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Financial Reporting Destined to External Third Parties as a Tool for Analyzing Credit Worthiness: Usefulness and Limitations. The Italian Case

By Maria Silvia Avi

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Keywords: financial reporting, communication, creditworthiness analysis, static and dynamic analysis, disclosure limits of the financial statements for external parties.

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Abstract- Financial reporting to external third parties is the primary document based on which, at least in theory, a company's creditworthiness should be assessed. Income, capital, financial and sustainability performance should be understood through a thorough analysis of the financial reporting and sustainability report data. Here, we will focus exclusively on Financial reporting. As we will see, Financial reporting intended for the outside world is characterised by an information gap that tends to preserve the company's right to information and privacy. The main objective of Financial Reporting for External Purposes is to ensure that all Financial Reporting prepared by a nation's companies is consistent in structure and thus comparable. The spread of IAS/IFRS makes it no longer a national but a supranational objective. The significant unsolvable problem is that such financial statements, precisely in order to guarantee the privacy of certain information of a strategic nature or the disclosure of which could be detrimental to company management, are characterised by a lack of information that prevents an in-depth analysis of the situation with a global company. Static analysis employing classic ratios and dynamic analysis using the determination of cash flows can only be carried out partially. The results are often unsatisfactory because there is so much missing data to render the analysis almost useless. To this must also be added the circumstance that, if this is true for ordinary financial statements, it is even more true for the abridged financial statements associated with small and medium-sized enterprises, for micro- or tiny enterprises comma one cannot even speak of financial statements as an information instrument intended for the outside world because the eh content of such a document is so limited that third parties cannot understand anything about the company's condition. Whoever applies for a loan from a bank OA a lender, and therefore, it is desirable to add to the balance sheet data intended for the outside and regulated by law, other data internal to the company point. If this does not happen, the lender will be forced to draw deductions from partial, incomplete and often impossible-to-interpret data. In this case, the answer to the financing will probably be the negative point we do not intend here, to enter into the problem of the widespread practice worldwide, which is connected to the constant request for personal skulls by the bank or the lender even in the presence of balance sheets eh that presents optimal income, financial and patrimonial company positions point collateral or personal guarantees are generally always requested by the lender, for greater protection of its credit. It can be said that only in very few cases is financing granted solely and exclusively based on balance sheet data. Despite this, the balance sheet remains one of the main elements on which decisions are made as to whether or not to accept an application for a credit line. However, the decision is also strongly influenced by the ability of the borrower of the potential loan to provide additional collateral of a real or personal nature.

Keywords: financial reporting, communication, creditworthiness analysis, static and dynamic analysis, disclosure limits of the financial statements for external parties.

I. External Financial Reporting: Potential Disclosure Limits[1]

Financial reporting identifies the primary economic-financial communication tool intended for users outside companies.

The subject of our interest will be the 'information potential' of financial reporting regulated by the Italian Civil Code. However, similar considerations to those illustrated in the following pages also apply to financial statements prepared by IAS/IFRS adopter companies.

The information limitations of financial reporting deposited at the company registrar's office can be grouped into three different categories:

1. Inherent limitations of financial reporting which, as such, cannot be overcome;
2. Disclosure limitations arising from the adoption of accounting behaviour that does not adhere to proper financial reporting postulates;
3. Disclosure limitations arising from the specific content of the statutory financial reporting requirements.

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[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 since the bibliography is endless, 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.

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Inherent limitations of financial reporting that, as such, cannot be overcome

In addressing the issue of the so-called 'inherent limitations of financial reporting, it is appropriate to recall two peculiarities of financial reporting that, although they may be considered potential limitations, are inherent to financial reporting itself and, consequently, must be interpreted, not as 'shortcomings or limitations of the financial statements, but rather as elements characterising that document.

The two distinctive elements of financial reporting mentioned above can be summarised as follows:

1. Since management is characterised by what is commonly called economic unity, financial reporting breaks down into annual periods, which is, by its nature, indivisible. While the company's total income (i.e. the income produced from the beginning of the company's life until its liquidation) is an objective value, the profit/loss and capital determined at the end of each administrative period, due to the presence of estimated quantities (i.e. approximations to the 'true'), and conjectured values (i.e. subjective representations of the 'true'), identify aggregates lacking an objective 'absolute truth'. For this reason, concerning financial reporting, instead of speaking of 'truth', the terms 'reliability' or 'veracity' of accounting values are used. This intrinsic feature of financial statements, identifying an element inherent in the balance sheet and profit and loss, cannot, however, be counted among the informational limitations of this document as it identifies
2. Another distinctive element of financial reporting concerns the type of data recorded therein: the accounting values recorded in the balance sheet and the profit and loss are actual quantities, although the presence of forecast aspects also characterises them. This is a direct consequence of the presence, in the balance sheet, of subjective values, the determination of which depends, not on a mere ascertainment of facts that are now past and concluded, but on an estimation/planning of future events. Consider, for example, the determination of depreciation. The annual depreciation charged to the financial year also depends on considerations regarding the future use of the long-term asset. Similar considerations can be developed concerning quantifying all provisions for future liabilities and charges.

Even though the determination of balance sheet and profit and loss accounting values implies the consideration of future events, there is no doubt that the documents constituting financial reporting for the year are of a consumptive nature.

Although the assessment of creditworthiness cannot disregard the analysis of the company's prospects, the final aspect of financial reporting does not bring this element within the so-called "disclosure limits of financial statements". The circumstance that the values recorded in the balance sheet and the profit and loss are data referring to the closing date of the financial year rather than a limitation represents, therefore, a distinctive trait of financial reporting that, as such, must be accepted and, consequently, interpreted not as a shortcoming but as an intrinsic requirement of such a document.

Concerning the undoubted interest that every user external to the company (shareholders, employees, the community, scholars, etc.) has in information regarding the company's prospects, it must be emphasised that Article 2428, paragraph 3 of the Italian Civil Code establishes that, in any case, the management report must include information on the foreseeable evolution of operations. This specific point will be further discussed in the following pages.

Disclosure limitations resulting from accounting behaviour that does not fully adhere to correct financial statement postulates

The list of 'limitations' of financial reporting, understood as a tool for assessing creditworthiness, may include so-called 'information limitations arising from the application of accounting behaviour that does not perfectly adhere to correct financial statement postulates'.

For obvious reasons, we do not intend to refer to the hypothesis that, voluntarily, the accounting data are distorted by false disclosures of objective values implemented to carry out unlawful balance sheet policies.

Regardless of the objectives of manipulating financial statement data, implementing such operations renders the balance sheet, profit and loss, report of the notes to financial statement report on operations, and documents devoid of any informative consistency. Of little relevance for our analysis appears the consideration of the informative consequences on the determination of the company's creditworthiness, deriving, for example, from the inclusion in the accounts of incorrect objective values as the result of not recording revenues or balance sheet items, the recording of inexistent costs; the recording of assets that do not exist in the company; etc. In this case, however, it seems inappropriate to include such a hypothesis among the "limits" of financial reporting, since the desire to communicate a company condition that is different from the "real" one by falsifying the accounting values does not appear to be an informative limitation of the financial statements, but rather a fraudulent practice that, like any other operation carried out to mislead third parties, renders financial reporting invalid and, in the cases provided for by Article 2621 of

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the Italian Civil Code, transcending the civil field, and to all intents and purposes, falls within the criminal field.

While leaving aside the transactions described above, it is appropriate to address an issue that identifies a widespread practice in companies.

Analysing the financial statements of companies and delving into company practice concerning the determination of financial reporting values that require a subjective valuation intervention, it can be seen that an 'accounting habit' is widespread, which, if not adequately considered in the interpretation phase of the accounting values, can lead to erroneous convictions concerning the company's income and financial situation.

We intend to refer to the often implemented osmosis between tax data and economically (and therefore civil law) correct values.

As is well known, the balance sheet, the profit and loss, the report of the notes to financial statements and the financial statement, i.e. the four documents that, in Italy, constitute the financial reporting destined for the outside world of the company, should only contain civil law correct data, i.e. economically actual accounting values. Since, by its very nature, the civil code contains only very concise rules, the opinion has been consolidated over time that the legal articles should be supplemented/completed/interpreted in light of what is illustrated by the accounting principles.

As noted above, our focus is on financial reporting civil law and, consequently, the accounting standards 'supplementing/completing' the legal norm are those issued by the OIC (Organismo Italiano di Contabilità) even if, in the absence of explicit contradictions with Italian law, there is nothing to prevent the application of international accounting standards (IAS/IFRS).

If the purpose of income values is in determining taxable income, the rules to which reference must be made are the tax provisions whose primary objective is to limit the taxpayer's discretion in determining taxable income.

Therefore, it is possible to identify a precise dividing line between valuation principles applicable to determining financial reporting data and tax criteria since the two regulations are characterised by profoundly different objectives.

Even though most companies are aware of this, in many entrepreneurial realities of our country, financial statements marked by a trib-veridicality, i.e. by a 'truthfulness' influenced by tax assessments, can frequently be identified. In other words, widespread practice is the 'importation' into the civil sphere of the valuation criteria identified by the tax legislator. Implementing such accounting behaviour causes what is generally referred to as 'tax interference in financial'.

It appears evident how, when such a hypothesis occurs, the external communication implemented through the financial statements is distorted by the presence, in the profit and loss and balance sheet, of values that have nothing to do with the economically correct measurement of the events, accounted for.

There is no need to elaborate further to understand how, if implemented, tax interference, understood in the sense described above, can distort the income, financial and patrimonial situation communicated to users outside the company, first and foremost, the lenders who, based on the financial statements, assess the company's creditworthiness.

In order to provide a complete view of reality, it should note that the application of tax valuation criteria in the civil sphere occurs, in most cases, in full awareness of the implementation of incorrect accounting behaviour. However, there are cases where the party responsible for quantifying year-end valuations implements so-called tax interferences in the belief that it is adopting a legally unobjectionable principle. In the occurrence of such a circumstance, which is especially prevalent in small businesses, the implementation of a policy of tax pollution of year-end financial reporting occurs, albeit voluntarily, in terms that we could define as 'unconscious', that is, in the mistaken belief that this corresponds to the dictate of the law regulating financial reporting.

In order to understand the impact on external information resulting from the implementation of so-called fiscal interference, consider, by way of example, the cost corresponding to the depreciation of a plant.

Let us assume that the tax depreciation amounts to 200 while the economically correct value is 70 and that, for tax reasons, a value of 200 is recognised in the balance sheet. In this case, since the value recognised in general accounting exceeds the correct amount, it is evident that the costs are overstated in economic reality. The costs recognised in profit and loss are not actual. The consequences of such incorrect recognition are easy to imagine.

It is evident that, in the opposite hypothesis, the repercussions on the decision-making process could be even more severe. If the economically correct depreciation amounted, for example, to 600 against a tax-deductible cost of 200, the recognition in financial reporting of the tax value would result in a total cost underestimated compared to the actual company situation. A circumstance that would cause easily intuitable consequences on assessing the company's creditworthiness.

It should be noted that both of the above-mentioned hypotheses (economic value higher or lower than the fiscal value erroneously entered in the general accounts and, therefore, in the financial statements) often occur in the entrepreneurial reality of many companies in that, the double calculation of costs and revenues, relevant respectively in the civil/economic and fiscal sphere, causes a sort of 'duplication' of

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administrative work with a simultaneous increase in the complexity of the calculations aimed at determining taxable income and civil law income.

Although we are aware that such behaviour may give rise to doubts as to the legitimacy of financial reporting under civil law, and even though the impact of such accounting practice on the informative capacity of financial statement data is evident, there appears to be a widespread tendency to carry out such interference, frequently leading to internal financial reporting analyses conducted on such data being distorted by assessments that have nothing to do with the veracity of the financial statements.

This is not the appropriate place to analyse the legal and internal company management consequences of the fiscal pollution of financial reporting caused by the osmosis between tax valuation criteria and statutory principles.

Since the object of our interest is to identify possible informational limitations of financial reporting that, directly or indirectly, may influence the assessment of the creditworthiness of companies, it seems relevant to emphasise the possibility that such an accounting practice may distort the income/financial/asset data being analysed.

Although it is difficult to understand whether tax valuations pollute financial reporting data, it should be emphasised that the presence of certain circumstances may facilitate the verification of the implementation of such an accounting practice. The indication, for example, that depreciation and amortisation, annual accruals to provisions for risks and charges, closing inventories, and other items of tax interest included in financial reporting coincide perfectly with the data used to determine taxable income should give rise, in this regard, to some doubt as to the economic veracity of the assets, liabilities, and income components recognised in the financial statements. While it cannot, a priori, be ruled out that economically correct values may coincide with tax values, the doubt as to the implementation of tax interferences is legitimate if, over the years, such identity continues unabated.

Whenever any uncertainty arises about possible tax interferences, those assessing the company's creditworthiness should investigate this 'information issue' to have any valuable cognitive element for the correct understanding of the company's income/financial-patrimonial situation.

Communication limitations arising from the objective of the legal regulations on corporate financial reporting

The last category of information limitations that, at least theoretically, may characterise financial reporting specifically concern the content of financial reporting governed by Articles 2423 et seq. of the Civil Code.

In order to understand how financial reporting can be profitably utilised as a tool for assessing creditworthiness, it is necessary to bear in mind the objectives that the civil legislator wishes to achieve through the legal regulation of the balance sheet, profit and loss, the notes to the financial statements, the cash flow statement and the directors' report, which, although not part of the financial statements, is mandatory for all corporations.

The primary objective of the legislation is, on the one hand, to guarantee the communication to the outside world of values that are economically, financially and patrimonial, correct, truthful and clear, and, on the other hand, to homogenise, formally, this communication by limiting the discretion of companies in the phase of 'creation' and disclosure of accounting data.

Over time, the legislator has identified a series of rules that, at least according to the vision of those who promulgated the laws, should combine two fundamental needs: the uniformity of corporate disclosure intended for third parties and the recognition of dutiful and appropriate confidentiality concerning corporate data deemed sensitive.

Homogenising external disclosure is, without a doubt, one of the main objectives of the civil legislator, the OIC accounting standards, and the IAS/IFRS. Indeed, this element facilitates the understanding of accounting data for external users of companies.

However, this consideration must be interpreted in light of two elements that cannot be underestimated. Firstly, it must be remembered how the law and accounting standards correctly consider the need to guarantee the company a fair right to confidentiality that not even the broader 'stakeholder vision' of the company can deny.

Specific information cannot be extracted from financial reporting as it identifies sensitive data and, although theoretically valuable for those who must assess the company's economic-financial situation, it cannot and must not be disclosed. Without referring to apparent elements such as, for example, the disclosure of data concerning the research and development of new products (even though c. III of Art. 2428 of the Civil Code III c., requires that research and development activities must, in any case, be disclosed in the management report), it is possible to identify other values that, although sensitive, do not identify striking cases such as the one mentioned above. Consider, for example, the requirement to disclose in the financial statements revenues and income, costs and expenses net of returns, discounts, allowances and premiums, as well as taxes directly related to the sale of products and provision of services (Article 2425 bis of the Civil Code). This provision prevents the company from being obliged to disclose data concerning its sales policy that, in

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theory, could be used by competitors in a way that would harm the company's strategy.

In contrast to these examples of sensitive data, the non-disclosure of which is rooted in the company's right to confidentiality, there are disclosure limitations in publicly available financial reporting that create difficulties in interpreting accounting data without a fundamental right to privacy of the company being attached to them.

Consider, for example, the fact that while there is an obligation to disclose the short-term and long-term portion of all debts (aggregate D, balance sheet liabilities), there is no similar obligation in respect of provisions for risks and charges and severance pay liabilities.

This is not the appropriate place for a doctrinal disquisition on the motivations that led the legislature to adopt certain decisions regarding the content of financial statements.

There is no doubt, however, that the dictates of Articles 2424, 2424 bis, 2425, 2425 bis, 2427, 2427 bis and 2428 of the Italian Civil Code entail a series of limitations on the disclosure of information to the outside world that, directly or indirectly, may prevent a constructive and correct analysis of the company's financial and balance sheet data.

In these cases, it appears correct to refer to 'disclosure limitations of financial reporting publicly because, unlike the limitations analysed above (intrinsic limitations and limitations arising from incorrect application of the valuation principles governed by the Civil Code), the inability of the external user to access certain valuable information for corporate analysis, derives from an actual legislative imposition resulting, on the one hand, from the need to guarantee corporate confidentiality on sensitive data or, on the other, from legal choices that, for a series of more or less understandable reasons, the legislator has deemed correct than others. For an overall view of the operational consequences of such disclosure limits in financial reporting, the reader is referred to the following paragraph.

II. Financial Reporting to Third Parties External to the Company: Analysis by Parties External to the Company; Objectivity vs. Subjectivity of the Profit and Financial Indicators Determined

The assessment of a company's creditworthiness must be based on a careful study of financial reporting data combined with an equally in-depth analysis of the company's prospects.

In this regard, it is worth emphasising how, nowadays, the performance of a correct, complete and structured financial reporting analysis is often considered an 'obsolete' operation and the result of theoretical knowledge that is now definitively outdated. Commercial motivations to develop new products push towards creating tools with fancy names that implicitly place financial reporting analysis among the technical tools of secondary importance.

Nothing is more deviant and dangerous. The analysis of financial reporting or, better still, of the latest financial statements (studying the trend of values is more meaningful than dwelling on the punctual data of a single financial year) can never be considered obsolete or replaceable by 'more innovative and/or refined' means of research.

Every value can be studied through various 'reading lenses' and the search for constant improvement of the classic study tools must be a common objective but, in no case, can balance sheet and profit and other investigative tools replace loss analysis since everything the company represents in economic and financial terms is summarised in the accounting values recorded in the financial reporting for the year.

Our investigation will focus on the problems that an external operator (such as a lender wishing to assess a company's creditworthiness) encounters in applying the so-called 'classical analysis tools to the financial reporting filed with the commercial register office.

What distinguishes us from other authors is that, in our opinion, the term 'classic' must be associated with a positive valence, unlike those who, in order to allow the dissemination of fanciful, as much as dangerous, theories, consider this locution as a synonym for 'outdated, obsolete and therefore, no longer usable'.

In every company, everything is reflected in the accounting data of the balance sheet. In reality, every policy, every action, and every decision is summarised in the company's balance sheet and financial and income figures. Even the debate on so-called corporate social responsibility frequently focuses on the inter-relationship that can be identified between the implementation of sustainable socio-environmental policies and the maximisation, in the medium and long term, of operating income.

This assumes fundamental relevance in the assessment of creditworthiness.

In order to understand, on the one hand, the degree of difficulty an external user encounters in analysing a published financial report and, on the other hand, the degree of objectivity of the aggregates/indicators determined based on the findings of such a document, it is necessary to identify the elements based on which it is possible to make a judgement on the income, financial and asset situation of a company.

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It is a well-known fact that the financial reporting output of the general accounts, if not properly processed, prevents any judgement on the company's condition. In this document, the values recorded in the balance sheet and profit and loss are entered randomly.

Only a proper re-aggregation of these values, followed by the identification of valid performance indicators, allows the development of a reliable and consistent analysis of the company's economic-financial situation.

It is not within the scope of this work to delve analytically into the subject of financial reporting reclassifications and the identification of the grid of indicators indispensable for understanding the 'real' company situation.

Here, we will 'only' investigate the theoretical possibility of implementing a complete and objective analysis of the financial reporting data published at the company registry office.

Concerning the problem of the reaggregation of balance sheets and profit and loss values, it should be emphasised that the doctrine has developed a plurality of reclassification schemes. In the face of such a plurality of models, the analyst's choice, whether internal or external to the company, must fall on the scheme deemed most consistent with the objective of the analysis.

In the writer's opinion, the model that best succeeds in investigating the trend of the company's income and financial values is the integrated information system, as it is characterised by integration, formal and substantial, vertical and horizontal, of every part of the system which, on the contrary, is lacking in any other theoretical schematisation.

Since, however, the objective of this work is to identify the degree of complexity encountered by an external operator in analysing the accounting data recorded in financial reporting, it seems appropriate, instead of focusing on the structures envisaged explicitly by the integrated system, to attempt to identify the points in common of the various analysis schemes proposed by the doctrine. This makes it possible to assess, albeit in general terms, the main obstacles that any external analyst encounters when investigating a financial reporting public, regardless of the theoretical structures applied.

It appears evident how an external analyst can only perform a complete and objective analysis of financial reporting if the reclassifications imposed by the Italian Civil Code allow for the passage, automatically and free of any subjective evaluation element, to the regrouping schemes of the values chosen as reference for the calculation of the economic-financial indicators.

Concerning the balance sheet, comparing the various schematisation proposed by scholars to analyse the financial and equity situation of companies, it is possible to identify a characteristic that tends to permeate every reclassification structure.

Generally speaking, the reclassifications proposed by the doctrine envisage, at the very least, the subdivision of assets and liabilities according to a liquidity/exploitability criterion. According to this principle, assets, liabilities and shareholders' equity are interpreted as items that will be transformed into cash inflows or outflows in the future. Since the objective of any asset reclassification is to assess the short- and long-term financial equilibrium, the reclassified assets and liabilities/equity must be 'time-split', i.e. divided according to the maturity of the liquidity/expendability of the individual items. Conventionally, the separation time space taken as a reference is one calendar year. According to this logic, the accounting items are broken down as follows:

Reclassified Assets: Items that will translate into future income

Short asset: Items that will result in future revenue within 12 months

Long-term asset: Items that will result in future income beyond the next 12 months

Total reclassified assets are generally referred to as invested capital (IC)

Reclassified Liabilities: Items that will result in future cash outflows.

Short Liabilities: Items that will result in future cash outflows within 12 months

Long-term liabilities: items that will result in future cash outflows in a period beyond 12 months after the closing of accounts

Reclassified Shareholders' Equity: Items that will result in future cash outflows (in theory, the company's last outflow before liquidation) and which, at the same time, identify the 'real' net wealth available to the company.

The reclassified liability total is generally defined as total sources.

On the other hand, as far as profit and loss are concerned, the various schematisation proposed by scholars, while presenting profound differentiation, generally provide for the determination of two particular aggregates:

1. The income produced by the company's ordinary operations. This value derives from the contraposition between typical revenues (sales revenues) and characteristic costs (i.e. production, administrative, commercial, and research and development costs). This income is identified by various acronyms: ROGC (Characteristic Operating Income), GOP (Gross Operating Profit), etc.
2. Income from operations. This aggregate derives from the contraposition of the costs and revenues concerning the company's core business, the

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income components deriving from asset management (income components inherent in the assets invested in speculative and/or purely investment activities) and, lastly, the revenues connected with active financial management (revenues deriving from receivables and foreign exchange management). Operating income is generally identified by the acronym RO (Operating Income) or OP (Operating Profit)

As already emphasised, the systems of analysis prepared by the doctrine and considered as a whole, present profound substantive and formal distinctions. Here, however, given the objective of our study, we shall focus our attention only on the aggregates listed above, which, transversally, can be identified in almost all the reclassification structures proposed by the various scholars, albeit in the full knowledge that, even within the scope of the determination of these values, certain theoretical differentiations can be identified. In our investigation, we shall adhere to what has been indicated in the preceding pages because, in the writer's opinion, the content of the items illustrated therein represents the best compromise obtainable from a comparison of the various doctrinal positions expressed on the issue analysed here.

Only the objective and automatic placement of civil law items (Articles 2424, 2424 bis, 2425, 2425 bis of the Italian Civil Code) in the aggregates illustrated above, guarantees the determination of impartial and subjectivity-free indicators.

Even with regard to the calculation of the indicators, the solutions proposed by doctrine and practice appear extremely varied.

Among the various ratios identified by scholars and practitioners, the ratios that most frequently present similarities, in terms of quantitative determination, can be summarised as follows:

Current ratio: short-term assets/short-term liabilities. It is used to assess the static short-term financial balance

Quick ratio: short-term assets net of inventories and non-core short-term investments/short-term liabilities. This indicator is used to investigate the static financial balance in terms of liquidity (cash, bank and receivables)

Debt ratio: invested capital/equity. Another formula used: (Short-term liabilities+Long-term liabilities)/ Shareholders' equity. This ratio shows the company's degree of indebtedness

ROE: operating income/equity. ROE quantifies the company's overall profitability, i.e. the profitability of the company's equity

ROA: operating income/invested capital. ROA, considering both the numerator and the denominator, the operational management, i.e. the totality of the company's characteristic, capital and financial assets, is used to express an opinion on the company's operating performance

ROI: income from core business operations / capital invested in core business operations (i.e. total invested capital stripped of all items not related to the company's core business)

ROS: income from ordinary operations/typical revenues. ROS, or return on sales, measures the degree of profitability of the company's turnover.

The indicators mentioned above identify only a fraction of the ratios identified by the various systems of analysis proposed by doctrine and practice. Despite this, however, it is possible to state that, albeit with some differentiations, the ratios illustrated are 'transversal', and therefore present, in every theoretical schematisation.

The objectivity of the indicators, which are calculated on the basis of the values of the financial reportingpublicly available at the company registry office, depends on the possibility of unambiguously placing the items provided for by the Civil Code in the aggregates identified above.

The more the phase of regrouping the book values is characterised by subjective assessments of the analyst, the greater the danger of determining approximate, partial and arbitrary ratios.

To conclude this brief introduction, it must be emphasised that interpreting reclassification as a mere automatic operation devoid of considerable importance in analysis results in the potential determination of aggregates marked by significant theoretical errors.

Those who underestimate the relevance of the re-aggregation of financial reporting data and, consequently, delegate this operation to non-experts often believe that the 'noble' part of the analysis is confined to the interpretation of the indicators determined based on those re-aggregations.

If the starting basis for calculating the indicators is incorrect, determining the economic/financial indices/flows/aggregates will also lead to false and, consequently, misleading results.

Merely by example, we can analyse an account that frequently has a conspicuous and absurd posting in the wrong aggregate in the restatements: advances from customers.

This value appears in the having section in a balance sheet output of the general ledger (and thus, not reclassified). Hence, in the statutory scheme, the recognition of this item in the aggregate D) Payables.

One of the most frequent errors made by inexperienced analysts is to place advances from customers as a deduction from the item receivables.

Such a placement results from a misinterpretation of the item. Advances do not represent, like the allowance for doubtful accounts, an adjusting item to receivables already entered in the

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reports, but rather identify an article that, in the event of successful contracts, will result in a reduction in future receipts (compared to the value shown on the invoice) deriving from the sale of products or services.

The error inherent in recognition of advances to customers is easily understood by considering this example:

1/6/n receipt of advances from customers for 1000 + VAT: recognition, in General Ledger., of advances from customers for 1,000, debit VAT for 220, cash entry for 1,220;

1/7/n sale invoice issued in connection with the preceding advance for 10,000 + VAT: recognition, in General Ledger .., of revenue for 10,000 with simultaneous closure of advance payments from customers and recognition of the receivable from customers for an amount equal to revenue (10,000) + VAT (1,980 or both 22% of 9,000) net of the advance payment (1,000) which, at the same time, is closed. The credit to the customer is credited in the amount of 10,980.

This simple example shows how the presence of an advance from customers in debit is incompatible with recognising the associated trade receivable in debit. If the passage exists, the receivable from customers cannot have been opened while, on the contrary, the existence of the trade receivable implies that the advance account has been closed. For this reason, customer advances cannot relate to trade receivables recognised in debt and, consequently, can never be deducted from trade deferred cash or long-term assets.

When analysing reclassified financial statements for analytical purposes, it can see that another frequent error is the recognition of customer advances in either short-term or long-term liabilities.

This placement is not always acceptable. Advances from customers represent an item whose reclassification presupposes an analysis of the contracts associated with the advance.

For the reclassification to determine the significant aggregates, it is necessary to distinguish advances according to whether the contract to which they refer is supposed to be successful or, on the contrary, subject to potential termination and/or cancellation. Secondly, it is necessary to consider certain peculiarities of the individual hypotheses. If the advance relates to contracts with a definite term, it must distinguish the case of advances concerning tangible goods from that in which the passages relate to services. On the other hand, if the advance was paid by customers whose contracts are supposed to be terminated, it is necessary to subdivide the advance payments according to whether there is an obligation to repay the amount paid by the debtor.

This subdivision of advances is necessary because each type of advance corresponds to a specific reclassification. In particular:

1. Advances from customers related to contracts subject to hypothetical future termination or cancellation with the right to repayment of the amount paid must be included in short-term non-financial liabilities if repayment to the customer is expected within the following year, or in long-term non-financial liabilities, if repayment is expected beyond the following year.
2. Advances from customers in connection with contracts subject to hypothetical future termination or cancellation without the right to reimbursement of the amount paid cannot, on the other hand, be included in short-term or long-term liabilities because they will not transform such advances into future outflows precisely because of the absence of the customer's right to reimbursement. Since the retained advancement will turn into out-of-period income, the monetary flow of which has already occurred previously (at the time recognised in advance), the item in question is characterised by the absence of future impact on the cash/bank. Therefore, the advances from customers under analysis will result in neither future income nor expenditure. For this reason, to avoid reclassification leading to the determination of non-significant aggregates, it is deemed appropriate to recognise this item within sources, taking care not to include it in any of the sums constituting the liability side of the balance sheet. Therefore, while forming part of the "breakeven total" recognised on the debit side of the reclassified balance sheet, these advances do not form part of either short-term or long-term liabilities or shareholders' equity. They, therefore, constitute a separate item, forming part of the general total of the debit side of the balance sheet, the recognition of which in the reclassified balance sheet is necessary to reconcile needs and sources.
3. Advances from customers related to contracts not subject to hypothetical future termination and/or cancellation concerning the supply of goods with materiality cannot be included in the short or long-term liabilities as they will not result in future outgoings.

   Nor can this item be recognised, with a negative sign, within the accounts receivable from customers. When the sale of products is recorded, the debit item "advances from customers" is eliminated, without giving rise to any disbursement, to show the residual receivable from customers in the accounts and thus net of the amount already paid.

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On the other hand, advice from customers in connection with contracts that are not subject to hypothetical future termination and/or cancellation must be deducted from liquid assets.

In this regard, it should note that inventories are included in short-term assets because it is believed that income at least equal to the financial reporting valuation of the stocks can be derived from the sale of the inventories. However, suppose the customer has already made a down payment. In that case, the monetary income from the stock sale will be at least equal to the financial reporting value of the inventories, less the down payments made by the customer.

The situation may be more problematic if the amount of the down payments exceeds the value attributed to the inventory (a particularly unusual hypothesis). Should this circumstance occur, it must deduct the amount of the down payments up to the value of the stock itself from the stock. On the other hand, the considerations made above regarding advance payments from customers in connection with contracts are subject to hypothetical future termination or cancellation without the right to refund the amount paid to apply. In this case, as well, it is deemed that, due to the impossibility of recognising the item within the asset and liability aggregates illustrated above, the item should be recognised within sources, taking care, however, not to include it in any of the aggregates constituting the liability side of the balance sheet. Therefore, even though these advances will form part of the sources, they will not form part of either the short-term or long-term liabilities, nor will they form part of shareholders' equity. They will therefore constitute a separate item whose recognition in the reclassified balance sheet is necessary to reconcile requirements and sources.

4. Advances from customers in connection with contracts not subject to hypothetical future termination and/or cancellation concerning the provision of services cannot be included in short-term or long-term liabilities because they do not represent future expenditures.

   The circumstance that the services to which the advances refer are not recognisable as assets make it impossible to deduct them within the scope of liquid assets.

   Their inclusion in the context of short-term or long-term liabilities or assets with a negative sign would lead to determining insignificant aggregates.

   For these items, the considerations outlined above for advances to customers not recognisable in any of the aggregates of current/long-term assets and current/long-term liabilities/equity also apply. Even in this case, these amounts will constitute a separate item whose recognition in the total of the "debit" section of the reclassified balance sheet is necessary to ensure the document's balance.

This simple example, to which many others could be added, shows how the reclassification of financial reporting data requires in-depth accounting expertise in what seems trivial, evident and obvious. The choice for this demonstration has fallen on advances from customers, not because this item, in the financial statements, assumes a particular relevance, but because it identifies an accounting item that, in the face of an apparent reclassification triviality, hides a complexity that only an expert analyst can understand, address and overcome.

The list of items potentially creating considerable problems during the data regrouping phase is exceptionally long. However, this is not the appropriate forum to investigate such a problem in depth.

The brief considerations above aim 'only' to understand whether an analyst outside the company, in possession of only the published financial reporting, can identify objective income and financial-equity indicators or whether, on the contrary, subjective intervention is required for the correct placement of accounting items in the reclassification schemes from which, directly, the quotients and other aggregates indispensable for assessing the creditworthiness of a company arise.

As already pointed out, the objectivity of the indicators is guaranteed by the presence of two conditions:

1. The party responsible for reclassifying financial reporting data must possess a high level of technical expertise;
2. All the information required for correctly reclassifying accounting items must be present in the financial reporting.

Assuming that the first condition is observed (which, in reality, is not always the case), our attention must focus on the existence of the second condition.

Given the nature of this work, it is not possible to perform an analysis of every civil law item.

However, let's compare the civil law reclassification structures, supplemented by the contents of the report of the notes to the financial statements of the management report, with what is required by a regrouping of the accounting values carried out for analysis. It is possible to find some specific information gaps. Merely by way of example one may, for instance, note that:

Article 2424 of the Civil Code does not require the indication of the short-term and long-term portion of provisions for future risks and charges. The transposition of the civil item in the reclassification for analysis inevitably implies a subjective intervention by the party responsible for regrouping the balance sheet data. It is evident that, in the absence of specific

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information, the breakdown of all provisions can only occur based on assumptions that, if they do not reflect the company's reality, lead to the determination of non-significant aggregates.

In addition to these considerations, it must also emphasise t identifying future expenditures, but instead, turn into lower revenues or even lose any element of financial impact. Take, for example, the product guarantee fund. The portion corresponding to the value of spare parts in the warehouse should, hopefully, be deducted from the stock amount just as it would be correct to remove from inventory the portion of a customer premium fund corresponding to goods produced within the company itself. If, then, it could reasonably assume that the funds would turn into contingent assets (e.g. due to rulings of tax commissions, judgments of merit or legitimacy, etc.), the item, in the absence of any future financial impact, would have to be recognised in an aggregate that, although part of the breakeven total or invested capital, cannot, of course, influence the short or long term liabilities/assets. Consider the case where a tax provision.is connected to a tax dispute that is the subject of a ruling in favour of the taxpayer issued concerning a situation similar to the one for which established the provision In such a case, the tax provision, in anticipation of its cancellation with the simultaneous recognition of a contingent asset, must necessarily be recognised in an aggregate of separate items which, although forming part of the section total (in this specific case, the total assets section), cannot be recognised in any short and/or long term asset/liability aggregate since, in connection with this item, no future cash inflows or outflows will realise. Still, it will be implemente in a mere scriptural operation of cancellation of the provision. It is clear that the total absence of such information in the civil law context prevents the provisions for liabilities and charges from being correctly allocated. This circumstance, which, in the presence of conditions characterised by significant amounts, can significantly affect the results of the financial statement analysis. In this regard, it should note that point No. 4 of Article 2427 of the Civil Code requires that, in the notes to the financial statements, 'the changes that have occurred in the consistency of the other items of assets and liabilities; in particular, for equity items, for provisions and severance pay, the formation and utilisation . Point No. 7 of the same article emphasises that the report of the notes to the financial statements must also indicate 'the composition of the items "accrued income and prepaid expenses" and "accrued expenses and deferred income" and the item "other provisions" in the balance sheet, when their amount is appreciable, as well as the composition of the item "other reserves"'.

Based on the statutory provision, at least in theory, it might be possible to derive useful information about the timing of the collectability of requirements. For this regulatory provision to allow for the perfect and objective allocation of the short-term and long-term portions of all requirements (including the part that must necessarily be recognised as a separate item), it must observe three contextual conditions:

1. The analyst must reclassify the financial reporting in light of the information contained in the report of the notes to the financial statements;
2. In this document, all accounting operations performed on the individual provisions for risks and charges must be illustrated, in detail and with specific reference to each type of provision included in the three aggregates B Provisions for risks and costs (1 for pensions and similar obligations; 2 for taxes, including deferred taxes; 3 others), with particular reference to utilisations (specifying the reasons for utilisation), provisions, accounting reversals, etc.;
3. The operator carrying out the analysis must have the financial report of the financial year following that, which identifies the last year to which the index analysis refers. In other words, if the years being analysed are N, N+1, and N+2, the analyst must also be able to consult the financial report of the year N+3. In the absence of this possibility, the funds reported in the financial information for the period N+2 cannot be objectively placed even if the conditions set out in points 1 and 2 were perfectly observed. It seems appropriate to emphasise that, by definition, if the last financial year considered was the year before the period still to run, the condition set out in this point is, technically, not feasible.

The simultaneous fulfilment of the above three conditions appears to reflect, rather than reality, mere wishful thinking. In particular, the conditions identified in points 2 and 3 appear to be very difficult to observe due, on the one hand, to the conciseness of the information that, in general, characterises the report of the notes to financial statements, and, on the other, to the frequent technical impossibility of analysing the financial report of the financial year following the last one being analysed as it is, often, still in progress. While not excluding, therefore, the theoretical possibility of objectively placing the provisions for risks and charges in the reclassified profit and loss, it seems arduous to affirm that such a hypothesis is frequently realised or even, can be found in the reality of financial reporting analyses carried out exclusively from outside the companies.

Article 2424 of the Italian Civil Code requires the recognition of the termination indemnity liability (aggregate C) without requiring the simultaneous indication of the short-term and long-term portion. In the absence of this reference (e.g. analysis of the company's most recent financial reporting), it is impossible to divide the item into the short and long

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term. Unlike the provisions for liabilities and charges, however, the specific expression of the TFR portion about the year and the total amount of the TFR debt allows, by cross-referencing the two data, to objectively determine the breakdown of the short-term and long-term portion of the debt. However, this can only be done if the analyst also possesses accounting data for the year after the analysis.

As an example, let us assume the analysis of the financial statements of financial years n and n+1. Financial reporting year n: termination benefit liability 100; accrued termination benefit 20. Financial reporting year n+1: termination benefit liability 104; accrued termination benefit 10. If at 1/1/n+1, the TFR payable is 100 and the TFR accrual in year n+1 is 10, at 31/12/n+1, one would expect a TFR payable of 110. Since it is instead 104, it can state that in year n+1, it paid out termination benefits in 6. Consequently, in the financial reporting of year n, the termination benefits payable is short-term in the amount of 6 and long-term in the amount of 94. On the other hand, in the absence of the data for year n+2, it is impossible to identify the short-term and long-term portion of the TFR debt existing at 31/12/n+1.

It is evident how the analysis of the data of a financial report published, therefore, if not in the presence of the financial reporting of the following year, may lead to an inappropriate allocation of the item in question with the potential consequences easily identifiable on the results of the analysis.

Since no. 4 of Article 2427 of the Italian Civil Code also refers to the liability for termination indemnities, the considerations set out above in respect of provisions also apply, in total, to the item considered here..

Article 2424 of the Civil Code does not require the specific recognition of certain advances. Suffice it to think of advances on severance pay, an item that, in some companies (e.g. co-operative societies), may be characterised by relatively high amounts. In the Civil Code, such advances are recognised indistinctly, with all other receivables. In the context of the reclassification carried out for analysis, the inclusion of this item under either short-term or long-term assets would constitute a severe logical error since the advance given to workers will not be transformed into future income but instead will result in a lower outflow. The passage on severance pay must, therefore, necessarily be deducted from the short-term or long-term liabilities, depending on the maturity date connected with the employee's severance pay liability to which part of the severance pay has been advanced. In the presence of such advances, the transition from financial reporting civil to reclassified reporting for analysis purposes entails the determination of aggregates that, potentially, could be insignificant. It should also note that, even though the individual amounts are available for advances to customers and suppliers, information is absent from the published financial reporting that, while in many cases is of little interest, in others, may be very important. We intend to refer to the issue related to down payments that, in all likelihood, will not result in less revenue or expenditure (as is the case with contracts that are assumed to be successful) but will be subject to write-off due to probable termination/termination of the contract. When these cases occur, checking whether the advance payment is expected to be repaid necessary. If not, it is essential to assume recognition of the entry in the separate items of the debit (advances to suppliers) or debit (advances from customers) column. The information required for this purpose is not included in the data prescribed by the Civil Code. In the case of small amounts, this absence does not affect the analysis results. In the presence, on the other hand, of significant quantities, the lack of such information could, at least theoretically, seriously affect the correct reclassification of the item.

Article 2424 of the Civil Code does not require specific recognition of own bonds, i.e., bonds purchased by the issuing company. Such securities must, indistinctly, be recognised under securities (B III 3; C III). Should such values have the company for cancellation of the same, the recognition of such amounts under assets would result in the determination of incorrect aggregates since, as is the case for severance indemnity advances, in the event of future cancellation of the bonds, the value is to be recognised, not under assets, but as a deduction from liabilities. Again, failure to disclose the presence of own obligations may be a harbinger of potential reclassification errors.

Article 2425 of the Italian Civil Code provides that ordinary capital gains (arising from the sale of deferred assets) and ordinary contingent assets (arising, for example, from valuations of events to which the funds are connected that have turned out not to be following reality) are to be recognised in item A5. In this item, characteristic revenues from the sale of company by-products, rents receivable and so-called 'other revenues' must also be entered, with a separate indication only of operating grants. In item B 14, on the other hand, ordinary capital losses and contingent liabilities are also to be recognised indistinctly regarding sundry operating costs. This circumstance makes it impossible to identify the total amount of regular capital gains/losses/ out-of-period expenses, which, by definition, in the reclassification of profit and loss carried out for analysis purposes, do not form part of either ordinary or operating management. Such an information gap can, in the presence of such items, represent the element that radically impedes the determination of income from normal business activities and operating income. Often, the indistinguishable indication, concerning other revenues and expenses, of typical

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gains/losses and out-of-period income causes items A 5 and B 14 to be recognised, for their total amount, in expected revenues and expenses, with grave detriment to the informative capacity of these aggregates.

Based on the above considerations, the degree of objectivity/subjectivity of the indicators listed in the preceding pages and determined based on the mere results of the financial reporting to be disclosed to third parties outside the companies are as follows:

Current ratio: subjective determination as it is not possible to objectively determine current assets and current liabilities

Quick ratio: subjective determination, as it is not possible to objectively determine short-term liabilities

Debt ratio: subjective determination in that particular item which, on regrouping, must be deducted from the opposite column (e.g. advances from customers, specific provisions for risks and charges with particular characteristics, advances on termination indemnities, own bonds destined for cancellation, etc.) are not shown in the statutory schemes

ROE: objective determination since, from the financial reporting public, it is possible to quantify, in a precise manner, both operating income and shareholders' equity

ROA: subjective determination as neither operating income nor invested capital can be determined objectively

ROI: subjective determination as it is not possible to determine, objectively, either the income from operating activities or the invested capital

ROS: subjective determination as it is impossible to objectively determine income from core business activities.

The above highlights just some of the reclassification problems encountered by a user outside the company.

Since financial reporting civil analysis represents a fundamental element of knowledge for multiple users (credit institutions, potential customers, existing customers who need a new assessment of the company's creditworthiness, etc.), it appears not only legitimate but indispensable to find solutions to the obstacles created by the information gaps in financial reporting civil analysis. The external operator must, therefore, necessarily make subjective choices regarding items lacking the specific legal indications that would guarantee a correct and objective placement in the reclassification schemes.

Acknowledging the existence of obstacles does not mean that it is impossible to proceed with the analysis of external financial reporting.

As in the case of certain infirmities, according to Sigmund Freud's authoritative statement, the patient's 'consciousness of illness' represents a decisive step towards the solution of the medical problem, even in the field of our interest, the perception of the limits of the instrument used for analysis identifies the critical element for overcoming the difficulties connected with the study and for correctly interpreting the results which, in an ineluctable manner, arise from the subjective choices made by the analyst.

The perception of the subjectivity of the aggregates determined based on what is imposed by the civil code and the consequent recognition of the lack of objectivity and neutrality of the indicators selected based on such regrouping allows, at the very least, for the interpretation of the results obtained, more coherently and correctly than would be the case if one were to attribute to such values, unrealistic impartiality and equanimity.

The significance of the analysis carried out on the financial reporting published at the company registry office depends on the ability to ensure that the analysis's subjective choices reflect the management reality of the company being examined.

Unfortunately, in this specific context, the most relevant obstacle is represented by the circumstance that, if one relies exclusively on statutory data, it is not possible to assess the degree of subjectivity of the restatements and, consequently, there is the impossibility of expressing a judgement on the soundness of the indicators identified as a result of the analysis carried out from outside the companies.

From the above, it can understand that it is perfectly conceivable that the indicators, identified from the outside, correctly represent the business reality of which they are an emanation.

For the same reason, however, it is equally possible that the results of the analysis carried out on the financial reporting are distorted by incorrect interpretations of the values, which, necessarily, must be subjectively re-aggregated by the analyst.

Unfortunately, it is not known when either case occurs.

Of course, it can resolve any potential interpretative problems by gathering specific information, which, hopefully, should be provided directly by the company subject to the creditworthiness assessment.

Therefore, the analysis can only be correct and objective if the company is willing to provide all the data for implementing the balance sheet analysis, not included in the information set provided by the statutory legislator. For the results of the research to be reliable, it is, however, necessary that the willingness of the client company to communicate is accompanied, on the one hand, by the desire of the analyst to supplement, what is provided for by the code with supplementary information, and, on the other hand, by verifying that the person charged with carrying out the analysis is endowed with a vast knowledge of the problems

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connected with the reclassification of accounting documents and the determination of the quotients. All too often, even in economically significant realities, the analysis is delegated to operators who, despite having general expertise, show deficiencies in the specific area covered by this discussion.

III. The Management Report, Which is not Part of Financial Reporting but is a Mandatory Document, can make up for the Informational Limitations of Financial Reporting Intended for Third Parties Outside Companies?

In the previous pages, we have shown how the determination of aggregates and financial-patrimonial-income indicators carried out based on financial reporting intended for outside the company (and, in Italy, published at the company registry office)can hide pitfalls that, at least in theory, can lead to erroneous considerations about the company's situation and, consequently, about the creditworthiness of that business entity.

A superficial reading of Art. 2428 c.c. could mistakenly lead one to believe that the informational limitations of financial reporting civil illustrated in the preceding pages can be overcome by what must be, obligatorily, contained in the management report.

Indeed, Article 2428 c.c., in I and II c., states that "financial reporting must be accompanied by a directors' report containing an accurate, balanced and comprehensive analysis of the company's situation and the performance and results of operations, as a whole and in the various sectors in which it has operated, including through subsidiaries, with particular regard to costs, revenues and investments, as well as a description of the principal risks and uncertainties to which the company is exposed.

The analysis referred to in the first paragraph shall be consistent with the size and complexity of the company's business and shall contain, to the extent necessary for an understanding of the company's situation and the performance and result of its operations, financial and, where appropriate, non-financial performance indicators relevant to the company's specific business, including information about the environment and personnel. The analysis shall contain, where applicable, references to the amounts reported in the financial reporting and additional clarifications on them."

The explicit reference to the requirement to include "financial performance indicators", if misinterpreted, could instil in the reader the certainty that, from reading the annual report, information can be derived, which, as provided by the company, is marked by the absence of the interpretative problems illustrated in the preceding pages.

To assess the external informational impact of the management report, it seems appropriate to point out that Article 2428 of the Civil Code requires the disclosure of a series of news, the objective identification of which is difficult to achieve.

The prescriptions in I c. of Art. 2428 c.c. Concerning, for example, "the faithful, balanced and exhaustive analysis of the company's situation and the trend and result of management as a whole and in the various sectors in which it has operated" and "the description of the main risks and uncertainties to which the company is exposed," identify in fact, concepts whose schematization is subject to such a degree of subjectivity that, inevitably, makes the boundary between exhaustive/correct information and incomplete disclosure of company data very haphazard.

This feature is accentuated when considering the additional information that, by law, must be disclosed through the management report. The use of the locutions financial performance indicators (Which ones? Constructed in what way? Based on what reclassification? etc.) and, where appropriate (When, in pragmatic terms, does this need arise?), non-financial ones (Which indicators? Determined according to what logic? Based on what doctrinal assumption of analysis?) relevant to the company's specific business, including information about the environment and personnel (Specifically, what information about the environment? And through what form of communication should such information be disclosed? Through subjective evaluations, quantitative determinations, or even economic-financial assessment?), points out that the content of the management report, as governed by Article 2428 of the Civil Code, is far from being free of evaluative elements of a purely subjective nature. Indeed, the above identifies a list of information, the exact connotation of which takes on contours that cannot technically identify objectively.

If subjectivity inevitably characterises the preparation of any financial statements, the degree of "personal evaluation" in the drafting of the management report reaches its apex.

Apart from these general introductory considerations, to clear the field of misunderstandings, it is necessary, first of all, to clarify that the phrase "financial performance indicators" refers not to ratios, whose task is to delve into the company's financial situation, but to all quotients of a financial, income and equity nature. On the other hand, "non-financial indicators pertinent to the company's specific business" refer to the various ratios that measure efficiency, development, productivity, innovation, customer relations, strategic and/or market positioning, etc...

The obligation to disclose financial and non-financial indicators could, mistakenly, be interpreted as

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the "missing" objective information element in the financial reporting published at the corporate registry office (financial reporting for third parties).

Apart from the problematic theoretical nature of determining the list of indicators to be included in the report (doctrine and practice have identified a plurality of indices, and selecting those considered "most significant" is not a simple matter due to the divergent doctrinal opinions on the concept of "relevant and significant"), it is necessary to deal with an additional problem. Indeed, from a comparison of the various doctrinal opinions shows that the same index is often given different titles, and the same acronym identifies a plurality of ratios, profoundly different from each other.

To understand the impact of this issue, it is helpful to refer to two values that unquestionably play a crucial role in financial statement analysis: the debt ratio and the net financial position.

The value assumed by the debt ratio assumes considerable importance in understanding the degree to which the company depends on external borrowing sources. This ratio, however, can be determined according to various formulations:

1. Capital Employed/Equity
2. (Total short-term liabilities + total long-term liabilities) /Equity
3. Equity/invested capital
4. Equity/ (Total short liabilities + total long liabilities).

The various technical formulas pose no problems interpreting the data as long as the analyst knows the relevant procedure. Stating, for example, that the debt ratio amounts to 3.2 in itself does not provide any information about the company's autonomy from external sources if, upstream, there is no knowledge of how the ratio is calculated.

The net financial position, an aggregate to which, in recent years, has been attributed an ever-increasing informative capacity, also poses the same interpretative problems. In this regard, enlightening is the analysis carried out By the Research Institute of Certified Public Accountants and Bookkeepers (henceforth RICPAB) in Paper No. 22 of 2013 entitled "The Recording of Indicators in the Management Report. The net financial position." The paper states, "business-economics doctrine has not devoted ample space to the issue in question; nevertheless, interpretative positions can be found that are sometimes not entirely convergent, leading to the formulation of different configurations of Net Financial Position. The issue is mainly attributable to the consideration (and related interpretation) of the items that become part of the computation: one alludes, in particular, to the declination of non-liquid/liquidate financial assets given that while one part of scholars seems to exclude them, others vice versa seems to advocate it." After conducting a theoretical survey of the doctrinal proposals considered of more outstanding merit, IRCDEC concludes by stating that "the review conducted so far makes it possible to highlight how, on a theoretical and methodological level, there coexist a variety of approaches identifying the net financial position, although there is no prevailing representation. Rather, the utmost attention should be paid to the correct interpretation of this quantity, specifying the calculation methods on the occasion undertaken, as these are strictly instrumental to the related cognitive needs."

In the face of such a varied composition of doctrinal, theoretical proposals, there is also an equally multifaceted overview of the reference models used by the practice. After pointing out how, often, from official IAS/IFRS documents, CESR, Assonime, etc., differentiated locutions are used to identify what the RICPAB identifies as net financial position, document No. 22/2013 it is emphasized how each body has seen fit to propose a differentiated quantification of the aggregate as mentioned above. At the end of this examination, the RICPAB offers a conceptualization of the net financial position that, at least in the intentions of the research institute, should represent a theoretical synthesis of what is illustrated in the document using substantial "reasoned" adherence, with the consequent contribution of modifications, to the approach proposed by a part of the doctrine defined, by the research institute as "the most accredited".

Following this synthesis, the RICPAB arrives at the following determinations/definitions:

1. Liquid and readily liquid assets (< 3 months)
2. Short-term financial assets (< 12 months)

Short-term financial receivables
Short-term securities
Short-term financial receivables from subsidiaries/ associates
Other short-term financial assets
Short-term (financial) accrued income and prepaid expenses.
(...)

3. Medium- to long-term financial assets (> 12 months)

M/l-term financial receivables
M/l-term securities
M/l-term financial receivables from subsidiaries/ associates
Other m/l-term financial assets
Multi-year accrued income and prepaid expenses (financial)
(...)
TOTAL FINANCIAL ASSETS (a+b+c)

4. Short-term financial liabilities

Current account overdrafts
Short-term financial liabilities

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Payables to/from factoring companies
Payables to/from leasing companies
Short-term payables to other lenders
Short-term accounts payable to subsidiaries/associates
Short-term accrued expenses and deferred income (financial)
(...)

5. Medium- to long-term financial liabilities

Payables vs banks
Debenture loans
M/l-term interest-bearing payables to shareholders
Financial liabilities to subsidiaries and affiliates
Debts to/other lenders
Debts vs/leases
Long-term accrued liabilities and deferred income (financial)
(...)

TOTAL FINANCIAL LIABILITIES (d+e)

SHORT-TERM net financial position
Net financial position Level I = (a-d)
Net financial position level II = (a+b) - d
LONG-TERM net financial position
Net financial position level I (a) - (d+e)
Net financial position level II (a+b) - (d+e)
Total net financial position = (a+b+c) - (d+e)

More than the composition of the net financial position proposed by the RICPAB, the conclusion reached by this research institute is of considerable significance. After highlighting the proposed determination of the net financial position above, the RICPAB states verbatim that "it constitutes only one of the possible approaches that can take."

All this demonstrates that well alive is the awareness that the locutions used by doctrine and practice to identify financial (and income) aggregates will continue to be marked by substantive and formal differentiations about their composition and determination.

What has been given above as an example to demonstrate the impossibility of attributing unambiguous meanings to locutions identifying aggregates and/or indicators applies, in reality, to any accounting value resulting from reaggregations and/or comparisons between values.

The indicators derived from the various positions, doctrinal and/or proposed by practice, take on different meanings depending on how the data is constructed, with the apparent consequence that associating a given result with a specific acronym, in the absence of analytical indications on how both the indicator and the essential aggregates used to determined that indicator, may prove to be a useless or, even, dangerously misleading operation.

This, of course, leads to a severe problem of communication with the outside world. The absence of specific information regarding the composition of the data disseminated through the management report may render the value insignificant.

The above considerations, regarding both the structuring of the indicators and the reclassification basis to which these ratios refer, have caused authoritative scholars and prestigious study centres and/or institutions to highlight the need to accompany financial performance indicators with the supplementary information mentioned earlier.

It should be noted, however, that despite the solicitations from various organizations/bodies/scholars, the indicators provided in the reports, in the majority of cases, are not accompanied by any specification as to how the ratio is calculated, resulting in a reduction or, even, nullification of the informative capacity of the data disclosed to third parties outside the companies.

Even if the problem identified above was overcome by comprehensive disclosure of how the ratios are constructed to attribute the correct meaning to the indicator's performance, it is still necessary to overcome a further difficulty, which is undoubtedly the most difficult.

The significance of each indicator is directly related to the correctness with which the individual items have been regrouped and reclassified. The incorrect recognition of an item can distort the results derived from the calculation of the ratios.

Any incorrect reclassification of accounting items must, therefore, be stigmatized, regardless of the consequences that this unacceptable accounting behaviour causes on the amount of financial performance indicators.

The recognition, within the reclassified financial reporting, of advances from customers in the liabilities, of advances from severance pay, in the assets, of provisions in the long liabilities, of provisions for depreciation in the liabilities, of own shares in the assets, and so on, also appears very frequent. Circumstances can lead to unmeaningful results in underestimation and overestimation of the dangers and/or positive elements identifiable in the company's income, financial, and asset situation.

Since we have not researched a statistically relevant sample, we do not claim to identify and generalize correlations between events with certain degrees of probability. Each of our statements, therefore, represents an element of knowledge that may indicate certain caveats/appropriate/inappropriate behaviours, the existence of which must be verified on a case-by-case and company-by-company basis.

However, there is no doubt that the frequency of such reclassification errors is incredibly significant, especially in small and medium-sized companies. A circumstance which follows, is the possibility that, in the presence of such logical/technical errors, any

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consideration based on such values is not meaningful and, therefore, misleading.

The previous highlights the difficulty or, rather, the impossibility of considering the management report as a document that directly can fill the information gaps in the financial reporting of the financial year published at the Registrar of Companies office relating to individual accounting items.

Since art. 2428 c.c., in III c, imposes that the report must, in any case, show the foreseeable development of operations; one might lead to assume that, at the very least, concerning this element, beneficial information can be drawn to assess the creditworthiness of a company. Here, too, the hope often runs up against a different reality from what, in theoretical terms, might be assumed from the tenor of the legal standard.

The information regarding the company's prospects is usually substantiated by a very general analysis of the trend of the reference markets with generic indications about the company's economic-financial planning.

There is no doubt that, concerning this issue, the company must recognise a broad right of confidentiality since the disclosure of sensitive data could backfire on the company itself. A reading of management reports highlights the general tendency of companies, especially if they are medium-sized, to disclose generic data, in reality lacking any informative weight regarding the assessment of creditworthiness.

As evidence of this, it can be borne in mind how, assuming the assessment of a company's creditworthiness, a business plan is required to be prepared, which, very rarely or, more correctly, practically never, is included in the management report. The imposition of the preparation of such a document that is not present in financial reporting in documents attached to the latter demonstrates, if ever there was a need, that the papers published at the business registry office be considered a valid basis of information to assess creditworthiness, must be supplemented by a range on the information provided, directly, by the company subject to analysis.

Assuming that it is possible to judge a company's situation based solely on published documents can identify unrealistic operations unless the internal corporate culture is so high that it perceives communication to external operators as a fundamental element of an ethical/social and strategic nature. In listed or large companies, disclosure unimaginable in other categories of companies is implemented. The financial reporting culture in such large companies, often having a global impact, is not comparable to what is experienced daily in smaller companies.

It is always a mistake to make apodictic statements. To believe that public financial reporting can guarantee a complete, exhaustive and perfect analysis of a company's earnings-financial-equity situation would identify an incorrect peremptory position.

To think, however, that, on the contrary, considering especially non-multinational and not very large companies, financial reporting public and management reports can provide some aspects for correct, complete and exhaustive creditworthiness assessment seems even more misleading..

IV. The Financial Reporting of So-Called Small and Medium-sized Enterprises: Abbreviated Financial Reporting and other Disclosure Limits

The Italian Civil Code stipulates that so-called "small enterprises," understood according to the legal meaning governed by Article 24235 bis, can draw up a more concise financial reporting than that controlled by Articles 2424, 2425, 2425 bis, and 2427 of the Civil Code.

In the specific case, in the legal context, companies are considered minor and medium-sized enterprises, which, not having issued securities traded on regulated markets in the first fiscal year or, subsequently, for two consecutive fiscal years, have not exceeded two of the following limits:

1. Total balance sheet assets: 4,400,000 euros;
2. Revenue from sales and services: 8,800,000 euros;
3. Employees employed on average during the fiscal year: 50.

The facilitation of financial reporting decades if companies, for the second consecutive fiscal year, have exceeded two of the limits specified in the first paragraph. Upon such a circumstance, it must prepare financial reporting in the ordinary form.

As is well known, the concept of small and medium-sized enterprises is not unambiguous. However, it is worth mentioning that the document issued in November 2012 by the National Council of Certified Public Accountants and Accounting Experts, entitled "The Preparation of Financial Reporting of Smaller Companies: Regulatory Provisions and Critical Issues," pointed out that the one hand, the preparation of simplified financial reporting is a critical issue for small companies and, on the other hand, smaller companies constitute the main economic-productive force at the national and European level, representing 99.9% of all companies operating in the European Union area, to touch 99.95 per cent of Italian companies.

Not all small and medium-sized enterprises, determined according to "economic-business" canons, fall into the category of companies governed by the 2435 bis civil code. Despite this, the quantitative limits identified by the civil law legislature are such that financial reporting is abbreviated widely.

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There is nothing to prevent the preparer of the financial reporting abbreviated, according to "voluntaristic" criteria or to apply better the postulate of clarity imposed by art. 2423 c.c., from supplementing the minimal information set indicated by art. 2435 bis c.c. Companies that opt for financial reporting abbreviated, however, are unlikely to adopt communication strategies that differ from what the code requires. Those who perceive the need to provide the market with a broader disclosure than that governed by Article 2435 bis tend to opt for "ordinary" financial reporting. Preparing financial reporting abridged form is, in fact, a voluntary choice of the company and not a legal obligation. Consequently, there is nothing to prevent a company, while having the option to prepare financial reporting in an abbreviated form, from opting for the full version of the balance sheet, profit and loss, report of the notes to financial statement the management report.

Companies that choose the abridged version of financial reporting tend, therefore, to apply what is identified in Article 2435 bis. However, there is no shortage of examples of companies that, although they have opted for abridged financial reporting, communicate externally additional information to what is required by statutory legislation.

The following simplifications mark abbreviated financial reporting:

1. The balance sheet includes only those items marked in Article 2424 with capital letters and Roman numerals; items may include A and D of assets in item CII; from items, BI and BII of assets, depreciation and amortization must be deducted in an explicit form; item E of liabilities may be included in item D; in items, CII of assets and D of liabilities, receivables and payables due beyond the next financial year must be shown separately.

Based on these indications, the condensed balance sheet takes the following structure:

ATTIVITA'	PASSIVITA' E PATRIMONIO NETTO
B) Fixed Assets	A) Equity
I Intangiblefixed assets - accumulatedamortization - otherwrite-downs	I Share capital II Share premium reserve III Revaluationreserve
II Tangiblefixed assets - accumulateddepreciation - otherwrite-downs	IV Legal reserve V Statutoryreserves VI Reserve for treasury stock in the portfolio
III Financial fixed assets	VII Otherreserves VIII Retainedearnings (losses) carriedforward IX Profit (loss) for the year X Negative reserve for own share
C) Current Assets	B) Provisions for risks and charges
I Inventories	C) Severancepay
II Receivables (includingreceivables from shareholders for payments still due, accruals receivable and discount on loans)	D) Accounts payable (includingaccruedexpenses and loaninterest)
III Financial assets that do notconstitutefixed assets	

2. Profit and loss may include the following groupings of the items required by Article 2425 of the Civil Code.

(a)items A2 and A3
(b)items B9(c), B9(d), B9(e)
(c)items B10(a), B10(b), B10(c)
(d)items C16(b) and C16(c)
(e)items D18(a), D18(b), D18(c)
(f)items D19(a), D19(b), D19(c)
(g)item E20 separate disclosure of capital gains is not required
h)item E21 is not required to disclose capital losses and taxes related to previous years separately.

Based on the provisions of Article 2435 bis of the Civil Code, profit and loss can be abbreviated as follows:

Production value:

1. Revenues from sales and services
2. Changes in inventories of work in progress, semi-finished and finished goods and changes in contract work in progress

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3. Increases in fixed assets for internal work
4. Other revenues and income, with operating grants shown separately

Costs of production:

5. For raw, ancillary and consumable materials and goods
6. For services
7. For the use of third party assets
8. For personnel:
   (a) Wages and salaries
   (b) Social security charges
   (c), (d), (e) severance, retirement and similar benefits and other costs
9. Depreciation and amortization:
   (a) amortization of intangible assets, depreciation of tangible assets and other write-downs of fixed assets
   (d) write-downs of receivables included in current assets and cash and cash equivalents
10. Changes in inventories of raw materials, supplies, consumables and merchandise
11. Provisions for risks
12. Other provisions
13. Miscellaneous operating expenses
    Difference between value and cost of production (A - B)

Financial income and expenses:

14. Income from equity investments, with separate disclosure of income from subsidiaries and affiliated companies
15. Other financial income:
    (a) From receivables recorded as fixed assets, with a separate indication of those from subsidiaries and affiliated companies and those from parent companies
    (b), (c) from securities included in fixed assets that are not equity investments and from securities included in current assets that are not equity investments
    (d) Income other than the above, with separate disclosure of income from subsidiaries and affiliates and income from parent companies
16. Interest and other financial charges, with separate disclosure of those from subsidiaries and affiliates and parent companies
    17bis) foreign exchange gains and losses. Total (15 + 16 - 17 +/- 17a)

Value adjustments of financial assets:

17. Revaluations:
    (a), (b), (c) of equity investments, of financial fixed assets that are not equity investments, and of securities under current assets that are not equity investments;
18. Write-downs:
    (a), (b), (c) of equity investments, financial fixed assets not constituting equity investments, and securities under current assets not constituting equity investments
    Total adjustments (18 - 19)

Extraordinary income and expenses:

19. Extraordinary income
20. Extraordinary charges
    Total extraordinary items (20 - 21)
    Income before taxes (A - B +/- C +/- D +/- E)
21. Income taxes for the year, current, deferred and prepaid
22. Profit (loss) for the year

Without prejudice to the indications required by the third, fourth and fifth paragraphs of Article 2423 ("If the information required by specific provisions of law is not sufficient to give a true and fair view, it shall provide additional information necessary for the purpose. .....No need to comply with the obligations on recognition, measurement, presentation and disclosure when compliance with them would have insignificant effects on giving a true and fair view. Obligations regarding the regular maintenance of accounting records remain unaffected. Companies shall explain in the report of the notes to financial statements the criteria by which they have implemented this provision. If, in exceptional cases, the application of a provision of the following articles is incompatible with true and fair representation, it shall not be the provision. The report of the notes to financial t apply statements must give reasons for the exemption and indicate its influence on the representation of the financial position, financial position and results of operations. Any profits arising from the waiver must be entered in a non-distributable reserve except to the extent of the value recovered"; from the second, fifth and sixth paragraphs of Article 2423-ter (Items preceded by Arabic numerals may be further subdivided, without elimination of the overall item and the corresponding amount; they may be grouped only when the grouping, because of their amount, is irrelevant for the purposes indicated in the second paragraph of Article 2423 or when it promotes the clarity of the financial statements. In the latter case, the report of the notes to financial statements must contain the items subject to grouping separately.....; for each item of the balance sheet and profit and loss, it must indicate the amount of the corresponding item of the previous year. If the items are not comparable, those for the previous year must be adjusted; the non-comparability and the adjustment or impossibility thereof must be reported and commented on in the notes to the financial statements..... Matching offsets are prohibited. In those cases where offsetting is permitted by law, the gross amounts subject to offsetting shall be indicated in the report of the notes to the financial statement."), by the second paragraph of Article 2424 ("If an item of assets or liabilities falls under more than one item of the schedule, in the report of the notes to financial statement shall be noted, if this is necessary for the

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understanding of the financial statements, that it also belongs to items other than the one under which it is entered.", from the first paragraph, numbers 4) (4) fixed assets consisting of equity investments in subsidiaries or associated companies may be valued, concerning one or more among said companies, instead of according to the criterion indicated in number 1), for an amount equal to the corresponding fraction of the shareholders' equity resulting from the last financial reporting of said companies, after deducting dividends and making the adjustments required by the principles of preparation of the consolidated financial reporting as well as those necessary for compliance with the regulations indicated in articles 2423 and 2423-bis.

When the equity investment is recorded for the first time under the equity method, the acquisition cost over the corresponding value of the equity reported on the date of acquisition or resulting from the latest financial reporting of the subsidiary or an associated company may be recorded as an asset, provided that the reasons for this are stated in the notes to the financial statements. To the extent attributable to depreciable assets or goodwill, the difference must be amortized.

In subsequent years, the capital gains resulting from the application of the equity method, compared to the value indicated in the financial reporting of the previous year, shall be recorded in a non-distributable reserve),)and (6), (6) goodwill may be recorded as an asset with the consent, if any, of the Board of Statutory Auditors, if acquired for consideration, within the limits of the cost incurred for it. Goodwill is amortized over its useful life; in exceptional cases where it can reliably estimate its useful life, it is amortized over a period not exceeding ten years. In the report of the notes to the financial statement an explanation of the period of amortization of goodwill) of Article 2426, the report of the notes to financial statement shall provide the information required by the first paragraph of Article 2427, numbers 1)(1) the criteria applied in the valuation of items in the financial statements, in value adjustments and the conversion of values not initially expressed in a legal tender in the State;), 2)(2) the movements of fixed assets, specifying for each item: the cost; previous revaluations, depreciation and write-downs; acquisitions, transfers from one item to another, disposals occurred during the year; revaluations, depreciation and write-downs made during the year; total revaluations concerning fixed assets existing at the close of the fiscal year), 6)(6) separately for each item, the amount of receivables and payables with a remaining term of more than five years, and payables backed by collateral on corporate assets, with specific indication of the nature of collateral and with specific breakdown according to geographical areas;)), for the latter limited only to debts without indication of geographic breakdown; 8)(8) the amount of borrowing costs charged during the year to the values entered in the assets of the balance sheet, separately for each item;), 9)(9) the total amount of commitments, guarantees and contingent liabilities not resulting from the balance sheet, with indication of the nature of collateral provided; existing commitments in respect of pensions and similar commitments, as well as commitments made to subsidiaries, affiliates, as well as parent companies and companies controlled by the latter shall be disclosed separately;), 13)(13) the amount and nature of individual items of income or expense of exceptional magnitude or incidence;)), 15)(15) the average number of employees, broken down by category)for the latter also omitting the breakdown by category, 16) 16) the amount of remuneration, advances and credits granted to directors and auditors, cumulatively for each category, specifying the interest rate, the main conditions and any amounts repaid, cancelled or waived, as well as the commitments made on their behalf as a result of guarantees of any kind given, specifying the total for each category ;))(, 22-bis)(22-bis) the transactions carried out with related parties, specifying the amount, the nature of the relationship and any other information necessary for the understanding of financial reporting relating to such transactions, if the same have not been concluded at normal market conditions. Information relating to individual transactions may be aggregated according to their nature, except when their separate disclosure is necessary for understanding the effects of such transactions on the company's financial position and results of operations;)), 22-ter) the nature and economic purpose of agreements not shown on the balance sheet, with an indication of their effect on the company's financial position, financial position and results of operations, provided that the risks and rewards arising from that place are significant and the disclosure of the same is necessary for assessing the company's financial position and results of operations for the latter also omitting the indications regarding the equity, financial and economic effects, 22-quarter), 22-sexies)), for the latter also omitting the indication of the place where the copy of the financial reporting consolidated is available, as well as by the first paragraph of Article 2427-bis, number 1).

Companies may limit the disclosures required under Article 2427, first paragraph, number 22-bis to transactions carried out directly or indirectly with their major shareholders and those with members of the management and control bodies, and limit the disclosures required under Article 2427, first paragraph, number 22-ter to the nature and economic purpose.

The number and par value of both treasury shares and shares or quotas of parent companies purchased or disposed of by the company, during the fiscal year, including through trust companies or intermediaries, with an indication of the corresponding portion of capital, the consideration and the reasons for

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purchases and disposals. 4) If the companies specified in the first paragraph provide in the report of the notes to financial statements the information required by numbers 3) and 4) of Article 2428, they are exempt from preparing the management report. Small and medium-sized enterprises, falling within the range provided for in the Civil Code, are, therefore, not required to prepare the report on management if, in the notes to the financial statements, the number and par value of both the company's shares and the shares or quotas of parent companies held by the company, including through trust companies or intermediaries, are indicated, with an indication of the corresponding portion of capital.

The structure of abbreviated financial reporting governed by Article 24235 bis of the Civil Code makes this document unsuitable for developing a meaningful income-equity-financial analysis. Faced with a sufficiently analytical profit-and-loss, companies that opt for the abbreviated financial reporting may draw up a balance sheet that, due to its extreme conciseness, does not offer the necessary information cues so that a severe in-depth analysis of the company's situation can be carried out.

In fact, should the financial reporting abbreviated be prepared according to the provisions of Article 24235 bis, in addition to the information absent in the financial reporting ordinarily highlighted in the previous pages, the following data would also be missing:

1. Breakdown, based on the principle of liquidity/expendability, of each asset and liability item
2. Information about the amount of receivables from shareholders for payments still due
3. Composition of fixed assets (intangible, tangible and financial) and current assets (inventories, receivables, current financial assets and cash and cash equivalents)
4. Composition of total payables
5. Composition of total provisions for risks and charges
6. News about any significant events, which occurred after the closing of the accounts that could affect, in a material way, the assessment of creditworthiness because, potentially, they may have radically changed the final situation reflected in the financial reporting of the closing financial year
7. Foreseeable developments in operations.

Earlier it was pointed out that, to conduct a financial statement analysis, financial reporting values must be reaggregated to determine certain vital quotients to deepen the company's situation.

For the reasons already fully explained, the aggregates and ratios on which we have focused our attention are as follows:

Aggregations:

1. Short-term assets
2. Short-term liabilities
3. Long-term assets
4. Long-term liabilities
5. Net worth
6. Income from the conduct of the enterprise's ordinary activities
7. Operating income.

Ratios:

1. Current ratio
2. Quick ratio
3. Debt ratio
4. ROE
5. ROI
6. ROA
7. ROS.

In the preceding paragraph, we have pointed out how, in the presence of financial reporting civil drawn up in ordinary form, some of the essential information to determine the ratios listed above does not allow their objective determination.

To complete the analysis of the informational limitations of financial reporting published in the corporate registry office, it is necessary to understand whether, in the presence of financial reporting abbreviated, the rules characterizing financial reporting ordinarily are subject to such an amplification that a severe and complete analysis of the accounting data is not feasible.

To this end, it can be stated that in the hypothesis that the financial reporting object of analysis is the abridged one prepared according to Article 2435 bis of the Civil Code, the aggregates and indicators considered above are marked by the following characteristics.

1. Short-term assets: not determinable unless assumptions are made that are so subjective as to make the aggregate insignificant
2. Short-term liabilities: not determinable unless assumptions are made that are so subjective as to make the aggregate nonsignificant
3. Long-term assets: not determinable unless assumptions are made that are so subjective as to make the aggregate nonsignificant
4. Long-term liabilities: not determinable unless assumptions are made that are so subjective as to make the aggregate nonsignificant
5. Net worth: not determinable unless assumptions are made that are so subjective as to make the aggregate nonsignificant
6. Income from the performance of the firm's characteristic activities: not determinable unless assumptions are made that are so subjective as to make the aggregate nonsignificant

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7. Operating income: not determinable unless assumptions are made that are so subjective as to make the aggregate insignificant.
    1) Current ratio à: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant
    2) Quick ratio: not determinable unless assumptions are made that are so subjective as to make the ratio nonsignificant
    3) Debt ratio: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant
    4) ROE: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant
    5) ROI: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant
    6) ROA: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant
    7) ROS: not determinable unless assumptions are made that are so subjective as to make the quotient nonsignificant

From this, it follows that the degree of reliability of the ratios identified above is as follows:

As pointed out earlier, it is up to each company to supplement the minimal disclosure governed by Article 2435a with the revelation of non-mandatory data. The closer the abbreviated financial reporting comes to the ordinary structure, the more significant the reduction of the limits univocally connected to the summary structure will be.

Even if the financial reporting from outside the company is prepared in an ordinary form, the analysis conducted from outside the company will be marked by the insurmountable limits illustrated in the preceding pages.

Only the company's practical cooperation can ensure that the analysis carried out on its accounting data is complete, exhaustive and, above all, meaningful insofar as it adheres to the reality it intends to investigate.

In assessing creditworthiness, financial reporting analysis assumes a key role so that the lender understands the "real" income-financial-equity situation of the loan applicant. For this to occur, however, the financial reporting data must be intended for third parties outside the company. Be supplemented by a range of information held only by the company's internal managers. Conducting financial reporting analyses based exclusively on the content of public documents can lead to results that are perfectly consistent with the investigated business reality. Due to the informational deficiencies of statutory financial reporting, it is equally possible that the results of the accounting investigation are not meaningful and, therefore, misleading. As has already been pointed out, the irresolvable problem is related to the impossibility of assessing in which situation the financial reporting analysis carried out on mere public data falls.

V. Corporate Financial Dynamics Analysis as the Cornerstone of Creditworthiness Analysis: Financial Dynamics as a Complementary Element to Static Analysis

As is well known, in financial reporting, equity and financial "stock" values referring to a precise instant are contrasted with income "flow" data whose determination implies the analysis of a period. In this sense, operating income represents a "flow value" whose dynamicity is relative since it is determined only by the presence, in profit and loss, of nonpoint values.

"Income dynamism" should not, however, be confused with "financial dynamism," the analysis of which, transcending the static view crystallized in the values recorded in the balance sheet, is capable of capturing the interweaving of flows of a monetary-financial nature that, incessantly, are created and consumed in the flow of business management.

Therefore, the deepening of the "dynamics" of accounting values is marked by a dual representation. Against an analysis of negative and positive components-flows of income, it must implement an 'investigation of a financial nature.

As is the case with the income analysis, the investigation of financial dynamics cannot be implemented through the mere consideration of balance sheet and profit-and-loss values, especially when aggregated according to statutory logic. Integrating financial reporting findings with information that cannot be drawn from balance sheets, and financial and income accounting data identifies a necessary operation to conduct the determination and interpretation of flows correctly and profitably.

Dynamic analysis by flows constitutes a fundamental cognitive element in assessing creditworthiness.

The amendment principle of the new standard OIC 10 Tthe Cash Flow Statement emphasizes, in this regard, that the informational benefits of the cash flow statement, i.e., the document that summarizes all flows created and consumed by the company's operations, are multiple in that this statement makes it possible to assess:

1. The cash generated/absorbed by the income operation and how it is used/covered;
2. The ability of the company or group to meet short-term financial commitments;

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3. and the power of the company or group to finance itself,

Shareholders, workers, customers, and lenders are interested in understanding whether the company can produce monetary-financial flows such that dividends are paid, salaries are paid, and debts are settled regularly. For these reasons, each of the above categories is interested in investigating the cash flow statement.

The creditworthiness assessment identifies the study of the flows generated and consumed by management as the pivotal element in understanding whether lending represents a viable and profitable avenue or, on the contrary, identifies a dangerous operation that is a harbinger of potential default.

The assessment of creditworthiness can never, therefore, disregard the analysis of cash flows.

To understand the complexity of studying the financial dynamics of an enterprise, it is necessary, first of all, to differentiate between two concepts:

1. Cash flows understood in a broad sense (i.e., including values related to payables and receivables);
2. and monetary cash flows.

Understanding the divergences between these concepts is crucial to avoid dangerous misunderstandings.

In the various doctrinal theorizing concerning financial statement analysis, there is often a lack of formal and substantive integration, which, on the contrary, should be considered a fundamental element of any accounting investigation. As we have already needed to point out, attributing similar meanings to different concepts or, on the contrary, other acronyms to values that are, essentially, identical creates an environment conducive to making decisions that are inconsistent with the "real" business situation that, when such conditions occur, is poorly represented by information systems lacking essential and fundamental congruity between the constituent parts.

The integrated information system of analysis, ensuring complete integration, vertical and horizontal, among all elements that make up the complex structure of production/communication of values, does not present the above operational problems.

In such a system, the concept "financial" is, as far as possible, linked to credit, debit and/or liquidity relationships.

The phrase "liquidity," on the other hand, refers only to items subject to monetization. This makes the concept of liquidity part of the broader notion of a "financial" relationship.

Given this juxtaposition, it can be understood how cash flows, understood in a broad sense, include accounting elements related to the arising of debts and credits, as well as impacting liquidity. While monetary liquidity flows analyze only the values that directly change the amounts present in the cash and bank.

If the focus is on financial flows understood broader than monetary flows, it must choose the "dimension" to be investigated. Generally, when one intends to verify the intertwining of flows created by management in terms other than cash, the reference value is the so-called characteristic net working capital. Since working capital is derived from the juxtaposition of short-term assets and liabilities, characteristic (or typical) net working capital (henceforth CNWC) strips this aggregate of items not about the company's characteristic activities. Leaving aside the critical accounting issues related to this aggregate, it can be said that, in simplified form, Characteristic net working capital (henceforth CNWC) is formed by the algebraic sum of cash and bank assets, trade receivables, inventories, and accounts payable. Any value affecting at least one of these accounting items identifies a CNWC cash flow.

At the state of the art, doctrine and practice believe, almost unanimously, that the only useful analysis to investigate the financial dynamics of companies is that conducted in terms of liquidity.

Liquidity flows represent an indispensable element of information since, to understand the overall financial situation of companies, it is essential to supplement punctual data referring to precise instants with information concerning events that occurred between those moments. In other words, comparing the situation existing as of 12/31 for a plurality of fiscal years allows the trend of accounting data to be traced. But such an analysis, nothing says about what occurred within each administrative period. For example, consider the assumption that two given values are identical at 12/31/n and 12/31/n+1. The trend shows a perfectly constant pattern. This, however, does not imply a denial that the value that is the subject of interest during the year n+1 may have undergone profound changes that led, at 12/31/n+1, to the determination of a value equal to that present in the accounts at 12/31/n. This information limit is all the more relevant the longer the duration of the period under consideration (fiscal year, bimonthly, quarter, semester, month, week, day).

From the above, it can be understood how a time limitation of the period considered can, albeit in reduced terms, circumscribe the overhead information obstacle.

In the face of such a possibility that indirectly makes it possible to reduce the information gap related to the trend analysis of financial ratios, there is, however, a limitation that cannot overcome since it is intrinsic to the ratios themselves. Even if the financial study were conducted in a systematic, systematic, and integrated manner, only employing ratios or other static aggregates, the results associated with such in-depth

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analysis could never be considered complete, exhaustive, and reliable.

All this assumes particular relevance in assessing the creditworthiness of companies.

Suppose lenders and accounting investigations were implemented only using static indices and aggregates. In that case, the possibility of lending to unworthy firms or denying credit to firms with perfect financial and income balances appears very high.

For example, consider the scenario where the loan applicant is a service enterprise lacking inventory and uncharacteristic investments. In such a context, the ratio that contrasts short-term assets with short-term liabilities (availability ratio) shows an ideal financial situation if it falls within the range of 1 to 1.5. Assume that, in the enterprise analyzed, this quotient is 1.5 and offers a constant trend over time. Assume, for simplicity, that the short-term assets consist of inventory and customers and that the liabilities identify the annual portion of a loan. Based on this information, it could argue that the availability ratio's value represents a solid assurance of an excellent short-term financial position.

Let us now assume that we supplement the above with the information that, in the following period, the firm believes that it will liquidate its short-term assets and that it will have a single additional relevant income corresponding to obtaining a new mortgage against outlays related to the payment of short-term liabilities and wages.

It is evident how such information calls into question the apparent financial balance that could have been assumed by considering the mere availability ratio.

In fact, in the face of a harmony of the static values recorded at the time of closing the accounts, if a company is forced to take out a bank loan (an income that, by definition, is occasional, i.e., non-recurring within each financial year) to cope with recurring outgoings for payment of salaries and annual instalments of financial loans, it is not possible to consider that there is an overall financial balance.

This consideration sheds new light on the interpretation of ratios. Although implemented systemically and systematically, the analysis by quotients does not allow for studying the type of business income and expenditures.

As already noted, this limitation cannot be overcome in the context of analysis by ratios since it is an intrinsic element of such instruments. The financial quotient is, in fact, static and devoid of informative elements regarding the characteristics of income and expenditure related to the period under consideration. The index analysis is, therefore, limited and deficient in itself and, as such, needs to be supplemented by further insights into financial dynamics.

Leaving aside any technical considerations about the difficulties an analyst encounters in determining cash flows, it is possible to state that only a balance between recurring sources (i.e., revenues that recur over time) and recurring needs (i.e., non-occasional outgoings) ensures financial soundness for the company.

In fact, in the presence of recurrent needs financed by occasional sources, the enterprise cannot be said to be financially balanced.

On the occurrence of the opposite hypothesis (financing occasional needs with sources of a recurring nature), financial balance is transformed, on the other hand, into a situation of superior stability. Using sources that are bound to recur periodically over time to meet occasional outlays represents, in fact, the achievement of maximum dynamic financial soundness.

Also, in this context, as highlighted in index analysis, the correct interpretation of data requires the cooperation of the company under investigation.

By way of example, consider dividend distributions or severance payments. Generally, these items are deemed recurring because it is assumed, on the one hand, that the allocation of dividends, tends to be constant over time to avoid negative impacts on the ownership structure and, on the other hand, that the physiological turnover of workers, causes a substantial repetitiveness of the payment of severance pay liabilities. However, there is nothing to prevent that, within a given enterprise, such items should be considered occasional. This may occur, for example, in small- to medium-sized enterprises in which there is extremely low worker turnover and in which the distribution of dividends represents an event of an occasional nature as a result of the need for re-investment of profits in the company. Upon the occurrence of these specific assumptions, the requirements, from potentially recurring, would become occasional.

Specific information regarding certain peculiarities of the enterprises can, as a result, cause the judgment to veer from positive to negative or vice versa.

Therefore, in this case, as with ratios, the interpretation of data is facilitated by the possession of a complete information set concerning the company that must be provided voluntarily by the company itself.

In conclusion, it is worth noting that, at the state of the art, doctrine and practice unanimously hold that cash flows are more significant than cash flows expressed in characteristic net working capital. As we have already needed to point out, the latter flows include every transaction that, directly or indirectly, has impacted at least one item constituting this capital (cash bank, customers, inventory, suppliers). Characteristic revenues, for example, generate a CNWC cash flow equal to their total amount. This income component can be subject to immediate collection or deferred collection. Since cash and accounts receivable are part of CNWC, revenue generates a total flow equal to its

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amount. To understand the informational insignificance of the flow expressed in terms of CNWC, imagine that a firm, during year N, carried out only two transactions: sales for 1,000: deferred receipt 990, ready cash 10; raw material purchases for 300: deferred payment 10; cash balance 290.

Given these figures, if focused attention on CNWC's cash flows, the company could be considered to have a perfectly balanced financial situation. Against a recurring source of 1000 (10 collected, 990 deferred), there is, in fact, a recurring requirement of 300 (of which 290 is paid in cash). According to a broad financial view, expressed in terms of CNWC, the credit rating should be positive.

The reality is, however, quite different. While it is true that the broad conception of the locution "CNWC financial flow, at least in theory, has its raison d'être, there is no doubt that the result of such an analysis has no utility in assessing the ability of a company to meet, regularly, the payment of its debts.

Despite the presence of a recurring financial source (1000) significantly higher than the needs of a similar nature (300), the company shows, in reality, a clear economic imbalance understood in the strict sense, that is, expressed in monetary terms, since, a recurring liquid income of 10 contrasts with a recurring liquid expenditure of 290.

In the standard OIC 12 Composition and financial reporting formats of mercantile, industrial and service enterprises, issued in 2005, while recognizing cash flows as having a greater signalling capacity of the financial situation, it was pointed out how the statement expressed in terms of CNWC continued to retain its validity. In the past, while highlighting the greater significance of monetary flows, it was still considered valid also to determine CNWC flows. Instead, the later version of standard 12 OIC highlights the need to determine only cash flows and not CNWC flows since they lack real significance-.

On the other hand, the current situation sees doctrine and practice converging toward a specific position that considers working capital flows an element devoid of any interest. Even the principle OIC 10 IL cash flow statement highlights how cash flows represent an increase or decrease in the amount of cash and cash equivalents. This statement, which echoes what is stated in IAS 7 Statement of Cash Flows ("cash flows are inflows and outflows of cash and cash equivalents"), identifies, in cash flows, the only changes worthy of recognition and disclosure.

According to the view prevailing today, flows expressed in terms of characteristic net working capital are not counted among the valuable financial information to internal managers and users outside companies.

VI. Alternative Forms of Cash Flow Statement: from the Lacunae of the Civil Code to Doctrinal and OIC/IAS-IFRS Guidance

Even though cash flows (understood in a sense and/or expressed in terms of liquidity) represent a fundamental cognitive element for anyone interested in assessing the financial situation of a company, civil law merely mandates the preparation of the cash flow statement as the fourth part of financial reporting. Still, it does not illustrate particular ways of structuring the report, except to point out that the results of operating and investing must indicate financing activities. The code, therefore, as required by existing regulations in Italy, regarding the peculiarities of the substance and form of the statement refers to the principles issued by the Italian Accounting Board, which, with principle No. 10, The cash flow statement, explains, in a very analytical manner, how this document should be prepared.

If the imposition of the cash flow statement in Italy is relatively recent, the international situation is different.

Quite a different situation is found, in fact, in the IAS/IFRS international accounting standards.

Indeed, IAS 1 Presentation of Financial Statements states that "a complete set of financial statements comprises:

1. A statement of financial position as of the end of the period;
2. A statement of profit or loss and other comprehensive income for the period;
3. A statement of changes in equity for the period;
4. A statement of cash flows for the period;
5. Notes, comprising a summary of significant accounting policies and other explanatory information;

5.1 Comparative information in respect of the preceding period as specified in paragraphs 38and 38A; and

6. A statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements..."

From this, it can be deduced that, unlike what is indicated by the OIC standards, the IAS/IFRS considers the cash flow statement to be a mandatory part of the company's disclosures intended for an external business. The principle is also underscored in the Conceptual Framework for Financial Reporting, where in § OB20 Financial performance reflected by past cash flows it points out that "information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash

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inflows. It indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of the debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance."

Companies that, even in the absence of a regulatory requirement, wish to supplement their external reporting by disclosing the cash flow statement may disclose this data by opting for the formal structure that, in their sole opinion, best illustrates the intertwining of financial needs and sources.

Those preparing the statement can choose from three alternatives:

1. Apply what is outlined in IAS 7 Statement of Cash Flows;
2. Refer to what is outlined in the standard OIC 10, The Preparation of the Statement of Cash Flows;
3. Use a format proposed by national and/or international doctrine.

IAS-adopting companies should use what is stated in the IAS 7 Statement of Cash Flows.

Any other company, without any constraint or limitation, may, on the other hand, refer to any formal structure.

The IAS 7 Statement of Cash Flows and the OIC 10 standard, The Cash Flow Statement, identify the theoretical bases that must be applied when determining flows without imposing specific formal reporting formats.

The IAS 7 Statement of Cash Flows and the OIC 10 the Preparation of the Cash Flow Statement present a partial overlap in that the objective of the OIC document is to introduce, as much as possible, in the national context what is established by the international standards. Despite some differentiations, the similarity of the primary logical scheme of the two standards is, in fact, evident.

In summary terms, IAS 7 Statement of Cash Flows requires that, in the statement of cash flows, cash flows be presented, and divided between operating, investing and financial management.

IAS Standard No. 7 specifies the above concepts and explains their contents as follows:

Operating management

Cash flows generated by operating management are derived from the main revenue-generating activities of the enterprise. Therefore, they are usually derived from the other facts and transactions involved in determining profit or loss for the year. Examples of cash flows from operations are:

1. Receipts from the sale of products from the provision of services;
2. Collections from royalties, fees, commissions and other income;
3. Payments to suppliers of goods and services;
4. Payments to and on behalf of employees;
5. Collections and payments from an insurance company for premiums and claims, annuities, and other benefits under the policy;
6. Payments or refunds of income taxes-unless they can be made explicitly under financial and investment management;
7. Collections and payments arising from contracts entered into for commercial trading purposes.

Certain transactions, such as selling an item or plant, may give rise to gains or losses that should include recognition of profit (loss) for the year. Cash flows related to such transactions are cash flows from investing activities. However, cash flows from operating activities are cash payments to produce or acquire assets held for lease to others and subsequently held for sale as described in paragraph 68th of IAS 16 Property, Plant, and Equipment. Receipts from leases and subsequent sales of such assets are also cash flows from operating activities.

IAS 7 also points out that an entity may hold securities and loans for trading or trading purposes; in this case, they are treated as inventories purchased specifically for resale. Therefore, cash flows from the purchase and sale of securities held for trading or trading purposes are part of operating activities. Similarly, cash advances and loans from financial institutions are usually classified as operating activities since they relate to the entity's principal revenue-generating activity.

Investment management

Distinguishing information about cash flows from investment management is essential because these amounts represent a measure of costs incurred to acquire resources intended to produce future income and cash flows. Examples of cash flows arising from investing activities are:

1. Payments to acquire property, plant and equipment, intangibles, and other fixed assets. These payments include those related to capitalized development costs and internally constructed property, plant machinery;
2. Income from the sale of property, plant machinery, intangible assets and other fixed assets;
3. Payments for the acquisition of equity securities or debt securities of other enterprises and interests in joint ventures;
4. Collections of equity securities or debt securities of other enterprises and interests in joint ventures;
5. Advances and loans made to third parties;
6. Collections from the repayment of advances and loans made to third parties;

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7. Payments for forward delivery contracts, futures contracts, premium contracts and exchange contracts except when the contracts are held for trading purposes or payments falling under financial management;
8. Collections from forward delivery contracts, forward contracts, and premium contracts exchange contracts except when the contracts are held for commercial trading, each supply falling under financial management.

Financial management

Separate disclosure of cash flows from financial management is crucial as it is essential in forecasting demands on future cash flows from those who provide capital to the enterprise. Examples of cash flows arising from financial management are:

1. Cash receipts from the issuance of shares or other equity securities;
2. Payments to shareholders to acquire or release the company's shares;
3. Collections from the issuance of bonds, loans, notes, fixed-income securities, mortgages, and other short-term or long-term loans;
4. Loan repayments;
5. Payments by the lessee to reduce existing liabilities related to a finance lease.

The OIC 10 principle the cash flow statement, in a partially similar way, considers that the cash flow statement, cash flows should be recognized and aggregated according to the following logic:

Operations management

Cash flows from operations management, referred to as income management in an early version of the document, generally include flows that arise from the acquisition, production and distribution of goods and the provision of services and other flows not contained in investing and financing activities.

Some examples of cash flows generated or absorbed by so-called operations reported in the OIC 10 standard are:

- Cash receipts from the sale of products and the provision of services;
- Receipts from royalties, commissions, fees, insurance reimbursements and other revenues;
- Payments for the purchase of raw materials, semi-finished products, goods and other inputs
- Production factors;
- Payments for the acquisition of services;
- Payments to and on behalf of employees;
- Payments and refunds of taxes;
- Payments for financial charges;
- Receipts for financial income.

Investing activities

Cash flows from investing activities include:

- Purchasing and selling property.
- Plant and equipment.
- Intangible assets.
- Financial assets are not held as fixed assets.

By way of example, the cash flows generated or absorbed by investing activities disclosed in principle OIC 10 arise from:

- Purchases or sales of buildings, plant, equipment or other tangible assets (including tangible assets of internal construction);
- Purchases or sales of intangible assets, such as patents, trademarks, and concessions; these payments also include those relating to capitalized deferred charges;
- Acquisitions or disposals of investments in subsidiaries and affiliates;
- Acquisitions or disposals of other equity investments;
- Acquisitions or disposals of other securities, including government securities and bonds;
- Disburse advances and loans made to third parties and collections for repayment.

Financing activities

Cash flows from financing activities include flows that result from obtaining or returning cash from venture capital or debt capital.

By way of example, according to OIC Principle 10, cash flows generated or absorbed by financing activities financing are:

- Cash receipts from the issuance of shares or units representing risk capital;
- Payment of dividends;
- Payments for the repayment of risk capital, including in the form of the purchase of treasury shares;
- Collections or payments arising from the issuance or repayment of bonds, fixed-income securities, bills of exchange, taking out or repayment of mortgages and other short-term or long-term loans;
- Increase or decrease in other debts, including short- or medium-term debts of a financial nature.

At the end of this brief examination of the guidance provided to prepare the cash flow statement, companies may opt for a reporting structure proposed by doctrine in the absence of precise legal regulations.

In this regard, scholars have proposed a plurality of reference schemes. In the opinion of the writer, the formal structure with the most significant informative value is the statement submitted within the integrated information system because, unlike other schemes, this document, on the one hand, is an integral part of a coherent and integrated system, vertically and horizontally, with every other accounting helpful tool for business analysis and planning (e.g., reclassifications, ratios, financial and income aggregates, analytical values of product/area/sector, etc.) and, on the other hand, provides a piece of clear and intelligible information set on cash flows even to subjects who are not exceptionally expert.

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Cash flow statement prepared as part of an integrated analysis/programming system

Operations Description	Needs	Sources
Cash flow from carrying out characteristic activities (characteristic cash flow) Long-termtangible and intangible asset management * * * Financial management * * * Severance management * Asset management * * * Provision management * * * Non-characteristic management by definition * * * Tax management * * Net worth management and dividends * * * Delta cash and bank		

Against such a scheme, it can identify many other equally appreciable technical structures proposed by the doctrine.

This is not the appropriate place to illustrate all the positions scholars take regarding the formal drafting of the statement.

It is relevant to point out that any structure proposed by any author does not identify "The cash flow statement" but merely identifies one of the many structural forms such a document can take. And it is precisely for this reason that accounting standards, national and international, rather than identifying a structured formal scheme, have found it more appropriate to limit themselves to illustrating the principles that must underlie the preparation of such a document.

On the other hand, the formal scheme proposed under the integrated information system has a predefined structure in that it identifies one part of a more extensive set of elements that must be marked by perfect consistency and integration at the legal and substantive levels. Hence the need to indicate a binding structure that, in the writer's opinion, succeeds in communicating valuable information to the user that other schemes do not provide for dissemination.

VII. Valutazione Del Merito di Credito Delle Aziende: Cash Flow Statement vs. Mera Determinazione Del Cash Flow

As pointed out in the previous pages, the assessment of creditworthiness cannot be separated from the analysis of cash flows.

In this regard, however, the question must ask whether the determination of the so-called cash flow can identify sufficient information elements to make a valid judgment on the dynamic financial situation of a company. The determination of this aggregate represents, in fact, very often the only component that companies provide to those who request quantitative determinations about the cash flows produced/consumed in a given financial year.

First, it should point out that this locution does not have an unambiguous meaning. In contrast to those who interpret cash flow in terms of the cash flow

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produced by typical operations, some attribute to this aggregate a broader financial sense that, often, converges toward a conception of flow that, although produced by characteristic activity, is expressed in terms of net working capital. Those who interpret cash flow in a broader sense tend to make, however, a second technical step to highlight, in addition to the aggregate thus determined, the cash flow coming from the performance of the company's typical activity.

By way of example, consider the following example:

Characteristic short-term assets and liabilities:

	31/12/N	31/12/N+1		31/12/N	31/12/N+1
Customers	100	400	Suppliers	100	200
Inventories	50	100			
Total characteristic short-term assets	150	500	Total short-term liabilities characteristic	100	200

Profit and loss es. N

Characteristic costs includingpurchase of rawmaterials, wages, contributions, purchase of services, consulting, commissions, miscellaneousoperating costs	1100	Characteristic revenues including sales and service revenues	2800
Inventories 1/1	50	Inventories 31/12	100
Depreciation and amortiztion**	400		
Financial chargers	200		
Severancepay and provision for risck and charges**	300		
Totatalexpensens	2050		
Net profit	850		
Total	2900	Total	2900

*Characteristic operating expenses and revenues may be paid/collected in year n+1, or they may be, in part, paid/contained in year n+1, and the amount be subject to deferred payment/collection. To understand, with reference, for example, to sales revenue, how much has been collected and how much has been deferred to customers, it is sufficient to look at the difference between customers at 12/31/n and customers at 12/31/n+1. In our example, customers increased by 300, which means that, for 300, it did not collect the revenue recognized in profit and loss. The total revenues then (2,800) can be conceptually divided into revenues collected for 2,500 and revenues subject to a deferral for 300(i.e., revenues that only generated a credit but no cash receipts). This concept also applies, of course, to suppliers. Using the same reasoning, we can say that characteristic costs for the purchase of raw materials, wages, contributions, purchase of services, consulting, commissions, and miscellaneous operating expenses were paid in cash in the amount of 1,000 while in the amount of 100 they were subject to deferred payment (i.e., a debt arose but no impact on money)

** non-cash costs identify costs arising from year-end valuations. These costs are charged on an accrual basis and have no impact on cash, the bank. They are just "scriptural" accounting items with no financial impact whatsoever (neither in the broad sense self in terms of liquidity).

Poiché il capitale circolante netto caratteristico identifica la variazione derivante dalla sommatoria algebrica dell'attivo e passivo a breve caratteristico, in base ai dati sopra esposti, il CNWC ammonta a:

	31/12/N	31/12/N+1
Customers	100	400
Inventories	50	100
(suppliersi)	-100	-200
characteristic net working capital (CNWC)	**50**	**300**

As can be seen, the CNWC increased by 250. It will explain the significance of this change in the following pages.

In operational terms, the financial characteristic cash flow broadly understood, that is, interpreted as the algebraic sum of typical expenses and revenues that impacted net working capital, amounts to:

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Posta contabile	Importo	
Characteristic revenues including sales and service revenues*	2800	*non importa se oggetto di incasso immediato o dilazionato in quanto entrambi i valori (cassa e clienti) sono compresi nel CNWC
Inventories 31/12	100	
Characteristic costs includingpurchase of rawmaterials, wages, contributions, purchase of services, consulting, commissions, miscellaneousoperating costs**	(1100)	**non importa se oggetto di pagamento immediato o dilazionato in quanto entrambi i valori (cassa e fornitori) sono compresi nel CNWC
(Inventories 1/1)	(50)	
Characteristic cash flow understood in the broadfinancialsense(orfinancial cash flow expressed in terms of CNWC)	**1750**	

Financial cash flow, understood in a broad sense (or cash flow of CNWC), represents a flow that includes, in itself, also the share of cost and revenue related to receivables and payables. This cash flow, in the broad sense, amounts to 1,750. To understand the monetary impact of this flow, it is necessary to consider net working capital. Net working capital is like a sponge immersed in liquid: if the sponge increases in volume, it has absorbed the liquid. If the sponge is "squeezed," it decreases in volume because it releases liquid. In technical terms, corporate liquidity (cash and bank) is the above liquid. Therefore, if net working capital increases, liquidity has been drained, while if it decreases, it implies liquidity has been created. The more significant the increase in net working capital, the smaller the flow expressed in terms of liquidity.

Therefore, if cash flow is 1750 and net working capital has increased by 250, it means that liquidity of 250 has been drained. The cash flow (or characteristic monetary cash flow) is less than the financial cash flow by an amount equal to 250. And, the monetary cash flow (which can also be calculated simply by contrasting monetary costs (i.e., that we paid = 1000) vs monetary revenues (i.e., that we collected= 2500)) amounts to 1500.

The characteristic monetary cash flow can, therefore, be represented as follows.

Accounting items	Amounti
Core revenues including sales and service revenues	2800
Closing inventories	100
Characteristic costs includingpurchase of rawmaterials, wages, contributions, purchase of services, consulting, commissions, miscellaneousoperating costs	(1100)
(Opening inventories)	(50)
Characteristic cash flow understoodin abroadfinancialsense	**1750**
Δ CNWC	**(250)**
Cash flow characteristicmonetary	**1.500**

Characteristic monetary cash flow is derived from the logical summation of the portion of characteristic revenues collected and the amount of typical costs subject to prompt cash payment. It can also quantify characteristic monetary cash flow without the prior determination of financial cash flow broadly. For this reason, it can also determine cash flow from the performance of the typical business activity in the following technical manner:

Accounting post	Importo	
Core revenues comprising sales and service revenues collected on a prompt cash basis	2500*	*thisamountisderived from the contrastbetweentotal revenue (2800) and Δ customers (300), the increase of whichidentifies a deferred payment granted to customers
Characteristic costs comprisingpurchase of rawmaterials, wages, contributions, purchase of services, consulting, commissions, miscellaneousoperating costs paid for on a cash basis	(1000)**	**thisamountisderived from the contrastbetweentotal costs (1100) and Δ suppliers (100) whoseincreaseidentifies a deferred payment obtained from suppliers
Characteristic cash flow	**1500**	

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As pointed out in the previous pages, the doctrine and accounting standards focus unanimously on cash flows. In contrast to those who prefer to highlight financial cash flow understood in a broad sense and Δ CNWC, some favour the determination of cash flow by contrasting "monetary" costs and revenues (i.e., the shares of positive and negative income components that impact cash/bank). Regardless of the chosen solution, there is no doubt that the ultimate goal is consistently identified in determining cash flow.

In conclusion of these brief methodological remarks regarding the quantitative calculation of the characteristic cash flow, it seems appropriate to mention that it can determine this value by applying two different logical, quantitative methodologies: direct or indirect.

Direct determination involves contrasting characteristic "monetary" costs and revenues (i.e., the shares of positive and negative income components that impacted cash/banking), with or without the "intermediation" of financial cash flow andΔ CNWC. The numerical examples above illustrate the direct calculation of cash flow.

Against this technique, there is the indirect determination of the aggregate that is the subject of interest. In this case, cash flow is derived from the summation of profit, and all costs and revenues that are non-cash by definition (such as depreciation and amortization, allowances for provisions, etc.) and are not part of core business (such, for example, finance charges, tax costs, capital gains, etc.).

In the above example, the indirect determination of cash flow would result from the following summation:

Posta contabile	Importo
Utile di esercizio	850
+ ammortamenti	400
+ TRF e acc.tia fondi rischi e oneri futuri	300
+ oneri finanziari	200
Cash flow caratteristico in senso finanziario	1750
+/- Δ CNWC	(250)
Cash flow monetario caratteristico	1500

In the writer's opinion, the direct calculation methodology is preferable because it is immediately understandable. The indirect calculation, on the other hand, while achieving the same accounting result, may appear difficult to interpret because it derives a monetary value from the summation of data that, by definition, do not represent liquid values.

After this brief methodological analysis, it is necessary to understand whether knowledge of the characteristic monetary cash flow is sufficient in the context of creditworthiness assessment or whether, on the contrary, full reporting is required.

The cash flow resulting from the performance of typical activities (or characteristic monetary cash flow) is an indispensable element of knowledge for those who must assess a company's financial situation. Indeed, this aggregate highlights, in a dynamic sense, the liquid source that should identify the primary "source" of liquidity.

Therefore, creditworthiness assessment is strongly influenced by knowledge of this value. Since civil regulations do not require the disclosure of such a figure, it seems relevant to understand whether it can determine such an aggregate based on the indications in the financial reporting published at the business registry office.

One of the most significant obstacles that an external operator encounters in determining characteristic monetary cash flow is related to the impossibility, already noted in the preceding pages, of identifying typical costs and revenues. Indeed, the conformation of profit and loss governed by Article 2425 of the Civil Code does not allow the identification of such items. Determining such flow on the exclusive basis of publicly disclosed data appears, therefore, a complicated operation unless one opts for very obvious simplifications (such as, for example, the inclusion in the characteristic cash flow of any ordinary capital gains, ordinary capital losses, rental income, ordinary contingencies, etc.). For this reason, the calculation of the above flow should be facilitated by the direct cooperation of the enterprise under analysis.

Even if the analyst does not attach particular importance to the characteristic monetary cash flow and opts for the sole determination of the cash flow from income management, as identified by IAS 7 or OIC 10, they would encounter the same obstacles mentioned above.

As is the case with ratios, the determination of cash flow calculated based on financial reporting published values may be perfectly true, just as it is possible, on the contrary, to contain matters that do not pertain to the calculation in question. Unfortunately, even in this case, the external operator cannot assess the degree of correctness/accuracy of the quantitative determination of the flow determined based on mere financial reporting intended for third parties external to the enterprises.

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Beyond the considerations regarding the difficulty an outside operator encounters in calculating cash flow or earnings management flow and imagining that companies voluntarily provide such an aggregate, the question must ask whether knowledge of this aggregate can replace the requirement to prepare the complete statement.

The answer is negative because, although it may give the characteristic monetary cash flow essential relevance, dynamic financial analysis requires the judgment of the company's situation based on verifying the balance between sources and recurrent needs. Only a thoughtful balance between income and expenditure that tend to recur periodically in the business environment can ensure financial stability for the enterprise.

Knowledge of the mere monetary characteristic of cash flow does not allow such an analysis. It is conceivable that, even with a significant cash flow, the financial dynamics show a set of recurring needs (e.g., taxes, finance charges, payment of severance pay, repayment of financial loan instalments, etc.) such as to make the above aggregate, insufficient to guarantee balance and solidity to the company.

Such a situation would be created even if the external operator owns only the flow deriving from income management (as per IAS 7 and principle OIC 10). In this case, since some recurring values are included in determining the flow, the abovementioned problem might be less disruptive. Unfortunately, however, even in this hypothesis, the mere knowledge of this flow would not allow, in any case, to judge the enterprise's ability to meet recurrent needs with sources marked by similar time characteristics.

The assessment of creditworthiness, therefore, inescapably requires the analysis of the complete statement referring to the period under investigation.

It is unnecessary to dwell on this to understand how those outside the companies prevent the drafting of such a document. Regardless of the formal structure chosen, the statement's drafting requires knowledge of information known only to corporate management.

Even in this case, it is not possible to rule out the possibility that an external party would be able to draw up a complete statement since; theoretically, it is conceivable that, for example, the report of the notes to financial statements the management report would contain a range of information, provided for in the code, that would allow the determination of all cash flows.

If it could prepare such a statement based on the data that can be drawn from the published financial reporting publicly available, there would be no need to question whether the report should be compulsorily prepared/disseminated. Such a consideration reflects mere wishful thinking, far from the practice followed by companies. And this is evidenced, quite clearly, precisely by the doctrinal and legal debate concerning the advisability of including the statement among the documents with compulsory dissemination.

Therefore, the assessment of creditworthiness cannot disregard the requirement of drafting the cash flow statement, otherwise is the possibility of making wrong decisions regarding the company's ability to repay its debts regularly.

In conclusion, it seems appropriate to emphasize that the assessment of creditworthiness implemented based on mere actual values identifies a hazardous operation. These planned values need to be set out in the general business budget to place the analyst in a position to determine prospective ratios and flows. Indeed, the prospects of the company appear to be a fundamental element of knowledge so that the decisions of potential and/or existing lenders are harmonious concerning the actual conditions of the companies being evaluated.

To understand the relevance of the cash flow statement in the context of creditworthiness assessment, assume that a firm, at the request of lenders, in year N, provides an income and equity budget for year N+1, which shows an excellent static income and financial situation:

Economic Budget:

Sales revenues	18.400
Total characteristic revenues	**18.400**
Depreciation and amortization	530
Opening inventoriesfinishedgoods	400
Wages and contributions	1.600
Trade costs	280
Depreciation costs	1.300
Ind.costs	4.500
Miscellaneouscharacteristic costs	1.500
severancepay	160
Rawmaterialpurchases	6.193

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(Finishedprod. inventories)	- 1.648
Total characteristic costs	**14.815**
Operating incomegenerated by characteristicoperations	**3.585**
Interestincome	200
Dividends	100
Financial charges	(1.728)
Income taxes	(1079)
net profit	**1.078**

Patrimonial Budget:

Assets		Liabilities and equity	
Cash	50	banks	9.959
inventories 31/12	1.648	Suppliers	1.651
Short-term customers	3.680	Short-termdebt	100
Speculative securities	14.000	Short-termportion of loan	100
		Tax payables	1.079
Total short-term assets	**19.378**		
		Total short-term liabilities	**12.889**
Buildings	11.000		
Plant	13.000	Loan	12.385
(depreciation fund)	(8.530)	Long-term liability for severancepay	460
Controllinginterests	1.000		
		Total long-term liabilities	**12.845**
Total long-term assets	**16.470**		
Assets		Share capital	8.221
		Revaluationreserve	100
		Profit for the year	1.078
		Profit reserves	715
		Equity	**10.114**
Net Assets	**35.848**	Total	**35.848**

From the above data, we can determine the following ratios:

Current ratio: current assets/short-term liabilities = 19,378/12,889 = 1.50

Debt ratio: invested capital/equity = 35,848/10,114 = 3.54

ROE: operating income/shareholders' equity = 1,078/10,114 = 10.65%.

ROI: operating income from ordinary operations/capital invested in characteristics operations = 3,585/20,848 = 17.19%

Based on the indices mentioned above, one could erroneously assume the existence of an ideal prospective situation in terms of income and finance (naturally within the limit that the analysis of a single financial year can allow). Particularly exceptional values mark ROI and ROE, and the two ratios of availability and indebtedness show an extraordinarily stable and balanced financial situation, both short-term and overall. To express an opinion on creditworthiness, however, it is also necessary to analyse the cash flow statement to verify the balance between needs and recurring sources.

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Let us assume that the company presents the following planned statement, determined based on a comparison between actual data and prospective values summarised in the budget above.:

	Needs	sources
CASH FLOW OF CHARACTERISTIC BUSINESS MANAGEMENT (OR CASH FLOW IN STRICT SENSE	502	
LONG TERM TANGIBLE AND INTANGIBLE ASSET MANAGEMENT *purchase of plant *purchase of buildings	 5600 3000	
FINANCIAL MANAGEMENT * obtaining bank loan * obtaining new loan * annualloanrepayment *repayment of short-termdebt *payment of financialcharges	 300* 3000* 1728*	 9659 12.085
ASSET MANAGEMENT * purchase of securities * purchase of participations *receipt of interestincome * collection of dividends	 12000 1000	 200* 100*
MANAGEMENT OF NON-TAX EXPENSE PROVISIONS AND RISK PROVISIONS *		
TAX MANAGEMENT * tax payment	 700*	
NON- CHARACTERISTIC MANAGEMENT BY DEFINITION		
SEVERANCE PAY MANAGEMENT * payment of severancepay	 50*	
EQUITY MANAGEMENT AND DIVIDENDS * share capital increase * dividenddistribution	 500*	 6336
Δ CASH AND ACTIVE BANK		
TOTAL	28380	28380

An asterisk has been affixed to recurring needs and sources to facilitate the interpretation of the data.

An analysis of the statement shows that:

1. The characteristic monetary cash flow, which should represent the recurring source par excellence, causes, on the contrary, a need;
2. Total recurring requirements are 6,278 (not including requirements from typical operations) against frequent sources, amounting to 300.

As can be seen, the company does not produce a positive cash flow. The flow produced by the typical management, instead of bringing liquidity to the company, drains cash flow abundantly.

It is clear how, in the presence of a negative cash flow, the recurring sources are considerably, less than the non-occurring needs. This circumstance points to a significant dynamic financial imbalance.

Pivotal to the assessment of creditworthiness is the analysis of the company's ability to pay its debts regularly. The lack of characteristic incoming cash flow and the significant excess of recurring requirements over the amount of sources of a similar nature identify two pieces of information that should cast doubt on the existence of an absolute financial equilibrium.

Any judgement pronounced without carrying out an accurate analysis of the cash flow statement can, therefore, potentially lead to erroneous assessments of companies' 'real' creditworthiness since what the flows show cannot be extrapolated from any other information tool.

Analyses developed only through ratios, or other static aggregates are harbingers of possible significant problems. In this case, too, as is the case with the static analysis of financial reporting published at the company registry office, the greatest interpretative obstacle is the impossibility of assessing the degree of reliability of the valuations made in the absence of precise information on the company's financial dynamics

VIII. Conclusions

From what has been said above, it is clear that it must verify the assessment of a company's creditworthiness through an in-depth analysis of the entire financial report for the year and any statements

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that may be complementary to it, such as in Italy, the management report, i.e. the report that, although not part of the financial reporting, can provide beneficial information on the company's income, equity, financial and action situation in the context of sustainability. The analysis of the balance sheet of the profit and loss of the cash flow statement of the report of the notes to financial statement represents, however, the focus of the in-depth analysis by a lender wishing to assess a company's creditworthiness. As we have been able to highlight in the preceding pages, the financial report destined externally is often characterised by information limits deriving from a problem of company privacy point the structure of the financial report destined externally has, in fact been studied at least in Italy, but this is the case in all European countries, to provide information that is comparable between the various countries belonging to Europe or countries that intend to use international standards. The objective is not to offer every neolithic and peculiar information on the company's situation as this would go against the interest of the company, which, necessarily, must be considered as a subject characterised by the right not to disclose information of a strategic or other nature that could negatively affect its management due to the disclosure of information to competitors, customers and suppliers. Static analysis through ratios and dynamic analysis through flows may be prevented by the structure of the externally-directed financial report precisely because of the lack of such information. In this case, assessing the creditworthiness of a company becomes very difficult. Suppose the company does not provide the lender or bank with further details. In that case, it is often impossible to comprehensively analyse the company's situation. Therefore it is almost impossible to make a meaningful judgement on a company's creditworthiness based solely on the data in the externally-directed financial report. This is all the more true if one considers that in Italy and most other countries, there are for small and medium-sized companies financial reporting structures that are short and therefore characterised by a reduction of information to be disseminated to third parties outside the company. For micro-enterprises, i.e. tiny enterprises, the problem of external communication does not even arise because financial reporting contains so little information that it cannot at least be considered an instrument for communicating financial assets to the outside world. It will therefore be up to the borrower to decide whether or not to formally tell the potential lender the information that supplements the information gleaned from the financial reporting destined by law to third parties outside the company. In the absence of such information, the lender will probably have severe difficulties in assessing the company's creditworthiness and comma in this case, the denial of the loan itself will be high eh probable to conclude this summary on analysis that the reality is not doctrinal in which everything is decided based on the results of financial reporting, but often, loans are only provided in the presence of collateral, real or personal comma that the recipient can give point. It can also happen that such guarantees are not requested; for example, it is unnecessary to ask for guarantees for start-ups or companies that show such a development. In percentage terms, it can say that this happens in about 5% of cases of bank loans.

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