

Accounting Standard in Italy: Interpreting and Essential Integrating Instruments of the Law about Financial Reporting But...

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Abstract

In Italy, companies are divided into two categories: companies listed on the stock exchange or otherwise required by law to prepare their financial statements by applying IAS/IFRS (Alexander D., Britton A., Jorissen A., (2007); Ankarath N., KJ Mehta K.J., Ghosh T.P., Alkafaji Y.A., (2010); Delvaille, P., Ebbers, G. and Saccon, C. (2005); Cristea, S. M. and Saccon, C. (2008); Hopwood, A. G., Chapman C. S., Shields M. D. (2007a) Hopwood, A. G., Chapman C. S., Shields M. D. (2007b)) and companies that, on the other hand, prepare financial reporting on the basis of the Italian Civil Code. The latter is supplemented, to all intents and purposes due to the enactment of Law 116 of 11 August 2014, by the Italian Accounting Standard, issued by the body whose name is OIC

(The Italian Standard Setter) (Benston, G. J., M. Bromwich, R.E. Litan, and A. Wagenhofer, (2006); Godfrey, J.M., Chalmers K., (2007)).

It is now unanimously accepted that accounting standards, for those who have to draw up financial reporting according to the civil code, are principles that supplement and interpret the law. It is therefore, mandatory to refer to these standards. However, in Italy, there is an extremely significant limit to this fundamental principle deriving from a judgement of the Court of Verona of 18 September 2010, which has never been called into question by any other subsequent judgement. According to this jurisprudential decision, the mere referral to standard accounting of the OIC (The Italian Standard Setter) entails the radical nullity of the financial reporting and the possibility to challenge the financial reporting by anyone, not only the shareholders Mouritsen, J., K. Kreiner (2016)).

The following pages will illustrate this particular situation that has arisen in Italy.

Accounting Standard OIC (The Italian Standard Setter) and Articles of Code Civil about Italian Financial Reporting

It is well known that the claim to draw up financial reports based on the exclusive provisions of the Civil Code is impossible because of the very nature of the legal provisions.

The civil law identifies the legislative reference framework of the postulates and operating principles of the financial reporting which, obligatorily, must be applied by the unlisted companies and

not included in the list of companies indicated in the Legislative Decree No. 38/2005 (for which the obligation of application of the international principles is provided for)¹.

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

Reading the articles of the civil code, clearly, in the legal sphere, the problem concerning the drafting of financial reporting is dealt with in an extremely short manner.

In a few brief articles, the civil code provides the basic elements that financial reporting editors must observe in order for this document to be truthful, correct and must apply understandability from a lawful point of view (Adelberg, A.H., (1983); Avi, M.S., (2018)).

Given the summary of the legal provisions, even an inexperienced subject understands that the civil regulations only indicate the postulates and operating principles of the financial reporting without, however, providing detailed elements useful to "fill in" the technical and accounting content of the regulations themselves.

In this context, there is the problem of "accounting standards", i.e. those "criteria/principles" which, although they are not part of the civil code and, consequently, even though they cannot - legally - being considered sources of law, identify indispensable tools for the drafting and drafting of financial reporting (Hopwood, A. G. and Peter Miller (1994)).

The relationship between standard accounting and lawful regulations has been the subject of numerous in-depth studies by both scholars and legal organisations².

¹ In this work, the focus will be exclusively on the issue about the relationship between civil law (Articles 2423 et seq. of the Italian Civil Code) and standard accounting. Therefore, the financial statements that, by the legislative provision, must be prepared by applying IAS/IFRS principles (such as, for example, the financial statements of companies listed on the stock exchange) are essentially excluded from the analysis.

² Accounting standards have developed in a more timely and organic manner in countries characterized by the presence of an official and, above all, well-organised accounting profession (Hopwood, A.(1987); Nobes, C.W., (2013); Nobes C. , Parker R., (2016) ; Wagenhofer, A. (2006); Haller, A., B. Eierle (2004) Steven, M., FloryT., Phillips, J, Maurice Jr.,Tassin F., 1992)) . This, in essence, has been a process that has been "self-powered": the accounting standards were formulated only if there was a strong accounting profession and the latter, became increasingly lawful thanks to the application of those criteria.

Knowledge of accounting standards is therefore, an indispensable step in the preparation of legally licit and economically correct financial reporting.

The United States and Great Britain were the first countries to see these principles born and developed.

As far as our country is concerned, already in the 1940s the need to fill the gap caused by the lack of uniform accounting standards began to be felt: it is for this reason that in 1942 the Uniconiti Commission was created which, with the aim of accounting unification, should have allowed, at least in part, the overcoming of this situation.

However, this body failed in achieving the purpose for which it was set up because the practical application of the unification of accounts proposed by the above-mentioned commission was essentially null and void.

After the bankruptcy experience of the Uniconiti Commission, in Italy, for some time, the problem of accounting unification was no longer taken into account.

It was only in the 1960s that this issue was re-addressed following the imposition on electricity companies of a compulsory financial reporting structure. In this decade, the lack of "correct accounting standards" to which reference could be made began to be perceived by an increasing number of scholars and operators.

The issuing of accounting standards was no longer a need that could be postponed.

Moreover, the lack of "generally accepted accounting standards" was destined to become a real "historical anachronism" because, as a result of the legislative evolution that took place in our country during the 1970s. It was the same legal regulation that presupposed the existence of a series of correct accounting standards.

In 1975, in fact, with Decree No. 136, the Italian legislator made, for the first time, an explicit reference to the criteria mentioned above, stating that "the audit firms if the financial reporting and the profit and loss account correspond to the results of accounting records and findings made and comply with the rules for the preparation of financial reporting of the profit and loss account and if the operating events are exactly recorded by the records according to accounting standards issues certification ...".

At the time of issuing this regulation; however, despite the clear reference, no national body had yet prepared to issue those criteria that, from the letter of the law, seemed to have become Italian cultural heritage.

Understanding the correct role played by a set of "formalized accounting rules", which do not constitute normative sources, represents an indispensable step to be able to grasp the true essence of the identifiable inter-connection between civil law provisions and accounting standards.

The fact that the law never specifically regulates every topic concerning financial reporting (Alexander, D., Nobes C. (2013))Rankin, M., Stanton, P., McGowan, S., Ferlauto, K., & Tilling, M.

Finally, in 1975, the Order of Chartered Accountants undertook to form a commission whose task was precisely to formulate, similarly to what had been happening for over forty years in the United States, the so-called "correct accounting standards".

In 1982, Consob, with its resolution no. 1079 of 8 April, considered that "the series of accounting standards prepared by the national council of chartered accountants for commercial and industrial companies should be considered as a point of reference for both public companies and auditing companies, respectively for the preparation and certification of financial statements.

The introduction, at a regulatory level, of the clear reference to accounting standards is characterized by considerable temporal variability.

While the law has made distinct reference to these standards on several occasions, it has subsequently, and in no circumstances, deleted any reference to these standards.

In 1991, Article 4 of Decree 136/75 eliminated all references to the correct accounting standards.

The third paragraph of article 4 of the above-mentioned decree was, in fact, modified as follows: "the auditing company, if the management facts are exactly recorded in the accounting records, if the financial reporting corresponds to the results of these records and if the financial reporting complies with the (legislative) rules, shall issue certification ...".

For a number of years, the term standard accounting was no longer included in any lawful regulations. During this period, therefore, the doctrinal discussion on the actual role of accounting standards in the judicial framework concerning the drafting of financial reporting continued.

The economic doctrine, however, even after the deletion of the expression "accounting standard" from the aforementioned article, has always stressed that the reference to economically correct principles should, in essence, be considered implicit in the legal regulations governing financial reporting.

The situation changed radically with the entry into force of the regional tax on productive activities - IRAP - .

In Article 11 of Legislative Decree 446/97, which instituted IRAP, the "correct accounting standards" explicitly regained the role of supplementary instruments and; consequently, of interpreters of the Civil Code and, through tax regulations, provided that there were no obvious incompatibilities between legal principles and company technical regulations. If such a hypothesis were to occur, since economic principles do not represent sources of law, the only rule applicable in the preparation of public financial reporting would necessarily have remained the legislative provision.

In particular, art. 11 of Legislative Decree 447/97 stated that "regardless of their placement in the income statement, the positive and negative components are ascertained based on their classification according to correct accounting standards".

However, the situation has changed again over time. As was the case for art. 4 of Presidential Decree 136/75, the legislator has returned to its own steps with regard to art. 11 of Legislative Decree 446/97. The legislator has, in fact, opted for elimination . in article 11 of the decree establishing IRAP, reference is made to "correct accounting standards".

In 1999, in fact, art. 11, Civil Code was amended as follows: "regardless of their placement in the income statement, the positive and negative components are assessed based on their correct reclassification"

Even in this situation, the economic doctrine could only reiterate the observations made when the reference to standard accounting was removed from Article 4 of Presidential Decree 136/75.

The fact that accounting standards are not explicitly mentioned by law does not therefore imply abandoning the view that these accounting rules must, necessarily, be interpreted as complementary and complementary rules of the legal legislation.

Standard accounting, therefore, in the presence or absence of explicit references in civil law must be considered tools that allow to interpret, in an economically correct way, the legal provisions.

For example, consider how the concept of cost is often repeated in the articles of the Civil Code. It is well known that by cost we mean the quantitative-monetary value of a production factor entering the company. With regard to this concept, however, there is not a single concept of cost, and in fact, depending on the type of configuration adopted, we speak of first cost, industrial cost, total cost, economic-technical cost, etc.. In addition, we can refer to the actual cost, the standard cost, the average cost, the marginal cost, and so on.

From this simple example we can understand how the knowledge of accounting standards that define the concept of cost cited by the legislator, is an element, not only appropriate but essential so that the editor of the financial reporting can draw up an intelligible document and characterized by the presence of economically correct values.

The accounting standards, therefore, to all intents and purposes, supplement and complete the legislation, filling those gaps that, intrinsically, characterize the legislation. The characteristic of being tools for integration and completion of the legislation, means that the accounting standards play a role of extreme importance in the drafting of financial reporting.

(2012)) must be judged positively as it is appropriate that this subject is characterized by a certain elasticity and adaptability to the changes that occur in the outside world and within each company. Flexibility that, by definition, cannot possess a legal provision whose characteristic, in general, resides in its immutability for a generally rather long period of time.

Financial reporting legislation cannot, therefore, be separated from accounting standards.

In this regard, it should be noted that in Italy a law has been issued obliging companies to apply the OIC standards (The Italian Standard Setter) as supplementary and interpretative elements of the Civil Code. On 20 August 2014, in fact, Law 116 of 11 August 2014 was issued, converting Decree Law 91/2014, which recognises the role and functions of the OIC. The law integrates Legislative Decree 38/2005 with Articles 9-bis and 9-ter, maintaining unchanged the financing methods of the OIC (The Italian Standard Setter) already provided for by Law 244/2007.

The text of the provisions relating to the OIC (The Italian Standard Setter) is set out below:

Art. 9-bis - Role and functions of the OIC (The Italian Standard Setter)

1. The Italian Accounting Board, the national Institute for standard accounting:
 - a) Issue national accounting standards, inspired by best operating practice, for the preparation of financial statements in accordance with the provisions of the Italian Civil Code;
 - b) Provide support to the activities of Parliament and Government bodies in matters of accounting regulations and express opinions, when required by specific provisions of law or at the request of other public institutions;
 - c) Participates in the process of drawing up international accounting standards adopted in Europe, maintaining relations with the International Accounting Standards Board (IASB), the European Financial Reporting Advisory Group (EFRAG) and the accounting bodies of other countries.
Concerning the activities referred to in a), b) and c), it coordinates with the national authorities responsible for accounting matters.
2. In the exercise of its functions, the Italian Accounting Board pursues public interest objectives, acts independently and adapts its by-laws to the requirements of efficiency and cost-effectiveness. It reports annually to the Ministry of Economy and Finance on its activities.

Small Enterprises, Civil Code and OIC Accounting Principles

Based on what is established by art. 9 bis of law 116/2014, the diffusion, even in small-medium-sized companies, of the knowledge, at least hypothetical, of the accounting standards is required in an obligatory way and further proof of the widespread acceptance of the "philosophical" principle of the necessary interconnection between obligatory legal norms and accounting standards of application formally "voluntary" in that it is not imposed, at least explicitly, by regulatory provisions.

In order for the analysis of the problem analyzed here, to be conducted in a realistic and not merely hypothetical, we cannot ignore the fact that, in the face of an practically consensus on the need for accounting standards to identify interpretative / complementary tools of the civil regulations concerning financial reporting, there is an equally practically universal entry in financial reporting, at least in small and medium enterprises, values relevant for tax purposes rather than economically correct assessments established by the accounting standards mentioned above.

From a survey that involved more than a thousand companies, and that will be completed in the first months of 2021; this contrast is clear: on the one hand, there is full conceptual awareness of the need for the legal rules to be interpreted and integrated in the light of the accounting standards, but, on the other, there is a lack of a concrete willingness to implement this "rule of conduct". In the face of the lack of application of this purpose, we identify the increasingly widespread conduct of collecting, in the financial reporting of, the relevant values in the tax field.

OIC Accounting Principles and Italian Civil Code

This is not the right time to look into this issue in greater depth. However, it was considered appropriate to make a reference to what is happening, in reality, in order to fully understand the real essence of the relationship that can be identified - both in the theoretical-doctrinal field and at a pragmatic-operational level - between the legal provisions governing the drafting of financial reporting and accounting standards.

At least from a theoretical point of view, at the same time, everyone agrees that these "formalized accounting rules" play a fundamental informative role.

From this point of view, therefore, the OIC/IAS-IFRS principles become an indispensable knowledge tool so that the legislative provisions concerning financial reporting can be "completed", "integrated" and correctly "interpreted" from an economic and business point of view (Alexander D., (1993); Alexander,); Hopwood, A. G. (1976); D. and H. R. Schwencke (1997); Alexander, D. and H. R. Schwencke, (2003); **Barth M.E., (2008);**). Clearly, since the latter do not represent a source of law, if there is a discrepancy between the civil law and the accounting principle, what should be applied is, without doubt, the provision of law. The occurrence of such a situation, with reference above all to the national principles of the OIC, appears, however, at least in its present state, more of a theoretical hypothesis than a concrete danger.

With regard to the role of the IAS/IFRS international standards, it is also useful to remember that the evolution of the accounting standards and, in reality, also of the legislative regulations, tends to "transpose" the basic criteria illustrated by the international accounting standards into national law. At present, there is still a long way to go in this direction but, also considering what has happened in recent years, it can be said that, basically, there is a desire to make more and more reference to what is indicated by the standards issued by the IASB.

Nevertheless, we cannot underestimate the perplexity that various authors and numerous companies have begun to advance with regard to this evolutionary trend that leads to consider the international principles as indispensable reference points. In this period, in fact, some companies, supported in this sense by the opinion of part of the doctrine, show the will to re-evaluate what is regulated by our civil code and by the national accounting standards OIC, in contrast to some key concepts indicated, instead, by the IAS/IFRS.

In any case, regardless of the position taken by individual scholars or precise companies with regard to this particular issue, it is certain that the principle of "necessary integration" of civil regulations by accounting standards (national and/or international) now appear to be unanimously accepted.

It is therefore, possible to consider that the so-called "point of no return" has been reached and widely exceeded, i.e. the historical moment in which no one can consider it reasonable to propose, at least at a theoretical level, different convictions/principles/rules of behavior.

Reading the formerly considerations may almost inevitably give rise to a legitimate question: if the over represents a unanimously accepted position, at least in the theoretical-doctrinal field, why is it possible to speak of nullity of financial reporting resulting from a referral, made in the financial reporting itself, to the accounting standards and/or legislative provisions concerning financial reporting?

This question is extremely important for both a theoretical and operational level. If, in fact, it is correct to speak of unanimous acceptance of the integrative and complementary role of the accounting standards with respect to what is established by the lawful norm, it is also accurate to point out how a misinterpretation of the real role "assigned" by the judiciary to the accounting standards themselves and/or to the content of the lawful provisions can lead, inexorably, to the declaration of nullity of the financial reporting d'. This circumstance occurred precisely in the action brought before the Court of Verona, which led to the issue of the judgment of 18 September 2010 in which it is stated that an "incorrect concept of referral", implemented in the explanatory notes, to the accounting standards and/or the content of specific legal provisions, may be grounds for radical invalidity of the financial reporting itself.

In order to fully understand the problem in question, it is necessary to develop, in a synthetic way, some preliminary observations about it:

- A The potential connection between the individual financial reporting postulates and the concept of "correct referral - implemented in the notes to the financial statements - to accounting standards and/or civil law" in order to understand whether a misinterpretation of this reference can be considered as a non-application of understandability (Adelberg A.H., (1979); Adelberg, A.H., Razeq, J.R., (1984), Rachel F. Baskerville R.F., Rhys H., (2014) ; Jones, M., Smith M., (2014); Schwaiger, W.S.A., (2015) Patel C, Day R., (1996)) or of faithful representation in measurement of the economical facts object of accounting./regularity/accuracy or still of understandability and, at the same time, of faithful representation in measurement of the economical facts object of accounting./correctness (Alexander, D., Jermakowicz E, (2006);)Beest F., Braam G., Boelens S., (2009)
- B The priority/subordination scale, assigned by jurisprudence to the postulates connected with the "substance" (faithful representation in measurement of the economic facts objects of accounting. And correctness) and the "form" (understandability) of the financial reporting as the nullity of the shareholders' resolution, approving the latter document can only be considered illegitimate in the event of non-application of the postulates imposed by Article 2423 of the Italian Civil Code. A closer examination of this particular issue is of fundamental importance in order to understand whether an "erroneous reference to accounting standards and/or legal regulations" could have different consequences depending on the impact on the postulates mentioned above.

Only the knowledge of the "principles" that the judiciary considers "key elements of the legitimacy of financial reporting" allows us to perceive the real extent of the judgment of the Court of Verona, which we will discuss in the following pages.

The in-depth analysis of this subject would, of course, require an examination that is not well matched with the space allocated to an article. Our objective is not; therefore, to examine every issue underlying the above issues, but rather to summarize the operational consequences caused by accounting behavior adopted in the preparation of financial reporting that does not comply with what is required in order to recognize the full legitimacy of the "legal set" consisting of the balance sheet, income statement, notes to the financial statements and cash flow statement (Di Pietra, R, McLeay S., Riccaboni A.,(2001); Smith, M., Taffler, R., (1992); Godfrey, J.M., , Chalmers K., (2007)

With regard to the issue covered by point A) above, it is necessary, before carrying out any other analysis, to understand, which postulate may be considered incorrectly applied in the presence of a misinterpretation of the concept "reference to accounting standards (and/or the content of specific legal provisions concerning financial reporting)".

At the operational level, there may be a duplication of situations:

1. Assume that a particular accounting standard establishes a substantial obligation to comply with a certain valuation criterion, highlighting the erroneous nature of other alternative criteria. The case of depreciation is one example. The IAS principle no. 16 tangible fixed assets establish the possibility of determining annual depreciation by applying the criteria on a straight-line basis and/or on a decreasing scale, while it highlights the substantial impropriety and, consequently, the accounting inaccuracy of the criterion on a decreasing scale. If an editor of financial reporting claims to have applied the accounting principle and, subsequently, claims to have determined the amortization of deferred costs using the criterion of increasing shares, without a technical and operational explanation that makes these values acceptable for specific reasons (which, in the opinion of the writer, could be considered admissible under Article 2423 IV of the Civil Code), it is clear that the postulate "misapplied" would be the faithful representation in measurement of the economical facts object of accounting... The amount recorded as a

cost in financial reporting would, in fact, not be true because, clearly, it conflicts with what is indicated as "correct" by the same principles and, indirectly, through the implicit reference, to the latter, by the civil law. In the event of such a situation, therefore, the potential nullity of the financial reporting would derive from the failure to comply with the postulate concerning the "substance" and therefore, the faithful representation in measurement of the economic facts objects of accounting. Of the data recorded in the income statement and/or balance sheet despite the conventional reference to what is contained in an accounting standard. On the circumstance that the presence in financial reporting of a conventional reference to the application of an accounting principle with simultaneous objective non-correspondence to the criteria contained there in, identifies a valid reason for declaring the invalidity of the untrue financial reporting, there is a concordance of opinions.

Logically speaking; however, such a situation appears unrealistic or, in any case, not particularly widespread because the absence of faithful representation in measurement of the economic facts objects of accounting. It would manifest itself too clearly and, therefore, such a contingency appears to be dictated more by the error or better, by the lack of knowledge of accounting standards, rather than by the concrete desire to include in financial reporting an untrue figure (Barth, M. E (2014)).

2. Another hypothesis that, unlike the previous one, is found more widely regarding what we could define as the "blank reference" to what is established by the accounting standards and/or to the content of specific legal regulations concerning financial reporting, with the absence of a manifest error in the application of the latter. Think of the case, for example, of the capitalization of financial charges. The accounting principle OIC n. 16 tangible fixed assets established that financial amounts usually constitute expenses and as such, should be charged directly to the income statement of the administrative period in which they accrue. However, since tangible fixed assets identify assets intended for the permanent organization of companies and generate income merely when they are in operation, the financial charges incurred for their acquisition (purchase and construction), in specific and well-defined cases, can be capitalised in the value to be attributed to the fixed assets. However, such a transaction can only be carried out if a set of circumstances specifically indicated by the same accounting principle occurs. In particular, the accounting standard states that capitalization of borrowing costs is only possible if:
 - a) is not implemented to carry forward losses;
 - b) it is carried out with care;
 - c) is determined based on interest expense incurred on capital borrowed specifically for the acquisition of fixed assets provided that the loan has in fact been used for the acquisition of the multi-year assets;
 - d) is quantified by calculating the interest accrued during the 'construction period', i.e. the period from the disbursement of funds to the suppliers of the assets until the asset is ready for use, if this period is significant;
 - e) it is valued based on the interest rate reality paid for the medium/long-term financing used to pay for the tangible assets;
 - f) the value, including interest does not exceed the value recoverable through the use of the identical fixed assets.

Just when all the above circumstances occur does OIC accounting principle no. 16 allow the capitalization of financial charges as an economically correct practice.

As we pointed out in point 1, if, in the notes to the financial statements, reference is made to the provisions of OIC principle no. 16 and, clearly, the application of a calculation method that conflict with the provisions therein is highlighted, clearly financial reporting could be declared null and void due to the lack of application of the postulate of faithful representation in measurement of the economic facts object of accounting.

Black Reference to OIC Accounting Principles and Legal Consequences on Financial Reporting in Italy

Let us now assume, however, that financial reporting is limited to what we have previously defined as "blank reference" to what is established by the accounting standards and/or the content of specific legal regulations regarding financial reporting. We suppose that, in the notes to the financial statements, something contrary to what is established by the standard accounting standards is not explained, but that the circumstance is highlighted that the capitalization of financial charges has been carried out because the conditions exist to be able to carry it out. Since the conditions for implementing such capitalization are established, in summary, form, by civil law, and analytically, by the accounting standards, clearly such a statement represents, in essence, a "blank reference" to what is established by the legal regulations and by the OIC documents concerning the specific subject matter being evaluated in the accounts.

In the event of such a hypothesis, there is no clear contrast between the methodology applied in financial reporting and the content of an accounting principle to which the Italian Civil Code implicitly refers, but there would even seem to be a perfect coincidence between the data contained in the income statement/balance sheet and the amounts determined through the application of the legislative provision and the correct accounting standards.

Such a "blank reference" to the content of an accounting standard, whether national or international, and/or to the content of specific lawful provisions concerning financial reporting, results, however, from a misinterpretation of the role that the judiciary, or part of it, considers that such standards - accounting and/or lawful - should play in the drafting of financial reporting.

And it is precisely on this point that the judgment of the Court of Verona of 18/9/2010 focuses its attention by stating, explicitly, that if in the explanatory notes, there is the simple statement that "in the 'have been capitalized financial charges per euro as they meet the requirements" without any further specification or illustration of the characteristics indicated in accounting principle OIC No 16, it must declare the non-application of the postulate of understandability.

A simple blank reference to what has been established, synthetically by the civil law and, in a detailed manner, by the accounting standards does not appear, therefore, sufficient for the financial reporting to be considered clear and, as a result, intelligible.

It is true that, in the explanatory note to the financial reporting challenged before the Court of First Instance in Verona, the phrase 'unclear' does not make an explicit reference in a blank to the content of accounting principle OIC No 16 but is limited to supporting the existence of the requirements allowing the capitalization of financial charges. However, in the writer's opinion, this statement, as has already been pointed out in the previous pages, must be understood, without a shadow of a doubt, as a blank reference to what is stated by the Italian Civil Code in Article 2426, paragraph 1 of the Italian Civil Code and to what is illustrated in detail by the principle OIC no. 16, since the sources from which the essential requirements for capitalization are identified are illustrated, in summary form, by Article 2426, paragraph 1 of the Italian Civil Code and analytically by document OIC no. 16. This incontrovertibly demonstrates how the mere blank reference - without further explanation of the reasons - to the valuation criteria contained in an accounting standard and/or in a legal norm can be considered, by the jurisprudence, sufficient element to be able to declare the non-existence of the postulate of understandability (Ewer, Sid R. , (2007).; Nillson, S., (1997)).

The above considerations clarify the issue raised in point A) above regarding the potential link between compliance with financial reporting requirements and reference to accounting standards and/or civil law. In extremely brief terms, this analysis can be concluded by stating that the postulate "misapplied" is:

- 1) faithful representation in measurement of the economic facts objects of accounting. If, in determining the financial reporting items, there was an incorrect application of the content of an accounting principle;

- 2) understandability if, in the notes to the financial statements, we limit ourselves to a mere blank reference to what is established by the Italian Civil Code and/or in the accounting standards without further detailed explanation of the methods for the operational determination of the income, balance sheet and financial values contained in the income statement and/or balance sheet.

In order to avoid a challenge to financial reporting, it is necessary that, against a reference to legal provisions and/or standard accounting, in addition to the regulatory and/or accounting reference, there is also a broad and detailed description of the quantitative methods of calculation and the reasons that led the authors of financial reporting to apply certain valuation criteria or specific logics of presentation of economic and financial values. Obviously, this is true concerning any problem connected with financial reporting, since the Court of Verona has analysed the precise case that is the subject of civil action, but the general principle that led to the issue of the judgment, by analogy, can be applied not only to the particular problem addressed (capitalization of financial charges), but also to all the other items of the balance sheet and income statement.

At this point, it is necessary to clarify what the priority/subordination scale is, assigned by the jurisprudence to the postulates connected to the "substance" (faithful representation in measurement of the economic facts objects of accounting and correctness) and to the "form" (understandability) of the financial reporting (Morton, J.R., (1974) 55) Nobes C.W., , Stadler C. (2015)) . The in-depth examination of this particular issue appears to be of fundamental importance in order to understand whether a misinterpretation of the concept of "reference to accounting standards and/or the content of specific legal regulations concerning financial reporting" could have different degrees of consequences depending on the impact on the postulates imposed by Article 2423 of the Italian Civil Code.

In other words, it is necessary to understand whether the failure to apply the postulate of faithful representation in measurement of the economic facts objects of accounting. (which occurs when there is an erroneous application of the content of a civil article and/or accounting standard) has similar or profoundly different consequences from those incurred if the financial reporting is true in substance but not clear in form (a circumstance that occurs in the event of a "mere blank reference" to the content of an article of the civil code and/or accounting standard).

Furthermore, in this case, this is not the right place to carry out an exhaustive analysis of the evolution of the autonomy/subordination ratio that can be identified between the assumptions of understandability and faithful representation in measurement of the economic facts object of accounting/correctness (Wagenhoferb, A., Göxa R.F. (2009).

In this work, it is only possible to recall how the weight assigned to these postulates by jurisprudence has recorded, over time, a radical evolution.

In particular, it should be remembered that, in Italy, the postulate of understandability has been characterized by a very "troubled" life: until 1968, in fact, the judges were virtually ignored, as if the observance of this postulates did not have, in practice, any significant consequences on the legal level. With the judgment of the Court of Milan of 23/12/1968, it was stated instead that, even the violation of only one of the provisioned of art. 2424 c.c., entailed the radical nullity of the resolution approving the financial reporting; and it is clear how such an assertion revalued, enormously, that principle that until recently, by the jurisprudence, was not in spite of taken into account. This decision, therefore, gave rise to a new stance by the judiciary with regard to the issue of financial reporting. For several years, in fact, reaffirming the importance of the above principle, the case law declared the unclear balance sheets null and void.

In the second half of the '70s, however, there was a real "reversal" of the orientation followed by the prevailing jurisprudence after the leading case of 1968. In 1977, in fact, for the first time the Supreme Court, that is the judge of last instance in Italy, stated that the lack of understandability of financial reporting could result in nullity of the resolution approving the financial reporting only when it was such as to make objectively impossible the control of compliance with the principle of truth.

In this way, the postulate of understandability became instrumental and, consequently, subordinate to that of faithful representation in measurement of the economic facts object of

accounting, with the consequence that the violation of the rules governing the intelligibility of financial reporting was no longer considered an "autonomous" cause of nullity.

This orientation (present both in the judgments of the Court of Cassation, and in the decisions of most of the judges on the merits) which, in turn, referred to the thesis put forward by authoritative scholars, meant that, for more than a decade, the concept that "the violation of the rules governing the content of financial reporting could lead to the nullity of the resolutions passed by the shareholders' meeting for approval (was subject to the verification that), from a substantive point of view, the omission resulted in a concrete prejudice to the general interests that the rule is intended to protect (violation of the principle of truth of the financial reporting)"³.

On the contrary, the assumption of understandability as subordinate to that of truth was contrary to the constant jurisprudence of the Court of Milan, in whose sentences the independent detection of possible violations of the principle of understandability was reaffirmed for the purposes of the nullity of financial reporting⁴.

With regard to the "*revirement*" recorded by jurisprudence (or rather by a part of it) in the 1970s in relation to the non-autonomous relevance of the postulate of understandability, it must be stressed that, having considered understandability a principle merely instrumental to that of truth, has, to all intents and purposes, resulted in a significant devaluation of the rules that governed the content of financial reporting. This, in the final analysis, meant that the very recognition of the informative function of the document in question has suffered, in that period, a regression as a financial reporting, to be able to be a valid information tool to the outside, if on the one hand, it must be true, on the other hand, it must also be understandable and intelligible. In fact, if the prospectus under discussion contains correct information but at the same time characterized by ambiguity, confusion and inaccuracy, it is clear that users outside the company cannot consider satisfied with their legitimate right to information.

The understandability, therefore, like the truth, must be considered a postulate from which you can not ignore if you want to draw up a document that represents a means of knowledge for third parties outside the company.

In the context of the problems connected with corporate information intended for the outside world, the orientation taken by the Court of Cassation at the end of the 1970s and during the 1980s, therefore, represented a considerable step backwards.

This attitude of the Supreme Court is now completely outdated. In fact, the judiciary, with reference to the postulate of understandability, in the '90s, changed the position previously assumed, reversing, in a total way, the principle applied until then. The later circumstance was welcomed by most of the doctrine in a favourable way because most scholars believed and still believe that only the "equalization" of the postulates of understandability and faithful representation in measurement of the economical facts objects of accounting/regularity/accuracy can guarantee the drafting of a financial reporting that can be interpreted as a valid instrument of information to the outside world (Hopwood, A.G., (2009) ;Hopwood ,A.G., (2008).

The current economical, business and legal doctrine and jurisprudence share the view that financial reporting is the main instrument of economic-financial-equity communication intended for the outside world and, in the context of such a vision, even the postulate of understandability could not be exempt from a radical and profound "redress" of the jurisprudential position which stated that the later was a subordinate "element" and dependent on the principle of precision and faithful representation in measurement of the economic facts object of accounting (Hopwood, A.G. (1972); Hopwood, A.G. (1974); Obaidat, A. N., (2007)).

³ Appellate court Genova 19/1/82.

⁴ Among the various judgements we can mention: Tribunal Milano, 5 maggio 1983; Tribunal Milano 26/6/87; Tribunal Milano 9/7/1987; Tribunal. Milano 15/5/80; Tribunal. Milano 5/1/81; Tribunal. Milano 5/3/79; Tribunal Milano 10/9/81; Tribunal Milano 17/9/87, Tribunal. Milano 5 marzo 1979.

At the end of the 1990s, from the sentences in which the subordination of understandability to faithful representation in measurement of the economic facts objects of accounting was affirmed (Hopwood, A. G. (2000); Hopwood, A. G., (1990)), we moved on to the court rulings in which it is denied that the importance of the precept of understandability must remain subordinate to the respect of a super ordinate principle of truth of financial reporting.

According to this guideline, "notes that the financial reporting of a joint-stock company is illegal not only when the violation of the regulations in this regard determines a gap between the actual result of (or the data intended for the overall representation of the asset value of the company) and that of which the financial reporting counts, but also in all cases in which the financial reporting itself, and its attachments do not infer the full range of information that the law wants to be provided with regard to the individual items for which registration is required.

Given the emphasis on the essentiality of the information function of financial reporting (Nobes, C.W., Aisbitt S. (2001); Hopwood, A. G., (1990)), the orientation in question identifies the illegality of this whenever the violation of the mandatory precepts of law, which govern its formation, does not allow to perceive with sufficient understandability the specific information, which the reading of the document and its annexes must instead offer with regard to each of the items from which the financial reporting is formed. The principle of understandability is therefore, not subordinate to the principle of truth, since financial reporting that is unsuitable for providing, sufficiently legible information cannot be considered valid only because, in the final analysis, the data it contains are not, in their accounting expression, contrary to the truth. Such an opinion would be manifestly unsustainable after the formal receipt, in the Italian legal system, with the enactment of Legislative Decree No 127 of 1991, of the requirements of the fourth European directive on companies, clearly inspired by the maximum enhancement of the so-called principle of transparency of financial reporting. However, it does not appear to be acceptable, either, in the light of the previous legislation in force at the time of drawing up the financial reporting legislation at issue, the interpretation of which cannot, furthermore be disregarded by the principles which have long been set out in the 4th Directive, which was adopted in July 1978. While it is true that European directives, prior to their formal transposition, are not capable of direct application to the relationship between individuals, it is also true that - as the Court of Justice of the European Communities as well stated in its judgment of 14 July 1994 in Case No 91-94 - the court 'when applying provisions of national law, both prior to and subsequent to the directive, must interpret them as far as possible in the light of the purpose and wording of the directive'.

As well, Article 2423 of the Civil Code (old text) placed the obligation of understandability on the same level as that of precision, without suggesting any ranking of importance and without making compliance with the former conditional upon compliance with the latter or any other obligation. Moreover, the opposite opinion did not take into account other provisions, such as those aimed at regulating the content of the directors' report, which testify to the utmost importance attached by the legislator to the understandability of the individual information to be guaranteed to the recipients of financial reporting. And, therefore, it risks betraying, in essence, the very *raison d'être* of the regulations under examination, since it is quite clear that the lack of understandability in the single items in which financial reporting is fatally articulated compromised that information function (also outside the company structure) which has already been seen to be one of the main purposes pursued by the legislator in regulating the accounting profile of company law"⁵.

According to this approach, now unanimously shared by doctrine and jurisprudence, the postulates of understandability and faithful representation in measurement of the economic facts object of accounting are, therefore, characterized by mutual autonomy. The openness of the resolution approving financial reporting.

⁵ Court of Cassation 21 febbraio 2000, n.27. Così anche Cassazione, 14 marzo 1992, n. 3132; Court of Cassation 30 marzo 1995, n. 3774; Court of Cassation 3 settembre 1996, n. 8048; Court of Cassation 8 agosto 1997, n. 7398; Court of Cassation 3 settembre 1996, n. 8048; Court of Cassation 29 settembre 2005, n. 19097.

Based on this well-established jurisprudential orientation, at the level of invalidity of the resolution approving financial reporting, the non-application of the postulate of understandability causes, therefore, consequences, quite similar to those determined by the non-observance of the postulates of faithful representation in measurement of the economic facts object of accounting. and/or regularity/accuracy.⁶

This is because "the requirement of understandability in the preparation of financial reporting is enshrined in order to protect the general interest in providing information about the financial position of the company (Ballwieser W., G. Bamberg, M.J. Beckmann, H. Bester, M. Blickle, R. Ewert, A. Wagenhofer and M. Gaynor (2012) Hopwood, A. G. (1973);)Oderlheide, D. (2001)), and therefore, has independent relevance with respect to those of faithful representation in measurement of the economic facts object of accounting and correctness; accordingly, the resolution passed by the shareholders' meeting to approve financial reporting must be considered null and void, because it is contrary to the mandatory rules, not only when the approved accounting document contains results that do not conform to the real situation of the company, but also when the approved financial reporting and the relative annexes do not provide the full range of information that the law requires to be provided for each of the items entered."⁷ (Zeff S.A., (2013);)Yuthas K., Rogers R., Dillard J.F., (2002); Hopwood, A.G., (1999).

Underdevelopment and veracity are therefore, autonomous elements with the same theoretical and operational weight. This means that the non-application of even just one of the two postulate causes the total nullity of the financial reporting . No postulates, therefore, has the supremacy, much less the principle of faithful representation in measurement of the economic facts objects of accounting. compared to that of understandability. Each principle is of equal importance, and it is excluded that a postulate may override, in terms of importance, any other basic principle of financial reporting. Therefore, understandability is no less important than faithful representation in measurement of the economic facts objects of accounting and is totally unrelated to the latter postulate. Each of the two postulate lives its own life and there are no mutual inter-relationship and/or submission of one to the other principle.

Based on the above, it can therefore be assumed, without fear of being denied by anyone, that the lawful consequences of an "inappropriate" reference to accounting standards and/or specific lawful rules on the subject matter of interest are, in substance, identical. As we have highlighted above, an improper reference to accounting standards (and/or civil law) may cause, depending on the case, the non-application of the postulate of faithful representation in measurement of the economic facts objects of accounting/regularity/accuracy or of the postulate of understandability. Even if, in the two hypotheses, the causes appear completely different, the legal consequences are, instead, perfectly identical.

Furthermore, the "gap" relating to understandability and deriving from the blank reference to the legislative principles and/or to the accounting standards without, at least in a evident manner, any misinterpretation of the content of the legal provisions and/or of the OIC/IAS documents, causes the same type of illegitimacy as would be found in the event of a obvious failure to apply the postulate of faithful representation in measurement of the economic facts object of accounting. Caused by the

⁶ "Therefore, the orientation that subordinates the importance of the precept of clarity to the observance of a super ordinate principle of truth can no longer be followed, almost as if financial reporting that is unsuitable for providing sufficiently legible information can be considered valid only so that the data contained in it are not, in their accounting expression, contrary to the truth". Court of Cassation no. 8048 of 3 September 1996. "The principle of clarity (therefore) is by no means subordinate to that of regularity/accuracy and faithful representation in measurement of the economic facts' objects of accounting of financial reporting... but has its own independent value, since the fundamental objective of the legislator is to guarantee not only the faithful representation in measurement of the economic facts' objects of accounting and regularity/accuracy of the accounting results but also the widest transparency of the financial reporting data that those results provide". Court of Cassation 2 maggio 2007, n. 10139.

⁷ Tribunale of Milano, 4 novembre 2010.

insertion of items not correctly determined or by the omission of items which, on the contrary, should have been entered into financial reporting.

For these reasons, also the Court of Verona, in the judgment analyzed here, states that "the principle of understandability is violated ... and that (therefore) a defect of nullity of the resolution approving the financial reporting seems configurable"⁸.

In conclusion, it can therefore be said that, while, on the one hand, standard accounting is an essential tool for legislative integration and interpretation, on the other hand, it is equally true that the mere reference to these principles undermines the postulate of understandability. This position is now well established among scholars and judges. Consequently, financial reporting and, in particular, the supplementary report must explain in detail all the reasons that lead to the application of a specific accounting standard OIC. While, the mere reference to the principle in question, is considered to be detrimental to the postulate of understandability. This entails the radical nullity of the resolution approving the financial reporting itself Burchell S., C. Clubb, A. Hopwood, J. Hughes, J. Nahapiet, (1980); Burchell S., C. Clubb A.G. Hopwood (1985 Haller, A. (2002) Haller A, P. Walton and B. Raffournier B. (2003) Jonas, G.J., Blanchet J. (2000); Hopwood, A.G., (2009); De Franco, G., S. P. Kothari and R.S..Verdi (2011); Hopwood, A.G. (1990)).

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