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Understandability of Financial Reporting Requires Comprehensive Explanations and Not Mere References to Accounting Standards or Reports Attached to Financial Reporting

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ABSTRACT: The understandability of Financial reporting requires that the profit and loss, the balance sheet, the notes, the cash flow statement and all the reports that, although not part of the Financial Reporting, constitute the company's communication to the outside world be intelligible and understandable by anyone reading a portion or all of the Financial reporting. And it should be noted that the person who has to understand everything set out in the financial reporting must, necessarily, have an even minimal basis of the concepts set out in the Financial reporting because it is impossible to draft a Financial report without using accounting terms or techniques that may be clear to a person who does not have the even minimal basis in accounting and financial reporting itself point.

Understandability is achieved by applying national or international accounting standards, depending on the type of company in question, as well as civil law for companies obliged to do so, and by implementing the advice that the board of statutory auditors or auditors highlight in their documents and reports that they draw up during the audits that are periodically carried out in the company and that are drafted especially during the period of preparation of financial reporting. However, this article points out that merely referring to an accounting standard or a report by the board of auditors in which findings are highlighted and the consequent assertion that the accounting standard has been duly applied and all conclusions made by the auditors have been slavishly observed does not ensure the understandability of financial reporting. A particular analytical method must specify the accounting standard used and its involvement in financial reporting. In the presence of auditors' reports with findings, the findings made by the board of auditors must be explicit. It must be explained unambiguously in what manner and according to what accounting method the recommendations in the report in which the findings are highlighted in the accounting and corporate field were implemented.

KEYWORDS: understandability, truthfulness, correctness, the invalidity of financial reporting, mere references to documents attached to financial reporting or accounting standards.

1) UNDERSTANDABILITY: FINANCIAL REPORTING POSTULATE WITH EQUAL WEIGHT OF TRUTHFULNESS AND FAIRNESS [1]

It is now unanimously accepted that financial reporting must be prepared based on understandability, truthfulness and fairness. Nowadays, it is unanimously accepted that the postulate of understandability represents a principle with equal dignity to fairness and truthfulness. This is not the place to illustrate how this postulate has evolved in Italy and various countries where financial reporting is regulated by civil law. In this regard, one can only recall how, in the 1930s and 1940s, fairness was not even considered a principle to be referred to. In the 1960s and 1970s, in different ways in the various countries that, with different timeframes, regulated financial reporting at a legislative level, it began to be understood that understandability was a postulate as indispensable as truthfulness. With evolutions and involutions, today we have come to unanimously believe that understandability is a postulate with materiality identical to correctness and truthfulness.

[1] [1] To facilitate reading, I have decided not to include in the text, except in exceptional cases, the names of the scholars who have dealt with the subject under analysis. I have opted not to indicate all the terms of the scholars in the text because this would have meant a continuous interruption of the reading of the complete sentence in which I express my thought. All bibliographical references are cited in the references

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It appears evident how even to analyse the judicial consequences of the non-application of this postulate, it is necessary, in advance, to fully and correctly understand what is to be understood by the term 'understandability'.

In Italy, comprehensibility is excited by Article 2423, which regulates the fundamental postulates of financial reporting but is not legally explained. For this, there is an implicit reference to the national accounting standards, which, in Italy, are issued by the Italian accounting body known by the acronym OIC. This organisation, by legal provision, interprets and fills in the indispensable gaps in the legislation. The oic standards deal with the issue of understandability very concisely, limiting themselves to stating that financial reporting must be understandable and therefore be analytical and accompanied by notes to the financial statements that facilitate the understanding and intelligibility of the schematic accounting symbology. However, the information provided must not be excessive and superfluous (OIC Principle No. 11 Financial Reporting - Purpose and Postulates).

The materiality, which is theoretical and academic but pragmatic and relevant in judicial matters, obliges us to delve more analytically into the concept of understandability.

From the above, one can see how this postulate pertains to a problem of form and not substance. Understandable communication does not imply correct and truthful information but only identifies a flow of information intelligible to the recipients.

Information is, therefore, understandable when the user can fully understand the message addressed to him.

In this regard, we would like to recall how, at the end of the 1960s, communication studies underwent a genuine scientific revolution in the Kuh¬nian sense of the term. In 1979, Watzlavich, together with some of his colleagues, after conducting an in-depth analysis of the subject in question, concluded that one could not communicate. This assertion created a profound break with previous studies; the definitions of communication for¬malised in the 1940s and 1950s, although they revealed a remarkable evolutionary process, had never explicitly emphasised this particular aspect of human behaviour. Watzlawich, on the other hand, analysed the consequences of what one might call the 'passive behaviour' of an individual and came to affirm that every individual, regardless of whether or not they set themself the goal of sending messages to third parties, communicates with the outside world by simply adopting or not adopting a particular behaviour. Watzlavich's axiom derives the need for each individual to formulate a true and proper communication strategy since it is only by acting in this way that individuals can programme, and thus keep under control, the messages that they voluntarily or involuntarily, continuously send to the outside world.

It is easy to understand how such statements, having considerable materiality in every field of human action, acquire particular importance even in the corporate world, 'whatever the company does or does not do, it brings a piece to the mosaic of its image in the general public ... If an image policy is not explicitly and rationally planned, it is not (therefore) that no image is formed, it will simply be chaotic and uncoordinated, and that is to say, ultimately, it will be a bad image'.

Therefore, it is in the company's interest to plan its communication activity since only in this way does the company avoid the danger of sending unfavourable messages to third parties, perhaps unwittingly. As emphasised in the preceding pages, the primary corporate communication tool is the annual financial statement, a document concerning all the general considerations that can be made relating to a possible reticent and passive conduct of the company that is not explicitly connected to financial and asset communication apply.

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

The judgement on the observance of the postulate of the understandability of financial reporting cannot disregard two specific orders of consideration:

a) to inform means to send, using appropriate tools, messages to the outside world

b) informing also means not losing sight of the actual reception capacity of the user to whom the message is sent.

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

The main problems a person faces when trying to understand the set of signs that is financial reporting are, therefore related to the interpretation of the symbolism contained in the document.

These problems can be, essentially, traced back to three different cases:

1) in financial reporting, expressions that are also typical of everyday language are often used. This circumstance, on the one hand, can sometimes simplify the task of those who have to interpret those signs; on the other hand, it can instead create considerable problems since, in many cases, it happens that the accounting symbology - although using terms that are typical of the spoken language - uses such terms with meanings that are also profoundly different from the purposes in which they are accepted in

ordinary language. In such a situation, the interpreter can be led to attribute to the accounting symbol the meaning commonly accepted in common language, with the possibility of falling into misunderstandings, even macroscopic ones, of interpretation;
2) many accounting terms do not find an immediate correspondent in ordinary language. Those who have to understand financial reporting, in other words, are faced not only with phrases that could mislead them, as their accounting meaning is different from that generally attributed to those terms in ordinary language but also with purely technical accounting entries which, not being directly translatable into ordinary language, are in practice incomprehensible to a non-expert reader
3) Lastly, identical symbols often designate different objects or, vice versa, that other signs refer to similar phenomena. If one then adds to this the observation that different authors, on the one hand, can attribute heterogeneous meanings to identical items and, on the other hand, are likely to assign the same meanings to different terms, one can understand how the work of those who have to interpret financial reporting data can become arduous and complex.

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

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

The postulate of understandability must be interpreted based on all of the above observations since only by bearing in mind the complex problem of the intelligibility of a document made up of symbols can one arrive at the correct connotation of the concept of understandability.

"If, on the one hand therefore, financial reporting, often representing the only means of information to the outside world, must, without a doubt, be understood even by non-experts, on the other hand, it is not possible to disregard the consideration that accounting language is a form of communication characterised by a problematic interpretation inherent in the language itself .

In relation to the degree of intelligibility that it would be desirable to find in public financial statements, there is, however, no unanimity of opinion among scholars. In fact, while some authors believe that accounting language cannot do without an inevitable technicality, other academics affirm, on the contrary, that there is a possibility that the drafting of the document in question can instead be done by abstaining - at least in part and as far as possible - from excessively technical symbology. Often, adopting such an attitude, the authors belonging to this second doctrinal current point out, means clashing with the opinion of those who believe that financial reporting items should be as concise as possible. Therefore, this 'necessary' conciseness is not of such materiality as to justify a substantial decrease in the informative capacity of financial reporting and, consequently, some scholars have argued that greater specification, even if apparently in conflict with the ancient canons of accounting aesthetics, should in any case be chosen in order to ensure the best understanding of those indications. According to some scholars, this thesis would also be implicitly accepted by the Italian legislator in that financial reporting, by law, is considered an information tool directed to a set of users in relation to whom one cannot, a priori, assume a particular receptiveness. Moreover, the legislator disregards any reference to specific accounting techniques, which would further prove the acceptance of the thesis advocated by the doctrinal current to which they adhere.

The various authors who have dealt with this issue have therefore expressed divergent opinions as to the degree of 'accounting technicality' that should characterise the financial reporting stage. Nevertheless, the doctrine basically agrees on the need for financial reporting to become a comprehensible and accessible information tool for an increasing number of subjects.

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

We therefore fully agree with the authors when say that understandability consists of a mode that allows the accounting document to be understood by recipients with an average accounting culture.

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

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In contrast to these items, however, some are comprehensible only by those with a piece of minimum accounting knowledge. These include accounts receivable for deferred tax assets, deferred tax liabilities, revaluation reserves, valuation reserves according to Article 2426 IV c., treasury shares, other intangible assets, etc... It is evident that understanding these items presupposes a knowledge, albeit not expert knowledge, of accounting. Again by way of example, consider the case where, in the notes to the accounts, reference is made to the fact that qualified participations have been valued by applying the equity criterion. Even in this case, the information provided is only apparent to a person with basic accounting knowledge. Indeed, this sentence is obscure to a person without any knowledge of accounting and bookkeeping. But not for this reason, it can describe financial reporting as 'unintelligible'.

In conclusion, it can be considered that "understandability does not mean that financial reporting can be understood by anyone, even those with no accounting knowledge: it means, on the other hand, that it must be easy to read by people with average accounting knowledge".

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

It is also evident that understandability must cover all the components of financial reporting: balance sheet, income statement and notes to the financial statements.

To conclude, it is necessary to highlight a final observation concerning the relationship between the amount of information provided externally and the receptiveness of that information to users. Informing understandably does not, by any means, mean 'overwhelming' the potential user of the data with a considerable mass of news since it is well-known that the best method of not informing is to inform too much.

The intelligibility of a financial report containing a disproportionate amount of news concerning the actual needs of the user is undoubtedly less than that of a document in which, even though fewer data is recorded, an attempt has been made - when preparing the 'grid' of news to be provided - to take into account the actual cognitive needs of the users. Therefore, the communicative capacity of financial reporting (like any other disclosure document) increases, not when the mass of information provided rises quantitatively, but as stated in doc. No. 11 OIC Financial reporting for the year - Purposes and postulates - when the two principles of materiality and selectivity are correctly applied, concepts that, in reality, should always be kept in mind when aiming to communicate effectively with the outside world.

To assess the observance of the understandability postulate legally imposed by the civil code and illustrated, albeit briefly, by the accounting principles, if, on the one hand, it is necessary to bear in mind the above observations, on the other hand, it is equally obligatory to consider the civil law regulations issued to regulate the form that, by law, must characterise financial reporting for the financial year.

Concerning the technical structure that necessarily, must characterise the parts of financial reporting, a distinction must be made between the issues about the two accounting documents constituting the financial reporting itself (balance sheet and income statement) and those concerning the notes to the financial statements.

In Italy, Articles 2424 and 2425 of the Italian Civil Code identify two structural schemes that companies must observe when preparing their financial reporting. Since understandability identifies a characteristic linked to the comprehensibility and intelligibility of the message contained in the document being disclosed, it is evident that compliance with the articles mentioned above is a fundamental condition for the postulate of understandability to be considered observed.

Concerning the notes to the financial statements, the third document constituting financial reporting, the issue of understandability takes on different contours since, for this document, there is no mandatory technical, structural form. The legal article governing the notes to the financial statements identifies the minimal content that must characterise the notes to the financial statements. The drafting of this component of the financial reporting may be done in discursive form and with the help of tables, graphs, etc., at the discretion of the financial reporting editor. As far as the notes to the financial statements are concerned, it is evident that this raises the observations made in the preceding pages to relevant principles, also in a legal context. The understandability of the notes to the financial statements cannot be "measured" by analysing the correspondence to a scheme predetermined by the legislator and, consequently, to assess the observance of the postulate that is the object of our interest, it is necessary to verify, as a whole, the intelligibility, completeness, "simplicity" (the latter characteristic that must be interpreted in the light of the considerations made above and, in particular, bearing in mind the observations contained in the IAS Framework) and the comprehensibility of the information contained therein.

However, regarding the understandability of the balance sheet and profit and loss account, some additional considerations must be made concerning what has been stated so far.

If one were to stop at the analysis carried out thus far, one could incur an error that, in judicial terms, could lead to the invalidity of the balance sheet and profit and loss account. In fact, under current legislation, the slavish observance of the structural layouts indicated in Articles 2424 and 2425 of the Civil Code, respectively, does not guarantee that financial reporting can be defined as "understandable" and can therefore be considered legitimate.

The analysis of compliance with the understandability cannot disregard Article 2423 ter (2), (3) and (4).

This provision requires that:

* paragraph 2: items preceded by Arabic numerals may be further subdivided without eliminating the total item and the corresponding amount; they may only be grouped when the grouping, due to their amount, is irrelevant for the purposes indicated in the second paragraph of Art. 2423 (obligation to comply with the postulates of understandability, truthfulness and fairness) or when it promotes the understandability of financial reporting. In the latter case, the notes to the financial statements must contain the grouped items separately.
* paragraph 3: other items must be added if their content is not included in any of those provided for in Articles 2424 and 2425
* paragraph 4: items preceded by Arabic numerals must be adjusted when the nature of the business activity so requires.

From an analysis of Art. 2423b, it is evident that slavish compliance with the reclassification structures indicated in Articles 2424 and 2425 of the Italian Civil Code does not guarantee the understandability and, therefore, the legitimacy of financial reporting. These schedules must be considered 'basic' structures that must be modified if the postulate of understandability requires it.

Therefore, understandability requires that the structural indications of Articles 2424 and 2425 be supplemented by information elements that, by their nature, cannot be rigidly schematised.

Intelligibility and comprehensibility, and thus understandability itself, depend on a subjective assessment that must go beyond the provisions of reclassification schemes structured in such a way as to be used in a generalised manner.

The postulate of understandability implies, in itself, the consideration of elements connected to the business reality being communicated by financial reporting, which, by their very nature, cannot be identified in a thorough, definitive and generalisable manner by a reclassification scheme whose objective is to provide the basis for comparability of the economic-financial data made public by companies.

A balance sheet and an income statement are, therefore, straightforward, not when they are drawn up following the provisions of Articles 2424 and 2425, but rather when the data reflecting the economic and financial reality of the business entity are presented in such a way that the company's situation can be correctly understood and interpreted by the user to whom the information is addressed.

It appears that understandability depends on a series of subjective elements extraneous to the pre-packaged and generally usable structural schemes governed by Articles 2424 and 2425, which are well summarised by Based on the considerations made in the preceding pages, it can therefore be stated that three inseparable peculiarities must characterise understandability;

1) a morphological understandability (understandability of forms), which relates to the compilation of financial reporting and focuses on how the data are arranged systematically

2) a syntactic understandability concerning the logical expressiveness of financial reporting

3) lexical understandability about the language used is necessary to avoid risk factors implicit in ambiguity, generality or even erroneous terminology" (Pontani, 2013).

Regarding the meaning of the postulate of understandability, the considerations made by Colombo appear particularly interesting. This author, after an in-depth examination of the provisions contained in Articles 2424, 2425, and 2423 ter, states that "the principle of understandability, in its formulation as a general clause superordinate to the specific rules, thus ends up being of relevance mainly concerning how the notes to the financial statements are drawn up: precisely because rigid schemes do not govern this 'part' of financial reporting, the need for an orderly, easily understandable, unambiguous and exhaustive formulation is significant for it".

Understandability, therefore, is interpreted mainly as a postulate that must guide those who prepare the notes to the financial statements, a document that is a component of financial reporting but not characterised by a form structured within rigid accounting schemes and, as such, in need of a communication modality free of ambiguity and imprecision and, on the contrary, characterised by intelligibility and comprehensibility of the message contained therein.

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Very important is the considerations set forth by the jurisprudence of legitimacy concerning the "temporal moment" with which compliance with Article 2423 must be assessed. The Court of Cassation had highlighted how "understandability and completeness .... are required at the time when the shareholders' meeting resolves on approval because the formation of the financial reporting for the year must take place according to strict annual deadlines, and therefore subsequent events are not worth, per se, to justify ex-post determinations that must take place in the situation in which they were when they were taken into consideration during the approval of the financial reporting" (Court of Cassation21 February 2000).

In conclusion, it should note that both the national OIC and international IAS/IFRS standards emphasise that the principle of materiality must be observed when preparing financial reports.

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

This materiality principle applies, of course, not only to the notes but also to financial reporting. Financial reporting must therefore be analytical and accompanied by explanatory notes to be understandable and comprehensible. However, the analyticity must not be excessive, as analyticity would be misused in such a scenario. An excessively high level of analyticity, both in the accounting schedules (balance sheet and income statement) and in the notes to the financial statements (as well as in the report on operations), does not lead to an increase in understandability but to a reduction in the informative capacity of financial reporting itself.

The correct interpretation and application of the materiality principle are also essential to understand the effects of errors/simplifications that can identify in financial reporting. We will devote an entire paragraph to this issue in the remainder of this work. Here, we only wish to emphasise how errors, simplifications, and rounding-offs are technically unavoidable and find their 'limit' precisely in the concept of materiality: that is, they must not be of such magnitude as to have a material effect on the financial reporting data and their meaning for the recipients.

The IAS framework states that to be valid, information must be significant to the information needs of the users' decision-making process. Information is qualitatively substantial when it can influence users' economic decisions by helping them evaluate past, present or future events or by confirming or correcting evaluations previously made by them.

The significance of information is influenced by its nature and materiality. In some circumstances, the nature of the information alone is sufficient to determine its materiality. For example, information about a new segment may affect an entity's assessment of the risks and opportunities facing the entity regardless of the materiality of the new segment's performance in the period. In other cases, nature and materiality are essential, as is the case, for the amounts of inventories in each significant category appropriate to the entity's operations.

Information is material if its omission or misrepresentation could influence the economic decisions of users made based on financial reporting. Materiality depends on the quantitative size of the item and the error judged in the specific circumstances of omission or misrepresentation. Therefore, materiality provides a threshold or limit rather than representing a primary qualitative characteristic that information must possess to be helpful.

2) THE MERE REFERENCE TO A REPORT ATTACHED TO FINANCIAL REPORTING, IN ITALY, RESULTS IN THE INVALIDITY (NULLITY) OF THE FINANCIAL REPORTING ITSELF.

Regarding the reports, which, legally, must be linked to financial reporting, each country is characterised by legislation which differs from country to country.

In general, the legislation provides various types of checks on the keeping of accounts. Regardless of the tenor of the individual regulations, in all western countries and most other countries, a board of auditors or an auditor in office is required in every company. This figure must check that the financial reporting is done according to the postulates laid down in the regulations. In Italy, the Civil Code in Article 2429. - Report of the auditors in office and filing of the financial reporting .- provides that" The directors must communicate the financial reporting to the board of auditors, and the person in charge of the statutory audit of the accounts, with the report, at least thirty days before the date set for the shareholders' meeting that is to discuss it.

The board of auditors shall report to the shareholders' meeting on the results of the financial year and the activity performed in the fulfilment of its duties and make observations and proposals regarding the financial reporting and its approval, with particular reference to the exercise of the waiver provided for in Article 2423, paragraph four. The board of auditors, if it exercises accounting control, shall also prepare the report provided for in Article 2409-ter.

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The financial report, with complete copies of the latest financial reporting of the subsidiaries and a summary statement of the primary data of the latest financial reporting of the affiliated companies, must remain deposited in copy at the company's registered office, together with the reports of the directors, the auditors in office and the person in charge of the legal audit of the accounts, during the fifteen days preceding the shareholders' meeting, and until it is approved. Shareholders may inspect them.

The filing of copies of the latest financial reports of the subsidiaries required by the preceding paragraph may be replaced, for those included in the consolidation, by the filing of a summary of the primary data of the latest financial reports of those subsidiaries."

During the period in which financial reporting is being prepared, the auditors in office or the entire board of auditors must carry out checks to verify the correctness, truthfulness and understandability of what is being prepared. At this stage, the auditors in the office can make observations that the company's directors must observe and apply slavishly when preparing the financial report. The remarks made during this period are always written down and drafted in a document signed by each auditor in Office so that the comments made remain on record. These documents do not form part of the financial reporting, and neither does the auditors in office report mentioned above. However, as we shall see on the following pages, these documents are highly relevant so that the financial reporting does not become invalid. However, it is necessary to fully understand what function these documents perform and what use should be made of the content of the auditors in office reports in their periodic checks.

If, in such interim reports or reports drawn up in the financial reporting period, no remarks are made on what has been done in the company, no problems arise in the use of the contents of such reports because, since there are no remarks to be made, the auditors in office point out that all checks have yielded positive results. Therefore there are no elements to be pointed out or changed. In financial reporting, one can cite such reports highlighting how the auditors in office, from their checks, have found a legitimate and legal situation in bookkeeping and the data recorded in financial reporting.

The problem arises when in the reports, the auditors in the office make findings, i.e. they point out situations that are not following the law. The company must apply that to avoid the financial reporting being considered invalid or the accounts not being appropriately kept.

It is very interesting how, in Italy, in a very recent ruling of the Court of Cassation, which in Italy represents the last level of judgement, a fundamental principle was highlighted that had already been highlighted previously by a court (Court of Verona, Italy) concerning accounting principles.

In its recent ruling, the Court of Cassation essentially established that financial reporting must be considered radically invalid, i.e. null and void, for lack of comprehensibility if, in the financial reporting itself, there is a mere indication that the changes proposed by the board of auditors have been implemented without explaining what changes the committee had proposed. According to the Court of Cassation, in its judgment No. 7433 of 15 March 2023, the mere indication in financial reporting that the proposals made by the board of auditors during the period for the preparation of financial reporting were implemented is not sufficient to make the financial reporting valid because such a situation could lead to doubts as to the correctness of the accounting data entered. These changes may also be explained at the meeting of the shareholders approving the financial reporting, in which case everything must be reproduced, slavishly, in the meeting minutes so that third parties can also understand what changes the board of auditors had proposed.

The case before the Court of Cassation had previously been the subject of a ruling by the Court of Milan and the Court of Appeal of Milan in 2015 and 2018, respectively. The Court of Cassation, in the judgment as mentioned above, stated that "The Court of Appeal of Milan, in its judgment of 15 January 2018, dismissed the appeal against the decision of the Court of Milan No. 9115 of 2015, whereby the shareholders' meeting resolution dated 25 May 2012 approving the financial reporting of Alfa s.p.a. for the year ended 31 December 2011 was declared null and void.

The territorial court found that the resolution in question approved the financial reporting "by adopting the amendments proposed by the Board of auditors in its summary note of 24 May 2012" after the auditing body had formulated a series of remarks concerning certain expenses incurred by the company and the item "other payables", and therefore held, sharing the court's conviction, that this resulted in the breach of the principles of understandability and truthfulness of the financial reporting, as the approval by relation had left the actual content indeterminate. The violation of the rules for drafting financial reporting resulted in the nullity of the resolution approving it, as the first court correctly held. He added that it was not a question of a mere violation of the shareholders' right to information. However, this also occurred because of a lack of determinacy of the information rendered by the financial reporting itself.

The company appeals against this judgment on two grounds. The defendant shareholder resists with a counter-appeal.

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The parties have filed pleadings. The Court of Cassation emphasised that "- The territorial court set out its arguments on the nullity of the resolution approving the financial reporting by the ordinary shareholders' meeting of the company, considering that the accounting document violated the rules of understandability and truthfulness, as it was approved by merely referring to the remarks previously formulated by the board of auditors, employing the formula, transcribed in the minutes of the shareholders' meeting, according to which the financial reporting is approved "by incorporating the amendments proposed by the Board of auditors in its summary note of 24 May 2012".

It added that there had also been insufficient pre-meeting information to the shareholders but that this reason for annulment was not the subject of the decision, which was limited to a finding, like that of the Court, of nullity.

In arriving at this finding, the territorial Court focused on the textual content of the shareholders' meeting resolution of 25 May 2012 approving the financial reporting for the year ended 31 December 2011 and highlighted the various passages of the same minutes: the Court found the absence of any specific illustration and discussion of the findings of the board of auditors, ascertaining the absence, therefore, of any integration at the shareholders' meeting of the information provided by the financial reporting, beyond the mere generic wording, mentioned above.

Against those allegations, the appellant confines itself to contesting that there was any breach of the accounting rules for the preparation of financial reporting and to insisting that only, if anything, the individual rights of the shareholders had been infringed, thus re-proposing a different reading of the findings of the board of auditors, contained in the note of the board of auditors dated 24 May 2012. But the appellant's grievance on. It is inadmissible, implying a purely factual assessment.

That, then, the financial reporting item contested as "other debts" presented a variance of negligible entity is a finding rendered inconsistent by the reasoned argument of the Court of Appeal: which assessed ex-ante the lack of determinacy and understandability of the document in the light not only of that data but also of other expenses reported by the board of auditors, through those "remarks", only generic and not understandable, as transposed in the minutes". The order of the Supreme Court points out that, 'Firstly, the rules on the preparation of financial reporting, although often taken from accounting principles, are binding legal rules, which have a content of technical discretion, but only in the sense that this depends on their historical derivation and that, in certain cases, the legal rule refers back to it: for the same reason, however, making the technical criterion referred to legal and, in any case, the choices made, which do not fall within the proper scope of unquestionable management choices, are always open to review; financial reporting preparers are required to identify the manner most in keeping with the principles of fairness, truthfulness and clarity, in order to provide the accounting representation of the item considered, in compliance with the rules laid down by the legislature, so that the financial reporting information must satisfy the 'legal correctness' of the information provided, in order for the exercise of technical discretion to comply with the rules of the legal system (Cass. 12 May 2022, 15087). - Every choice of financial reporting, even where it has a more intense content of discretion, must, in any case, respond to the limit given with respect of the general clause of the understandability of accounting information (Court of Cassation No. 21494 of 6 October 2020).

In fact, within the scope of the precepts set forth in Articles 2423 et seq. of the Italian Civil Code, the principle of understandability plays an autonomous role, given that, according to paragraph 2 of the provision, financial reporting "must be drawn up in an understandable manner and must give a true and fair view of the company's equity and financial situation": and, in fact, as the Court has long pointed out, the function of financial reporting is not only to measure the company's profits and losses at the end of the financial year, but also to provide shareholders and the market with all the information that the legislature has deemed necessary in this regard, by setting forth Article 2423 of the Civil Code the 'principle of clarity', so that, in relation to that regulatory parameter, principle must find an effective realisation and not receive a response of mere appearance; if the lack of understandability or the incorrectness of the financial reporting does not allow the shareholder to have all the information, which is obviously also intended to be reflected on the value of the individual shareholding, that the financial reporting should offer him, he has an action for nullity, so that the relative declaratory judgement will entail the consequent necessary preparation of a new financial reporting, amended by the defects of the previous one, to which the challenging shareholder legitimately aspires; in short, the financial reporting of a capital company, which violates the precepts of understandability and precision dictated by Art. 2423, paragraph 2, Civil Code, is unlawful, so that the shareholders' meeting resolution approving it is null and void not only if the breach leads to a discrepancy between the actual result for the year, or the overall representation of the company's equity value, and that of which the financial reporting instead gives an account, but also in all cases in which it is not possible to deduce from the financial reporting itself and its annexes, including the report, the full range of information that the law requires to be provided for each of the individual items recorded.

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The Supreme Court made the considerations of the Court and the Court of Appeal of Milan its own, explicitly stating that "If, as mentioned above, any breach of the rules dictated to ensure the necessary degree of understandability of the financial reporting items is also relevant, in consideration of the informative function that it is intended to perform, it has also been specified that, precisely for this reason, the clarifications requested and provided during the shareholders' meeting that precedes the approval of the financial reporting itself may also sometimes assume importance: not because those clarifications become, in turn, part of the financial reporting document and themselves the subject of the subsequent approval resolution, but because they may be concretely capable of dispelling uncertainties.

Where this is the case, the original lack of understandability of the financial reporting is neutralised, not only for the requesting shareholder but also for the other shareholders and third parties, precisely because the publication of the financial reporting in the company register also concerns the shareholders' meeting minutes according to Article 2435 of the Italian Civil Code (Court of Cassation 9 May 2008, no. 11554; Court of Cassation 11 March 1993, no. 2959).

However, it should note that compliance with the requirement of clarity concerning the information content of the financial reporting would not be sufficient to remedy the other defect, if any, of the criteria of correctness and truthfulness of the financial reporting about the economic result (Court of Cassation No. 16388 of 24 July 2007). Ultimately, it must reaffirm that the principles of truthfulness and fairness are generally reflected in the result of financial reporting. In contrast, the principle of understandability requires that the explanations necessary for understanding the company's equity, economic and financial situation be provided: however, in the legal regulation of the financial reporting of companies, the principle of understandability is in no way subordinate to the principle of correctness and truthfulness of financial reporting, as it has independent binding force.

The considerations developed in the contested judgment, and in particular those concerning the findings mentioned above made by the board of auditors and the items indicated therein, indicate how the court recognised in those items a severe lack of clarity, such as to cast doubts on even the correctness of the accounting data reported therein, which was not dispelled by the non-existent explanations provided by the director in the shareholders' meeting.

- Nor does it matter that the territorial court stated an obiter: which is in no way capable of invalidating, in the present case, the clear statement made concerning the violation of the principle of understandability of financial reporting and the legal consequences that the court drew from it........On the one hand, it re-proposes the judgement on the fact when it insists that it is not a question, on the merits, of financial reporting that is null and void for violation of the principle of understandability and completeness of the information provided but of mere failure to comply with an endosocietal obligation to provide clarification. (Cass. 15.3.2023 no. 7433).

From the preceding, it can be understood how the Court of Cassation, in particular, wanted to emphasise that the information contained in financial reporting must be clear at a practical level, adequate and not merely formal. If the user of the financial reporting, be it the shareholder or a third party external to the company, is not able to have all the information that the financial reporting should provide him with, the financial reporting itself must be considered null and void for failure to apply the postulate of clarity. This hypothesis also includes the case of merely referring in the financial reporting to phantom proposals for changes made by the board of auditors or by an auditor in office without a suitable analytical explanation of what the board of auditors had asked to be done and how the accounting operation was implemented to bring the financial reporting into line with what the board of auditors itself had recommended. It is now well established that the nullity of financial reporting is not only connected to the lack of truthfulness and correctness and, thus, to a divergence between the value that should have been recorded in financial reporting and the value of the costs and revenues and the assets and liabilities recognised but is also connected to the absence of clarity, a postulate that requires a detailed explanation of the remarks made by the board of auditors or the auditors in office and the actions taken to address such comments.

The mere reference to such findings and the mere assertion that the recommendations made by the board of auditors have been observed does not allow financial reporting to be considered understandable. Consequently, the mere reference to a report, even if relevant and not part of the financial reporting, is cause for radical nullity and, therefore, civil law invalidity of the financial reporting.

With regard, therefore, to the documents that the board of auditors or the individual auditors in office draw up, if they contain observations concerning what has been implemented by the company at an accounting level, it is necessary that in the financial reporting, there is no mere reference to the document issued by the board of auditors or the affirmation that all that has been advised has been applied, but, on the contrary, must specify in a particularly analytical manner, the values that have been changed, the enormous formalities that have been changed, and the accounting technique that has taken the place of the accounting technique, if any, criticised in the documents issued by the board of auditors.

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Merely referring to a document does not achieve financial reporting understandability, which, for many decades now, has been on a par with the postulates of truthfulness and fairness, the absence of which causes financial reporting to become invalid and thus the possibility of anyone with interest challenging, before a court of law, the financial reporting itself the point.

3) THE MERE REFERENCE IN FINANCIAL REPORTING TO THE APPLICATION OF A PARTICULAR ACCOUNTING STANDARD CREATES NULLITY IN FINANCIAL REPORTING.

Already in a previous article (Avi, 2020), we had the opportunity to illustrate the circumstance that a mere reference to an accounting standard and the mere assertion that such a standard has been applied in the context of financial reporting does not lead to the preparation of understandable, true and fair financial reporting. We consider it appropriate here to refer back to what was written in that article, as the issue addressed in this paper is directly related to what was illustrated in the previous article.

Naturally, we will not slavishly repeat what we have already analytically illustrated in the article in which we dealt with accounting standards and a mere reference to an accounting standard, whether national or international. However, since the subject we are now discussing has interconnections with what we have pointed out in our previous article, we deem it appropriate to reference the circumstance analysed in that paper briefly.

It is well-known that the pretence of drawing up a financial report based on what is set forth exclusively by the civil code is impossible due to the very nature of the legal regulations.

The civil code legislation identifies the legislative reference framework of the postulates and operating principles of financial reporting, which, obligatorily, must be applied by unlisted companies not included in the list of companies indicated in Legislative Decree No. 38/2005 (for which the application of international standards is mandatory).

From reading the articles of the code, one can understand how, in the legal sphere, the issues concerning the preparation of financial reporting are dealt with exceptionally concisely.

In a few concise articles, the code provides the essential elements that the preparers of financial reporting must observe for such a document to be truthful, correct and legally understandable.

In this regard, it should note that in Italy, a law has been enacted obliging companies to apply the OIC standards as supplementary and interpretative elements of the civil code. In fact, on 20 August 2014, Law No. 116 of 11 August 2014, converting Decree-Law 91/2014, was issued, recognising the OIC's role and functions. The law supplements Legislative Decree 38/2005 with Articles 9-bis and 9-ter, keeping unchanged the financing methods of the OIC already provided for by Law 244/2007.

Below is the text of the provisions relating to the OIC:

Article 9-bis - Role and functions of the Italian Accounting Board

1. The Organismo Italiano di Contabilità, the national institute for accounting standards

a) issues national accounting standards, inspired by best practice, for the preparation of financial statements following the provisions of the Italian Civil Code;

b) provides support to the activities of Parliament and Government Bodies on accounting standards and expresses opinions when required by specific legal provisions or at the request of other public institutions

c) participates in the process of drawing up the international accounting standards adopted in Europe, maintaining relations with the International Accounting Standards Board (IASB), the European Financial Reporting Advisory Group (EFRAG) and the accounting bodies of other countries.

Concerning the activities under a), b), and c), it coordinates with the national authorities competent in accounting matters.

2. In carrying out its functions, the Organismo Italiano di Contabilità shall pursue public interest purposes, act independently and adapt its statute to the canons of efficiency and economy. It reports annually on its activity to the Ministry of Economy and Finance.

According to the provisions of Article 9 bis of Law 116/2014, the dissemination, also in minor to medium-sized companies, of the knowledge, at least theoretical, of accounting standards is compulsorily required and further proves the widespread acceptance of the 'philosophical' principle of the necessary interconnection between compulsory legal norms and accounting standards of formally 'voluntary' application as it is not imposed, at least explicitly, by regulatory provisions.

For the analysis of the issue analysed herein to be conducted in a realistic and not merely theoretical manner, one cannot, however, overlook the circumstance that, in the face of an almost consensus on the need for accounting standards to identify interpretative/complementary instruments of the civil law regulations concerning financial reporting, one finds an equally almost universal recognition in financial reporting, at least in small and medium-sized companies, of values that are tax-relevant for tax purposes instead of economically correct valuations established by the accounting mentioned above standards.

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A reading of the above considerations may give rise, almost inevitably, to a legitimate question: if the above represents a position, at least in the theoretical-doctrinal sphere, that is unanimously accepted, why is it possible to speak of financial reporting being null and void as a result of a reference, implemented in the financial reporting itself, to the accounting standards and legislative provisions concerning financial reporting?

This question takes on extreme relevance at both a theoretical and operational level. Suppose it is correct to speak of the unanimous acceptance of the integrative and complementary role of accounting standards concerning what is established by the legal regulation. In that case, it is equally valid to point out how an incorrect interpretation of the fundamental role 'assigned' by the judiciary to the accounting standards themselves and to the content of the legal provisions can inevitably lead to the declaration of nullity of the financial reporting d'. A circumstance that occurred precisely in action brought before the Court of Verona that led to the issuance of the ruling of 18 September 2010 in which it was stated that an "erroneous concept of reference", implemented in the notes to the financial statements, to the accounting standards and the content of specific legal provisions, can be grounds for the radical nullity of the financial reporting itself.

The ruling of the Court of Verona mentioned above dealt with the case of a company that, in its financial reporting, made a blank reference to a national accounting standard.

Consider the case, for example, of the capitalisation of borrowing costs. The accounting standard OIC No. 16 Tangible Fixed Assets states that borrowing costs usually constitute company expenses and, as such, should be charged directly to the profit and loss account of the administrative period in which they accrue. Since, however, tangible fixed assets identify assets intended for the permanent organisation of enterprises and produce income only when they are in use, borrowing costs incurred in their acquisition (purchase and construction) may, in specific and well-defined cases, be capitalised in the value to be attributed to fixed assets. However, such an operation can only be carried out upon a set of circumstances indicated explicitly by the same accounting standard. In particular, the latter states that capitalisation of borrowing costs is only possible if:

(a) it is not implemented to carry forward losses;

(b) it is made on a prudent basis

c) it is determined based on interest expense incurred on capital explicitly borrowed for the acquisition of fixed assets, provided that the borrowing was used for the purchase of the fixed assets

d) is quantified by calculating the interest accrued during the "construction period", i.e. the period from the disbursement of funds to the suppliers of the assets until the time when the investment is ready for use, provided that this period is significant;

e) is valued based on the interest rate incurred on the medium- to long-term loan used to pay for the tangible fixed assets;

f) the value, including interest, does not exceed the value recoverable using the same fixed assets.

Only when all of the above circumstances coincide does OIC Accounting Standard No. 16 allow, as an economically sound practice, the capitalisation of borrowing costs.

As we pointed out in. No. 1, if, in the notes to the financial statements, reference is made to the provisions of OIC No. 16 and the application of a calculation method that is in contrast with what is established therein is evidenced, the financial reporting could be declared null and void for lack of application of the postulate of faithful representation in the measurement of the economic facts object of accounting.

Let us assume, instead, that financial reporting merely makes what we previously referred to as a "blank reference" to what is set out in the accounting standards and the content of specific legal regulations concerning financial reporting. In other words, let us assume that the notes to the financial statements do not state anything contrary to the accounting standards but instead state that the capitalisation of borrowing costs has been implemented because the conditions for doing so have been met. Since the requirements for being able to implement such capitalisation are established concisely by civil law. Analytically, by the accounting standards, it is evident how such a statement represents, in substance, a 'blank reference' to what is established by the legal regulations and the OIC documents concerning the specific subject matter subject to accounting valuation.

If such a hypothesis were to occur, there would not be a clear contrast between the methodology applied in financial reporting and the content of an accounting standard to which, implicitly, the Civil Code refers; instead, there would even appear to be a perfect coincidence between the data contained in the income statement/balance sheet and the amounts determined through the application of the legal regulations and the correct accounting standards.

Such a 'blank reference' to the content of an accounting standard, be it national or international, and to the content of specific legal rules concerning financial reporting, however, derives from a misinterpretation of the role that the judiciary, or part of it, believes that such principles - accounting and legal - should play in the context of the preparation of financial reporting by.

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And it is precisely on this. That the judgment of the Court of Verona of 18/9/2010 focuses its attention by stating explicitly that if in the notes to the financial statements there is the mere statement that 'in the financial statements financial charges were capitalised for euro .... as the requirements were met' without any further specification or illustration of the characteristics indicated in the accounting standard OIC No. 16, it must be declared that the postulate of understandability is not applied.

A mere blank reference to what is established, briefly, by civil law and, in detail, by accounting standards does not appear sufficient for financial reporting to be considered understandable and, therefore, intelligible.

It is true that, in the notes to the financial reporting contested before the Court of Verona, the sentence considered 'unclear' does not make an explicit blank reference to the content of the accounting standard OIC No. 16 but merely asserts the existence of the requirements that allow the capitalisation of borrowing costs. This statement, however, in the writer's opinion, as has already been pointed out in the preceding pages, must be understood, without a shadow of a doubt, as a blank reference to what is stated in Civil Code Article 2426, paragraph I, no. 1 and to what is illustrated in detail by OIC standard no. 16, since the sources from which the indispensable requirements for capitalisation are identified are illustrated concisely by Article 2426, paragraph I, and analytically by OIC standard no. 16. This demonstrates, incontrovertibly, how the mere blank reference - without further illustration of the reasons - to the valuation criteria contained in an accounting principle and a legal norm can be considered, by case law, a sufficient element to be able to declare the non-existence of the postulate of understandability.

Understandability is not apply if, in the notes to the financial statements, there is a mere blank reference to the provisions of the Italian Civil Code and accounting standards without a further detailed explanation of how the income, balance sheet and financial figures contained in the income statement and balance sheet have been determined.

Therefore, to avoid financial reporting challenges, it is necessary that, in addition to a reference to legal provisions and accounting standards, there should also be an extensive and detailed description of the quantitative calculation methods and the reasons that led the authors of the financial reporting to apply certain valuation criteria or specific presentation logics of the economic-financial values. This applies to any financial reporting issue as the Court of Verona analysed the case subject to civil action. Still, the general principle that led to the issuance of the ruling can be applied, by analogy, not only to the specific issue addressed (capitalisation of financial charges) but also to all other balance sheets and profit and loss account items.

According to the Court of Verona, even the 'lacuna' relating to understandability and resulting from a blank reference to legislative principles and accounting standards without, at least prominently, misinterpretation of the content of the legal provisions and the OIC/IAS documents causes the same type of unlawfulness that would be found in the hypothesis of an ascertained failure to apply the postulate of faithful representation in the measurement of the economic facts object of accounting and caused by the inclusion of incorrectly determined items or the omission of items that, on the contrary, should have been recognised in financial reporting. For these reasons, the Court of Verona, in the judgment analysed herein, also states that 'the principle of understandability is violated .... and (therefore) a nullity defect of the resolution approving the financial reporting appears configurable' (Court of Verona, judgment of 18 September 2010).

In conclusion, it can therefore be stated that, while on the one hand, accounting standards are essential tools for legislative integration and interpretation, it is equally true that the mere reference to such principles undermines the postulate of understandability. By now, this position is well-established among scholars and judges. Consequently, in financial reporting, particularly the explanatory report, one must explain in detail all the reasons that lead to applying a specific OIC accounting standard. On the other hand, the mere reference to the principle in question is regarded as undermining the postulate of understandability. This entails the radical nullity of the resolution approving the financial reporting itself.

4) CONCLUSIONS

In conclusion, it can state that the postulate of understandability is not observed if, in the financial reporting, there is a mere reference to an accounting standard or has observations made by the board of auditors in a report drawn up in one of the audits carried out during the year or during the period in which the financial reporting was prepared. Even if the accounting standard has been slavishly observed during the preparation of the financial reporting, and therefore the financial reporting, from a . logical point of view, should be considered true and understandable, the mere reference to the standard is not sufficient to ensure understandability. Understandability will only be guaranteed if it is explained in writing in the financial reporting the part of the accounting standard used to prepare the company's financial reporting and how this accounting standard has been applied. This also applies to findings that may be identified in the reports the auditors write at the end of interim audits or during the financial reporting period.

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Even if the financial reporting has been prepared by following precisely the advice given by the auditors in their reports, or if, based on the remarks made by the auditors, entire parts of the financial reporting have been changed to adopt the principles to which the auditors claim to refer, understandability is not ensured. The mere blank reference to these recommendations or remarks, even if implemented in practice, is not sufficient to ensure the understandability of financial reporting. For financial reporting to be understandable, it is necessary to point out what advice and remarks the board of auditors has made in its reports and how these remarks have been implemented in the company's accounting or financial reporting.

The mere reference to an accounting standard OA, a document of the board of auditors highlighting certain remarks concerning the company's accounting situation, is therefore not sufficient to guarantee understandability even if the company has implemented all the content of the accounting standard in its financial reporting or all the remarks made by the board of auditors have been adopted by the company, with the subsequent modification of the accounting activity and the parts of the financial reporting that, according to the board of auditors, had to be formally modified OA level of substance.

The principle drawn from the above is that a mere blank reference to any document does not guarantee understandability. Understandability will only be observed if the financial reporting explains intelligibly what is intended to be applied, why the rules are being used, and how the accounting principles and the remarks made by the board of auditors have led to changes in the financial reporting itself. Only in this case can the financial reporting be considered valid because it is true, correct, and understandable.

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