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October 2023

Business management in the era of prevention and sustainability

Expert's Opinion

The "negotiated settlement of the business crisis"

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The so-called "negotiated settlement of the business crisis" is a new crisis settlement instrument introduced with Law Decree no. 118/2021 (turned into Law no. 147/2021), in a particular moment of the global economy, i.e., after the Covid-19 pandemic crisis, with the aim of providing companies with a further possibility to settle business crisis. The regulation on the negotiated settlement of the business crisis is included in Title II of the Business crisis and insolvency code (Legislative decree no. 14/2019, as amended by Legislative Decree no. 83/2022). The negotiated settlement procedure, in line with the provisions of the European Insolvency Directive, aims to prevent insolvency by promptly identifying and managing crisis situations which could prejudice the going concern, particularly property or economic-financial...

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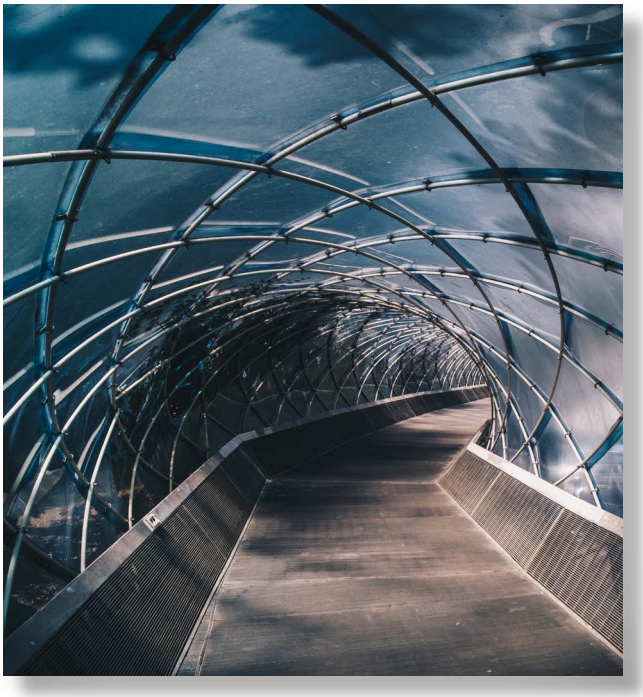

Overview

From internal governance to integrated compliance for corporate sustainability

Gabriele Felici

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Focus on

The bank-enterprise relationship

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The Italian production system, made up mainly of small and medium enterprises, has historically been characterized by a strong dependence on bank debt, with a subsequent need for companies to have stable relationships with credit institutions, based on trust and on a continuous exchange of information.
The trust relationship is consolidated through a constant dialogue and a typically one-way exchange of information, on the economic, wealth, and financial performance of the company, which is necessary for the credit rating assessment in order to grant and/or maintain credit lines.
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Supplemento Notizie flash n° 107 del 25 febbraio 1984

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The adequacy of the so-called internal governance, i.e. of the organizational, administrative, and accounting structure, has in fact become the new management model, both as a legal obligation in order to define liability of corporate bodies in case of a default (art. 2476, para. 6 of the Italian Civil Code) and – mainly – as an opportunity for entrepreneurs to ensure a correct and efficient performance of the business activity.

Moreover, the adequacy of management systems, which is required to companies under the reform of the insolvency regulation to prevent crisis and safeguard the going concern, finds an efficient correlation in organizational models under Law no. 231/2001 (MOGC) in the perspective of an effective integrated compliance.

In such a context, the regulation of the new negotiated settlement of corporate crisis has defined the content of adequate management structures from a functional perspective, providing for alert instruments and new alarms to safeguard the going concern.

Moreover, the European Banking Authority (EBA) defines planning and monitoring as the conditions to access credit. Lastly, debt management and sustainability aimed at safeguarding the going concern are among the specific contents provided by ESRS, i.e. the new European Sustainability Reporting Standards elaborated by EFRAG within the ESG field.

Particularly, non-financial – or better, "sustainability" – information, which integrates financial data, is a crucial element for the integration of ESG risks and factors into corporate management systems, thus confirming the need for all stakeholders to have continuous and timely access to updated and reliable information on the company's situation, including qualitative and mainly forward-looking information, in line with the forward-looking approach which is the pillar of the crisis prevention and risk management system which characterizes the so-called "integrated compliance".

Therefore, the adequacy of management systems is also a condition to disclose sustainability information and, as said, this is directly related to the going concern principle, since it requires an integration of information on the risks related to environmental factors (among others) in a strategic perspective (obligations and opportunities) and through a forward-looking approach, which is necessary for business management planning and for the identification of the relevant measurement parameters, in order to prove sustainability during the company's period of activity. In this sense, the above economic and business "going concern" principle is now turning into the multidimensional, more complete and integrated "business sustainability" principle.

This evolution is due to the mutual relation between both principles, since companies are required to integrate ESG sustainability factors and risks into their management systems to safeguard the going concern and, at the same time, they need to safeguard their going concern to pursue ESG sustainability.

Business activity sustainability was also the focus of the European programme in 2018, as a Sustainable finance action plan was implemented with the main aim to address capital towards sustainable investment and to introduce a mandatory integration of risks related to the environmental and social impact of economy.

An environmentally sustainable loan is defined as a loan aimed to finance sustainable economic activities from an environmental perspective. This is part of the wider "sustainable finance" concept, which means any financial instrument or investment, including shares, debt securities, guarantees, or risk management instruments issued against the provision of financing activities, which meet environmental sustainability requirements.

Therefore, the need to disclose information on sustainability is determined by the need for further and more detailed information by corporate stakeholders. In fact, ESG aspects are now relevant for companies as a competitive advantage and will become more and more relevant for their maintenance, as they also lever the intangible value of companies.

In such a context, a good tax governance related to the tax control framework and cooperative compliance falls within the ESG factors, too.

Therefore, ESG aspects will more and more represent a necessary condition which companies must learn to deal with, by implementing a reporting model, adopting recognized standards and criteria, and integrating the traditional reporting system, thus realizing a continuous monitoring of the sustainability strategy, where ESG targets contribute, together with financial ones, to the going concern, or, as newly defined, to corporate sustainability.

In brief, the adequacy of a company's internal governance and the forward-looking approach are the access point to an integrated compliance for the pursue of corporate sustainability.

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The so-called "negotiated settlement of the business crisis" is a new crisis settlement instrument introduced with Law Decree no. 118/2021 (turned into Law no. 147/2021), in a particular moment of the global economy, i.e., after the Covid-19 pandemic crisis, with the aim of providing companies with a further possibility to settle business crisis. The regulation on the negotiated settlement of the business crisis is included in Title II of the Business crisis and insolvency code (Legislative decree no. 14/2019, as amended by Legislative Decree no. 83/2022).

The negotiated settlement procedure, in line with the provisions of the European Insolvency Directive, aims to prevent insolvency by promptly identifying and managing crisis situations which could prejudice the going concern, particularly property or economic-financial imbalance situations which make business crisis or insolvency probable, and company reconstruction is reasonably feasible.

The negotiated settlement is an out-of-court procedure conceived for commercial and agricultural entrepreneurs registered with the Companies' register, who request their competent Chamber of Commerce for the appointment of an expert; such expert plays a crucial role in the negotiation phase and, besides the characteristics required by law to carry out the delicate task, must also have special skills, i.e.: be an able negotiator, a business expert and a crisis law expert.

The order of the abovementioned required skills is not random and is consistent with the progress of the procedure. In fact, the negotiation ability is required in the first phase of the procedure, as the expert must be able to negotiate with creditors in a convincing and assertive way, without alerting them too much and trying to understand which of them could approve the company reorganization. At the same time, the business expert figure is crucial, as this must support the entrepreneur in the difficult daily management of the distressed company during the negotiation period. Lastly, the crisis law expert must identify the best outcome of the procedure, which could be any instrument

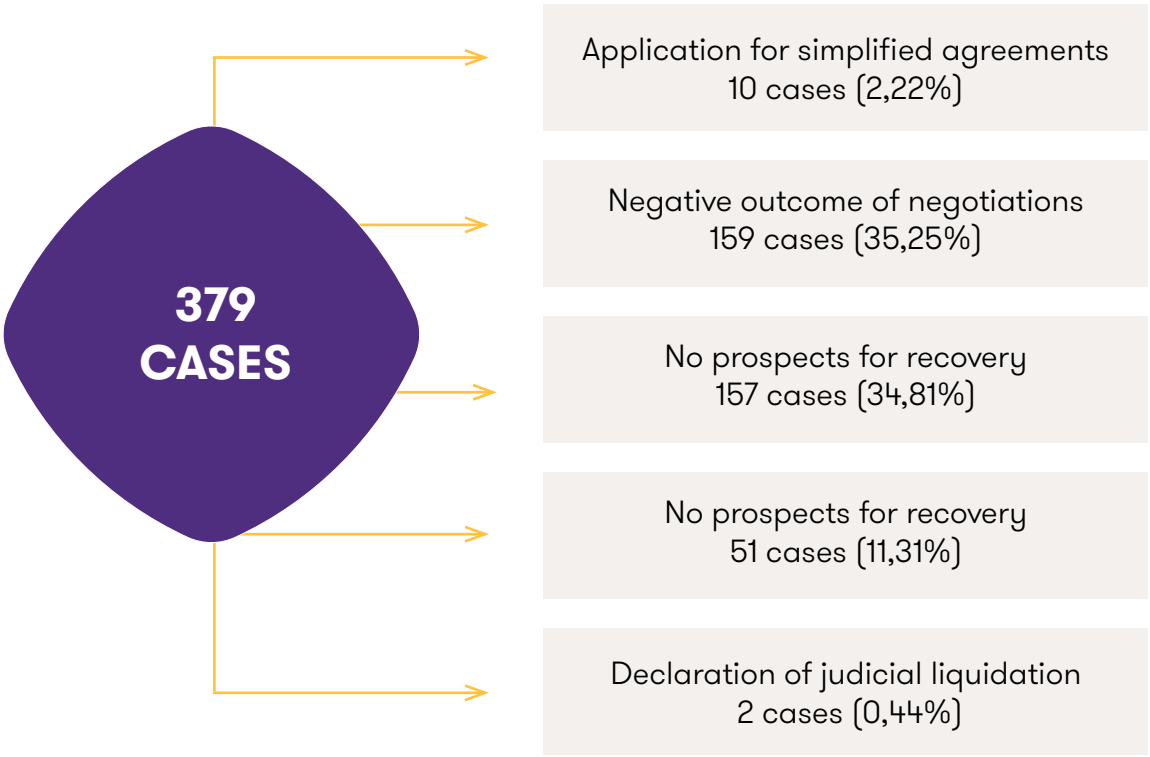
offered by the business crisis and insolvency code, lacking an agreement with one or more creditors. It must be pointed out that some of the possible outcomes ("approved recovery plan", debt restructuring agreements, and other crisis resolution instruments) are as well solutions aimed at business restructuring and at safeguarding the going concern, leaving as the very last solution only the "simplified liquidating composition" procedure.

In support to the above, it must be pointed out that at 15 September 2023 there were 451 dismissed applications, of which 379 had a negative outcome and only 12 ended up with liquidation.

Below is an analysis of procedures at 15/09/2023:

The unfavorable outcomes*

Analysis of procedures at 15/09/2023



Unioncamere, 15 September 2023

Another peculiarity of the new negotiated settlement procedure is the confidentiality it ensures with reference to the relationships with all stakeholders. However, this fails when wealth protection measures are requested and, therefore, the publicity requirements (publication to the Chamber of Commerce) would disclose the starting of the procedure at issue by the concerned company.

The negotiated settlement of the business crisis, which is a contractual and out-of-court procedure, does not impose the content of the agreements, but only the aim of the same, i.e.: the company reconstruction.

To this end, the evolution proposed by the legislator in this year's tax reform enabling law is of particular interest. In fact, although the possibility to include the tax settlement procedure within the "negotiated settlement of the business crisis" was mentioned in the drafts of Law Decree no. 13/2023, it was excluded by the provision at the moment of publication of the national recovery and resilience plan (PNRR)-ter. Currently, tax reform enabling law provides for the possibility to introduce within the "negotiated settlement procedure" a composition agreement aimed to write off or delay tax debt. Should this provision be confirmed, it would probably lead to a considerable increase in the number of the negotiated settlement procedure applications.

Reply to request for ruling no. 443/2023 should also be mentioned. In fact, it clarifies that, within the negotiated settlement of the business crisis, taxpayers can propose to the tax authorities a payment deferral of no more than 120 instalments, which should include the whole resulting tax debt, and that instalments can be invariable or increasing, depending on the cash flow resulting from the restructuring plan, whose definition must be confirmed (or modified) by the Revenue Office.

Focus on

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The Italian production system, made up mainly of small and medium enterprises, has historically been characterized by a strong dependence on bank debt, with a subsequent need for companies to have stable relationships with credit institutions, based on trust and on a continuous exchange of information.

The trust relationship is consolidated through a constant dialogue and a typically one-way exchange of information, on the economic, wealth, and financial performance of the company, which is necessary for the credit rating assessment in order to grant and/or maintain credit lines.

From the perspective of credit institutions, the reference regulatory framework has been enriched with regulations (Basel 2, IFRS 9, new definition of default, EBA Guidelines), which have already impacted – and will still impact – the credit rating assessment and the monitoring of companies' performance.

The EBA position, known as Guidelines, specify the internal governance devices, processes, and mechanisms, the requirements on credit risk and counterparty risk, as well the requirements related to the consumer's credit rating assessment.

In particular, the Guidelines provide instructions on information, data, and other elements – including ESG ones – that credit institutions must consider when assessing credit rating at the moment of granting and/or renewing lines of credit.

The documentation requested by credit institutions to their clients, regardless of their size (small, medium, and large enterprises), is aimed to reach a – both current and future – detailed overview, allowing the same to assess the clients' capacity to comply with and repay their financial obligations.

The Guidelines attribute considerable importance to the estimation of future revenues and cash flow – which must be as real and sustainable as possible – deriving from the ordinary management of client enterprises, based on financial projections and on sensitivity analyses of the repayment capacity in case of a worsening of future economic conditions, of the organizational structure, of the business model, and of the corporate strategy.

Such revenue and cash flow estimations are carried out by credit institutions by analysing the financial position, the wealth structure, the composition of working capital, of revenue flow, of cash flow, and of the relevant capacity to fulfil contractual obligations.

Moreover, in order to periodically and constantly monitor clients' insolvency risk, EBA Guidelines suggest preparing and use specific economic and financial parameters, depending on the type of credit granted.

Companies, for their part, in order to continue such constant trust and exchange information relationship and to avoid their credit to be reduced and/or cancelled, should promptly provide any documentation requested by credit institutions in order to allow them to carry out their investigations.

This is the aim of the important updates under art. 2086, para. 2 of the Italian Civil Code and art. 3 of the Business Crisis and Insolvency Code, which impose companies of any size to start and consolidate the establishment of an own organizational, administrative, and accounting system.

The rationale under such obligation is to supply companies of a set of instruments allowing them to ensure debt sustainability on a going concern basis and a prompt identification of possible crisis situations.

In this perspective, entrepreneurs need to take many actions in order to comply with the above regulatory updates. First of all, they need to understand what are the internal and external risks which their business activity is subject to and, subsequently, to develop actions aimed to mitigate such risks, including those related to ESG issues.

From a practical perspective, entrepreneurs need to be aware of their companies' performance and the main – but not the only and exhaustive – instrument to do it is the budget, which must be prepared on a going concern basis. It must be underlined that the concept of going concern, in the light of the recent regulatory provisions, includes a period of at least 12 months.

The budget must be prepared knowing the risks and the external variables that condition the business activity. For example, in this historical moment, it is appropriate to forecast the economic performance in a context characterized by further increases in interest rates or in raw material procurement costs. Therefore, it is necessary to also forecast the so-called stress test situations (as also required under EBA Guidelines).

Preliminarily, the budget allows companies to provide credit institutions with the introductory but necessary information to assess debt sustainability, thus impacting credit rating assessment.

For example, entrepreneurs must verify whether they meet the requirements provided by the Check list issued by the Ministry of Justice on 21 March 2023 within the "negotiated settlement of the business crisis" procedure.

Therefore, it is now crucial that any entrepreneur supplies their companies with all instruments being necessary to assess their expected earning power, not only for the assessment of their management performance on a going concern basis, but also to obtain from credit institutions the necessary resources to continue the business activity.

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