CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY IN ITALY: ADVANTAGES AND DISADVANTAGES OF A NON-EXPLICITLY-EXISTENT SYSTEM*

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Abstract

The greatest distinctions between corporate governance practices around the world appear to result from differences in law and not from differences in recommendations that emanate from the types of codes adopted. With the evolution of the concept of Corporate Governance the area of connections with the concept of Corporate Social Responsibility has become more and more wide. The possible way to separate ownership and control, so the corporate governance in the private sector of Italian economic system, has not been based on a unique model but on a set of different models for the different kind of enterprises involved. This paper analyses the connection between corporate governance and corporate social responsibility focusing on the Italian case where, since the system of corporate governance has never been clearly defined, the current outcome shows a unique system that well incorporates both concepts.

Keywors: corporate governance; corporate social responsibility; social capital; SMEs; industrial districts

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1. Introduction

The neoclassical model of the firm is based on the shareholder as the only "principal", all other stakeholders being considered as "agents". This paradigm goes back to the hypothesis that capital is the only one scarce factor of production, while labour is abundant and environment is a "free" good. These premises suppose that the shareholder is the owner of a firm's assets. Capital as an asset can be owned. However, the more intangible assets (such as reputation, trust, human capital, partnership etc.) become fundamental ingredients of value of a firm, the less this paradigm becomes relevant. Based on the neo-classical theory, one of the main challenges for Corporate Governance is to govern the potentially conflicting relationship between the principal and the agent[1], between the creation of shareholder value and the corporate strategy developed by managers. From the perspective of Corporate Social Responsibility, this basic challenge should be enlarged to include all potential conflicts of interest within a firm; this not only from a shareholders' point of view, but from the broader stakeholders' perspective (Van den Berghe and Louche, 2004, p.13).

There is no formal link between Corporate Governance (CG) and Corporate Social Responsibility (CSR) with the only exception being the OECD guidelines which contain an explicit recommendation to this extent. However, there is an evolving connection between the two. Risk and transparent reporting are essential component of Corporate Governance codices.

Risk in connection with CSR includes the environment, labour, social issues as well as the company's reputation. The value of a corporation can suffer visibly if any of these risks materializes, i.e. by falling revenues or by losing its license to operate. Accordingly a growing number of investors expect that CSR risks are being reported in a meaningful, detailed, quantified and timely manner and they expect corporation to install an effective risk management system, which also takes these CSR risks properly into account.

The attitude towards CSR is very responsive to the corporate governance system, since it exerts an influence on the importance given to different stakeholders. The listing brings in the foreground investors' expectations generally increasing

[1] In corporate governance terms, as it is known, the principal is defined as the shareholder(s) while the manager is seen as the agent.

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enterprise exposure towards media and the public entailing a grater importance of the image compared to other companies. If, on the one hand, the reputation is the expression of the company's identity, on the other hand it imposes a special attention to transparency and fairness of behaviour, creating a close connection with the overall development project of the company and the creativity in satisfying the needs of the stakeholders. All this is pointed out by data concerning listed companies, which are higher (or considerably higher) than those related to other companies (Unioncamere, 2003). The debate whether there is a convergence or divergence in CG systems around the world can find useful hints if we consider the concept of Corporate Social Responsibility. The basic corporate form has already achieved a great deal of uniformity; i.e. economies are approaching a world-wide consensus, managers should act in the interests of shareholders and this should include all shareholders, whether controlling or non-controlling. If we include the set of stakeholders in the subjects that managers have to consider in their decision making process, the border within Corporate Governance and Corporate Social Responsibility becomes very thin. There are three principal factors driving economies towards consensus: the failure of alternative models (e.g. manager-oriented, labour-oriented, and state-oriented models of corporate law), the competitive pressures of global commerce, and the shift of interest group influence in favour of an emerging shareholder and stakeholder class. Convergence in corporate law proceeds more slowly than convergence in governance (CG and CSR) and Italy can be a good example of the application of this process.

Because of historical (e.g. importance of the cooperative movement) and structural (the predominance of Small and Medium Sized Enterprises – hereafter SMEs) reasons, the attentiveness to the social relationships of companies has characterized the Italian national economic system. As we will see, the Italian Corporate Panorama is permeated by various corporate social responsibilities initiatives, both at private and public level, that derive from different approaches and tools.

This paper presents in par. 2. an evolution of the CSR and CG concepts, in par. 3 and 4 the actual non-explicitly defined system of CG in Italy and some of its advantages and disadvantages, in par. 5 and 6 the actual state of application of CSR in Italy and one of the most recent initiatives in terms of CSR that incorporates many principle of "good" corporate governance. Paragraph 7 concludes.

2. Some evolutions on CG and CSR concepts: a short survey

Corporate governance has generated intense interest among institutional investors over the past few years - with particular attention to the area of protecting socially relevant interests - as it has generated interest among large Italian groups which capitalise on the opportunity to protect stakeholders and to create "added value" for them through good corporate governance.

Corporate governance is concerned with the way in which corporations are governed by management. In particular, corporate governance is connected with the relationship between the management of a company and its ownership. A situation that is quite common is that ownership and management do not have the same objectives or subjective aims. For instance, the main objective of management and ownership could be to have the highest possible profit. But shareholders may be interested in such an objective because they prefer to have maximum dividends while management could be interested in high profit because this is a method of acquiring capital to invest without using external financial sources (Hughes 1994; Mayer 1994).

A definition for corporate governance can be built starting from the qualitative goodness of Board operations. Sheridan and Kendall (1992 p. 22) state, "Management is concerned with the company's operations, governance with ensuring that the executives do their jobs properly". So, corporate governance is a form of quality assurance on the Executive Board's operations.

As Dunlop (1998 p.236) points out, "Corporate governance is widely regarded as the evaluation of the performance of the executive Directors of the company by, or for, the company stakeholders (shareholders, employees, banks and creditors)". This definition highlights the important role of incentive that the Board receive from the Annual General meeting, in terms of control and reward. Probably the widest and more complete definition of corporate governance can be found in the work of Zingales (1994) in which corporate governance is defined as "the complex set of constraints that shape the ex-post bargaining over the quasi-rent generated in the course of a relationship" (Zingales 1994 p.3). Even in the work of Zingales there is evidence that a main role in this kind of system is played by the initial contract which, however, will be incomplete in the sense that it will not specify the division of surplus in every possible situation. The reason for this incompleteness it is to be found in the fact that it could be too costly to do or impossible because the situation was reflecting uncertainty (Williamson, 1996).

In a public context it may be that the government objective is to maximise profit or a combination of producer and consumer surplus while the main management objective is to maximise a function of the effort in managing the firm, its pecuniary returns and the utility generated by different non-pecuniary aspects of his entrepreneurial activities. For instance, a manager can regard as a non pecuniary reward all the

personal relations deriving from his managerial role, the amount of charitable contributions, a big and fast computer (good for videogames) and possible indirect rewards (monetary or not) deriving from purchase of production input from friends (Jensen and Meckling 1976). Since the objective function of management contains these three different variables, the optimum mix of effort, reward and benefit is characterised where the marginal utility derived from an additional quantity of expenditure in corporation activities is equal to each of the non-monetary benefits, the monetary reward and the disutility of work (effort).

Clearly there are some problems connected with the ownership of the firm and effective control. Basically the main issues to be analysed can be summarised as “environment”, “objective” and “behaviour”. The variable environment is connected with the availability and nature of information for each actor involved. The variable “objective” can assume different spatial dimensions (single/multiple) for each of the actors involved and the “direction” that the “objective” can have is of fundamental importance too. As previously seen, some objectives can be the same (maximum profit) but the action deriving from achieving the objective could be completely different considering different actors. Instead, in other situations, we could have completely conflicting objective between principal and agent. The variable “behaviour” is completely inter-connected with the other two previously examined variables. Given the nature of information and the nature of the objectives of the different actors, the possible set of behaviour could be large enough to be impossible to control.

The antagonism between capital and labour or between private interest and common good is obsolete, though this is not to say that there is a harmony, but rather that there is a resulting disharmony. The key lies in tension and in conscious searching. CSR begins where dualist thought ends (Van den Berghe and Louche, 2004).

Bowen (1953) provided the first modern contribution to the theme of CSR. He proposed the following definition of the social responsibilities of the businessman: "It refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society" (1953, p. 6). In Bowen's opinion, businessmen are responsible for the consequences of their actions in a sphere somewhat wider than that covered by their profit-and-loss statements (Carroll, 1999, p.270).

The CSR concept evolved in the following years despite some scepticism (Friedman, 1962, 1970) and many authors have underlined the positive relationships between social responsibility and business opportunities in terms of market opportunities, productivity, human competence and improvement of the competitive context (Tencati et al., 2004), i.e., the quality of the business environment in the location where companies operate (Porter and Kramer, 2002). Managers of firms have obligations to a broader group of stakeholders than the simple shareholders; a stakeholder is "any group or individual who can affect or is affected by the achievement of the firm's objectives" (Freeman, 1984, p. 46). Corporate Social Responsibility "encompasses the economic, legal, ethical, and philanthropic expectations placed on organizations by society at a given point in time" (Carroll, 1991; Carroll and Buchholtz, 2002). Therefore, by pursuing economic, social and environmental objectives the CSR-oriented company increases its intangible assets of knowledge and trust, which support the processes of value creation (Joyner and Paine, 2002). The stakeholder value created makes it possible to reward, in specific and appropriate ways, the different social stakeholders who contribute resources. Sustainability therefore becomes the strategic objective of socio-economic systems and responsible companies (Perrini and Tencati, 2003), which aim to pursue long-term economic development, consistent with promoting social needs and protecting the environment (Margolis and Walsh, 2003).

Corporate governance and CSR are two concepts that draw vigour from the same source: transparency, accountability and honesty.

Business activities and business operations need an ethical foundation, as the colossal downfall of major corporations has recently demonstrated both in the USA and in Europe (Zsolnai, 2002). As scandals spread throughout the corporate sector and into significant global organizations, management researchers have begun to examine ethics and social responsibility from a more global perspective. Doing so has been hampered by the lack of research that has a global perspective. Much of the literature on CSR, which is still in an emergent stage, has a national (US) or regional (Europe) focus. This is not surprising given the different cultures, laws and institutions that provide the context for social responsibility.

The European Union (hereafter EU) is concerned with CSR because it can be a positive contribution to the strategic goal adopted in March, 2000, during the European Council in Lisbon: "to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion" (Commission of the European Communities, 2001, p. 3). The Green Paper (presented by the European Commission in July 2001) suggests an approach based on the strengthening of partnerships among all interested parties (for example, companies, NGOs, social partners and local authorities). After the consultation process on the Green Paper closed on December 31, 2001, the EU has begun to work on a new document. The new Official Communication entitled "CSR: A

Business Contribution to Sustainable Development" has been released on July 2, 2002 (Commission of the European Communities, 2002b).

According to the Green Paper, "CSR is essentially a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment" (Commission of the European Communities, 2001, p. 4) and "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis" (Commission of the European Communities, 2001, p. 6). An increasing number of companies recognize social responsibility as part of their identity. This responsibility affects employees and more generally all stakeholders and this in turn can influence corporate success. The Green Paper identifies four factors, which lie behind the growing success of the CSR concept:

1. The new concerns and expectations of citizens, consumers, public authorities and investors in the context of globalization and large scale industrial change;
2. Social criteria, which are increasingly influencing the investment decisions of individuals and institutions both as consumers and as investors;
3. increased concern about the damage caused by economic activity to the environment;
4. Transparency of business activities brought about by media and modern information and communication technologies.

The EU proposes a framework to better understand the different elements of CSR: according to this approach, CSR has an internal and an external dimension. The CSR internal dimension encompasses human resources management; occupational health and safety management; business restructuring; management of environmental impact and natural resources. The CSR external dimension, which goes beyond the doors of the firm and involves many stakeholders, affects local communities; business partners, suppliers, customers and consumers; protection of the human rights along the whole supply chain and global environmental concerns.

Therefore, in order to respond to the pressures coming from society, companies should integrate social and environmental concerns into their business strategies, their management tools and their activities. That means going beyond compliance and investing more in human, social and environmental capital. Finally, the EU underlines the need for a holistic approach towards CSR integrated management in order to include social and environmental aspects into corporate planning, measuring and controlling of processes and to define a long-term strategy which minimizes the risks linked to uncertainty (Tencati et al., 2004, p.177).

The Green Paper defines a general framework for CSR, influencing the behaviour and strategies both in terms of public policies and private initiatives. The project launched in June 2002 by the Italian Ministry of Labour and Social Affairs on social responsibility of enterprises, as we will see, aims at promoting CSR among companies within this general European framework.

3. Separation of ownership and control in Italy

The possible way to separate ownership and control, in the private sector of Italian economic system, has not been based on a unique model but on a set of different models for the different kind of enterprises involved. The principles and norms of good corporate governance have been developing since the early 1990's, while they have been applied only recently. This can be seen as the way in which the system was self-organising given the fact that in Italy there has never been a law on corporate governance issue. Here we summarise the most common way to control firms in Italy:

i. For all the *individuals firms* (that in Italy represent a very high percentage of all the existing firms[2]) the individual exerts control with a majority of voting rights. It is more common among small firms and extremely rare among the largest ones.

ii. A *hierarchical group control* is the most frequent corporate governance model; it accounts for 52 per cent of manufacturing activity and is more frequent among larger firms.

iii. *Family control* is the second most relevant model. This is the case where family links exist among those in control or between the latter and non-controlling shareholders.

iv. *Coalition control*: is a model quite similar to the previous one but more complex. The trust-link between entrepreneurs and investors is based on their sharing common values (belonging to the same industrial district, to the same political party etc.). In a sort of way this can be interpreted as a Japanese Keiretsu and might be forged further with formal agreements.

v. The *financial supervision* model, where financial guarantees to non-controlling shareholders are represented by the presence of financial companies with privileged information exerting monitoring (banks, merchant banks, institutional investors etc). This model was basically absent among Italian manufacturing firms in 1992 since the Banking law did not allow the banks to own a relevant quota of shares in a firm.

vi. *Group*: important components of Italian economy are "Groups". A group is a set of companies with separate legal status, which are all subject to the direct or indirect control[3]

vii. *Voting rights in the AGM*. The Italian law does not adopt the principle of one share-one vote. Shares with limited vote (*privilegiate*) and non-voting shares (*saving*

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[2]This control model accounts in 1992 for approximately 9 per cent of the activity of manufacturing firms with more than 50 employees. See Bianchi et al.1998

[3]The ways to obtain the direct or indirect control in a group are several and they are not defined directly by the Italian law: The most *common ways (see Bianchi et al. 1998) are: through one or more lines of control - of one leadership - an individual, a coalition* of individuals or a government body.

shares) can be issued by listed companies. Even non-listed companies can issue shares with limited vote (i.e., just in an extraordinary AGM). The use of share without voting rights is however not widespread[4].

viii. For "*società cooperative*" the rule one share-one vote becomes one shareholder-one vote, according to which each shareholder has only one vote, whatever share of capital he owns. Under the Italian law multiple voting shares are forbidden. Voting caps instead are legal for listed and non-listed companies. The voting cap was very common for privatised companies: before the placement of its shares, the Government used its powers as shareholder to introduce voting cap amendments to the statutes of most of the companies to be privatised[5].

ix. *Shareholders' agreements.* Another source of separation between ownership and control are shareholders agreements. Shareholders' agreements concerning listed companies had to be notified to Consob, their contents have to be published in the press and they also have to be deposited at the company's register.

x. *Cross shareholdings.* A further source of separation can be found in the use of reciprocal shareholdings. The set of rules in this case is quite complex and it basically dependent on the fact that the firms involved are all listed or are not listed or some of them are listed and some not. The 1998 reform has introduced major changes in this regime. For a comprehensive analysis of this category and all the possible cases see Bianchi *et al.* 1998

xi. *Circular Holdings*. The separation between ownership and control may be obtained also by circular holdings, a device which is in place when a company A holds shares in company B, which holds shares, in company C, which in turn holds shares in A. Circular holdings are neither prohibited nor limited by the Italian law.

xii. *Interlocking Directorates* are not subject to any limitation under Italian law. They are not relevant for anti-trust purposes. It is also to note that no indirect disincentive against such separation tool comes from the legal regime of Directors' conflict of interests: the case law has in fact greatly relaxed such regime (which was originally intended to be quite strict).

At this point, an important feature is to understand which are the legal constraints that are present in Italy among the several forms in which a firm can be legally organised. The most relevant legal distinction is between partnerships, where liability is unlimited for at least some of the owners, and limited liability companies, where liability is, normally, limited. For the former, the legal regime is quite basic and a wider discretion is left to private parties' arrangements. For the latter, the law designs also the internal structure of the company, and is normally mandatory.

An important contribution to identifying the fundamental elements to establish effective corporate governance was the 1996 "Corporate Governance Project for Italy". Its scope was to adapt the US-based COSO Report (Committee of Sponsoring Organizations, USA 1992) on internal control, and to further examine the roles, responsibilities and processes of various players (shareholders, directors, supervisory bodies, external audit companies and other stakeholders).

The Consob provisions of 1997 charge the board of directors with the obligation of supervising the general trend of operations within the extent of their controls, stressing the importance, among other things, of the exercise of proxies assigned. Many of the issues arising from the above-mentioned project were then resolved via the reform introduced by the Draghi law on corporate governance (which came into force in 1998), while leaving ample room for self-regulation by market regulatory authorities and company statutory independence).

As a consequence, certain corporate governance principles have in fact been stated in subordinate legislation, particularly by the implementing regulations subsequently issued by Consob. A further and fundamental contribution in the Italian context was the Code of Conduct for listed companies, issued in October 1999 by Borsa Italiana S.p.A. and also known as the Preda Code.

The drawing up of the Code by a Committee for the Corporate Governance of Listed Companies, with the necessary competence and authority, received strong support at the beginning of January 1999, showing the Italian business world's need for a definition of "best practice" in company effective management. The Committee deliberately sought conformity of the Code of Conduct guidelines to the international context, with a view to making the Italian situation increasingly comparable to and competitive on the international scene. A recent further confirmation of the importance of the principles of corporate governance was provided by the creation of the STAR segment ("segmento titoli alti requisiti": high qualified security segment), operational since Spring of 2001.

This decision represents a revolution for the Milan stock exchange, as it rewards those companies that best apply certain fundamental corporate governance rules. Following the Freedomland case, which brought under fire the regulations governing company listing and the retaining of such status, the supervisory (Consob) and market management (Stock Exchange) authorities have sought to increase the reliability of investment in listed companies.

The last important legislative act influencing corporate governance in Italy is the legislative decree 19/01/03 no. 6 that has introduced, for the S.p.As (Stock company) two alternative management and control systems, respectively deriving from the German/French and English experience and recommended by the EU Council Regulations on the "European Company By-laws" dated 8 October 2001.

a) The *"dualistic" system* (s. 2409 ff., Civil Code)

This alternative provides for

[4]At the end of 1997, they represented together only 8.4 percent of the total Milan Stock Exchange capitalisation (7.1 percent for nonvoting shares and 1.3 percent for shares with limited vote). See Bianchi et al. 1998.

[5]See 1994 law on privatisation by the Italian Parliament.

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i) a Management Board, with the same type of responsibilities as those which are attributed to the BOD and

ii) a Supervisory Board whose tasks are wider than those of Statutory Auditors, in that it sees to the appointment and revocation of Management Board members and to the approval of the company's accounts. The Supervisory Board is also exclusively enabled to promote actions in liability against members of the Management Board and to waive such actions by way of settlement out of court. Consequently in a company managed in accordance with this two-tier system the functions of the Shareholders' Meeting are confined to appointing and revoking members of the Supervisory Board.

b) The *"monistic" system* (s. 2409 sexiesdecies ff. Civil Code)

According to this system, management is entrusted to a regular Board of Directors at least one third of which must be represented by independent members. Supervision is attributed by the Board to a Management Control Committee whose members are chosen from among independent directors. It is up to the Board to determine the number of members of such Committee. In companies which make recourse to the capital market, the Committee must be formed by no less than three members. At least one member of the Control Committee must be a registered auditor. In both types of governance, save for small unlisted companies, supervision of accounts is invariably entrusted to an external auditor or auditing firm.

Some points have been assessed even for S.r.l. (limited liability company). In the view of the legislator S.r.l should be the swiftest and most flexible tool in the hands of shareholders. Articles of associations will be set forth by shareholders in accordance with their needs. Therefore, they will be less formal and, quite probably, drawn up in the form of contracts.

In line with this very flexible structure, the managing body of an S.r.l. may be freely shaped by shareholders by way of recourse to some alternative solutions as summarised in the following figure:

	Solution 1	Solution 2	Solution 3
Body	Sole Director	Board of Directors (traditional)	Board of Directors not acting as a committee,.
Way of action	Managing Director	It acts as a committee (collectively), presided by a Chairman and by a Managing Director	Formed by a plurality of members having the same powers Depending on the shareholders' choices, such directors may operate severally, severally on certain issues, jointly and jointly on certain matters

Supervision of accounts is entrusted to a Board of Statutory Auditors or to a sole auditor only where the company share capital is in excess of € 120,000 or when the turnover or the size of an S.r.l. are beyond a certain threshold determined by law.

4. The Italian system of corporate governance: advantages and disadvantages

In Italy, dissatisfaction with the state of corporate governance has increased in recent years. This is probably due to the process of privatisation conducted in Italy with the creation of millions of new (and fractional) shareholders that probably do not have the feelings of being protected by the actual structure of corporate governance. In fact, the Italian system of corporate governance is very similar to the U.S. system but there are several differences with the role of institution and institutional investors in the two ways of governance (see Boot *et al.* 1998) and with the structure of economy. The success of the Italian economy is due mostly to the large number of small firms that perform very well. A small firm is one with less than 20 workers and in Italy this kind of firm represents 98% of the total number of firms (see Macey 1998). The solution that these small firms find to the problem of corporate governance is the simplest possible: they lack the separation of ownership and control that generates agency problems and that basically defines the corporate governance puzzles in more complex systems.

The big differences and the main critics that the Italian system collect are connected to the low ability to fill in gaps in contingent contracts due to the poor legal system and absence of protection for investors' rights[6]. The fact that the duty of loyalty is not an operational concept in Italy for several reasons mean that Italian corporate governance also does not perform very well in terms of its ability to resolve agency problems and this is evidenced by the fact that courts have no expertise or inclination to provide protection for non-controlling investors (Barca 1994, Macey 1998). The exit device has also been unavailable. The failure of financial and non-financial institutions to act as advisers or intermediaries and the high concentration of

[6]In Italy there is not a specific law or a set of recommendations for Corporate Governance. The main document that is used to infer some principles of corporate governance is the law for the OPA (offerta publica d'acquisto) done from the Draghi Committee and the Legislative Decree 19 JANUARY 2003 No. 6

ownership, as well as the lack of rules concerning public offers, have prevented this development. Company law, securities law and investment regulations do not provide a framework for institutional investors to play much of a role in corporate governance. The information available to shareholders is also inadequate. Corporate bodies have exercised no independent monitoring. The Board of Directors in Italian companies is generally fully identified with controlling shareholders. The Boards of Auditors whose members are chosen by the majority shareholders can have many problems in terms of conflict of interests.

One of the main characteristics of the Italian model, the system of state-owned enterprises has come under particular attack and in 1992 a process of privatisation was initiated. Major problems have been encountered in replacing the old system with alternative devices (Barca 1997; Roncaglia 1997).

Another difference in corporate governance between Italy and other industrial countries consists of the lack of financial institutions exercising interim and ex-post monitoring via share or debt capital or via financial services. The Bank of Italy holds virtually no stake in non-financial companies. This is the result of the separation between banking and industry introduced by a law promulgated in 1936. No other financial institutions have taken over the role of banks in the ownership structure of Italian companies, partly due to the absence of pension funds as a consequence of the country's broad coverage pay-as-you-go public pension system.

In the absence of financial institution, fiduciary duties and the market for corporate control, corporate governance in Italy has relied on three main actors (Barca 1997): the State, that played a double role as owner and a source of resources for the private sector; pyramidal groups and, last but not least the family and/or coalition control.

The State has directly controlled a major stake (50% of medium size and large companies. It has held 1/6 of the entire agricultural sector (1/8 in France 1/10 in Germany 1/16 in UK). De facto it has held about 80% of the commercial banking system's deposits and an even larger stake of long-term lending banks (Barca 1994). The role of the State in corporate governance is hardly salutary. The politicisation of capital investment decisions inevitably results in sub-optimal decisions on capital allocation in corporate governance system where the State plays a decisive role. So, State activism in the sector is seen much more in a political way than in an economic way. In private firms the role of active actors is fundamental in the system as the Italian one. But even here there are some criticisms that can be made. Institutional investors in general and even banks are characterised by the lack of activism that they perform in their role as creditors. Italy's particular bankruptcy law plays an important role in explaining this behaviour. Banks play a relevant role in the transfer of control when a company is in financial distress but they do not monitor entrepreneurs' long term strategies (Barca, 1994) and they do not appear particularly active in soliciting the adjustment of companies' ownership structures.

Banks and non-bank financial institutions play a minor part in corporate governance in Italy. In spite of their remarkable share in corporate external financing, feeble bank-firm relations jeopardise the bank's role. The thin and underdeveloped stock market does not provide the appropriate arena for involvement of the other financial intermediaries in corporate governance (Ferri and Pesaresi, 1996).

As previously said, pyramidal control is another device widely used in Italy. This way of achieving separation puts the interests of minority shareholders in all subsidiaries of the groups at particular risk. The head of pyramid looks to the group as a whole but the shareholder of a particular firm of the group wants good performance for his own firm. The company at the top of pyramid if private has been governed by family control[7] and coalition control[8] (Bianco *et al.,* 1998).

5. CSR in Italy

A large area gathering the majority of Italian companies is characterized by the presence of enterprises having in common a substantially passive position towards CSR matters. These are mainly very small and small enterprises which usually are not familiar with CSR topics and tools. This does not exclude that these enterprises take into consideration expectations of workers and territory, but their programme implementation is informal and not systematic. This situation is explained by the informality of management aspects in these enterprises, due also to the limited resources they can allocate to the development of specific tools or high-impact projects (Unioncamere, 2003, p.8).

The characteristics of the Italian economy in terms of SMEs and network organizations represent an unique background in which to explore the relationship between CSR strategies and these two industrial specificities. The Italian system has an average of 3.9 employees per company. In industrial spheres, enterprises with over 250 employees account for 19.7% of the total in Italy. Another important feature is that the Italian industrial system is characterized by the widespread diffusion of industrial districts concentrated in Northern and Central Italy, along the Adriatic coast and in a few areas of the South (Becattini, 1987; Lipparini, 2002; Tencati and al., 2004). In some traditional and engineering industries, these districts have a

[7]An ownership structure in which the non-controlling owners belong to the same family as the entrepreneur 22%of total capital Barca 1995

[8]Where the entrepreneur and the non controlling owners share a common value and/or are linked through contracts (13%) Bianco et al. 1997

leadership position in the global market and overall account for over two-thirds of total national exports (Tencati, 2006).

Italian SMEs are an integral part of the local community and their success is often related to their capability to acquire legitimacy and consensus from local stakeholders such as employees, public authorities, financial organizations, banks, suppliers and citizens (Tencati and al., 2004). These local networks are based on informal and tacit relationships. With regard to this point, it is possible to introduce the notion of social capital.

In the contemporary debate about social capital, the aspect of trust is stressed in economics, in sociology the aspect of networks is highlighted, and in political science the aspect of civil society engagement is focused upon. Ahn and Ostrom (2002) make a distinction between three key elements of the concept: trustworthiness, network structures and institutions. The World Bank (1999) sees social capital as a key concept against poverty and inequality. It uses the following definition: "Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions (…) social capital is not just the sum of the institutions which underpin a society – it is the glue that holds them together".

One can distinguish two main categories of social capital: structural (roles, rules, precedents, and procedures) and cognitive (norms, values, attitudes, and beliefs). Social capital is an accumulation of various types of social, psychological, cultural, cognitive, institutional, and related assets that increase the amount (or probability) of mutually beneficial cooperative behaviour. This behaviour is productive for others as well as for one's self (Uphoff, 2000). The components of social capital are therefore many, varied and, in many instances, intangible as they consist of different types of relationship and engagements. Social capital is unlike other assets that economists call capital because investment in its development does not seems amenable to quantified measurement, even in principle. Social capital is important in CSR because it deals with the engagement in the community in which a firm is expected of to operate in order to succeed; it provides alternative currency for the stakeholder debate; it offers an understanding of the channels and internalisation/externalisation process by which knowledge flows too effectively or not at all; it highlights how firms can increase the effectiveness and efficiency of their external networks with other firms and reduce transactions costs; and how firms can find alternative means of employment, motivation and retention for their employees.

Social capital is about more than getting employees to relate to one another: this is without doubt an aspect of social capital at the micro-level, but it is not the whole picture and myopia in this regard can lead to the neglect of the social capital which facilities firms' interactions with their community.

Companies are inevitably and intimately involved with the communities in which they operate. Whilst in one sense they may represent an impermeable and monolithic entity installed in a foreign land, from a different perspective they are diffused, exposed and intimately involved in the communities in which they are located – whether they wish to be or not. They alter the social configuration of the communities, nations and world in which they operate, regardless of whether or not they desire this (Lombardo, 2005, p.12).

The intangible assets in terms of reputation, trust, legitimacy and consensus related to the concepts of social capital are at the basis of the long-term performance of Italian SMEs and of their districts (Lipparini, 2002).

As shown in a broad range of literature (Azzone et al., 1997; Gilardoni, 2000), the particular features highlighted above have historically influenced the diffusion of managerial tools and standards in Italy. A well-known example was the low diffusion rate in Italy of: the ISO standards on Total Quality Management (ISO 9001:1994); the environmental management systems (ISO 14001) and the voluntary environmental regulations such as EMAS (Eco-Management and Audit Scheme). Despite the limited diffusion of managerial tools, responsible business practices seem to be vital and hence an embedded element of the Italian model of capitalism centred on SMEs (Tencati et al., 2004, p.174).

In a context such as the Italian national economic system characterized by variety of structural (the predominance of SMEs and the role of local districts) and historical (e.g., importance of the cooperative movement) reasons that have conditioned the attentiveness to social relationships as a whole, several initiatives on CSR have been promoted to face the rising attention paid by public opinion to environmental protection, product safety and the respect of human and workers' rights. These spontaneous experiences from companies and institutions can be classified into three main groups: private, public and corporative association.

Private Sector Experience

With regard to the private sector, different ambits show a considerable interest in CSR issues from companies and other players. Depending on the tool adopted and its impact on corporate strategy and processes, we can divide the various initiatives into four main groups: adoption of reports/statements and other reporting activities; adoption of managing and certification systems; financial experience (ethical investment funds, rating); other initiatives.

The first group embraces accountability initiatives (on environmental, social and sustainability matters), that is, reporting on the CSR

activities, that companies started voluntarily by using manifold reference standards and methods.

In Italy:

- There are more than one hundred bodies (companies, no-profit organizations, etc.) that publish social reports;
- there are more than one hundred bodies (companies, no-profit organizations, etc.) that publish environmental reports;
- there are almost twenty companies that publish sustainability/social-environmental reports, in line with the triple-bottom-line approach that is being established at the international level.

The second group focuses on the dissemination of CSR managing systems on all its components[9]: environmental, human resource, supplier, information safety systems etc and certification systems by third parties. Environmental labels and quality labels are included in this group.

The third group embraces initiatives and projects that relate to the corporate financial area and the evaluation processes. In this context we mention:

- The phenomenon of socially–responsible managed saving or ethical finance that is acquiring a rising importance. The Forum per la Finanza Sostenibile (Forum for the Sustainable Finance) has among its members the ABI (Associazione Bancaria Italiana – Italian Banking Association), the ANIA and different banking, financial and insurance institutions with the aim to promote the sustainable development among representatives of the financial community
- the Banca Etica (founded in 1998) specialized in no-profit financing, solidarity economics, social and international cooperation.

Entrepreneurial Associations

As it concerns other initiatives, some entrepreneural associations such as the already mentioned ABI and Federchimica have operative working groups for these issues and different research centers, technical committees which give theoretical and practical advises.

Various organizations promoted by companies and entrepreneural associations – among which Gruppo di Frascati/Cittadinanza Attiva, Impronta Etica and Sodalitas – work within a framework of CSR with cultural promotion, bestpractice diffusion, stakeholders engagement programs etc. Furthermore, the National System of Chambers of Commerce is particularly sensitive and attentive to promoting CSR among companies working in Italy.

Public Sector Experience

Each Italian region has the possibility of contributing to the promotion of CSR in the drawing up of its development program. So far, many initiatives have been promoted within the pubic sector both the regional and provincial level. As far as **Regions** are concerned:

- the Regione Toscana - starting from June 2000 - activated the Fabrica Ethica project to promote SA 8000 certification among SMEs; the certification envisages the activation of supporting training and information services and the allocation of funds to SMEs through the "Programming Complement" target n.2, 2000-2006, regarding financial aid for consultancy services. This financing should cover 50% of the total expense expected. The aim of this program is to reward companies holding a certification in the fields of environmental quality (EMAS or Iso14001) and social responsibilities (SA8000). Moreover, in May 2005 the Regional Government created an ethical regional commission for CSR, whose members are representatives of local stakeholders: Chambers of Commerce, local bodies, non-profit and non-government organization, consumer associations, trade unions and entrepreneurial associations. Three groups work within the Commission on the following items:
  - i. certification of district and production process;
  - ii. ethics in economy and finance;
  - iii. tools for CSR and its applicability to small and medium size companies.
- the Regione Umbria supported CSR with decisive action: two bills were approved, the first - the Regional Act n.20 of 2002 - creates the regional Register of SA8000 certified companies; the second - the Regional Act n.21 of November 12, 2002 titled "Measures for the certification of quality, environmental, safety and ethical systems of Umbrian companies" - provides contributions without security covering 50% of the consultancy and certification expenses, addressed to those companies who implement certifiable management systems. Enrolment in the register entitles the company to priority status for:
  - i. financial incentives, contributions and facilities, according to the regional law;
  - ii. administrative authorizations, according to the regional law;
  - iii. choice of the subject to be invited to tenders for public works or goods and services supplying, when other requirements provided by the law in force are met.
- in addition to the programme "Chiaro, Sicuro, Regolare" (CSR – Clear, Safe, Regular) about working safety and quality, the Regione Emilia Romagna entrusted the Institute for Labour with a research project to detect the conditions that could ease the voluntary access to the Label of Social Quality for regional companies;
- the Regione Marche is a partner of the project carried out by the Training Center of Marche (CFM) – a consortium of Marche's training companies – aimed at conducting a feasibility study for the establishment of an informative system on corporate social responsibility;
- the Assessorato for Productive Activities of the Regione Campania started an investigating study on local, national and international CSR patterns and best practices.
- The CSR-Vaderegio Project, funded by the European Commission, involves four organizations: Agenda-

[9] In 2003, there were 52 companies with SA8000 certification, out of 285 global certifications. Italy had the highest number of certified organizations in the world.

Social Responsibility in Scotland of Edinburgh (Scotland), the Flemish Ministry of Labour (Belgium, Flanders), the Novia Salcedo Foundation di Bilbao (Spaing, Basque Region) and the Euro Association of Palermo (Sicily). By involving local institutions, the project aims at understanding and promoting CSR at a local level. Furthermore, the Regione Sicily supports the Etiqualitas Project that involves the Regional Observatory for the Environment (ORSA), the Euro Association and various Local bodies and cooperatives.

6. The Initiative of the Ministry of Labour and Social Affairs: The "Project on CSR-SC"

The Italian approach to CSR implies a nationally widespread network of highly innovative private and public interventions. It is indeed true that many of the voluntary activities carried out by companies, mostly SMEs, despite a strong relationship with the local community, are scarcely systematic; that is, they are not structured into formalized strategic processes, and they have low visibility outside the company. This approach to CSR that can be defined as a sort of sunk CSR is a frequent phenomenon, but cannot be appreciated and deeply enhanced from the competitive point of view, with traditional interpretation patterns suitable for multinational corporations.

The Project developed by the Ministry of Labour and Social Affairs on CSR in June 2002, called Corporate Social Responsibility - Social Commitment (CSR-SC) has the aim of promoting CSR culture among companies and guaranteeing citizens that the reporting of companies on ethical and social issues is not misleading. Moreover the CSR-SC project has defined a simple, flexible and modular standard that firms can adopt on a voluntary basis in order to implement CSR policies and identify socially responsible companies. This standard is based on a list of key performance indicators to measure social performance of companies. This initiative dedicates particular attention to SMEs. The Ministry of Labour and Social Affairs accepted the proposal of Unioncamere (The Italian Union of Chambers of Commerce) to carry out a survey throughout the Italian territory aiming at providing a reference framework on the extent and features related to corporate social responsibility. The study promoted in order to increase the knowledge needed for the implementation of CSR-SC Project, has involved many stakeholders (business associations, trade unions, universities, NGOs) and the network of Unioncamere.

The survey was conducted in July 2003 by means of telephone interviews (carried out with the CATI - Computer Aided Telephone Interviews - method) on a sample composed of 3,663 companies, which was stratified taking into account three structural features: business size, economic macro-sector and geographical areas.

The research underlined that business size influences deeply companies' stance towards social responsibility. Middle and large-sized enterprises have a high propensity to CSR; whereas, in very small and small-sized enterprises the commitment to CSR issues is limited, even though they show some signs of interest, in particular:

- the tools expressing values and guiding principles are quite well-known, as well as ISO 14001 environmental certification and EMAS registration;
- a large number of enterprises belonging to the first two business sizes make money donations and sponsorships on a regular basis;
- a high percentage of enterprises require from their suppliers a quality certification of the product/service or adopt it directly;
- enterprises with 20-49 employees implement many practices in favour of employees: flexible hours, meetings on a regular basis to present strategies and results achieved, training for more than 20% of the staff.

The differentiation existing among geographical areas, even though of minor importance, can be attributed to two variables:

- the socio-cultural context;
- the legal- institutional context.

As regards the socio-cultural context a greater attentiveness to CSR was noticed in areas where there is a concentration of services sector and most advanced industry and where companies with foreign capital and companies which are generally more open towards foreign markets are based. With regard to the knowledge of elements related to social responsibility, for instance, values above the average were noticed in Lombardy and in North-East (Unioncamere, 2003).

The second important variable is the legal-institutional context. Importance is hereby given to the noticeable influence of local regulations: in this regard, legal measures boosting the different management systems related to some CSR aspects stand out. During the Third European Conference on Corporate Social Responsibility held in Venice on November 14, 2003, the Ministry of Labour and Social Affairs proposed a two-level standard framework. Common elements of the proposal are the following:

- voluntary approach;
- corporate self-assessment;
- no traditional certification mechanisms;
- a set of performance indicators.

The first stage (CSR Level) is based on the set of performance indicators and on a system of guidelines in order to support companies in the self-assessment of their own social performance and in its reporting through a Social Statement. The main steps of this level are as follows:

- a company decides, on a voluntary basis, to participate in the CSR-SC project and present the Social Statement according to the set of indicators;

- an independent Authority, proposed by the Ministry of Labour and Social Affairs, is expected to be the party responsible for the final evaluation of Social Statements sent by participating companies;
- a comprehensive database will be organized to collect and make available the relevant information on the initiative.

The second stage of the project (SC Level) is based upon companies undertaking a proactive role in supporting the welfare policies promoted by the Government and local authorities. If a company, on a voluntary basis, decides to go beyond the CSR Level (presentation of the Social Statement and review carried out by the independent Authority), it participates, through its own resources, in the projects of social intervention proposed by policy makers. The underlying perspective is to integrate private and public resources according to a modern welfare mix approach and the subsidiary principle.

The CSR-SC Project, as we have seen, has the aim of promoting socially responsible behaviour among companies. In order to guarantee standardization in data presentation and comparability between the results obtained by different companies, the set of performance indicators will serve as an optimal point of reference in preparing the Social Statement. This set is projected according to a flexible and modular approach. In general, it is possible to identify at least three categories of companies that can use these indicators:

- publicly traded companies;
- large private companies;
- small and medium-sized private companies.

Listed companies should implement the most exhaustive reporting process according to a principle of broad disclosure (adopting the complete set of indicators).

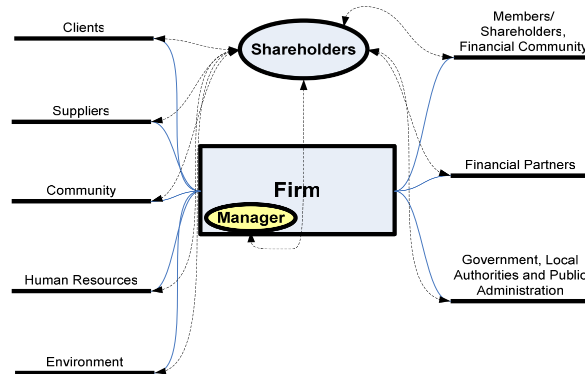
With regard to private companies, the purpose is to identify, within the framework, those measures which best meet information needs without requiring processing efforts which are beyond corporate capacity and resources:

- SMEs should use a set of common indicators;
- large companies should also adopt some additional indicators.

On the basis of the results of more than twenty pilot tests carried out in collaboration with pioneering companies of every size, the Ministry of Labour and Social Affairs proposal organizes the indicators according to a three-level framework (Global Reporting Initiative, 2002):

- Categories: Stakeholder groups which are specifically affected by clusters of indicators;
- Aspects: Thematic areas monitored by groups of performance indicators related to a given category of stakeholders.
- The indicators: Measurements that supply information related to a given aspect. They can be used to check and demonstrate organizational performance. The information can be qualitative, quantitative (physical and technical) or economic-monetary.

The stakeholder categories identified are: 1. Human Resources; 2. Members/Shareholders, Financial Community; 3. Clients; 4. Suppliers; 5. Financial Partners; 6. Government, Local Authorities and Public Administration; 7. community; 8. Environment:



The structure based on stakeholder categories focuses on the relationships and the related performance which companies, and especially SMEs, develop through their activities and behaviour. In the Italian context networks between companies and local stakeholders affect in a direct way the overall corporate performance (Zaheer, McEvily & Perrone, 1998). The survey gives a picture of a group of "selected companies" defined in coherence with the goals of the research project CSR-SC. Although the sample represents the overall population of Italian enterprises in terms of size, sector and geographical distribution, it is not a random sample. In any case, the survey pointed out some specific spheres of interest.

According to the findings of the survey, Italian companies showed a positive attitude towards CSR. Despite an unclear definition of CSR, firms seem to be engaged in socially responsible activities using several tools: specific programs on social issues, sponsorships, donations, direct investments and adoption of codes of conduct. The main reasons at the basis of the CSR initiatives are related to company image and relations with local communities. In particular, the relationship between SMEs and local community seems to be fundamental in order to understand the choices carried out by the companies in this field. This could be explained if we refer to the concept of social capital as key-driver for the long-term success of the firms in the Italian context (Tencati et al., 2004).

The survey identified some factors that could lead to the diffusion of CSR among firms in the near future. From a policy perspective, the public support is a critical factor in fostering CSR behaviour. In addition to fiscal incentives, companies need information on corporate social issues (the lack of publicity on CSR is one of the main obstacles to the diffusion of CSR). Public Authorities have to

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develop and spread knowledge about CSR in the business community through promotion and communication.

7. Conclusions

In a liberal economy, without government interference or regulation, the optimal firm behaviour is to ignore externalities, but the welfare economists, conscious that externalities can be very important, developed the thesis that it is the role of government to create stimuli to induce firm to take external factors into consideration. Given the social impact of the new invisible hand – constituted, in an information age, by various pressure groups, however, a forward-looking firm prefers to take into consideration all direct and indirect external effect of its operation, that is it prefers to take its societal responsibility into its own hands. In so doing it also hopes to make further regulation unnecessary.

In theory, CG refers mainly to the mechanisms which protect outsiders and ensure an effective working of the firm, while CSR refers mainly to the objective function of the firm and attention for various stakeholders. CG refers to the system by which business corporations are directed and controlled.

The principles of CG are an integral part of CSR which include:

- the right of shareholders;
- the role of stakeholder;
- disclosure and transparency;
- the responsibility of the board.

To assess the static efficiency of Italian corporate governance, reference can be made to two specific stages in a company's life when corporate governance is especially important: fast growth (and entry) and crises. While an a-priori judgement of the static efficiency of Italian corporate governance is therefore ambivalent, it seems there are no doubt about the negative dynamic efficiency of the system. Dynamic can be defined as a concept of efficiency that takes into account not just existing entrepreneurial skills but also those which would develop if all individuals were given fair access to control.

Several factors played a role in impeding turnover within the entrepreneurial establishment: the financial obstacles to entrepreneurs, particularly new entrants, who lack the right connections; the stickiness of the model of family control; the strong collusion between the top managers of state owned enterprises and top politicians who have helped each other to stay in power. People's abilities to develop new skills have been reduced.

It is probably the case that persistent dynamic inefficiencies, and the related consequent inequality of opportunity for upward social mobility, explain much of the consensus at the beginning of the 1990s for a reform of the entire system of corporate governance centred on a reduced role of State ownership. But the consensus for reform must be attributed to the perception that on the grounds of static efficiency the disadvantages by then largely out-weighed the advantages.

As regards fast growth and entry, by putting forced saving at the disposal of managers, State ownership mobilises finance for fast development, while family and coalition control allows accumulated savings to be channelled to investment since formal institutions are lacking. But these devices are inadequate to govern the growth of both small and large companies when there are shortages of capital, which should be matched by long-term debt or by private risk capital. The preponderance of short term debt and wide use of collateral are particularly unsuitable for financing fast growth, especially when firms do not have much of a record. Similarly, both family and coalition control tend to prevent the raising of new "outside" risk capital. For an entrepreneur to attract funds to finance his projects, qualities that most people do not possess are required: families' ties or political and social links with well-off members of society. Growth tends to be limited by the capital of incumbent families and coalitions. Several facts seem to corroborate this evaluation: the limited diffusion and high concentration of ownership; the very small size of the stock exchange; and the lack of medium sized firms.

However, in a series of other aspects, the Italian experience may offer some insights of general use, especially in analysing transitional economies. When a crisis occurs, all 3 models, family, coalition and State, tend to reduce the risk that signals of bad performance might too easily unsettle an allocation of control, even when there is no misallocation. This is possibly one of the main advantages of Italian governance environment. On the other hand, due to lack of continuous monitoring, these models may increase the risk of the opposite error: that a misallocation of control, though signalled by bad performance, does not lead quickly enough to transfer control. The relative independence of management from ministerial bureaucracies (serious problem when the latter are inefficient; Perrow 1995) can be another extraordinarily effective tool in separating ownership and control and this can play an important role in states where the all or the majority of corporations are in public hands. This is even more important during stages of powerfully accelerating growth and when shifts in the sectoral balance are needed; especially when a rapid generational turnover in management is also required. Political authorities must neither interfere excessively in management by frequently shifting their goals (Laffont and Tirole 1993) nor collude with management. To avoid collusion, sanctions are needed: the political market replaces the market for corporate control. The State in Italy has transferred substantial funds to firms (owned or not) in order to overcome situations of financial distress. It has

bought out mismanaged companies, has provided subsidies to achieve delayed restructuring and has granted subsidised credit.

For the Italian model of corporate governance to work, state owned enterprises must not be “limited” by special social objectives, such as worker participation or the rescue of ailing companies: the public policy aim of the model should be restricted to the highly relevant one of assuring control to individuals lacking resources to acquire control via ownership. Finally, if there is no functioning political market to guarantee democratic change (this is not the case of Italy of course but in some transition economies there are still some problems of existence of a sort of “political market”) of parties in power and if the “missio” culture of public manager is eroded the system is bound to degenerate: top managers and political overseers will inevitably capture one other. Adopting CSR may signify a holistic treatment of the corporate governance system. It generally results in better relations with stakeholders, more transparency and greater capacity for risk management, therefore in an enhanced corporate reputation. Effective CSR has to be developed on a “voluntary basis”. Nevertheless, existing national and European legislation, international conventions and other regulations deal with a number of issues that fall within the scope of CSR, whereby companies are legally bound. These are mainly concerned with social problems and environment protection.

CSR is continuously evolving; it has to be truly embedded in corporate values and strategic management process in order to generate long-term results.

This paper contains an outline of the initiatives carried on in Italy in the CSR field. The coexistence of different private and public approaches reflects the complex nature of the Italian economic system. However, Italy is at the forefront of CSR initiatives in Europe and despite the challenging global economic environment, the first signs of the kind of stable, economic growth that CSR promotes are beginning to take place.

The research CSR-SC that Bocconi University and Unioncamere carried out for the Italian Ministry of Labour and Social Affairs synthesizes some critical elements that deserve mention here:

- the relevance of European-wide guidelines;
- the existence of numerous spontaneous CSR initiatives;
- the divide between SMEs and large companies (by size), but also interesting differences by geographical areas and industry.

Stimulated and influenced by the new invisible hand market parties start to consider CSR and good CG as the prerequisite for sustainable growth and welfare within a globalising business environment.

In a competitive environment, firms need to balance the costs involved in coping with externalities while keeping their long-term economic profit in mind. Numerous pressures to make the business world responsible might lead to creating extreme and unrealistic expectations and defining CSR in too broad perspective.

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INTERNAL AUDIT RISK ASSESSMENT AND LEGAL RISK: FIRST EVIDENCE IN THE ITALIAN EXPERIENCE

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Abstract

The objective of this article is to analyze how Italian Firms comply with the Internal Audit rules regarding the administrative liability of entities and to explain what the effect on the organizational structure was. In particular we collected data from 21 companies listed on the S&P/MIB index by sending a questionnaire to each Internal Audit Director. We show the features of internal audit system required by the 231 Italian Decree and how risk assessment and internal audit could serve as Corporate Governance Instruments. The 231 Italian Decree, like the *Sarbanes*-Oxley Act enhances and extends companies' accountability, transparency and integrity especially in business conduct. The innovativeness of this work is due to the idea of considering these elements as influential for the risk management optimization. As a consequence, a risk reduction can be achieved by improving the organizational and management models. Thought is commonly accepted that the risk optimization leads to a reduction of the cost of capital for the enterprise, there is a difficulty in estimating how much the value provided could be.

Keywords: Internal Audit, Risk Assessment, Legal Risk

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+ "Even if this paper is the result of the shared research of all the authors, paragraph 1 can be attributed to A. Miglietta – Project Coordinator – paragraph 2 can be attributed to M. Anaclerio and paragraphs 3-4-5 can be attributed to C. Bettinelli."

1. Introduction and Objectives

This work aims to investigate how Italian Listed Firms comply with the Internal Audit rules regarding the administrative liability of entities. We considered a group of companies listed on the Italian Stock Exchange at the S&P/MIB Index. The S&P/MIB index shows the trend of equities which are selected considering their liquidity, their free float and their sector representation. It is the new benchmark for the Italian stock market.

The analysis of this group is important to value the Internal Audit efforts implemented after the Legislative Decree 231/2001 which regards the administrative liability of corporations. Under this law the company is liable for crimes committed in its interest or to its benefit by individuals who represent, administer or manage the Company. The crimes which determine the administrative liability of the companies are illustrated in Appendix 1, consider for example: embezzlement detrimental to the State, extortion, misappropriation of public funds (*peculation*), Market Abuse, fraud, corruption, false corporate communications, impediment to control, illicit distribution of profits and reserves etc..

The Company is exempt from liability for the crimes committed by the aforementioned individuals, if it proves it has adopted and effectively implemented appropriate *organizational and management models* to avoid the crimes. Furthermore it has to have charged an *internal Board* (i.e. Supervisory Body) with monitoring the functioning of and compliance with the models adopted.

The exemption from administrative liability for crimes is, for enterprises, an opportunity to reduce the risk of legal action, lawsuits or juridical proceedings (*legal risk)*.

This means that managers can reduce the probability of negative situations and of losses due to Pecuniary penalties, Disqualification penalties, Confiscation and Filings of judgment.

The reduction of *legal risks* is allowed only if the company has implemented organizational and management models which prevent the crimes, this implies an improvement of the Internal Audit Function. Our objective is to show that there are some important connections between these factors, in particular we will illustrate that legal risk can be reduced if the company puts into practice a Risk Assessment Process and an efficient Internal Audit System. These synergies led to the abovementioned risk-reduction which is fundamental for the creation of shareholders value by reducing the cost of capital.

2. Internal Audit and Italian Legislative Decree n. 231

The growing attention that companies operating on the Italian Market now dedicate to problems relating to internal control systems is a significative sign of the fundamental importance that such systems have on the smooth running of the companies themselves.

The need to better and optimize company risk assessment as a critical factor in achieving their own strategic aims, the international and national scandals, often a result of the weak internal control systems of the companies involved and the general inadequacy in the running of the same, as well as the frequent problems of internal revision, organization on behalf of the administrators and management responsibility, are all factors to be considered positive and stimulating because aimed at improving the administration of our companies, in respect of the normative and the interests of all the stakeholders.

Undoubtedly the companies that have from the beginning shown more sensitivity to such problems are those quoted on the Stock Exchange, the majority of which have thought it best to adapt themselves to the indications given in the "Codice di Autodisciplina" (Code). Although not a binding rule for the companies – that remain free to adhere – the Code (recently reviewed in March 2006) has gained the merit of propagating in our economic system the principles of 'best practice' in matters of corporate governance, as a system of pre-arranged rules on the planning, management and control of the company activity in its various aspects. In particular, a large part of the non-obligatory normative in the Code refer to the problems regarding the role, the composition, the performance and the responsibilities of the board of administration as well as the adoption of an adequate internal control system, with "rules, procedures and structural organization in order to consent, by means of an adequate procedure of identification, measure, management and observation of the principle risks, a healthy company conduction, that is correct and coherent with the aims that have been fixed in advance".

Given the entity and the involvement of the structure of the company, the Code provides the board of administration with the assistance of an Audit Committee for the definition of the guide lines of the internal control system as well as for the periodical rating of its adequacy. Furthermore, in order to guarantee even better operative co-ordination between the Board of Administration and the Audit Committee, the nomination of an Executive Administrator has been recently suggested with the job of supervising the smooth running of the internal control system. In particular, his duties regard the identification of the principle company risks, the execution of the guide lines defined by the Board of Administration and the proposal of the figure of a responsible for Internal Audit.

It is clear that this last intervention introduces the necessity to form an Enterprise risk management,, beginning with the more complex company organizations, with the duty to render the management of company risk a "corporate" aim.

The adoption of systems of company management characterized by an optimization of risk management has slowly but surely touched even those companies that are not quoted on the Stock Exchange, becoming a necessity felt more and more by medium enterprises that operate in our economic system. Such a necessity embraces moreover the regime of responsibility of the administrators disciplined by Art. 2381 c.c, in terms of adequacy of the organizational, administrative and accountancy system of the companies.

Theoretically the civil code provides for a Board of Auditors with the responsibility of supervising the adequacy of the system of internal control.

In such a context can be placed the D.Lgs. 231/2001, that introduce into our regulations the discipline of the administrative responsibility of corporations for a series of crimes – peremtorily foreseen by the decree – committed in their own interests by those that hold posts of representation, administration or direction of the same.

The innovation consists in the fact that if such crimes are committed in the interests of the company, as well as the person or persons who have committed the offence being held personally responsible, the company must respond with heavy financial and / or administrative penalties. This regime of responsibility is applicable only for certain types of crimes: offences against the public administration, company offences, offences against public trust, terrorism, subversive behaviour and crimes against individuals.

The D. Lgs.231 is substantially an 'open' normative in the fact that it is subject to continuous integration and up-dating according to the type of responsibility. However the legislative decree does leave a loop hole in that there is a possibility that the company will not have to respond if it can prove that:

1. The Board had adopted and successfully implemented, before the date of the offence, an appropriate organizational, management and control model to avoid the crimes.
2. The supervision of the functionallity and the observance of the organizational model has been attributed to Internal Board (supervisory Body) that has freedom of initiative and of control.
3. Someone has committed the crimes eluding in a fraudulent way the organizational model.
4. There has not been insufficient supervision on behalf of the Supervisory Body.

It is possible to note how the adoption on behalf of the company of precautionary methods in order to protect themselves from the risk of crimes being committed, does not in any way constitute an obligation, only for the fact of not having adhered to

the indications in the legislative decree. The implementation of the organizational model constitutes rather the opportunity for the company to revisit that part of the internal control system that gives it the possibility of having an adequate management and risk assessment against those offences specifically foreseen by the D.Lgs. 231, and therefore a minimization of the impact that these would have on the company itself. Therefore, even if there is no normative obligation for an adequate internal control system, it is obvious that the companies that are more sensitive to a culture of company assessment will not want to underestimate this.

It is possible therefore to assert that Internal Audit and organizational, management and control model according to the D.Lgs 231/2001 are fundamental in the context of an optimal management of the company. The risk assessment of the company in all of its aspects and possible manifestations is undoubtedly a necessary condition in order to reach the company aims efficiently and successfully. A company that does not adopt an adequate management system, that permits it to plan its aims and to verify this, by means of a system of regulations and structures oriented to optimize its risk profile, will have difficulty in expanding and resisting competition.

It is certainly obvious though that an optimal internal control system and the necessary up-dating for a functionallity has certain costs for the company (not only financial costs, but also in terms of impact on the organizational structures). But it is also true that the company will benefit in terms of risk profile. The adoption of adequate control procedures, will allow the company to reduce its exposition to risk of economical and patrimonial loss caused by those who operate within the company itself.

It is interesting to see how such considerations take on certain relevance on the value generation of the company. In fact on an equal basis of free cash flow generated by management, the company that is able to contain its risk profile, thanks to an adequate internal control system, will be able realize that same cash flow at a tax rate - expression of the cost of the capital in its two components (Equity and Debt) - more content and therefore with a less reduction in generated economic value in respect to those companies with a higher risk profile.

Finally, related to such a theory is the relevance that the risk profile of the company has on the rating placement and the credit merit according to “Basilea 2”.

Among the elements and facts that the Financial Institutions take into consideration for the rating, are those of a qualitative nature that can lead back to the governance system adopted by the company and the adequacy of its administration and its accountancy. A company that is found lacking under this profile would certainly benefit from a lower rating and consequently a heavier financial cost, with a higher impact in terms of devaluation in the generated financial flow.

3. Theory and literature review

Corporate Governance has became an important issue because business activities are nowadays a concern not just for shareholders, but also for the community in general, influencing individuals' savings and investment decisions (Abrahami 2005)[1]. In fact Corporate Governance means both directing the company as efficiently as possible and managing the broader responsibilities the company has with its stakeholders. These relationships are the core subject of present laws in force both in the United States and in Europe.

The American experience demonstrates that the *Sarbanes-Oxley Act* (SOA) compliance is a vital device that binds large international and local companies to enhance and extend their accountability, transparency and integrity especially in business conduct and financial reporting. The Sarbanes Oxley Act has a direct and severe impact on all US listed companies which have to fulfil particular obligations regarding information storage, business intelligence, data warehousing, documents management and internal audit. The SOA is mainly dedicated to the following arguments:

Public Company Accounting oversight board, Auditor Independence, Corporate Responsibility, Enhanced Financial Disclosures, Analyst Conflicts of Interest, Corporate and Criminal Fraud Accountability, White Collar Crime Penalty enhancements, Corporate tax returns, Corporate fraud and accountability. Considering the topic of this article, the most significant sections of the Sarbanes-Oxley Act are Sections 302 (Corporate responsibility for financial reports) and 404 (Management assessment of internal controls).

In accordance with Section 302 the principal executive officer is responsible for establishing and maintaining internal controls, has to design such internal controls to ensure that material information relating to the issuer is made known to such officers by others within those entities. Moreover he/she has to present in the report, conclusions about the effectiveness of internal controls.

The signing officer has to also disclose this information to the issuer’s auditors and the audit committee of the board of directors.

Moreover Section 404 imposes the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting. It also requires an assessment of the effectiveness of the internal control structure and procedures. The SOA is a complex issue and it concerns all the aspects of

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[1] Abrahami, A. 2005 “Sarbanes-Oxley Act Compliance” in Management Services 49 (3) :28:32

the company, notwithstanding this, it must to be considered that internal controls are pivotal to the Sarbanes-Oxley Act compliance.

Surely there are a lot of important similarities between the United States and European Union's corporate laws. In the Italian case, most of the rules contained in the SOA are foreseen in a similar manner to those in the Civil Code, in the Legislative Decrees No.58 of the year 1998 and No.231 in 2001, furthermore in Law No. 262 of 2005 ("law for the protection of savings"). It is possible to find a strong resemblance between the SOA and the Legislative Decree 231 taking into consideration that to comply in practice with the Sarbanes-Oxley Act, many companies formed corporate project management teams, frequently consisting of existing internal audit staff.

This kind of team typically has to draw up a personalized structure and methodology for assessing the company's internal control, the setting of projects, strategies and timescales (McNelly and Stephen 2005)[2]. In the report issued by Deloitte & Touche[3] it is argued that in the *Sarbanes Oxley era,* Internal audit appropriately structured, can provider great value to an organization, influencing both regulatory compliance and operational excellence. As a matter of fact, internal auditors can reduce costs for the company, by improving accounting controls, financial examinations and organizational support.[4]As a consequence Wallace (1984) found that the savings that the companies could achieve in bolstering the work of the internal audit (IA) function averaged 10 percent of the independent and external audit fees. In the transaction cost perspective (Williamson 1975,1979,1991)[5] it would be very expensive for an external IA provider to get the knowledge necessary to perform IA tasks while the firm may already possess the internal knowledge from its functioning activities (Lindow and Race 2002)[6].

Accordingly with the Agency Theory (Jensen and Meckling 1976)[7] agency costs are generated by the conflict of interest and information asymmetries between owners and managers of the firm.

In this view IA, may also serve as a monitoring answer to agency costs (Anderson et.al 1993; De Fond 1992; Carey, Simnett and Tanewski 2000)[8]. The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) defined internal control in an effective manner which could be useful to explain the relationship between internal audit and risk assessment. The COSO definition of internal control expands the internal audit's traditional activities, such as practices focused on policies and procedures, to embrace additional elements focused on control environment, information, communication, risk assessment and monitoring. Auditors need more than a catalogue of controls to measure how management deal with risks. Some best practices to be considered are monitoring business activities and performance indicators constantly coordinating with other organization's functions, building up the audit plan based on risk main concerns and getting involved in technology projects (Lindow and Race 2002)[9]. In other words, many internal auditors now offer more mixed control information and guidance than they did as traditional supervisors of only financial control situations (Widener and Selto 1999)[10]. An Internal Audit therefore regards how company's activities are managed, organized and monitored (Miglietta Anaclerio 2005)[11]. The attribution of the risk management role is incorrect, in fact the IA should only *monitor* the risk management process (Protiviti 2005)[12]. In the rational decision process, managers

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[3] Optimizing the Role of Internal Audit in the Sarbanes-Oxley Era, second edition 2006, Deloitte & Touche Report

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[11] Miglietta A. Anaclerio M. "Il D.Lgs 231/01 sulla responsabilità amministrativa degli Enti per le PMI: problemi o opportunità per essere più competitivi?", Convegno Ordine Dottori Commercialisti di Bergamo, 5 aprile 2006.

[12] Protitviti Indipendent Risk Consulting 2005, "Barometro dei Risk e del Risk Management italiano" prima edizione Protiviti Inc.

are likely to choose an internal and external control mechanisms combination that maximizes their profit or utility (Jensen and Payne 2003)[13]. For this reason we argue that the IA is strongly connected with strategic management decisions.

According to Woods Brinkley from the Bank of America Corporation, a good risk management is the aptitude to recognize the intended and unintended consequences of the company's actions and strategies. It's a constant activity and, in part, the role of every member of the team[14].

Enterprise Risk Management (ERM) calls for supervision of a company's complete risk selection rather than for many different supervisors managing specific risks.

With ERM a company sets up risk definitions and acceptance levels, it classifies procedures to determine and calculate risks and creates monitoring activities. It is indispensable to value the impact which risks associated with any project can have on the whole business (Banham 2004)[15].The creation of Organizational Models for risk management requests the introduction of the risk element in the planning and control budgets (Colombo and Cencioni 2005)[16].In order to defend assets and create shareholder value, managers should consider enterprise risk management. Several current business failures are due to senior level misjudgement and mismanagement of risk, unsuccessful *risk* management puts strong business models in danger.

Drew, Kelly and Kendrick (2006) present a model of corporate governance composed of five elements which can support an approach to corporate risk and help in risk management. Those elements are Culture, Leadership, Alignment, Systems, and Structure, they should encourage the addressing of the *complexities* of risk in meeting strategic objectives[17]. Strategists should be interested not only in how risks are distinct and measured, but also in how they are included in the decision making (Drew and Kendrik 2005)[18]. Moreover, it is argued that Enterprises that have a corporate risk management approach have also an ethical culture indeed in this age of high risk, the accomplishment of such a culture entails a longer-term cultural shift (Ewing and Lee 2004)[19].

Even though internal auditors perform many activities and duties that are unrelated to corporate business accounting information systems, many of their responsibilities are related directly to the creation and *monitoring* of accounting information (Moeller and Witt 1999)[20].

One of the *primary responsibilities* of internal auditors is to test, evaluate and make recommendations regarding an organization's accounting system and its internal accounting controls. By doing so, internal auditors reduce the risk of fraud and protect assets from theft or loss. Eternal auditors generally perform similar activities with similar benefits, particularly when they rely on an organization's internal control. Indeed both internal-and external-auditing texts devote attention to the importance of coordination between internal and external auditors to prevent duplication of effort (Moeller and Witt 1999, Knechel 2000[21], Jensen and Payne 2003, Widener 1999).

In other words, overall responsibility for enterprise risk is changing not only because of a strategic management initiative but also because of *law* requirements and rules. Both of them require the internal audit function in a company to monitor and evaluate the effectiveness of control systems and the company's risk assessment. The 231 Legislative Decree, by stating the administrative responsibility of the Entities, resolves the problem highlighted by Pae and Yoo[22] (2001). The authors argue that when the external auditor liability is excessive firms are willing to under invest in their internal control systems.

4. The Italian Case

Our research was aimed to analyze how the companies were attempting to comply with the Italian Legislative Decree 231 and to explain what the effect on the organizational structure was. In particular we collected data from 21 companies listed on the S&P/MIB index by sending a questionnaire with 51 questions to each Internal Audit Director.

All of them have implemented appropriate *organizational and management models* described

[13] Jensen K.L., Payne J.L.2003, "Management Trade-Offs of Internal Control and External Auditor Expertise" in Auditing: a Journal of practice & theory 22 (2) 99:119

[14] Brinkley Woods et.al in Corporate Board, 2006, 27 (157), 30:30;

[15] Banham R. "Enterprising Views of Risk Management" in Journal of Accountancy, 2004, 197 (6), 65:71

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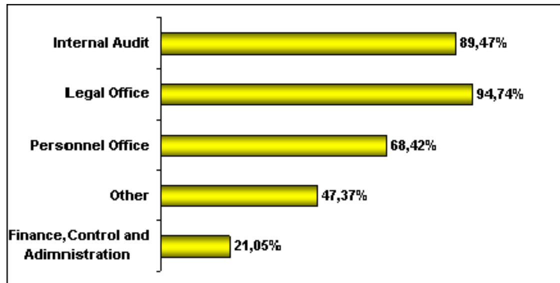
by Italian Legislative Decree 231. As shown on Graph 1 the companies examined referred in prevalence to their internal existing departments (Internal audit, Legal Office, Personnel Office, Finance, Control and Administration).

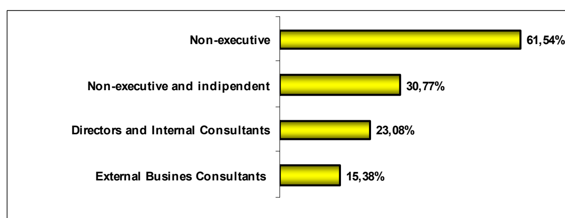


Graph 1. Departments involved

Anyhow, 90.5% combined with the abovementioned internal functions, some external consultants such as lawyers (47.37%), external auditors (36.84%), Business Consultants (21.05%) or Chartered Accountants (5.26%). The implementation of the models required in 76.19% of cases more than 6 months. In the 66.7% of companies examined there is already an *internal Board* (i.e. Supervisory Body) with monitoring functions of the models adopted.

The Internal Board (Graph 2) is composed predominantly by non executives (61.54%), non executives *and* independents (30.77%), directors, consultants and managers (23.08%), external Business Consultants (15.38%).

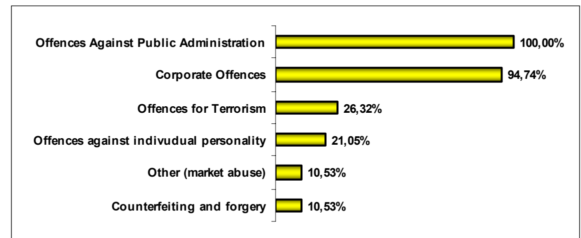
This means that the internal board is prevalently composed of internal members. Our findings are confirmed by a similar research made by the Internal Auditors Association[23] where it is shown that the Internal Board has a majority of internal auditors and only 12% of external consultants.



Graph 2. The composition of the internal board

In 52.5% of cases the Internal Board is assisted by external consultants which have to report exclusively to the Board. In all cases the Internal Board must report to the Board of Directors.

The companies declared to consider the following kind of *legal risks* as more incident on their activities: offences committed to the prejudice of the Public Administration (100.00%) and corporate offences (84.74%). Graph 3 shows the complete list of crimes including offences such as counterfeiting, forgery, offences committed for the purpose of terrorism or subversion of democratic order; offences against individual personality and Market abuse[24].



Graph 3. Legal Risks recognized

With reference to the types of offences indicated above, which are liable to entail a *legal risk* due to the administrative liability of the company, "sensitive" activities (i.e. Risk areas) have been identified, and broken down between those relating to: Purchase department (88.24%), Administrative and Bookkeeping Department (76.47%), Personnel department (64.71%), Finance and Control Department (58.82%), and others (17.65%).

Four Companies out of five intervened specifically in the aforesaid Risk Areas improving the internal process, the delegation schemes, the informative systems, and the whole organizational structure. The most remarkable result is that all the companies recognized that the implementation of some organizational models aimed to improve internal control effectiveness could also improve the risk-management process. Notwithstanding this, we found that it is difficult for all the enterprises to estimate and valuate how much this reduction would reduce the costs on capital. More then 94% declared that it is impossible to estimate the legal risk reduction due to the implementation of the 231 Legislative Decree model, internal audit system and internal board. In other words there is not, at this moment, the capacity to quantify the value created by the improvement of the Internal Audit System.

5. Conclusion

We considered a group of companies listed on the Italian Stock Exchange at the S&P/MIB Index to

[23] "La responsabilità amministrativa delle società" research made by the Pisa University and the Italian Association of Internal Auditors (IIA), they considered 97 listed companies (Italian Stock exchange) the survey is available on www.aiiaweb.it.

[24] These results and the ones of a survey made by the IIAA and Ernst &Young are very much alike, indeed they found that Offences against Public Administration and Corporate Offences were the most probable. The survey was done considering 72 listed and unlisted Italian companies, it is available on www.aiiaweb.it.

value the Internal Audit efforts implemented after the Legislative Decree 231/2001 which relates to the administrative liability of corporations. Under this law the company is liable for crimes committed in its own interest or to its benefit by members of the Company.

The Company is exempt from liability for the crimes committed by the aforementioned individuals, if it proves it has adopted and effectively implemented appropriate *organizational and management models* to avoid the crimes. Furthermore it has to have charged an *internal Board* (i.e. Supervisory Body) with monitoring the functioning of and complying to the models adopted.

The exemption from administrative liability for crimes is, for enterprises, an opportunity to reduce the risk of legal action, lawsuits or juridical proceedings (*legal risk)*.

This implies an improvement of the internal audit function and the creation of a risk assessment process.

The interaction of internal audit and risk assessment with legal risk leads to the creation of a shareholder value, by reducing the cost of capital and of stakeholders value by reducing the probability of crimes.

For these reasons the goal of a risk management optimization implies a strategic risk factors analysis. The Italian 231 decree, like the Sarbanes Oxley Act, is a device to develop accountability, transparency and integrity of companies. Moreover internal controls are also pivotal to the compliance of the Sarbanes Oxley Act..

We illustrated how Internal audit appropriately structured, can provide great value to an organization, influencing both regulatory compliance and operational excellence. As a matter of fact, internal auditors can reduce costs for the company, by improving accounting controls, financial examinations and organizational support (Wallace 1984).

In the rational decision process, managers are likely to choose an internal and external control mechanism combination that maximizes their profit or utility (Jensen and Payne 2003). For this reason we argue that the IA is strongly connected with strategic management decisions. With Enterprise Risk Management a company sets up risk definitions and acceptance levels, it classifies procedures to determine and calculate risks and creates monitoring activities. Strategists should be interested not only in how risks are distinct and measured, but also in how they are included in the decision making (Drew and Kendrik 2005). As regards the evidence in the Italian Experience we collected data from 21 companies listed on the S&P/MIB index by sending a questionnaire with 51 questions to each Internal Audit Director.

All of them have implemented appropriate *organizational and management models* described by Italian Legislative Decree 231. The companies examined prevalently referred to their internal existing departments (Internal audit, Legal Office, Personnel Office, Finance, Control and Administration). Anyhow, 90.5% combined with the abovementioned internal functions, some external consultants. The Internal Board (Graph 2) is composed predominantly by non executives. In 52.5% of cases the Internal Board is helped by external consultants who have to report exclusively to the Board. In all cases the Internal Board must report to the Board of Directors.

The companies declared to consider the following kind of *legal risks* as more incident on their activities: offences committed to the prejudice of the Public Administration (100.00%) and corporate offences (84.74%). “Sensitive” activities (i.e. Legal Risk areas) have been identified, and broken down between those relating to: Purchase department (88.24%), Administrative and Bookkeeping department (76.47%), Personnel department (64.71%), Finance and Control Department (58.82%), and other (17,65%).

Four Companies out of five intervened specifically on the aforesaid risk areas by improving the internal process, the delegation schemes, the informative systems, and the whole organization structure.

One of the most noticeable results is that all the companies recognized that the implementation of some organizational models aimed to improve the internal control effectiveness could also improve the risk-management process. Notwithstanding this, we found that it is difficult for all the enterprises to estimate and valuate how much this reduction reduces the cost of capital.

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Appendix 1

THE ITALIAN LEGISLATIVE DECREE N.231/2001

The Italian Legislative Decree includes the following crimes which determine administrative liability of the companies:

CRIMINAL CODE
Article 316-*bis* Embezzlement detrimental to the State
Article 316-*ter* Undue obtainment of grants detrimental to the State
Article 317 Extortion
Article 318 Bribery for the performance of official duties
Article 319 Bribery for the performance of acts contrary to one's official duties
Article 319 Bribery for the performance of acts contrary to one's official duties (aggravated pursuant to Article 319-*bis*)
Article 319-*ter* Bribery for the performance of judicial acts
Article 320 Bribery of a person responsible for public services
Article 321 Penalties for bribers
Article 322 Incitement to bribery
Article 322-*bis* Misappropriation of public funds (*peculation*), extortion, bribery and incitement to bribery of members of the boards of the European Communities and of officials of the European Communities and Foreign Countries
Article 640, paragraph 2, no. 1 Fraud
Article 640-*bis* Aggravated fraud for the obtainment of public grants
Article 640-*ter* IT fraud
Article 453 Forgery of money, concerted spending and introduction into the State of counterfeit money
Article 454 Counterfeiting of money
Article 455 Non-concerted spending and introduction into the State of counterfeit money
Article 459 Falsification of stamp duties, introduction into the State, purchase, possession or circulation of counterfeit stamp duties
Article 460 Counterfeiting of watermarked paper used to make instruments of public credit or stamp duties
Article 461 Making or possession of watermarks or instruments used for the counterfeiting of money, stamp duties or watermarked paper
Article 464, paragraph 1 Use of counterfeit or falsified stamp duties
Article 464, paragraph 2 Use of counterfeit or falsified stamp duties
Article 270-*bis* Associations for purposes of terrorism and for subverting democratic order
Article 280 Terrorist attacks
Article 600 Enslavement
Article 600-*bis* Juvenile prostitution
Article 600-*ter* Juvenile pornography
Article 600-*quater* Possession of pornographic material
Article 600-*quinquies* Tourism aimed at exploiting juvenile prostitution
Article 601 Trafficking in persons
Article 602 Sale and purchase of slaves

FINANCIAL LAW (TUF)
Article 184 Information Abuse
Article 185 Market Manipulation

CIVIL CODE
Article 2621 False corporate communications
Article 2622 False corporate communications detrimental to
shareholders and creditors
Article 2623 False representation in prospectuses
Article 2624 False representation in reports or notices by the accounting firm
Article 2625 Impediment to control
Article 2626 Undue refund of contributions
Article 2627 Illicit distribution of profits and reserves
Article 2628 Illicit transactions on shares or stakes of the Company or of its controlling company
Article 2629 Transactions prejudicial to creditors
Article 2632 Fictitious capital formation
Article 2633 Undue distribution of corporate assets by the liquidators
Article 2636 Illicit influence over the shareholders' meeting
Article 2637 Manipulation (*agiotage*)
Article 2638 Impediment to the performance of duties by public supervisory authorities

Regardless of the Company's administrative liability, if any, whoever commits one of the abovementioned crimes is personally and criminally liable for misconduct committed. Should the Company fail to prove the evidence above, it will be subjected to the following penalties:

Pecuniary penalties: from a minimum of € 25,823.00 to a maximum of € 1,549,371.00.

Disqualification penalties:
disqualification from conducting business;
suspension or revocation of authorizations, licenses or concessions
functional to the commission of the crime;
disqualification from contracting with P.A.;
exclusion from facilities, loans, grants or subsidies;
disqualification from advertising goods or services.

Confiscation of the price or profits from crime.

Filing of judgment.