

TOOLS TO DEAL WITH DIRECTORS' REACTION TO FINANCIAL DISTRESS AND RISK: THE ITALIAN MODEL

Patrizia Riva^{*}, Simone Accettura^{*}

^{*} University of Eastern Piedmont, Novara, Italy



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Abstract

The fear of failure and bankruptcy can paralyze decisions and make it difficult for directors to walk towards turnaround paths. Trying to manage the negative psychological connotation linked to crisis wording, the Italian Insolvency Code has introduced “warning procedures” intended as a tool aimed at supporting directors and corporate control bodies in identifying the first signs of crisis. If the first reaction is usually denial, then entrepreneur and directors need somebody who dialectically discuss their vision of the future exactly when decisions about it are taken and encourage the taking of timely decisions to resolve it. Therefore, the Italian model tries to find tools to deal with the board of directors' denial of critical issues by specific professional figures.

The Board of Statutory Auditors (B.O.S.A.) is dedicated to the *ex ante* supervision of board of directors and the company's management actions. It supervises first of all compliance with the law, the company statute, the principles of correct administration as well as the adequacy of the organisational, administrative, and accounting structure and its concrete functioning, and even more important the risks linked to directors' decisions.

The *supervision* activities and functions are completely different from audit ones — that express opinion regarding whether the financial statements are drawn up clearly and represent truthfully and correctly the financial and economic position of the company — and are entrusted, in the traditional governance system, to the B.O.S.A. who, in small and medium-sized enterprises (SMEs), can be composed by one independent professional so that it becomes a sole statutory auditor.

B.O.S.A is instead entrusted with specific intervention tasks in early warning which means timely interception of crisis signals. In the event of a potential crisis, B.O.S.A. performs a signaling role with a forward-looking approach to distressed situations.

A negotiated settlement is a new out-of-court tool introduced by the IC Code, which allows for lower costs and a confidential approach. It represents a tool to deal with directors where it allows the parties — debtor and creditors — to regulate their financial and non-economic interests through the agreement, providing support for the setting up and carrying out of the negotiations. This support is represented by the *facilitator* intervention of the independent professional (the *facilitator expert*). In the context of a negotiated settlement, the facilitator expert has the task of facilitating negotiations among the entrepreneur, the creditors, and any other interested parties, in order to identify a solution to overcome the imbalance conditions. In consideration of his function, the expert must be independent of all parties involved, impartial and confidential, appointed by a special commission part of the territorial competent Chamber of Commerce within a list of registered subjects with specific experiences or skills.

The expert is not comparable to the independent professional appointed by the debtor to express assurance opinion on the plan. Among the innovations introduced by the IC-Code there is the expansion of the institution of the assurance, as a focal instrument in terms of ascertaining the debtor's state of crisis both in a preliminary phase, on the basis of the *negotiated settlement* mechanisms, and in a possible subsequent phase with *crisis regulation procedures*. The independent auditor's — *attestator's* — work is important as the opinion he is asked to express — of course when positive and clean — helps to strengthen the reliability of the plan drawn up by management for the turnaround. Consequently, it improves the credibility of all commitments undertaken by the debtor for the recovery of the company. The opinion contributes to the knowledge of the company situation by third parties and creditors, especially if unrelated to the plan, so that the choices and renunciations they are faced with are decided and accepted taking into account a sufficiently robust, correct, and complete information base.

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