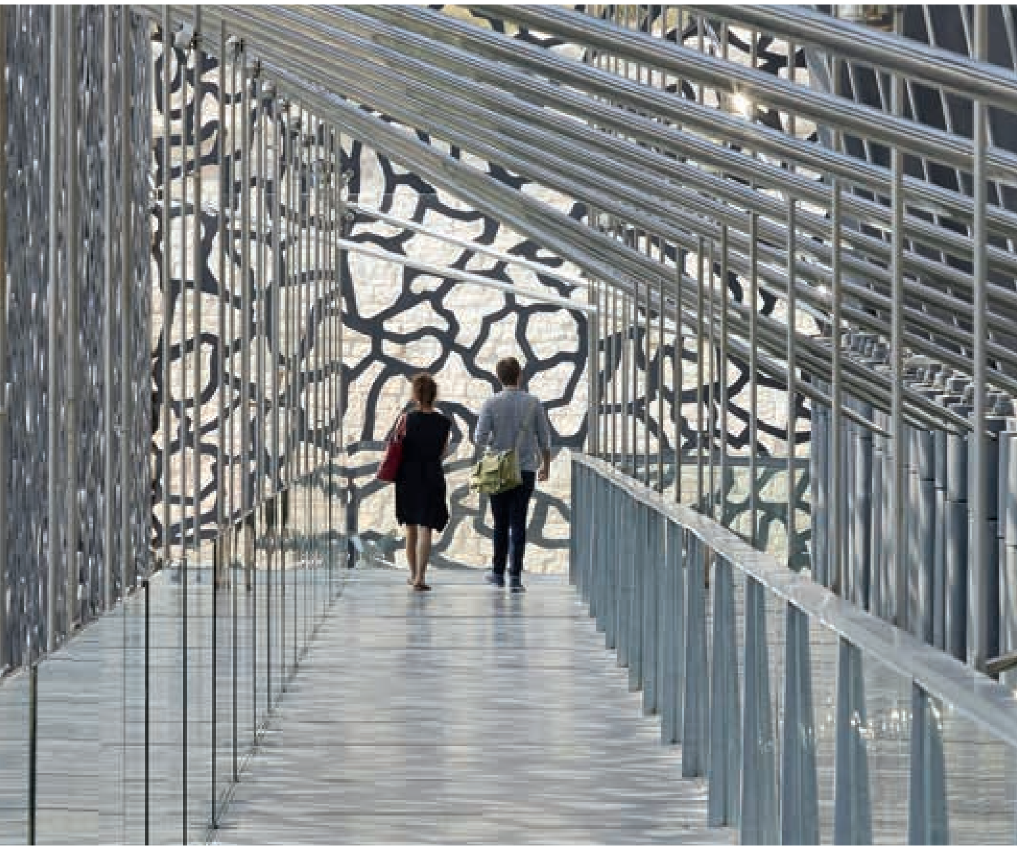
The new financial statements
A summary of revised Italian accounting standards

2016 financial statements: more transparent and aligned to European rules.
The reform and simplification process of the regulations, governing the preparation and publication of the financial statements, ended with the Legislative Decree No. 139/2015 (which implemented Directive 2013/34) and the revision of the Italian accounting standards (or "OIC standards") by the "Organismo Italiano della contabilità" (or "OIC").

The changes introduced in Italian law eliminate many of previously existing differences with IAS/IFRS: it has been introduced the notion of fair value as a method to recognize and measure derivative financial instruments and amortised cost as a criterion to measure receivables, payables and securities.

These are financial criteria, which allow to provide transparent and up-to-date information, suitable to express the investments and sources of funds ability to raise and absorb financial resources and to provide qualified information. The 2016 accounting reform is designed to produce financial statements that use a 'financial' language, the same used in the capital markets and by institutional investors.

Financial statements providing greater emphasis to related parties transactions, mandatory cash flow statement, substance over form principle, consistent presentation of hedging transactions are all innovations that provide appropriate interpretation and information value to the set of accounts of the Italian entities. The hope is that these new requirements will improve the financial information transparency and facilitate the access to financial markets also to SMEs.



The effort required to Italian entities will be challenging considering that, in certain circumstances, a retrospective approach is required and the timeframe for the preparation of 2016 financial statements is really tight.

Regulation changes and application provisions set out in the new OIC standards

The 2016 accounting reform introduces changes for all types of entities; the main ones relate to:

- introduction of facilitations;
- accounting policies;
- financial statements presentation;
- new measurement and classification criteria.

Facilitations

The new regulations are mainly designed to introduce important simplifications, especially for certain categories of entities.
The intent is to create an information stratification to be provided in financial statements based on the entities size, reducing the editorial burden for small and micro undertaking, mitigating the administrative issues and enhancing their productivity.

The effort to create an important reference both in defining the distinction between micro, small and large entities and to relieve the first one from the administrative task of preparing financial statements is appreciable. With regard to the aim at pursuing an accounting simplification that can be "modulated" based on the size of the entities, the most significant change is the effort to classify entities into three size categories, in detail:

Category	Parameters (at least 2 out of 3) in the first financial year or later for two consecutive years
Micro-entities as defined in art. 2435-ter of the Civil Code	Employees average number during the year up to 5; Total assets up to Euro 175,000; Revenues from sales and services up to Euro 350,000
Small entities as defined in art. 2435-bis of the Civil Code	Employees average number during the year up to 50; Total assets up to Euro 4,400,000; Revenues from sales and services up to Euro 8,800,000
Large entities	All the remaining entities

Micro-entities

These are only required to prepare the condensed financial statements (balance sheet and income statement) with the aggregations established for "small entities". In consideration of the reduced size, the legislator has waived those entities from the obligation of the notes presentation, the management report and the cash flow statement. However, the remaining significant information shall be reported at the bottom of the balance sheet (for examples: the directors and statutory auditors remuneration, own shares and shares held in parent companies, etc.). The measurement criteria are similar to those established for "small-entities". Micro-entities are also required to file the annual financial statements with the Companies' Register in accordance with law.

Small entities

These entities are not required to present the cash flow statement and the management report, but are required to prepare notes. Such entities are allowed not to apply the amortised cost method for receivables, payables and securities which is mandatory for "large undertaking".
It should be noted that "small entities" have the option to apply the above mentioned simplifications and if they consider it appropriate, they may provide additional information with respect to the provision of art. 2435-bis of the Civil Code and also apply the provisions applicable to the preparation of the financial statements in the "ordinary" form. It is important to provide "additional disclosures" where these are necessary to give a true and fair view of the entity's affairs in accordance with the art. 2423 comma 3 of the Civil Code.

Changes to financial statements layout

Cash flow statement

Leg. Decree No.139/15	Issues	Changes
Art. 2425-ter of the Civil Code: cash flow statement	Mandatory statement except for entities preparing condensed financial statements and for micro-entities	The 2014 release of OIC 10 recommended the presentation of a cash flow statement in the notes. The new law defines the cash flow statement as one of the three statements with the same importance as the balance sheet and the income statement. The scope of OIC 10 has been updated together with regulatory references to reflect the change in the Civil Code.
	Content	The 2016 release of OIC 10 is consistent with the 2014 release. The cash flow statement shows the amount and composition of cash and cash equivalents at beginning and at the end of the year.
	New disclosures in the notes	The disclosures required to illustrate transactions reported in the cash flow statement have been modified such as cash and cash equivalent not immediately utilized by the entity.
	Derivative financial instruments	Cash flows from derivative financial instruments (as defined in OIC 32) are presented in the cash flow statement as investing activities.

Balance sheet

Leg. Decree No.139/15	Issues	Changes
Art. 2424 of the Civil Code: presentation	Own share elimination	**OIC 21 Investments** Due to “own shares” item elimination from assets, has been introduced a negative equity reserve for own shares. **OIC 28 Equity** In accordance with the revised art. 2357-ter of the Civil Code, own shares are no longer recorded in assets (with a corresponding entry to a restricted equity reserve), but directly deducted from equity through a negative reserve.
	Advertising expenses elimination	**OIC 24 Intangible assets** If the advertising expenses, previously capitalized in accordance with OIC 24 (2014) meet the new capitalization criteria, may be reclassified, upon initial application of the revised OIC 24, from item B.I.2 to item B.I.1 *Start-up and expansion costs*.
	Research costs elimination from line B.I.2	**OIC 24 Intangible assets** Basic research costs are charged to the income statement. For the development costs, it is necessary that product and process to which the research refers have been already identified and defined. If they meet the new capitalization criteria, the applied research costs, capitalized in previous year the entry into force of OIC 24 (2016), will continued to be accounted in item B.I.2 *Development costs*.
	Memorandum accounts elimination	**OIC 22 Memorandum accounts** OIC 22 has been cancelled. The illustrative notes provide additional disclosures on given commitments and guarantees.
	Issue premiums/ discounts eliminated from prepayments, accruals and deferrals	**OIC 19 Payables** Bonds are carried out at amortised cost. If they are issued for an amount greather or lower than its nominal value, premium or discount is amortised through profit or loss over the instrument's life using the effective interest rate.
	Derivative financial instruments	**OIC 32 Derivative financial instruments** Derivative financial instruments are measured at fair value. If the fair value is positive, it is recognized in item B.III.4 or in item C.III.5 Financial no current/current assets; if the fair value is negative, it is recognized in item B.3 *Provisions for risks and charges*.
	Details of transactions with entities under parent companies control	**OIC 12 Financial statements presentation** Presentation changes: introduction of specific items for receivables, investments and payables to so-called “sister companies”. **OIC 15 Receivables** Financial receivables are classified in item B.III.2.d while trade receivables in item C.II.2.5. **OIC 19 Payables** Trade payables to subsidiaries, associates, parent companies and under the parent companies control are recognized in items D.9, D.10, D.11 and D.11-bis, respectively.
	Cash flow hedges reserve	**OIC 32 Derivative financial instruments** If a derivative instrument hedges the change in the expected cash flows of another financial instrument or of a forecast transaction, the change in fair value is charged directly to equity which will be released into profit or loss in subsequent years. This accounting treatment requires formal designation and documentation.

Income statement

Leg. Decree No.139/15	Issues	Changes
Art. 2425 of the Civil Code: presentation	Extraordinary operations elimination	**OIC 12 Financial statements presentation** Presentation changes: income statement section E elimination. The extraordinary income and expenses listed in OIC 12 (2014) are reclassified in the income statement lines deemed appropriate. It is clarified that item A.1 includes positive component of income related to the core business whereas item A.5 positive component of income not related to the core business or of a financial nature.
	Details of transactions with entities under the parent companies control	**OIC 12 Financial statements presentation** Financial income, item C.16, must show separately interest income on long-term loans to entities under the parent companies control and dividends from investment to the latter. Although not expressly required by Legislative Decree No.139/2015, the OIC 12 requires separate indication of interest paid to entities under the parent companies control.
	Derivative financial instruments	**OIC 32 Derivative financial instruments** Derivative financial instruments are measured at fair value. If they are not hedging transactions, the change in fair value is charged to profit and loss: if negative in item D.19.d Write-downs, if positive in item D.18.d *Revaluations*.

Recognition and Measurement

Goodwill
The principle governing the determination of the goodwill useful life has been changed. There have not been substantial changes with reference to the useful life, however there has been an inversion of the approach in the useful life estimation process. The previous wording of the Civil Code required an estimate of the goodwill useful life only when an amortisation period of 5 years was not appropriate to reflect it. The new wording requires first of all to determine the goodwill useful life and, if this cannot be estimated reliably, goodwill should be amortised over a period of 10 years. The current requirement explicitly requires to estimate the goodwill useful life reliably.

The useful life is estimated at initial recognition of goodwill and cannot be modified in subsequent years. Therefore, if a reliable useful life is estimated, the amortisation shall be charged based on the useful life, which cannot exceed 20 years. Otherwise, the amortisation shall be charged over a maximum of 10 years.

Measurement at constant values
Based on the general principle of relevance introduced in the legislation, OIC 13 Inventory clarifies that raw materials, supplies and consumables may continue to be recognized at constant values if they are constantly replaced and if they are immaterial with respect to total assets in the financial statement.
The standard clarifies the application of measurement at constant values of raw materials, supplies and consumables that in the previous release of OIC 13 was used on a discretionary basis when the goods are “insignificant”.

Fair value and derivative financial instruments
The new item 11-bis of paragraph 1 of art. 2426 of the Civil Code requires all entities other than micro-entities to recognize in profit or loss changes in fair value of derivative financial instruments, including embedded derivatives, unless they are used as hedging instruments. To interpret the new rule, the OIC published OIC 32 Derivative financial instruments. Following the requirements the new standard introduces a series of accounting principles supplementing the law provisions. Some of those principles are:
a. guidelines for derivative fair value measurement;
b. how to separate an embedded derivative in a host contract;
c. hedged items and eligible hedging instruments;
d. eligibility criteria for hedge accounting and subsequent measurement;
e. designation, accounting and discontinuing fair value hedges;
f. designation, accounting and discontinuing of cash flow hedges;
g. designating a combination of several derivatives as a hedging instrument;
h. simplified method for “simple hedges relationship”.

For hedge accounting purposes, only instruments that involve a party external to the reporting entity can be designated as hedging instruments. The subject of hedging is financial risk, which the law and OIC 32 divide into the risk of changes in fair value or future cash flows.

The purpose of a fair value hedge is to reduce or eliminate losses originating from changes in fair value of a financial statements item. The hedging transaction offsets a change in fair value of a hedged item against an opposite change in fair value of the hedging instruments. The fair value hedge is accounted for as follows:

- the derivative instrument measured at fair value is recognised as an asset or liability with changes in fair value reported in section D of the income statement;
- if the hedged item is a recognised as an asset or liability, its value is adjusted to the portion of fair value attributable to the risk being hedged (up to the recoverable amount) with changes in fair value reported in section D of the income statement. If the hedged item is a firm commitment, the fair value of the portion related to the risk being hedged is recognised on the same line as the assets or liabilities that will be affected by the firm commitment. Changes in fair value of the hedged item exceeding the changes in fair value of the derivative instrument shall not be reported in section D but in the item affected of the hedged item.

The purpose of a cash flow hedge is to protect the entity from adverse fluctuations in the estimated future cash flows associated with a recognised asset or liability, as with future payments or receipts of floating interest rate, or a forecast transaction, such as highly probable purchase or sale in foreign currencies. Recognition of a cash flow hedge takes place as follows:

- the derivative instrument measured at fair value is recognized as an asset or liability through profit or loss: the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge should be recognized directly in a equity reserve and the ineffective portion of the gain or loss on the hedging instrument should be recognized in profit or loss in section D;
- the hedged item continues to be measured in accordance with the accounting standard applicable to assets and liabilities (e.g. financial assets and liabilities measured at amortised cost).

The entity is only allowed to apply hedge accounting if it meets the specified qualifying criteria: the hedging relationship consists only of eligible hedging instruments and eligible hedge items, the hedge relationship meets the hedge effectiveness requirements, there is a formal designation and documentation of the hedging relationship and risk management objective and strategy at inception of the hedge. The documentation should identify:

- the entity's risk management objective
- the entity's risk management strategy for undertaking the hedge
- the hedging instrument;
- the hedged item;
- the nature of the risk being hedged;
- the method applied by the entity to assess the effectiveness of the hedging relationship.

OIC 32 sets out specific simplified accounting principles for "simple hedges relationship".

Foreign exchange risk

The new release of OIC 26 includes principles governing hedge foreign exchange risk of highly probable forecast transaction or firm commitments through non-derivative financial instruments. In particular, it has been extended to such transactions the guidance applicable to the recognition of hedges through derivative financial instruments set out in OIC 32, as foreign exchange risk might be hedged also by non-derivative financial instruments in foreign currency.

Amortised cost

The introduction of the amortised cost for measuring receivables, payables and securities is one of the most important changes that may have a significant impact on the financial statements.

Italian accounting standard define amortised cost, consistently with IAS 39, as "the amount at which a financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability".

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The key features of the effective interest method are the following:

i. the effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability;
ii. when calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses;
iii. the calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Other changes in the revised accounting standards

OIC 14 Cash and cash equivalents

Cash pooling: in Groups, treasury management may be centralized in order to optimize the use of financial resources (e.g. through cash pooling agreements). Since receivables do not have the same liquidity characteristics as cash and cash equivalents and given the layout rigidity of ex. art. 2424 of the Civil Code, which only allows bank and postal accounts to be recognized as cash or cash equivalents, the OIC excluded the classification of those receivables in cash and cash equivalents.
However, in the financial statements of individual entities involved in cash pooling, if allowed by the collection terms, the generated receivables are recognized within *non current financial assets* in a separate line called "Financial assets from cash pooling" with the counterparty indication (e.g. parent company, subsidiary) in accordance with art. 2423-ter, comma 3, of the Civil Code.

OIC 15 Receivables

Receivables derecognition: it is confirmed that the key elements to determine whether a receivable continues to be recognized are the existence of the right to receive cash and, if that right is transferred, the exposure to the receivable inherent risks.
When the receivable is expired or transferred in a transaction, which transfers substantially all the risks inherent to the financial instrument to the transferee, the receivable is derecognized.
In contrast, if the legal ownership transfer does not match the transfer of risk, the receivable continues to be recognized. This approach, consistent with International Financial Reporting Standards (IAS 39), has the advantage of providing the financial statements readers a more effective presentation of the risk associated with portfolios of receivables transferred in transactions that maintain the credit risks with the transferor. Consistently with International Financial Reporting Standards, the receivables transfers, that do not result in the substantially transfer of all the risks inherent in the receivable, are presented as financing transactions.

OIC 16: Tangible assets

Eliminated the option not to depreciate civil buildings: the buildings, which are an investment of financial resources, are not depreciated if the residual value is equal to or higher than the carrying amount.

OIC 19 Payables

Modification of payables contractual terms: if the contractual terms of the original payable differ substantially from those of the payable issued, the original payable is derecognized and at the same time a new payable is recognized. When the original payable is derecognized, the new payable initial carrying amount follows the rules for the initial recognition of payables measured at amortised cost and subject to discounting. The difference between the new payable initial carrying amount and the last carrying amount of the original payable is a financial income or expenses recognized to profit or loss, while transaction costs are recognized in the income statement as part of the profit gain or loss related to the elimination.
When the payable is not derecognized, the entity recalculates the payable carrying amount at the date of the revision of the estimate cash flows, discounting the redetermined cash flows using the effective interest calculated upon initial recognition. The difference between the present value of payable recalculated at the date of the revision of the estimate cash flows and the carrying amount previously calculated at the same date is accounted in the income statement in financial income and expenses. In this case, the incurred transaction costs adjust the payable carrying amount and are amortised over the term of the payable.

OIC 21 Investments

Dividends: the new standard eliminates the possibility to recognize dividends in the year of maturing of the related profit, based on the condition that its board of directors has approved the subsidiary financial statements prior to the date of approval of the parent company's financial statements by the board of the parent.
It is eliminated an exception to the rule which required the dividends recognition in the year when the shareholders' meeting decide to distribute and so in the year in which the right to receive the dividends arises.
Consequently, the parent company will register dividends receivable in the same year as the subsidiary recognizes a payable.

OIC 24 Intangible assets

Transaction costs: The previous release of OIC 24 allowed the transaction costs capitalization on loans, such as the title search fees and the substitute tax on medium-term loans. The amortised cost introduction caused a change in the rules governing transaction costs on loans. OIC 19 (2016) states that transaction costs on loans related to payables measured at amortised cost shall be included in the amortised cost calculation (in contrast, the transaction costs on loans measured at nominal value are recognized as prepayments). Therefore, the OIC 24 change results in the elimination of transaction costs on loans from the caption *Other intangible assets*.

OIC 26 Foreign currency transactions

Date change: The Legislative Decree No.139/2015 reworded the provision of n. 8-bis of art. 2426 of the Civil Code concerning the foreign currency translation items, in order to better explain that the obligation to measure foreign currency items at the exchange rate of the reporting date only applies to monetary items. The not monetary foreign currency assets and liabilities are recorded at the exchange rate in place at the time when they are acquired.

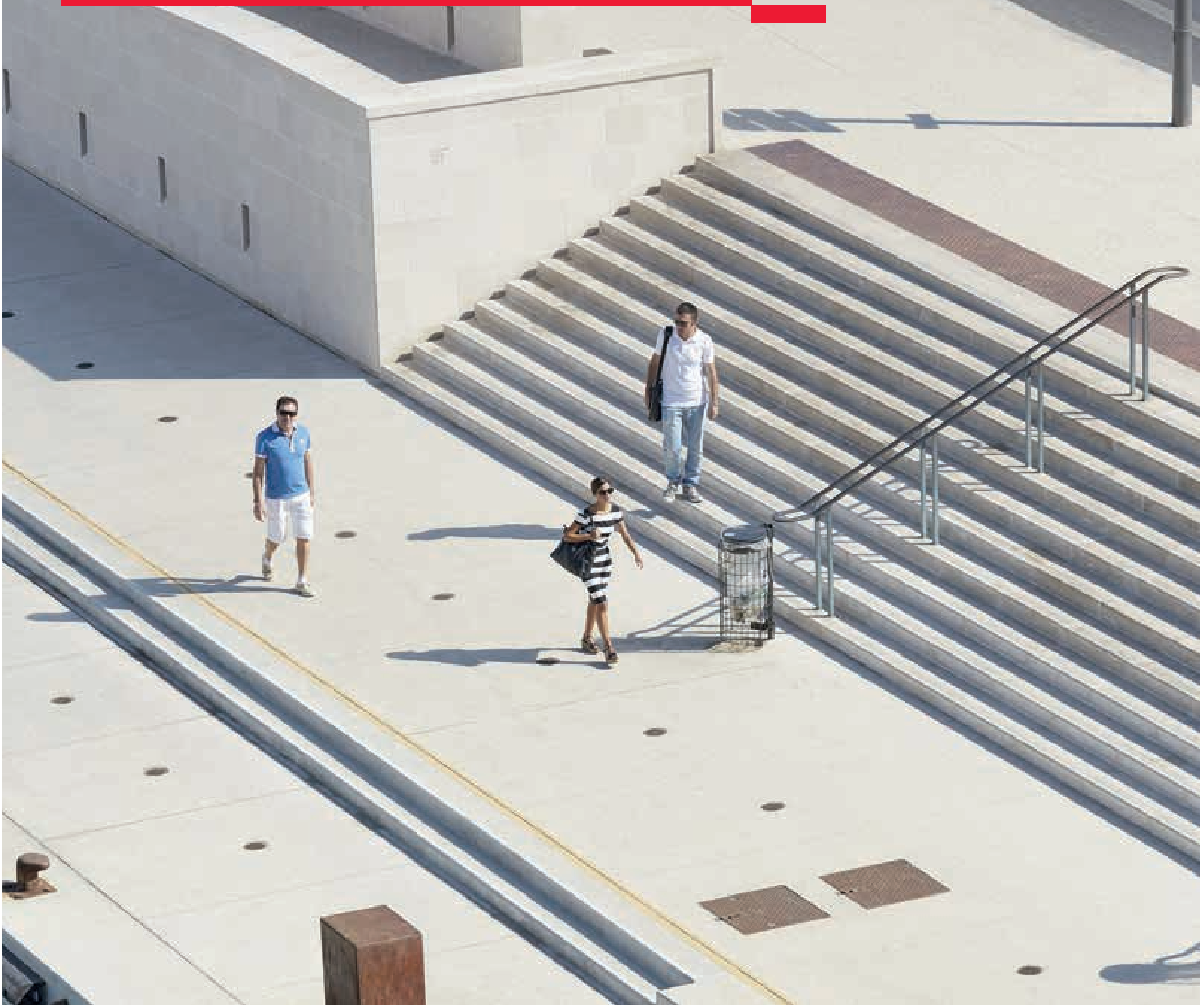
OIC 28 Equity

Own shares: in the new OIC 28, the purchase (or sale) of own shares is considered a decrease (or increase) in net asset and therefore any differences between the carrying amount of the negative reserve for own shares and the net realizable value of shares sold are recognized directly in net asset caption.

OIC 31 Provisions for risks and charges

Discounting: elimination of the prohibition to discount provisions for risks and charges.
Such prohibition is now superfluous as the law expressly contemplates the discount only for receivables and payables. However, the new standard clarifies that the time horizon is one of the elements to be considered in the estimation of provisions for which a cost arising from a legal obligation and over the long term is expected to be paid.

As result of the European accounting legislation being gradually aligned to IAS/IFRS and Italian accounting standards being continuously adjusted to the International Financial Reporting Standards, several Italian entities are considering the adoption of IFRS.



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