different authors, on the one hand, can attribute heterogeneous meanings to identical items and, on the other hand, are likely to assign the same meanings to different terms, one can understand how the work of those who have to interpret financial statement data can become arduous and complex.

The above three cases do not represent an exhaustive list of possible causes of difficulty that a non-expert reader encounters when interpreting a financial statement. However, these considerations must be borne in mind when judging compliance with the understandability postulate imposed by Article 2423 of the Italian Civil Code in business and purely legal terms.

However, bearing these brief observations in mind, it can be understood how often a financial statement can be totally or partially incomprehensible to many subjects who need to analyse a specific company's public financial statement. The latter is a problem that mainly affects those who are not competent in the field; even though it must note, it is not impossible to find - in particular financial statements - entries that are difficult to interpret even for accounting experts.

It must interpret the postulate of comprehensibility based on all the above observations. Only by considering the complex problem of the intelligibility of a document made up of symbols can the correct connotation of the concept of comprehensibility be achieved.

If, on the one hand, therefore, the financial statement, often

representing the only instrument of information towards the outside world, must, without a doubt, also be understood by non-experts, on the other hand, it is not possible to disregard the consideration that an accounting language is a form of communication characterised by a problematic interpretation inherent in the language itself.

However, scholars have no unanimity of opinion concerning the degree of intelligibility that would be desirable in public financial statements. While some authors believe that accounting language cannot disregard an inevitable technicality, other scholars affirm, on the contrary, that the possibility exists that the drafting of the document in question can instead be done by abstaining - at least in part and as far as possible - from excessively technical symbology. Often, adopting such an attitude, the authors belonging to this second doctrinal current point out means clashing with the opinion of those who believe that financial statement items should be as concise as possible. Therefore, this "necessary" conciseness is not of such importance as to justify a substantial decrease in the informative capacity of the financial statement and, consequently, some scholars have argued that a more outstanding specification, even if apparently in contrast with the ancient canons of accounting aesthetics, should, in any case, be chosen to ensure the best understanding of those indications. According to some scholars, this thesis would also be implicitly accepted by the Italian legislator. The financial statement is considered an information tool directed to a set of users concerning whom one cannot, a priori, assume a particular receptiveness. Moreover, the legislator disregards any reference to specific accounting techniques, which would further prove the acceptance of the thesis advocated by the doctrinal current to which they adhere.

The various authors who have dealt with this subject have therefore expressed diverging opinions about the degree of 'accounting technicality' that should characterise the stage of preparation of the financial statement. Nevertheless, the doctrine agrees on the need for the financial statement to become an understandable and accessible information tool for an increasing number of subjects.

In the writer's opinion, the postulate of understandability necessarily implies the assumption that the reader of the document is provided with a minimum knowledge in the field of accounting, since the financial statement adopts a technical language, ineliminable insofar as it is inherent in the document itself, the comprehension of which cannot disregard a knowledge, even minimal, that must inevitably characterise the person who is preparing to read and interpret the data contained therein.

Consider, for example, the problem of the titles of accounts used in financial statements. There are several examples of accounts whose comprehension is within reach of anyone and thus also of persons with no 'accounting knowledge'. Accounts receivable from customers, cash, active bank, accounts payable to suppliers, accounts payable to the state, etc. are understandable even by those with no expertise in the subject. They are devoid of any technicality.

However, there are some items which, on the contrary, are comprehensible only by those with minimum accounting knowledge. These include accounts receivable for deferred tax assets, tax liabilities, revaluation reserves, negative reserves for treasury shares in the portfolio, other intangible

assets, etc. Understanding these items presupposes knowledge of accounting, albeit not expert knowledge. Again by way of example, consider the case where, in the notes to the accounts, reference is made to the fact that qualified participations have been valued by applying the equity method. Even in this case, the information provided is only apparent to a person with basic accounting knowledge. Indeed, this statement is obscure to a person without knowledge of accounting and bookkeeping. However, this does not mean it can describe the financial statement as 'unintelligible'.

In conclusion, therefore, it can be assumed that understandability does not mean that the financial statement must be comprehensible to anyone, but can be interpreted, without any problems, by those with a basic knowledge of accounting.

When calling for more excellent intelligibility of the financial statement, reference is naturally made not so much - or instead not only - to better comprehensibility of the individual items included in the balance sheet and profit and loss account, but rather to greater comprehensibility of the document as a whole, and therefore as a whole. This depends on the fact that the individual items of the financial statement, although having their own "individuality", are part of a more extensive system. This circumstance prevents the interpretation of a specific income and/or capital item separately from all other components of the financial statement itself.

It is also evident how comprehensibility must cover all the financial statement components. In Italy, the financial statement consists of the balance sheet, income statement and notes to the financial statements. The financial statement consists of only part of these documents in other countries. However, the circumstance that must be emphasised is that it is stipulated that understandability must be distinguished from all the documents making up the financial statement in all countries.

In conclusion, it is necessary to emphasise a final observation concerning the relationship between the amount of information provided externally and the receptiveness of this information on the part of users. Informing understandably does not mean 'flooding' the potential information user with a considerable mass of news since it is well known that the best method of not reporting is basically to disclose too much.

The intelligibility of a financial statement containing a disproportionate amount of news to the actual needs of the user is, undoubtedly, less high than that of a document in which, although less data is collected, an attempt has been made - in preparing the 'grid' of news to be provided - to take into account the actual cognitive needs of the users. Therefore, the communicative capacity of the financial statement (like that of any other information document) increases, not when the mass of information provided is quantitatively increased, but rather - as is also stated in Doc. no. 11 of the OIC Financial Statement - Purpose and Postulates - when the two principles of relevance and selectivity are correctly applied, concepts that should always be kept in mind when aiming to communicate effectively with the outside world.

Based on the considerations made in the previous pages, one can therefore state, agreeing with Pontani (Pontani, 2005),

that three inseparable peculiarities should characterise that understandability

- 1) "morphological comprehensibility (comprehensibility of forms), which relates to the compilation of the financial statement and which focuses on how the data is systematically arranged
- 2) a syntactic understandability concerning the logical expressiveness of the financial statement
- 3) a lexical understandability, about the language used, which is necessary to avoid risk factors implicit in ambiguity, genericness or even terminological erroneousess".

Particularly interesting are the considerations expressed by the jurisprudence of legitimacy concerning the "temporal moment" in relation to which compliance with Article 2423 must be assessed. In fact, the Supreme Court of Cassation has pointed out that "understandability and completeness ..... are required at the time when the shareholders' meeting resolves on approval, because the formation of the financial statement for the year must take place according to strict annual deadlines, and therefore subsequent events are not worth, per sé, justifying ex post facto determinations that must take place in the situation in which they were when they were taken into consideration when the financial statements were approved" (Court of Cassation, 4 April 2001, sentence no. 4937).

In conclusion, it is worth emphasising that both the national OIC and international IAS/IFRS standards emphasise that a principle that can be defined as 'materiality' must be observed when preparing the financial statement.

Based on this postulate, in document no. 11 OIC Financial statements - purpose and postulates, it is emphasised that only information that has a significant effect on the financial statement data or the decision-making process of the recipients must be disclosed in the financial statement.

An excessively high level of analyticity, at the level of both the accounting schedules (balance sheet and income statement) and the notes to the financial statements (as well as the report on operations), in fact, causes not an increase in understandability, but a reduction in the informative capacity of the financial statement itself.

The correct interpretation and application of the principle of "materiality" is also essential to understanding the effects of errors/simplifications that can be identified when preparing the financial statement. Here, we only wish to emphasise how errors, simplifications and rounding-offs are technically unavoidable and find their "limit" precisely in the concept of materiality: that is, they must not be of such a magnitude as to have a material effect on the financial statement data and their meaning for the recipients.

In the IAS Framework, this principle is set out in § 5.12- 5-17, and in this respect the Framework states: "Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example: (a) it is uncertain whether an asset or liability exists...; or (b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low ..... The presence of one or both of the factors described in above

paragraph does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in above paragraph may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information. Existence uncertainty Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements. Low probability of an inflow or outflow of economic benefits An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38). If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes. Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example: (a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)). (b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information".

### **Truthfulness and fairness**

Concerning the financial statement, one cannot use the term 'truth' - which would imply the existence of absolute truth - but must instead refer to a concept of truthfulness, understood in the sense of reliability. In financial statements, in addition to objective values (and thus true in an absolute sense), personal items must also be noted, which identify conjectures and estimates, respectively. Subjective values identify estimated quantities if the determinations are approximations to the truth, while they determine conjectures if they represent 'subjective representations of the truth'.

It does not appear reasonable to analyse this issue in-depth. Still, to understand the concept of truthfulness imposed by

Article 2423 of the Italian Civil Code (as well as by Article 2217 of the Italian Civil Code), it is necessary to make some reference to the article mentioned above, as the correct interpretation of the postulate of truthfulness is interconnected precisely to the presence in the financial statement of conjectured and estimated items, or of objects that attempt to represent, on the one hand, an approximation to the "true" and, on the other, a subjective representation of the "true". Examples of subjectively measured values include depreciation and amortisation, the determination of the closing value of inventories, the identification of the exchange value based on which a payable or receivable expressed in foreign currency is to be recognised in the financial statement, the identification of receivables potentially subject to bad debts, the determination of the year-end valuation of securities, equity investments and derivative financial instruments, etc.

Bearing in mind these types of accounting items indicated in the financial statement, it can be understood how this document can therefore be more or less reliable depending on whether the approximations to the 'true' are made in a manner consistent with the reality to be shown in the balance sheet and income statement.

Therefore, it is possible to speak not of truth but a 'greater or lesser degree of approximation to the truth' concerning subjective quantities.

These items inevitably require the preparer of the financial statement to implement a correct evaluation process that identifies reliable values concerning the economic and financial reality that the financial statement must reflect.

Estimates and conjectures are not the results of arbitrary behaviour on the preparer of the financial statement, as they cannot express absolute subjectivity. They must express rational subjectivity, i.e. represent the result of an assessment that, although subjective, must have a sound theoretical basis. The IAS Framework states that "information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example: (a) it is uncertain whether an asset or liability exists (see paragraph 5.14); or (b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs 5.15-5.17). The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in paragraph 5.12 may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information. Existence uncertainty Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be

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It is evident how, given the characteristics of estimates and conjectures and subjective values in general, no one can guarantee the exact value to be attributed to such valuations. Whereas for approximate and estimated quantities, an ex-post 'control' of exactness is, in any case, conceivable, for conjectures, this is technically impossible because representing values which are attributed to different objects as a division of unique values common to those objects of imputation', they cannot be verified by subsequent verification.

Concerning the postulate that is the subject of our attention, the IAS notes that most financial information is subject to the risk of not wholly providing a reliable presentation of what it is intended to represent. This is not so much due to intentional distortions but rather to inherent difficulties in identifying the transactions and events to be measured or selecting and applying the valuation and presentation criteria that can provide messages that correspond to the transactions or events in question. In some circumstances, the measurement of the financial effects of various items may be so uncertain that entities generally do not recognise it in the financial statements; for example, although most entities generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other circumstances, however, it may be significant to recognise the items and disclose the risk of error surrounding their recognition and measurement.

In establishing and illustrating the concept of reliability, the IAS Framework emphasises that it must observe the principle of substance over form. Suppose information is to represent the transactions faithfully and other events it is

intended to represent. In that case, they must be recognised and represented according to their substance and economic reality and not merely according to their legal form. The significance of transactions and other events is not always consistent with what appears in their legal or construed form. For example, an entity may dispose of an asset to a third party in such a way that it appears from the records that ownership of the asset is transferred to the counterparty; notwithstanding this, there may be arrangements that ensure that the entity will continue to enjoy the future economic benefits associated with that asset. In such situations, recognition of a sale would not faithfully represent the transaction that has taken place (if a transaction at all).

Legislation on the subject of financial statement valuations cannot, by its very nature, regulate, in an analytical and specific manner, every issue related to the various items of a theoretical and estimated nature in financial statements.

The task of the legislation is 'only' to dictate the 'Framework principles' to which the parties preparing the financial statement must refer. It is not conceivable that legislation should set out, in a detailed and specific manner, the procedures and valuation principles that must follow for the financial statement to be said to be true.

The circumstance that the law never specifically and analytically regulates every subject concerning the financial statement and, in particular, every valuation criterion connected to the conjectures and estimates in the balance sheet and profit and loss account, must be judged positively because a certain elasticity and adaptability must characterise this subject to the changes occurring both in the external world and within each company that, necessarily, the legal rules cannot have. By definition, flexibility cannot be possessed by a lawful provision whose characteristic, generally speaking, lies in its immutability for a typically rather long period.

Based on these considerations, it is easy to understand how it can only find the articles of the code relating to the financial statement in the reference Framework to which the preparer must conform in evaluating estimates and conjectures. However, a careful reading of the code articles makes it immediately clear how these reference principles, although essential and relevant, require further indications of an economic-business nature. Stating that depreciation must be systematic and calculated based on the possibility of the remaining use of the asset, knowing that inventories, by law, must be valued at the lower cost and realisable value inferable from market trends, or even being aware that receivables must be recorded at their presumed realisable value, helps the preparer to understand the basic principle applies when determining the individual item, but does not provide the latter with pragmatic and theoretical elements useful for the quantitative-operational determination of the amount to be recognised in the financial statement.

As pointed out above, they have well shown how subjective values, in reality, are not precise numbers but rather identify a circle within which it is necessary to opt for the value that the preparer deems closest to the truth that he wishes to represent in the financial statement.

In the civil code or other legislation of foreign countries, the operating principles applicable in the drafting of the financial statement and the postulates can therefore only find the Framework of reference but, precisely for this

reason, they require an analytical and structured source external to the legislation.

The hypothetical source from which to draw valuable hints for the correct evaluation of conjectured and estimated financial statement items could, in theory, be represented by the economic-business doctrine that, daily, deals with these issues. However, it is easy to understand how an in-depth study of the doctrinal thinking of the various authors, although indeed fascinating, would, in essence, be impractical for financial statement preparers. This would mean studying and analysing hundreds of books that are constantly being written on the subject of our interest. This is why, for several decades, the need has been felt for the issuance of correct accounting principles, regularly formalised, representing the summary of the best doctrine and practice at the time of issuance. Principles that, by their very nature, are not immutable over time but capture the changing situation and, for this reason, identify the instrument that, due to its completeness and flexibility, succeeds in integrating and completing the legislative 'gaps' that, necessarily, characterise all legal regulations governing the financial statement.

This is why accounting standards are issued, which represent points of reference that are often, as is the case in Italy, referred to by financial statement legislation and therefore, albeit indirectly, identify sources of law by reference to other legal norms.

For this reason, when in the following pages, we will analyse the judicial consequences of non-compliance with the postulate of truthfulness; we will not be able to avoid reference to what is affirmed by national and international accounting standards as mere consideration of what is outlined in the articles of the Italian Civil Code would never be able to make it clear whether it can define the financial statement being challenged as truthful and reliable or untrue and unreliable.

Concerning the postulate of truthfulness (and clarity), which we have discussed in the preceding pages, it is worth emphasising what has been affirmed by case law about the "moment in time" about which it must assess compliance with Article 2423. The Court of Cassation had pointed out that "comprehensibility and completeness ..... are required at the time when the shareholders' meeting resolves on approval, because the formation of the financial statement for the financial year must take place according to strict annual deadlines, and therefore subsequent events are not worth, per se, justifying ex post facto determinations that must take place in the situation in which they were when they were taken into consideration when the financial statements were approved" (Court of Cassation 4 April 2001, No 4937).

On the other hand, concerning the postulate of correctness, expressly provided for in Article 2423 of the Italian Civil Code, it can be stated that, according to the majority of economic-corporate doctrine, this principle identifies a concept that, although different from that of truthfulness, has ineliminable connections with the latter. As we have already had to point out, in many countries, this postulate is implicit in that of truthfulness. In Italy, on the other hand, it is mentioned explicitly, but, as we have already pointed out, part of the doctrine considers that, in essence, it forms a whole with the postulate of truthfulness.

In synthetic terms, it can therefore state that the postulate of correctness "integrates.... the principle of truthfulness and is, in a certain sense, upstream of it, since the representation, albeit faithful, of valuation results arrived at by the preparer of the financial statement based on erroneous initial data or erroneous valuation criteria would not be "true and correct" (Colombo 2003).

It should note that other scholars have provided different definitions of the postulate of interest. According to Salafia (Salafia 1992), the financial statement can be correct when the preparer has adopted the schemes provided for by the legislator, has provided the information set required by the code, and applied the drafting principles dictated by law. As can be seen, although explained in other terms, the postulate of correctness is inter-related to that of truthfulness so much so that it can be affirmed that the two postulates form a whole, as happens in many legislations of countries other than Italy.

After the synthetic analysis of the postulates of clarity, truthfulness and fairness, the question arises as to whether a financial statement prepared following these postulates can be considered a definitive and specific financial statement.

The answer is negative.

Even if the person who drafted the financial statement has complied with the postulates of truthfulness, fairness and clarity, it is always possible that a shareholder or a third party considers that these principles have not been complied with and, therefore, brings an action before the court to challenge the resolution approving the financial statement.

At this point, one must ask oneself when a financial statement can be considered specific and definitive. Regarding this issue, legislation varies from country to country. In the next section, we will analyse the Italian situation.

## **2) When a financial statement becomes definitive: the case of Italy.**

In Italy, the issue we are interested in is regulated by Article 2434 bis of the Civil Code. This rule states that "The actions provided for in Articles 2377 (nullity of resolutions) and it cannot bring 2379 (nullity of resolutions) against resolutions approving the financial statement after the approval of the financial statement for the following financial year.

Shareholders representing at least five per cent of the share capital have the right to contest the resolution approving the financial statement on which the statutory auditor has issued an unqualified opinion (1).

The financial statement of the financial year in which the invalidity referred to in the preceding paragraph is declared shall take into account the reasons thereof."

Since our attention is focused on the 'substance' and 'form' of the financial statement and not on the procedure for its approval, the invalidity that is the subject of our analysis is the radical nullity of the resolution approving the financial statement. In contrast, if our interest were focused on the procedure for the approval of the resolutions, we would have to investigate the nullity of the same.

From a reading of Article 2434 bis of the Italian Civil Code, we understand how a financial statement, after the approval of the financial statement for the following financial year, becomes specific and definitive in that it can no longer challenge it.

The issue seems straightforward and not worthy of further study. The reality, however, is quite different and much more complex.

In the past decade, the judiciary has taken a well-defined position. The Court of Rome, for example, states, "That being said, coming to the hypothesis of a financial statement challenged for the same reasons already submitted, concerning the previous financial years, to the assessment of the court, the Court notes how Article 2377, paragraph 7 of the Italian Civil Code provides that, once the invalidity of a resolution adopted by the shareholders' meeting has been pronounced (regardless of its content), the directors are obliged to "take the consequent measures, under their responsibility".

It follows that, once the resolution approving a financial statement has been declared invalid - and only after such final declaration of invalidity - the directors are obliged both to draw up a new financial statement for the relevant financial year, to file it at the company's registered office, to convene the shareholders' meeting for its recent approval and, finally, to file the new text with the companies register, or to adopt (again as 'consequential measures') all the necessary corrections to the subsequent financial statements in so far as the corrections made necessary by the first contested financial statement produce consequences reflected in the items of the following financial statements (corrections which, in theory, might not actually be essential because the grounds of invalidity do not affect those subsequent financial statements, either because the foundations of invalidity might not entail any significant changes in the contested items or because in the meantime the company's financial situation might have radically changed so as no longer to be affected by the invalidity noted).

Such obligation constitutes the result of the general duty incumbent on the directors to ensure that the information published, using the financial statement, by the company is correct and that the values relevant to the organisation of the company's life are indicated truthfully and consistently concerning different and successive periods.

Consequently, as has also been affirmed by other rulings of the jurisprudence on the merits, also of this Court (see, Trib. Rome, section III, 6 October 2008, no. 19456, Trib. Rome, section III, 29 July 2013, no. 16678; but see also Trib. Milan, 4 December 1986), those who have asserted certain claims of invalidity of a resolution approving a financial statement not only do not have, therefore, the burden of challenging all subsequent financial statements, until the finality of the judgment, to obtain purely and simply a "derivative" ruling, but they do not even have the right to do so, precisely because the claim to the fulfilment of what is imposed by the above-mentioned Art. 2377 of the Civil Code becomes concrete and current at the time when the alleged invalidity has been definitively ascertained in Court. It is clear that, once a favourable ruling has been obtained concerning the "first" contested financial statement, the plaintiff is entitled to have the directors proceed to adopt the consequent measures, also about subsequent financial years, to the Court's ruling. It is, therefore, equally clear that, conversely, the adoption of such measures (adoption that constitutes the object of a precise regulatory obligation that the Code places on the directors) is capable of thoroughly

and exhaustively satisfying the interests of the party invoking the same defect about the financial statements after the first contested statement. In other words, in the present case, to ascertain the interest - in concrete and actual fact - in bringing proceedings, the requirement of the impossibility for the petitioner to achieve the same result that he demands without recourse to the courts is lacking.

Moreover, the Court considers that, to the contrary, it would not be worthwhile appealing to the principle of correspondence between the request and the ruling according to Article 112 of the Code of Civil Procedure, stating that the court hearing the first appeal must necessarily limit itself to assessing the items of the financial statement approved with the resolution that is the subject of the appeal, otherwise incurring - i.e. in the case of the assessment of defects that vitiate the resolution approving the subsequent financial statement - a violation of ultra-petition.

The inadmissibility of the claim brought concerning the challenge to the financial statements after the first one does not derive in any way from the circumstance that the Court seized with the first challenge, going beyond the subject matter of the decision devolving on it, assessed the existence of the same defect in the subsequent financial statements, but from the obligation of the company's directors to take the consequent measures that fully satisfy the plaintiff's interest without the need for the latter to have recourse to the courts.

Lastly, a different conclusion could not be reached by pointing out how the judgment relating to the first financial statement could end, possibly also on appeal or in a subsequent decision of legitimacy, with an unfavourable ruling for the plaintiffs. In fact, in such a case, the definitive ascertainment of the legitimacy of the financial statement and, therefore, of the directors' actions could only reverberate its effects with the legitimacy of the subsequent financial statement and the following steps directors themselves.

The reasons for the lack of a shareholder's interest in contesting the company's financial statement by claiming the same flaws already underlying the contestation of the previous financial statements were the basis of sentence no. 8104/2011 issued by this Court and filed on 19 April 2011 in a similar case between the same parties in litigation today and concerning the financial statement relating to the financial year 2006".

From reading the operative part of this judgment, one can understand how, about ten years ago, the judiciary tended not to consider it possible to challenge financial statements after the contested one, as this would have entailed a plurality of actions that would have improperly added up. According to judgment No. 19829/2014 of the Court of Rome, therefore, those who have challenged a resolution approving the financial statement not only do not have the burden of challenging all the subsequent financial statements until the final judgment, but they do not even have the right to do so, because the claim to the fulfilment of what is required by Article 2377, paragraph 7, of the Italian Civil Code becomes concrete and current only when the alleged invalidity is definitively ascertained. In other words, in the hypothesis considered above, the shareholder's interest in bringing the action would not be identifiable.

Therefore, the latter could not challenge any financial statement after the one challenged in the main proceedings. However, this judiciary position has been superseded by several recent judgments both of merit and legitimacy.

Currently, the judiciary's position has been completely reversed with considerable consequences on when a financial statement can be considered final and definitive.

Already in 2017, the Court of Turin, with sentence no. 5097 decreed, in substance, that "if pending the lawsuit concerning the challenge of a financial statement, the approval of the financial statement relating to the following financial year takes place, the preclusion provided for by Article 2434-bis paragraph 1 of the Italian Civil Code does not operate. If the contested financial statement is replaced, the matter in issue does not immediately cease to exist, since the court hearing the case must in any event verify, albeit only as an incidental matter, whether the "replacement" financial statement has eliminated the cause that had led to doubts as to the legitimacy of the previous financial statement.

In fact, the Court of Turin, in its judgment No. 5097, stated that "It is true that a part of the case law seems to affirm that the provision of Article 2377, penultimate paragraph of the Italian Civil Code is applicable. (a general provision also applicable to condominium assemblies of buildings) and that, consequently, the matter in issue ceases to exist when the assembly, regularly reconvened, has deliberated on the same matters as the resolution subject of the challenge, taking action substantially substituting the invalid one, albeit without particular forms (Court of Cassation 1997 no. 12439).

It is also true that case law assumes that according to Article 2377 of the Civil Code, where the replacement of the nonbinding resolution takes place, the annulment cannot take place. The matter in issue ceases to exist (Court of Turin, 1.4.2014), with the court hearing the appeal not having the power-duty to incidentally review the legitimacy of the renewal deed, which, if anything, may be subject to further appeal if it is considered that it too does not comply with the law or the deed of incorporation (Court of Bari, 15.4.2014).

However, this is not the position taken by case law (in accordance, moreover, with the same regulatory dictate) to which the Court considered to adhere before it brought the case.

The Supreme Court has explained that the annulment of the resolution of the shareholders' meeting of the company under Article 2377 of the Italian Civil Code cannot take place only if the solution has been replaced with another one taken in compliance with the law or the bylaws. In contrast, if the subsequent resolution is also unlawful, the previous resolution must be declared invalid (Cass. 2010 No. 2999).

It follows that, pursuant to article 2377, penultimate paragraph of the Italian Civil Code, if another has replaced the contested resolution, the judge must verify whether the previous cause of invalidity has been removed, as he must ascertain, for the limited purposes of ratification-renewal, whether the ratifying resolution is free from defects, even if no independent appeal has been filed against it (Court of Cassation 2008 no. 16017; Rome Tribunal, 6.8.2015).

In practice, the appellate Court may extend its examination to the new resolution to verify ("incidenter tantum")



whether the previous cause of invalidity has been eliminated, not otherwise being able to directly review the legitimacy of the resolution after the one challenged (Trib. Salerno, 23.6.2009) unless, as mentioned above, an autonomous appeal has been filed against the same (as in the case at issue in the present proceedings)".

As we pointed out above, according to Article 2434-bis, paragraph 1, of the Italian Civil Code, it cannot bring nullity actions against resolutions approving the financial statement after the approval of the financial statement for the following financial year. However, the rule does not apply according to the new position of the courts if the approval of the financial statement of the subsequent financial year occurs during the lawsuit. A circumstance that leaves the action admissible since what matters for the claim's admissibility is that the shareholders' meeting resolution approving the subsequent financial statement did not take place before the jurisdictional challenge of the previous financial statement (see Trib. Roma 26 April 2016 no. 8276. This Court pointed out that "According to the first paragraph of Article 2434 bis of the Italian Civil Code, it cannot bring both nullity actions and annulment actions (Articles 2377 and 2379) against the resolutions approving the financial statement after the approval of the financial statement of the subsequent financial year. The legislature of the reform - by recognising the challenge of the financial statements relating to "closed" financial years as having a strong destabilising potential on external and endosocietal relations - has, therefore, manifested the legislative will to prevent challenges of mere nuisance: in fact, it is considered that where the alleged defect has also had repercussions on the subsequently approved financial statement, the challenge of the latter is sufficient, whereas where the weakness has not produced negative consequences on the subsequent financial statement, it would only constitute a historical fact that has had no negative impact on the company's organisation.

In jurisprudence, then, it is affirmed that the rule outlined in Article 2434 bis bases its rationale on the absence of interest in bringing an action for the invalidation of a financial statement that has been superseded by the approval of the subsequent financial statement, to stabilise the resolutions in the face of late initiatives (Trib. Milano, 22 January 2015; Trib. Milano, 23 September 2015).

The authoritative doctrine has also clarified that the rule in question links the preclusion of the actions to the "approval" of the financial statement relating to the subsequent financial year, with the result that the identification of the dies a quo from which nullity and cancellation actions are precluded is the date of the shareholders' meeting resolution approving the draft financial statement after the contested one, with no relevance, however, of the execution of the publicity referred to in Article 2435.

And in fact, it is considered that the only circumstance to take on value is the presence of a new financial statement made by the shareholders' meeting and intended to represent, in an updated manner, the company's equity and financial situation and the economic result for the year: this representation supersedes all the financial statements previously approved ..... However, the Board of Statutory Auditors considers that, in the present case, Art. 2434 bis do not lay down a limitation or prescription period, the expiry

of which can be avoided only by the submission of the procedural act constituted by the summons but links the inadmissibility of the challenge of the financial statement to the occurrence of a "fact" consisting of the approval, by the shareholders' meeting of the company concerned, of the subsequent financial statement.

And once approved, only the last financial statement must be taken into consideration to verify whether the representation of the company's accounts is correct.

That being said, in the case envisaged by Article 2434 bis the same rationale that first led the courts and then the legislature to affirm the principle of the splitting of the time limits for notification cannot be found in the case contemplated by Article 2434 bis, since the rule in question gives precedence to the requirements of stability of the corporate structure by affirming the futility of an appeal referring to a deed that has lost its value in the context of the organisation of corporate life.

Therefore, as the principle of demerger cannot be applied, to assess the preclusive effect resulting from the approval of the subsequent financial statement, it is necessary to have regard exclusively to the time of the pendency of the litigation, which occurs with the completion of the service of the summons in favour of the defendant.

As previously noted, then, the circumstance that, at the time of the completion of the service of the summons, the publicity formalities required by Article 2435 had not been carried out cannot have any relevance.

Also, the Court of Milan, in judgment No. 9853, reaffirmed the same principles underlined by the judgment mentioned above of the Court of Rome. In judgment No. 9853 of the Court of Milan, it is noted that "the shareholders' interest exists in challenging, based on the same defects, all the resolutions approving the financial statements after the one challenged first; this notwithstanding the existence of the directors' obligation, according to Articles 2434-bis paragraph 3 and 2377 paragraph 7 of the Italian Civil Code, to revise, following the final decision on the challenge of the first financial statement, not only the financial statement of the current year but also the interim financial statements."

In the judgment, it is underlined that "The Court, considering the opposing views, does not share the defendant's defence and believes that the plea of lack of current legal interest in the action to challenge the resolution approving the 2017 financial statement is unfounded and must be disregarded since the shareholders' stake in challenging, for the same defects, all the resolutions approving the financial statements after the one first challenged remains, and this even considering the existence in the system of the directors' obligation according to Articles 2434-bis paragraph 3 of the Italian Civil Code and 2377 paragraph 7 of the Italian Civil Code. 2434-bis para. Three of the Civil Code and 2377 para. 7 of the Civil Code to review, following the final decision on the challenge of the first financial statement, the financial statement of the current financial year, and the interim financial statements.

The shareholder legitimated to challenge the financial statement is the bearer of a right towards the company to receive true and correct information with the accounting document, and this right is protected by the shareholder's right, attributed under certain conditions, to bring an action against the resolutions that he deems illegitimate; this is an

absolute endosocietal protection that is quite different from that which the shareholder himself may indirectly obtain under the intervention of the administrative body required to comply with the outcome of the First Appeal.

It should bear in mind that the appeal, if it concludes in the affirmative for the challenging shareholder, entails the endosocietal cancellation of the invalid resolution with effect vis-à-vis all shareholders according to Article 2377, paragraph 7, of the Italian Civil Code. The certainty of this result is not offered to the shareholder by the director's obligation to consider the reasons for the declared invalidity of a financial statement in the preparation of the current financial statement.

The shareholder, in the event of the administrative body's failure to comply with its obligation to adapt the internal acts to the decision on the challenge of the resolution, has compensatory protection (not always easy to demonstrate) that does not in itself entail the lapse of the so-called intermediate answers if they are not challenged promptly.

It should be added that the same provision of Article 2434-bis para. One of the Civil Code, in establishing that it may not bring the actions provided for by Articles 2377 and 2379 of the Italian Civil Code against the resolutions approving the financial statement after the approval of the financial statement of the following financial year - a rule to be interpreted concerning the situation existing at the time of the filing of the application for appeal and not to the situation that may arise in the course of the proceedings - shows that what is precluded is only the exercise of an appeal against a financial statement after the approval of the financial statement of the following financial year and nothing else.

Article 2434-bis of the Italian Civil Code is relevant because it is placed precisely on the level of interest in bringing proceedings; in fact, as this Court has already well clarified (sentence no. 8138/2019 Pres. Ri. Cr. Est. Ri.) "the rule is also aimed at implementing the general principle of interest in bringing proceedings (Article 100 c.p.c.), since - according to the assessment given by the legislator read in the light of the principle of continuity of the financial statements - once the subsequent financial statement has been approved, the representation of the company's economic and financial situation given with the previous financial statement to shareholders and third parties has exhausted its informative and organisational potential, and therefore also its deceptive potential, the recipients of the information, for any consequent organisational assessment and decision, having instead to refer to the last approved financial statement" (thus Trib. Milan, 5 November 2016, in proceeding no. 53952/2011).

Therefore, the legislator with the aforementioned provision marks the boundary of the situation in which it considers that there is no interest of the shareholder in challenging the resolution approving the financial statement, beyond which the interest in bringing an action must be recognised, with the consequence that the shareholder's interest subsists, if legitimated to do so, in bringing an action challenging the resolutions approving the financial statement even after a challenge to the resolution approving the previous financial statement has been brought, even if the challenges are all based on the same grounds; In fact, there persists a current and concrete interest of the shareholder in obtaining the

legally relevant useful result consisting in the removal, not otherwise achievable, of the corporate resolution which he assumes to be vitiated and unlawful. "

Also, the Court of Turin, in judgment 5777 of 2018, points out that "however, as has been authoritatively noted in a commentary on the decision of the Court of Rome under discussion here, the fact that the directors are required to remake the financial statement declared null and void - and the subsequent ones that depend on it - does not in itself imply a lack of interest of the shareholder in challenging the subsequent financial statement, even if the objections relate to (the violation of) the same valuation criteria... While it is disputable that the later financial statement may be subject to adjustment following the invalidation of the earlier one, this uncertainty appears to be sufficient reason to affirm the existence in general of the shareholder's interest in challenging also the later financial statement, where 'the legally appreciable useful result, not achievable without the intervention of the court' consists in the finding with authority of *res judicata* that the later financial statement is also affected by nullity, for having applied the same criteria in factual and legal circumstances unchanged from those of the earlier financial statement already challenged.

Secondly, it is not a remedy equivalent to action for nullity that the shareholder may bring an action for liability against the administrative body which, despite being obliged to do so because of the propagation of the nullity, has failed to correct one or more of the financial statements after the one declared void and to submit the updated financial statement to the approval of the shareholders' meeting... The shareholder's interest in challenging for nullity the resolution approving a financial statement drawn up in violation of legal requirements "does not depend only on the frustration of the expectation that the same shareholder may have of receiving a dividend or, in any event, an immediate capital advantage that a different and more correct wording of the financial statement might possibly give rise to" but arises "from the very fact that the poor comprehensibility or incorrectness of the financial statement does not allow the shareholder to have all the information - obviously also intended to be reflected on the value of the individual shareholding - that the financial statement should instead offer him, and to which, through the declaration of nullity and the consequent necessary drafting of a new financial statement amended by the defects of the previous one, the contesting shareholder legitimately aspires" (Court of Cassation, 3.9.1996, no. 80, paragraph 1, of the Italian Supreme Court, n. 6). 3.9.1996 no. 8048, in motivation)".

Bearing in mind, therefore, the considerations illustrated by the most recent judgments of both merit and legitimacy, it can be affirmed that shareholders and, in the writer's opinion, also third parties external to the companies that have an interest in acting are "required" to contest the resolutions after the one examined as the leading cause of action so as not to see their initial step rejected for the loss of their interest in acting even if art. As stated by the Court of Milan, sentence 9853/2021, the shareholders' interest in challenging, for the same defects, all the resolutions of approval of the financial statements after the one questioned first exists; this notwithstanding the existence of the directors' obligation, according to Articles 2434-bis paragraph 3 and 2377 paragraph 7 of the Civil Code, to

revise, under the final decision on the challenge of the first financial statement, not only the financial statement of the current financial year but also the interim and subsequent financial statements. The financial statement can be considered definitive and specific only after all the above-described process has been completed. In contrast, when the resolutions approving the financial statements after the one that is to be challenged as the leading cause of action have not been challenged, in the judicial process, the financial statements after the one challenged and the latter cannot be considered definitive.

### Conclusions

From what has been set forth above, it can be understood how the financial statement can be considered definitive and certain after the approval of the financial statement of the financial year following the year to which the resolution to approve the financial statement refers. On the basis of several recent judgments of both merit and legitimacy, it has been pointed out by the judiciary how shareholders are required to challenge also the resolutions after the one challenged and as the leading cause of action in order not to see their initial step rejected due to a lack of interest in bringing proceedings. The financial statement can only be considered definitive when the entire judicial process is completed. After the one challenged as the leading cause of action, the financial statements have also been challenged; they were the subject of a ruling by the courts. Only in this case can the financial statement be considered definitive. If, on the other hand, after the contested financial statement, other financial statements have been approved, which in turn have not been contested, the financial statement which is the subject of the main proceedings is not, in reality, yet definitive.

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