РАЗДЕЛ 3 КОРПОРАТИВНОЕ УПРАВЛЕНИЕ В ИТАЛИИ

SECTION 3 NATIONAL PRACTICES OF CORPORATE GOVERNANCE: ITALY

FAIR VALUE AND STAKEHOLDER-ORIENTED ACCOUNTING SYSTEMS. SOME EVIDENCE FROM ITALY

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Abstract

This paper examined the key issues related to the effects of introduction of fair value in a stakeholder-oriented accounting system. In particular, it discussed how the decision of the Italian policymaker to limit the distribution to shareholders of fair value gains is rooted on the importance of prudence in the Italian legal and GAAP framework. The paper seek to explore how the importance of the 'prudence' principle in the Italian legal and GAAP framework seems mainly due to the influence of broadly defined corporate governance issues, such as the ownership, control and capital structures that characterise Italian listed companies, the concept of the corporation as generally accepted in Italy, and cultural issues, in relation to prudence, risk-taking and uncertainty avoidance. This paper argued that the Italian regulator decision seems able to safeguard the interests of a wide range of corporate stakeholders, without lowering the quality of information to investors, and provided an example of income statement section (named comprehensive income statement) in which fair value gains and losses may be disclosed.

Keywords: stakeholders, fair value, accounting systems

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1. Introduction

The harmonisation process in the European Union is significantly fostered by the adoption of the International Financial Reporting Standards (IFRSs *[see andnote 1]*) by its member States (EU directive 65/2001; EU law 1606/2002).

Hence there is a need for managers, investors and other corporate stakeholders (including policymakers) to understand the implications of IFRSs adoption, which seems likely to have a profound effect on the financial statements of companies, especially in stakeholder-oriented countries (e.g. France, Germany, and Italy).

Accounting is concerned with how economic actors process information and make decisions. It cannot be considered simply a neutral technique for economic decision-making as it also has a social role. Societal changes influence organizations and therefore interact with accounting, especially because the latter is able to sanction the distribution of wealth among corporate stakeholders (including shareholders). Thus, the importance of studying accounting practice within its social and organizational context (Hopwood, 1983).

In fact, generally accepted accounting principles are not to be considered as 'universal' principles, but are clearly the result of the influence of several "environmental" factors (e.g. Choi and Mueller, 1992; Belkaoui, 1995; Onesti, 1995; Nobes, 1998). In particular, IFRSs are influenced by the shareholder-oriented Anglo-Saxon accounting model, while in some countries (such as Italy) national accounting standards were relatively more stakeholder-oriented accounting systems.

This paper aims to compare and contrast the different treatment of fair value in IFRSs and in the version of them adopted by Italy. The Italian policymaker requires listed companies to prepare their separate and individual (i.e. non-consolidated *[see andnote 2]*) financial statements with IFRSs since 2006. In Italy, non-consolidated financial statements are the basis for "distributable" income, that is the income that shareholders' annual general meeting may decide to distribute via dividends is based on the reported income. Thus, the paper will discuss the key issues related to the distribution of gains derived by fair value measurements, which represent one of the most important innovations in financial statements' preparation due to IFRSs.

There is a growing body of literature (e.g. Forker, 1992; Peasnell et al., 2000; Bushman and Smith, 2001; Klein, 2002; Beekes et al., 2004) that analyses how corporate governance issues influence the financial reporting process. This paper acknowledges such relationship (see e.g. Melis, 2004), however it differs from such literature: rather than analysing how a specific corporate governance feature influences a specific aspect of financial reporting at corporate level, it seeks to explore how the importance of an accounting principle in a specific social and economic context may be influenced by broadly defined corporate governance issues.

In particular, the paper explores the origins of the importance of the prudence principle within the Italian generally accepted accounting principles (hereafter GAAP) and commercial law, by examining the specific corporate governance issues that characterise the social and economic context in which Italian listed companies operate.

In order to achieve its aim, the paper firstly reviews the different importance of the accruals basis assumption and the prudence principle in the IFRSs and in the Italian GAAP, and seeks to explain the key underlying reasons of such difference. Then, it describes how the Italian lawmaker has chosen to balance the relevance and reliability principles, by overcoming the potential trade-off between the accrual basis assumption and the prudence accounting principle. It analyses the effects of the introduction of fair value on the financial statements of non-financial listed companies, by providing an example of how the Italian choice of treatment of fair value measurements seems to be able to better safeguard the interests of a wide range of corporate stakeholders, without lowering the quality of information provided to investors.

2. Accrual basis and prudence. A comparative analysis of IFRSs and Italian GAAP

An analysis of the IASB framework and Italian GAAP reveals significant differences with regard to the importance of prudence and accrual basis.

In the IASB framework, accrual basis is one of the underlying assumptions (together with going concern). It is clearly stated that "the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate" (IASB, 2004a, para 22).

According to IASB framework (IASB, 2004a, para 37), prudence is only instrumental to reliability Furthermore, while the 1997 version of IAS 1 mentioned prudence as one of the necessary conditions of reliable information, an analysis of the content of the revised IAS 1 (2004) shows that prudence is not mentioned anymore.

While there seems to be evidence of a waning of importance in the IFRSs for the prudence concept, prudence is at least as important as the accrual basis in the Italian GAAP.

In the latter, the principle of 'prudence' was not only instrumental to the reliability of the financial statements' information. In fact, although Italian GAAP framework and law (Civil code, para 2423 bis) do not explicitly establish a hierarchy between accrual basis assumption and the prudence principle, content analysis of Italian GAAP shows that prudence tends to prevail over on the accrual basis assumption.

Italian GAAP also differ from IFRSs with regard to the definition of prudence. While the IASB Framework defines prudence as "the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated" (IASB, 2004a, para 37), the Italian GAAP take a much narrower view. Its meaning of prudence may be summarised as 'anticipate no unrealised profit, but anticipate all potential losses' (also known as 'strong prudence', see Alexander, 2005).

The definition of realised income given by the Italian GAAP differs from IFRSs. While IFRSs include "enhancements of assets or decreases of liabilities that result in increases in equity" (IASB, 2004, para 70), Italian GAAP implicitly consider an income as 'realised' only when the following criteria are met: a) the completion of production, and b) the exchange of the good (or the rendering of the service) and the transfer of its legal title.

3. The adoption of fair value in a stakeholder-oriented accounting system. The Italian case

The widespread of historical cost in the Italian GAAP is consistent with the importance of prudence. In fact, information based on the historical cost is likely to be more reliable (as it tends to be less volatile) and conservative in comparison to information based on the fair value, as defined by IFRSs (see IAS 18, 2004, para 7).

Furthermore, prudence tends to override the use of historical cost in the cases when the two principles are in contrast (the 'lower of cost or net realisable value' accounting practice *[see andnote 3]*).

'Prudential' financial statements were aimed to safeguard capital maintenance in the interests of corporate stakeholders that do not have a 'voice' on the distribution of profit to shareholders. However, they provided an information which was likely to be less 'relevant' (i.e. less useful to the decision making) to investors.

Proponents of fair value advocate that the latter is more relevant than Historical cost because it reflects the amount at which an asset could be bought or sold, or a liability incurred or settled, in a current transaction between willing parties.

The preference of fair value versus historical cost in the IFRSs seems to be based on the assumption that the information based on the 'fair market value' is likely to be more relevant to decision-making. Because it is expected to incorporate the effects of economic events in a more timely (but volatile) manner in the financial statements, and better reflects financial risk management practice than information based on the historical cost.

First, such an assertion would be overwhelming in the context of perfectly efficient markets, in which market prices fully incorporate the fundamental values of all assets and liabilities. When there are imperfections in the markets, the superiority of a fair value over historical cost is no longer so immediate, especially with regard to the reliability of information provided by corporate insiders to other stakeholders.

Then, fair value is often only one of the allowed accounting treatments (e.g. IAS 16; IAS 38). Furthermore, not only can it not be adopted when it is not reliably measured, but also its adoption by IASB is only partial, as some items (e.g. inventories, see IAS 2), are still to be measured at their historical cost.

Last but not least, the introduction of fair value measurements does not lead to a balance sheet and a profit and loss account (P&L) that report the value created by the company operations in a given period. In fact, information relevant for decision-making (e.g. goodwill and other internally generated intangible assets, see IAS 38, para 51-53) is not included in the financial statements yet.

With the adoption of the IFRSs, Italy has tried to maintain a 'conservative' approach to fair value, by balancing the 'relevance' and 'prudence' principles.

Italian companies that adopt IFRSs can meet the 'relevance' principle in the financial statements as recommended by IASB, by disclosing the information at the fair value. At the same time, the Italian law (Decree n. 38, 28th February 2005) requires such companies to safeguard the 'prudence' principle, by prohibiting the distribution to shareholders of most of the gains (credited directly in equity or recognised in P&L) derived by fair value measurements.

The Italian law implies that most of the fair value gains are to be considered as 'unrealised' and explicitly mentions only the following gains as distributable: a) held for trading financial assets, b) fair value hedge financial instruments and c) operations in foreign currency exchange markets*[see and note 4]*. Any other fair value gain, recognised in the P&L or credited in equity, is to be credited in a non-distributable reserve (named 'Fair value reserve'). Such reserve may be transferred to a distributable reserve (or to retained earnings) only when the asset that generated it is either disposed of or is indirectly realised via its depreciation.

The fair value reserve can be used for settling losses, when there are no other reserves of equity. When profit is not adequate to form a fair value Reserve, in the next periods profits are to be credited until the reserve is equal to the revaluation amount (fair value less historical cost).

In this way, the Italian policymaker seeks to balance the potential trade-off between the relevance and the reliability of the information provided by financial statements *[see andnote 5]*.

Table 1 summarises the key accounting differences with regard to fair value between IFRSs and the Italian version adopted by Italy *[see appendices, tabl 1]*.

4. The underlying reasons of the differences of treatments of fair value between Italy and IFRSs

The Italian choice to balance the relevance and prudence principles is based on the importance of the 'prudence' principle in the Italian legal and GAAP framework, which persists in the version of IFRSs adopted by Italy. Prudence seems mainly due to the influence of broadly defined corporate governance characteristics.

We refer to the ownership, capital and control structures, the concept of corporation and the role and interests of corporate stakeholders as well as legal and cultural issues to the extent to which they may influence the financial reporting system.

4.1 Ownership, capital and control structures

Despite the fact that the IASB claims that its accounting standards are for the benefit of a wide range of organisations (see e.g. IAS 1), its framework (as well as its accounting standards) seems to take for granted a corporate entity where several small investors provide equity capital to large listed companies, which are under the control of their senior management. Taking a narrowly defined corporate governance perspective, the key issue then becomes how "to deal with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer, Vishny, 1997, p. 737). Financial reporting is *de facto* required to provide adequate information to investors (i.e. corporate shareholders and potential ones) in order to make them able to take decisions as well as to hold senior management accountable. The prevailing Italian corporate governance reality diverges from the above-mentioned assumptions. Empirical studies show that the Italian corporate governance system is characterised by a relatively poor capital market orientation (e.g. Pagano et al., 1998), a relatively high concentrated ownership and control structure (La Porta et al., 1999; Melis 1999; 2000). Consequently, the role played by the market for corporate control is very limited. This fact lessens the need for aggressive reported earnings to boost share price and avoid hostile take-overs. Furthermore, in Italy the presence of a controlling shareholder who is an 'active' investor, willing and able to monitor the senior management effectively (e.g. Molteni 1997; Melis 1999; Bianchi et al. 2001) is likely to exercise an influence on financial statements.

Thus, there is a little incentive for senior management, who is accountable to the controlling shareholder, for 'aggressive' reported earnings since the latter is a corporate insider, therefore s/he does not need financial statements to understand corporate performance.

Besides, Italian non-financial companies tend to have a capital structure that significantly differs from others. As for instance, Mcclure et al. (1999) report that, among the G7 countries, Italy (together with France) is the country in which non-financial listed companies tend to use a higher proportion of total debt vs. equity. Such capital structure gives birth to the important role of creditors among the users of financial statements.

Creditors are less interested than investors are that a corporation reports 'potential' profits (i.e. profits that are not realised but generated by fair value measurements), rather they have an interest that fair value gains are kept into the company, rather than being distributed to shareholders.

4.2 The concept of the corporation

It is generally accepted that accounting standards are to regulate the financial reporting process primarily for the benefit of the users of financial statements.

Although the IASB identifies several "users of financial statements" (IASB, 2004a, para 9), it seems to assume that the regulation (and consequent information) which meets the needs of the investors will also meet the needs of other users as well (IASBa, 2004, para 10).

Such belief seems to be based on the primacy of the shareholder value, which is the dominant paradigm in the Anglo-American corporate governance systems, in which corporate entities tend to be regarded as "commodities" (Charkham, 1990) *[see andnote 6]*. In Italy a corporate entity is considered as an enduring social and economic institution (e.g. Zappa, 1927; Onida, 1968, Viganò, 1998), rather than as a "legal fiction" which serves "as a nexus for a set of contracting relationships among individuals" (Jensen and Meckling, 1976: 310ff). Furthermore, in Italy companies (especially large companies) are considered as social organisations that are demanded by the State to act taking into the account the interests of a wide range of constituencies. Such stakeholders include employees who may find it difficult to relocate to another employment if the company closes, creditors whose claims will not be met in full if the company enters insolvency, and the State itself, which has a stake concerning taxes to be paid by the corporation as well as the socio-economic development of the country. Italian GAAP (and law) encourage a 'prudent' approach to asset valuation and liability recognition in order to facilitate contracting with corporate stakeholders, similarly to German GAAP and law (see, *inter alia*, Harris et al., 1994; Leuz, 2003).In particular, relative to historical cost, fair value estimates are more likely to be subject to managerial discretion. The difficulty of verifiability of many valuation estimates gives the controlling shareholder an incentive to introduce bias into value estimates, so that the Italian standard setter has recognised the importance of 'prudence' to safeguard capital maintenance.

By protecting the capital of the company, it seeks to safeguard the interests of the other corporate stakeholders against the wielding of power of the controlling shareholder.

4.3 Cultural issues: prudence and uncertainty avoidance

The importance of prudence in the Italian GAAP and commercial law seems to be based also on issues which are culture-specific.

Hostede (1980) elaborated the so-called Uncertainty Avoidance Index (UAI), which focuses on the level of tolerance for uncertainty, ambiguity, and risk within a society.

On the one hand, a high UAI ranking indicates that a country has a low tolerance for uncertainty and ambiguity. This is reflected in a country that is a rule-oriented society that institutes laws, rules, regulations, and controls in order to reduce the amount of uncertainty and risks. On the other hand, a low UAI ranking indicates the country has less concern about ambiguity and uncertainty. This is reflected in a society that is less rule-oriented and takes more and greater risks.

Given that the income reported in corporate financial statements represents that basis for 'distributable' income in Italy, the UAI rank seems to explain (at least partly) the decision of the Italian regulator to issue a law that explicitly limits the distribution of fair value profits.

According to Hosfede's study, Italy scores on a relatively high level on this index (75 out of 100), especially if compared to Anglo-Saxon countries *(see table 2).*

Table 2. Uncertainty Avoidance Index (UAI)

COUNTRY	*UAI*
Italy	75
Australia	51
New Zealand	49
Canada	48
U.S.A.	46
Ireland	35
United Kingdom	35

Source: Elaborated from Hostede (1980) database.

This evidence seems to support the importance of prudence within the Italian legal framework and GAAP, and is coherent with the decision of the Italian State regarding the distributability of fair value gains. A counterpart example is provided by the UK which ranked on a relatively low score (35 out of 100) on the UAI. Not only does this seem consistent with the argument of Evans and Nobes (1996, p. 368), who note that "the supremacy of prudence over the other principles is codified in all language versions of the Fourth Directive except for the English version", but also its UAI rank seems to explain why the UK regulator did not explicitly specified which fair value gains are to be considered as 'unrealised'. Rather, it chose to define as 'realised' (and thus distributable to shareholders) or 'unrealised' (and thus not distributable) what is accepted as being realised by professional accountants *[see andnote 7].*

5. The adoption of the Comprehensive Income Statement in Italy

By using the new IASB's face of the income statement (IASB, 2004b), the methods of crediting fair value gains or losses in the non–distributable reserve as required by the Italian law are discussed.

In particular, we recommend to insert a new section called Unrealised Gains or Losses (UGL) where unrealised fair value gains or losses, credited directly in equity or recognised in P&L, are disclosed jointly. We define this income statement as Comprehensive Income Statement (CIS).

When unrealised gains find realisation (directly on the disposal or indirectly with the depreciation, impairment or the revaluation decrease), they are disclosed in one of the sections of realised items. The equivalent amounts are transferred from the non–distributable reserve to a distributable reserve *[see andnote 8]*. If an asset's impairment loss is recognised and the asset has not previously been revaluated, then the loss is disclosed in one of the sections of realised items. In this way, in accord with prudence, the distributable income of the period is not overvalued. Any subsequent asset's increase is disclosed in the sections of realised items given that it does not exceed the carrying amount that would have been determined if no impairment loss for the asset had been recognised. The excess is disclosed in the UGL section. CIS is composed of four sections:

- Operating;
- Financing and Treasury;
- Discontinued Operations;
- Unrealised gains and losses.

While the first three sections disclose distributable economic items, the fourth discloses unrealised gains and losses from fair value (which are non-distributable by Italian law) *[see andnote 9]*. Table 3 shows the face of CIS *[see appendices, tabl 3]*.

The following examples will explain how the fair value unrealised items are disclosed.

5.1. Example 1

A company buys a fixed asset (100) carried at a revalued amount (IAS 16, para 31). Its estimated useful life is four years. Without revaluations or revaluation decreases, table 4 shows the depreciation plan in periods 1 and 2. Table 5 shows fair value changes in periods 1 and 2*[see andnote 10]:*

At the end of period 1, the asset's carrying amount (75) is lower than its fair value (90). The carrying amount must be revaluated (15 = 90 - 75).

Fair value revaluations have been measured proportionally (20% = 15/75) at the gross carrying amount of the asset (i.e. its historical cost, 100) and its accumulated depreciation (25) so that its carrying amount after revaluation equals its fair value.

Table 6 reports the updated depreciation plan.

IAS 16 requires fair value increases to be credited directly in equity under the 'Revaluation surplus' heading. In CIS, it is disclosed in the UGL section and then credited in the non–distributable fair value Reserve as required by the Italian law.

It is supposed that at the end of period 2 the asset's fair value is equivalent to its carrying amount (60). No revaluation is necessary. The non–distributable fair value Reserve may be transferred directly to a distributable reserve (5). This amount is equal to the difference between depreciation based on the revalued carrying amount of the asset (30) and depreciation based on the asset's original cost (25).

At the beginning of period 3, the asset is sold. The non–distributable fair value Reserve is transferred to a distributable reserve, as required by IAS 16. Table 7 reports the gain arisen from the disposal.

Table 8 shows the different income statements. Column 1 reports the current Italian face, Column 2 the Italian application of CIS, Column 3 the current IASB's income, and column 4 the IASB's proposal of CIS (IASB, 2004b) *[see appendices, tabl 8]*.

Table 9 shows the statements of changes in equity.

Table 4. Depreciation Plan

	Period 1	Period 2
Gross carrying amount	100	100
Depreciation	25	25
Accumulated depreciation	25	50
Carrying amount	75	50

Table 5. Fair Value Changes

	Period 1	Period 2
Fair value	90	60
Recoverable amount = Fair Value	90	60

Table 6. Updated Depreciation Plan

	Period 1	Period 2
Gross carrying amount	120	120
Depreciation	25	30
Accumulated depreciation	30	60
Carrying amount	90	60
Fair value revaluation	15	

Table 7. Gains From Disposal

	Revaluated amounts at the beginning of 3rd Period	Historical cost amounts at the beginning of 3rd Period
Gross carrying amount	120	100
Depreciation	-	-
Accumulated depreciation	60	50
Carrying amount	60	50
Net disposal amount	80	80
Gain from the disposal	20	30
Non-distributable Reserve becoming Distributable	10	

Table 9[see endnote 11]. Statement of Changes in Equity

	Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB	Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB	Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB
	Period 1	*Period 1*	*Period 1*	*Period 1*	*Period 2*	*Period 2*	*Period 2*	*Period 2*	*Period 3*	*Period 3*	*Period 3*	*Period 3*
Equity												
Share Capital	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000
Non-distributable Fair value Reserve	**-**	**15**	**15**	**15**	-	10	10	10	**-**	**-**	**-**	**-**
Distributable Reserve (or Retained Earnings)	-	-	-	-	**-**	**5**	**5**	**5**	**-**	**10**	**10**	**10**
Distributable Comprehensive Income	200	200	200	200	200	195	195	195	230	220	220	220
Total	**100 200**	**100 215**	**100 215**	**100 215**	**100 200**	**100 210**	**100 210**	**100 210**	**100 230**	**100 230**	**100 230**	**100 230**

Column 1 underlines the measurements and the disclosures for the companies that adopt Italian GAAP. The *Revaluation model* is not allowed by Italian GAAP, the fixed asset is carried at its historical cost less accumulated depreciation. *[see andnote 12].*

Column 2 allows reporting the assets and the liabilities carried at fair value, at the same time it underlines the non–distributable fair value gains disclosing them in the UGL section. CIS points out the unrealised items and their recycling to the distributable income once they are realised directly or indirectly *[see andnote 13].*

This approach has the informational advantage to get the unrealised items (previously disclosed in UGL section) shared in the realised and distributable income of *Operating or Financing and Treasury* sections. Recycling forbidden, the realisation of the fair value gains is disclosed in the Statement of changes of Equity through the transfer of the fair value Reserve in a distributable reserve.

Column 3 does not report the fair value gain in period 1 because IFRSs require crediting it directly in equity. There are no other differences with Italian CIS.

Column 4 shows the disclosure of fair value gains and losses having regarded their economic nature (*operating, financial, treasury, discontinued*) rather than their realisation. Fair value gains are disclosed in the 'Remeasurements' column. There is no UGL section. Unrealised surplus contributes to produce the operating income.

This presentation seems to be able to disclose adequately the financial performances attained in the different sections but does not give an immediate information of what is realised or unrealised. The adoption of IASB's CIS does not seem suitable for Italian companies as the law regards such difference as significant. On the disposal, the gain is determined as the difference between the net disposal proceeds (80) and the carrying amount of the revaluated item (60), not disclosing the effective realisation of the gain. *[see andnote 14].*

Italian CIS is able to disclose the realised and distributable items and neutralise the higher depreciations (arising from the revaluation) that influence the operating income.

Using this approach, financial statements prepared with IFRSs and Italian GAAP are comparable and are able to provide information useful to predict the corporate capacity to generate cash flows (fixed asset available for use and its disposal).

On the contrary, IASB's approach does not use recycling and this information shall be sought only in the Statement of changes in Equity, while the revaluation and the higher depreciation affect substantially the operating performances.

5.2. Example 2

An investment property is bought (100) and carried at fair value model, as recommended by IAS 40 (2004, para 33). IAS 40 requires neither to credit fair value gains in a reserve nor to limit their distribution to shareholders. Table 10 shows fair value changes in periods 1 and 2 and the disposal value in period 3. Operating income and Share capital are given. Investment property at fair value model has not to be depreciated (IAS 40, para 33-55). According to Italian GAAP (OIC 16, 2005, para D.XI.5), investment property may or may not be depreciated. In this example, it is not depreciated. Table 11 shows the different income statements. Column 1 represents the current Italian face, Column *2* the Italian application of CIS, and Column 3 the current IASB's. Table 12 and 13 show the differences in equity and the effects of the fair value measurements in the distributable income. The IASB's approach is less prudent than the Italian one.

Table 10. Fair Value Changes

	Acquisition	Period 1	Period 2	Disposal
Fair value	100	120	130	110
Revaluation from Fair value recognised in Profits and Loss		20	10	
Loss				20

Table 11. Face Of The Comprehensive Income Statement (CIS)

	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS
	Period 1	*Period 1*	*Period 1*	*Period 2*	*Period 2*	*Period 2*	*Period 3*	*Period 3*	*Period 3*
Operating									
Revenues	1 000	1 000	1 000	1 000	1 000	1 000	1 000	1 000	1 000
Expenses	(950)	(950)	(950)	(960)	(960)	(960)	(970)	(970)	(970)
Operating income before taxation	*50*	*50*	*50*	*40*	*40*	*40*	*30*	*30*	*30*
Taxation	(30)	(30)	(30)	(30)	(30)	(30)	(30)	(30)	(30)
Operating income	**20**	**20**	**20**	**10**	**10**	**10**	**-**	**-**	**-**
Financing and treasury									
Treasury gains and losses	-	-	20	-	-	10	10	10	(20)
Financing and Treasury before taxation	-	-	20	-	-	10	10	10	(20)
Taxation	-	-	-	-	-	-	-	-	-
Financing and treasury	**-**	**-**	**20**	**-**	**-**	**10**	**10**	**10**	**(20)**
Realised (Distributable) Income of the Period	**20**	**20**	**40**	**10**	**10**	**20**	**10**	**10**	**(20)**
Unrealised Gains and Losses									
Revaluation / Revaluation decreases of Financial Assets	**-**	**20**	**-**	**-**	10	**-**	**-**	**(30)**	**-**
Taxation	-	-	-	-	-	-	-	-	-
Unrealised Gains and Losses	**-**	**20**	**-**	**-**	**10**	**-**	**-**	**(30)**	**-**
Comprehensive Income	**20**	**40**	**40**	**10**	**20**	**20**	**10**	**(20)**	**(20)**

Table 12[see ednote 15]. Statement Of Changes In Equity

	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS
	Period 1	*Period 1*	*Period 1*	*Period 2*	*Period 2*	*Period 2*	*Period 3*	*Period 3*	*Period 3*
Equity									
Share Capital	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000	100 000
Non-distributable Fair value Reserve	**-**	**20**	**-**	**-**	**30**	-	**-**	**-**	**-**
Distributable Reserve (or Retained Earnings)	-	-	-	**-**	**-**	**-**	**-**	**30**	**-**
Distributable Comprehensive Income	20	20	40	10	10	20	10	(20)	(20)
Total	**100 020**	**100 040**	**100 040**	**100 010**	**100 040**	**100 020**	**100 010**	**100 010**	**99 980**

Table 13. Changes of distributable Equity

	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS	Italy before IAS	CIS - Italy	IAS
	Period 1	*Period 1*	*Period 1*	*Period 2*	*Period 2*	*Period 2*	*Period 3*	*Period 3*	*Period 3*
Changes of distributable Equity	**20**	**20**	**40**	**10**	**10**	**20**	**10**	**10**	**(20)**

IFRSs recognise fair value gains as available for distribution. In period 1, the "shareholders of IASB's Statement" might receive dividends for an amount of 40 (20 from operating profits and 20 from unrealised gains). In period 2, shareholders might receive dividends for an amount of 20 (10 from operating profits and 10 from unrealised gains). However, in period 3 they might understand the impoverishment of the corporate share capital (20).

Italian CIS and the legal disposition to credit fair value gains in a non–distributable reserve are able to disclose the unrealised income and the fair value of entity's assets and liabilities. However, its capital maintenance is not impaired by the distribution of unrealised income.

Since period 2, investors and all other stakeholders have been able to evaluate the corporate ability to generate cash and the timing and certainty of such generation.

Investors receive information relevant to take their own economic decisions and other stakeholders have their interest in the corporate capital safeguarded.

6. Concluding remarks

This paper examined the key issues related to the effects of introduction of fair value measurements in the financial statements of Italian non-financial listed companies.

In accord to EU options, Italy has required listed companies to prepare their separate and individual financial statements with IFRSs since 2006. In Italy, the income reported in non-consolidated financial statements is the basis for 'distributable' income, thus the paper examined the key issues related to the distribution of fair value gains.

Italy has a stakeholder-oriented accounting system. Therefore, in order to safeguard the interest of corporate stakeholders, the Italian law limits the distribution to shareholders of fair value gains. This decision is rooted on the importance of 'prudence', which persists in the version of IFRSs adopted by Italy. The paper examined how Italian GAAP and law give a different definition and importance to the concepts of accrual basis and prudence in comparison with IFRSs.

It explained how the considerable importance of prudence in Italy seems based on broadly defined corporate governance factors, such as the Italian prevailing ownership, capital and control structures, the concept of corporation in Italy and cultural issues, in relation to prudence, risk-taking and uncertainty avoidance.

Last but not least, the paper presented a face of income statement section in which fair value gains and losses, that are not distributable under the Italian law, are disclosed in a section named 'Unrealised gains and losses'.

The Italian law and CIS seem to be able to safeguard the interests of a wide range of corporate stakeholders, without lowering the quality of information to investors.

Although this paper focused on Italy, other countries, either in Europe or elsewhere, are characterised by stakeholder-oriented accounting systems and are facing (or are likely to face in the near future) similar problems with the adoption of IFRSs.

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Endnotes:

1. For ease of exposition, we will use the term 'IFRSs' to refer to both IASs and IFRSs.

2. Separate financial statements are "those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees" See IAS 27 (2004, para 4). Individual financial statements are those presented by a company that does not present consolidated financial statements.

3. There are only few notable exceptions in which Italian GAAP allow to record a value that is higher than HC: 'extraordinary revaluations of assets' (see Civil code art. 2423), investments in subsidiaries accounted for using the equity method, and exchange differences arising on translating monetary items at closing rate. Any profit due to these procedures shall be credited in non-distributable reserves, until the amount is realised on disposal or via depreciation.

4. Such exceptions do not seem consistent with the overall importance of prudence. For example a company that adopt only Italian GAAP shall credit the gains from operations in foreign currency market to a non-distributable reserve, while if it adopts IFRSs it is allowed to distribute them. Furthermore, the underlying reasons that lead to the mentioned exceptions have not been disclosed by the Italian policymaker.

5. The IASB (2004, para 45) itself acknowledges in its framework that "a balancing, or trade-off, between qualitative characteristics is often necessary".

6. However, Deakin (2005, p. 11) notes that "It is surprisingly difficult to find support within company law for the notion of shareholder primacy." Shareholder primacy is "essentially a cultural rather than a legal point of reference" (p. 16).

7. We are indebted for this argument to Professor David Alexander, University of Birmingham, UK.

8. This approach, named "Holding tank", has been used in the US since 1997 (SFAS 130). IASB takes a different approach (called "Component approach"): gains or losses are disclosed only once, when they arise. 'Recycling' is not permitted.
9. Only the before-mentioned exceptions of fair value gains should not be disclosed in this section because they are considered distributable by the Italian law.
10. In this example, the asset's fair value is always higher than its value in use and the costs to sell are not estimated. Therefore, the recoverable amount coincides with the asset's fair value.
11. The distributable comprehensive income and the distributable reserve of a period will be distributed to shareholders in the course of the next period.
12. In period 2, *ceteris paribus*, there are less operating costs (-5) because the depreciation (25) is calculated on its non–revaluated cost (100). In period 3 the gain arising from the disposal is included in the operating section for an amount of 30 (80 – 50).
13. In period 2, the fair value revaluation is indirectly realised with depreciation of 5. This amount is shown in the Operating section (as realised item) and recycled from the UGL section. In period 3 the gain arising from the disposal of the asset (30 = 80 – 50) is reported in the Operating section. In the UGL section, the remaining FAIR VALUE surplus credited in equity (– 10) is recycled.
14. The information of the gain is determined as the difference between disposal value and original asset's cost (not revalued) less depreciation will be lost.
15. See note 11.

Appendices

Table 1. Fair value Accounting Differences

Item of Financial Statement	Italian GAAP	IAS/IFRS		IAS/IFRS adopted in Italy and the requirements of D.Lgs. n. 38/2005	
Accounting of changes in carrying amounts	-	Profit or Loss	Equity	Profit or Loss	Equity
Intangibles and Fixed Assets	Historical cost		Fair Value		Fair Value. Gains shall be credited directly in a Non – Distributable Reserve
Investment properties	Historical cost – no Depreciated	Fair value		Fair Value. Gains shall be credited in a Non – Distributable Reserve	
Investments in subsidiaries, jointly controlled entities and associates in Separate Financial Statement	If classified as *Non – Current Assets*: - Equity Method or Cost. The revaluations shall be credited in a non – distributable Reserve. If classified as *Current Assets*: - At the lower of cost and net realisable value	Fair value. Held for sale - IFRS 5		Fair Value. Gains shall be credited in a Non – Distributable Reserve. Held for sale - IFRS 5	
Other Equity Instruments	If classified as *Non – Current Assets*: Cost. If classified as *Current Assets*: At the lower of cost and net realisable value	Fair value (see: *Held for trading* or *Available for sale*)		Fair value (see: *Held for trading* or *Available for sale*)	
Financial Assets Held for trading	If classified as *Current Assets*: At the lower of cost and net realisable value	Fair value		Fair Value. Gains could be distributed to shareholders	
Financial Assets Available for sale	If classified as *Current Assets*: At the lower of cost and net realisable value		Fair Value		Fair Value. Gains shall be credited directly in a Non – Distributable Reserve
Financial Assets at Fair Value Option	Not allowed	Fair value		Fair Value. Gains shall be credited in a Non – Distributable Reserve	
Fair value Hedges	Not allowed	Fair value		Fair Value. Gains could be distributed to shareholders	
Hedges of a Net investment and Cash flow Hedges	Not allowed		Fair value		Fair Value. Gains shall be credited directly in a Non – Distributable Reserve
Financial liabilities Held for trading	Settlement value	Fair value		Fair Value. Gains could be distributed to shareholders	
Financial liabilities at Fair Value Option	Not allowed	Fair value		Not allowed	
Biological Assets and Agricultural produce	At the lower of cost and net realisable value	Fair value		Fair Value. Gains shall be credited in a Non – Distributable Reserve	

Changes of fair value of non – monetary items that are measured at fair value in a foreign currency	Not allowed	Exchange rates at the date of fair value when a gain or loss on a non-monetary item is recognised directly in Profit or loss	Exchange rates at the date of fair value when a gain or loss on a non-monetary item is recognised directly in Equity	Exchange rates at the date of fair value when a gain or loss on a non-monetary item is recognised directly in Profit or loss. Gains shall be credited in a Non – Distributable Reserve	Exchange rates at the date of fair value when a gain or loss on a non-monetary item is recognised directly in Equity. Fair Value. Gains shall be credited directly in a Non – Distributable Reserve
Actuarial gains and losses on Defined Benefits Plans	Not allowed	*Corridor approach* and *Immediate recognition approach*		*Corridor approach* and *Immediate recognition approach.* Gains shall be credited in a Non – Distributable Reserve	

Table 3. Face of adoptable Italian CIS

	Total t+1	*Total t*
Operating		
Revenues		
Expenses		
Operating income before taxation		
Taxation		
Operating income		
Financing and Treasury		
Financial Gains and losses		
Treasury Gains and losses		
Financing and treasury before taxation		
Taxation		
Financing and Treasury income		
Discontinued Operation		
Realised (Distributable) Income of the Period		
Unrealised Gains and losses		
- Revaluations or Revaluation decreases of Fixed, Intangible Assets and Investment recognised at fair value;		
- Revaluations or Revaluation decreases of Investments in subsidiaries, jointly controlled entities and associates and other Equity instrument recognised at fair value or accounted for using the Equity method;		
- Revaluations or Revaluation decreases of the financial instruments at fair value;		
- Changes of fair value of non-monetary items that are measured at fair value in a foreign currency;		
- Revaluations or Revaluation decreases of Biological Assets or Agricultural produce recognised at fair value;		
- Hedges of a Net investment and Cash flow Hedge;		
- Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation;		
-Actuarial gains and losses on Defined Benefits Plans		
Unrealised gains and losses income before taxation		
Taxation		
Unrealised gains and losses income		
Comprehensive Income		

Table 8. Face Of The Comprehensive Income Statement (CIS)

	Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB			Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB	Italy before IAS	**CIS** - Italy	IAS	**CIS** - IASB
	Period 1	*Period 1*	*Period 1*	*Period 1*	*Before Remeasurements*	*Remeasurements*	*Period 2*	*Period 2*	*Period 2*	*Period 2*	*Period 3*	*Period 3*	*Period 3*	*Period 3*
Operating														
Revenues	1.000	1.000	1.000	1.000	1.000		1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Surplus realised on Disposal of Fixed asset	-	-	-	15	-	15	-	**5**	-	-	**30**	**30**	**20**	**20**
Expenses	(700)	(700)	(700)	(700)	(700)		(700)	(705)	(705)	(705)	(700)	(700)	(700)	(700)
Operating Income before taxation	*300*	*300*	*300*	*315*	*300*		*300*	*300*	*295*	*295*	*330*	*330*	*320*	*320*
Taxation	(90)	(90)	(90)	(90)	(90)		(90)	(90)	(90)	(90)	(90)	(90)	(90)	(90)
Operating Income	**210**	**210**	**210**	**225**			**210**	**210**	**205**	**205**	**240**	**240**	**230**	**230**
Financing and Treasury														
Financial gains and losses	(10)	(10)	(10)	(10)	(10)		(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Treasury gains and losses														
Financing and Treasury Income before taxation	(10)	(10)	(10)	(10)	(10)		(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Taxation														
Financing and Treasury Income	**(10)**	**(10)**	**(10)**	**(10)**			**(10)**	**(10)**	**(10)**	**(10)**	**(10)**	**(10)**	**(10)**	**(10)**
Realised (Distributable) Income of the Period	**200**	**200**	**200**	**215**			**200**	**200**	**195**	**195**	**230**	**230**	**220**	**220**
Unrealised Gains and losses														
Revaluation / Revaluation decreases of non - current asset	-	**15**	-	-	-	-	-	(5)	-	-	-	(10)	-	-
Taxation														
Unrealised gains and losses Income	**-**	**15**	**-**	**-**	**-**	**-**	**-**	**(5)**	**-**	**-**	**-**	**(10)**	**-**	**-**
Comprehensive Income	**200**	**215**	**200**	**215**			**200**	**195**	**195**	**195**	**230**	**220**	**220**	**220**