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Chair of Financial Statement Analysis

**DEBT COVENANTS DISCLOSURE IN ITALIAN
LISTED COMPANIES: AN EMPIRICAL ANALYSIS
OF THE IMPACT OF IAS AMENDMENTS**

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TABLE OF CONTENTS

Introduction	3
CHAPTER 1 Theoretical and Regulatory Framework.....	5
<i>1.1 Introduction to accounting standards.....</i>	<i>5</i>
<i>1.2 IAS 1 – Presentation of Financial Statements</i>	<i>6</i>
<i>1.3 Amendments to IAS 1 (2020)</i>	<i>8</i>
<i>1.4 Feedback and enquiries about amendments</i>	<i>12</i>
<i>1.5 Amendments to IAS 1 (2022)</i>	<i>13</i>
<i>1.6 New disclosure requirements.....</i>	<i>18</i>
<i>1.7 IFRS 7 – Financial Instruments: Disclosures</i>	<i>19</i>
<i>1.8 European Common Enforcement Priorities</i> <i>for 2024 corporate reporting</i>	<i>24</i>
<i>1.9 Debt covenants: definitions and implications</i>	<i>29</i>
CHAPTER 2 Research Methods and Data Sample	36
<i>2.1 Purpose and structure of the empirical analysis</i>	<i>36</i>
<i>2.2 Sample and data collection</i>	<i>37</i>
<i>2.3 Disclosure index</i>	<i>38</i>
<i>2.4 Disclosure items and scoring system.....</i>	<i>43</i>

CHAPTER 3	Main findings and considerations.....	64
	<i>3.1 Summary of results</i>	<i>64</i>
	<i>3.2 Further analysis</i>	<i>67</i>
	<i>3.3 Content analysis of significant disclosure changes.....</i>	<i>70</i>
	<i>3.4 Limitations</i>	<i>73</i>
Conclusions.....		75
Bibliography.....		77

Introduction

In recent years, disclosure about debt covenants has become a major topic of interest for regulators, companies and investors. Covenants are conditions attached to loan agreements that may affect a company's financial flexibility and significantly increase its liquidity risk. Recognizing their importance, in 2020 the IASB issued Amendments to IAS 1 to provide guidance on how to classify liabilities as current or non-current, also introducing directions related to the classification of liabilities with covenants. Due to some concerns raised about new requirements, IAS 1 was further amended in 2022. The IASB provided clarifications and, most importantly, established new disclosure requirements related to liabilities subject to compliance with covenants. Amendments are effective for annual periods beginning on or after 1 January 2024. Additionally, even the ESMA, pursuing its objective of retail investors protection, identified debt covenants disclosure as a European common enforcement priority for 2024 corporate reporting.

This thesis aims to provide an empirical evaluation of the level of compliance of Italian listed companies with new disclosure requirements on debt covenants. The study examines the implementation process in the first year of adoption, analysing disclosure provided in the consolidated financial statements of both 2023 and 2024. Using a disclosure checklist designed to consider all relevant items, a scoring system based on a disclosure index is developed to assess companies' level of compliance in 2023 and 2024, highlighting whether any significant change has occurred since the new amendments came into effect.

Chapter 1 provides a regulatory framework covering the relevant accounting standards, as well as a detailed explanation of the role of covenants in loan arrangements. A description of the methodology by which the analysis is conducted can be found in Chapter 2. Selected sample, data collection process and the construction of the disclosure index are thoroughly outlined. Furthermore, clarifications about the scoring system are provided to ensure a transparent evaluation. In Chapter 3, results obtained are reported, including statistical comparisons to highlight trends and changes. Moreover, limitations and suggestions for future research are discussed.

CHAPTER 1

Theoretical and Regulatory Framework

1.1 Introduction to accounting standards

The IFRS (International Financial Reporting Standards) Foundation is an independent, privately organized, not-for-profit organization created in 2001 to establish and promote globally used and accepted accounting standards whose main objective is to promote trust, growth and long-term financial stability in the global economy by improving transparency, accountability and efficiency in capital markets (IFRS Foundation, 2018). IFRS Accounting Standards are the instruments through which the Foundation pursues its goals. They consist in a set of requirements followed by listed companies and financial institutions in the preparation of financial statements. IFRS Standards are set by the IASB (International Accounting Standards Board), an independent group of experts which is also responsible for approving the Interpretation of IFRS Accounting Standards provided by the IFRIC (IFRS Interpretations Committee). IFRS Foundation and IASB were established to replace the IASC (International Accounting Standards Committee), responsible for the formulation of IAS Standards from 1973 to 2001. In the same way, IFRS Standards are gradually replacing IAS Standards, although some of these latter are still applied. IAS 1 provides an example of this.

1.2 IAS 1 – Presentation of Financial Statements

IAS 1 – Presentation of Financial Statements was issued in 1997 by the IASC and later adopted by the IASB in 2001. The objective of IAS 1 is to provide “*the basis for presentation of general purpose financial statements to ensure comparability both with the entity’s financial statements of previous periods and with the financial statements of other entities*”, by setting general requirements to properly present financial statements, guidelines for their structure and minimum requirements for their content. In the scope of the Standard, it is stated that general purpose financial statements of all entities should be prepared and presented in accordance with IFRSs, as they are intended to “*to serve users who are not in a position to require financial reports tailored to their particular information needs*” (Deloitte IAS PLUS).

According to IAS 1.9, financial statements should assist users in economic decision-making by providing information about an entity’s financial position, financial performance, and cash flows. It is presumed that financial statements are drafted at least annually (IAS 1.36), and assuming the entity is a going concern. In order to be compliant with IFRSs, financial statements must comply with all their requirements, while the entity is required to make an explicit and unreserved statement of such compliance in the notes (IAS 1.16).

One of the key concept to consider in the formulation of financial statements is materiality, which should be applied to every aspect of financial statements: “*information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make*

on the basis of those financial statements, which provide financial information about a specific reporting entity” (IAS 1.7).

IAS 1.10 sets out how a complete set of financial statements should be composed:

- *A statement of financial position as at the end of the period.*
- *A statement of profit or loss and other comprehensive income for the period.*
- *A statement of changes in equity for the period.*
- *A statement of cash flows for the period.*
- *Notes, comprising material accounting policy information and other explanatory information.*
- *Comparative information in respect of the preceding period (for all amounts reported in the financial statements).*

Over the years, IAS 1 has been revised and amended several times and, even if it will be superseded by *IFRS 18 – Presentation and Disclosure in Financial Statements* that will be applied to annual periods beginning on or after 1 January 2027, there are still some important recent changes to analyse. This is the case of 2020 (*Classification of Liabilities as Current or Non-current*) and 2022 (*Non-current Liabilities with Covenants*) amendments, effective for annual periods beginning on or after 1 January 2024. In the following paragraphs both of them will be thoroughly discussed.

1.3 Amendments to IAS 1 (2020)

In January 2020, the IASB issued *Amendments to IAS 1 – Classification of Liabilities as Current or Non-current*, which should have been effective from 1 January 2022. These amendments were only intended to change the presentation of liabilities in the statement of financial position, without making any adjustments to the amount or timing of recognition of assets, liabilities, income and expenses, as well as to the disclosure required (Deloitte IAS PLUS, 2020). IASB considered these amendments as a further explanation of already existing IFRS requirements, as some contradictions detected in IAS 1 paragraphs led to misalignment in how entities classify liabilities. An additional driver that prompted the IASB to issue the amendments is the relevance for many entities of the distinction between current and non-current liabilities, which can significantly impact key metrics, covenants and liquidity measures, especially in the case of financial liabilities (BDO Global, 2020).

The 2020 amendments were mainly focused on IAS 1.69, in which requirements for the settlement of liabilities are stated. The intention of the IASB was to provide further guidance on two specific elements (BDO Global, 2024):

- *Clarification on the meaning of settlement*, needed to solve some difficult circumstances. Specifically, IASB noted that the roll-over of a liability cannot be considered settlement as economic resources are not transferred. Furthermore, some liabilities may be settled with other types of economic resources rather than cash.
- *Liabilities that an entity will or may settle by issuing its own equity instruments*. Prior the amendments, IAS 1.69 (d) stated that classification was not affected by

the “*terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments*”. However, the IASB noticed that even the transfer of equity instruments should be considered as a settlement of a liability, affecting its classification as current or non-current.

The first new feature introduced concerns precisely IAS 1.69 (d), which was significantly modified. IAS 1.69 establishes the criteria for classifying a liability as current or non-current and the revised requirements apply to all liabilities. At least one of them must be satisfied to classify a liability as current. After the amendments, the new text of IAS 1.69 is as follows. “*An entity shall classify a liability as current when:*

- a) it expects to settle the liability in its normal operating cycle;*
- b) it holds the liability primarily for the purpose of trading;*
- c) the liability is due to be settled within twelve months after the reporting period;*
- or*
- d) it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.”*

Therefore, according to the amended IAS 1.69 (d), a liability can be classified as non-current if the entity has the right to defer settlement for at least twelve months and the requirement for a right to be unconditional is removed. IASB clarify that classification is unaffected by an entity’s intentions or expectations about the exercise of its right. Moreover, the introduction of paragraph 72A explain that an entity’s right to defer settlement must have substance and the classification of a liability can be affected only by rights existing at the end of the reporting period. Related to this point, the right to defer settlement may be subject to the compliance with some conditions specified in loan

arrangements (“*covenants*”), and the right was supposed to exist at the end of the reporting period only if the entity was compliant at the end of the reporting period, no matter when the entity was required to check such compliance (BDO Global, 2020). As it will be broadly discussed in the following pages, this was one of the aspects that raised the most doubts and misunderstandings, leading IASB to introduce the new 2022 Amendments.

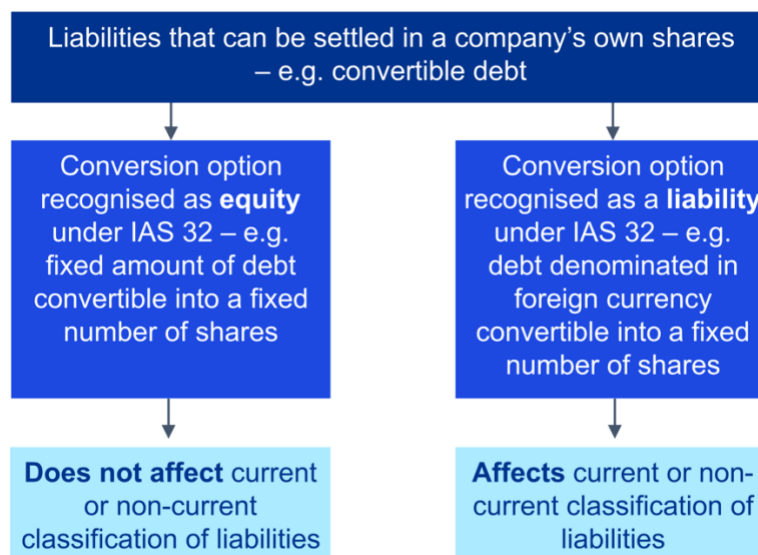
Paragraph 73 was also amended to be consistent with the other provisions. Before the amendments, IAS 1.73 stated that an entity had to classify a liability as non-current if it expects, and has discretion, to refinance or roll over an obligation under an existing loan facility for at least twelve months after the reporting date, even if the liability would otherwise be due within twelve months. Under the new amendments, intention is not relevant anymore and it is removed from the assessment, while classification of liabilities is only affected if the entity has the right to roll over an obligation for at least twelve months under an existing loan facility (BDO New Zealand, 2022).

Regarding the definition of “*settlement*”, the amendments introduce new paragraphs 76A and 76B, useful to clarify that settlement is a “*transfer to the counterparty that result in the extinguishment of the liability*”. IAS 1.76A specify that the transfer is not limited to cash, but it could also consist of other economic resources or the entity’s own equity instruments. The text of the new IAS 1.76A is the following. “*For the purpose of classifying a liability as current or non-current, settlement refers to a transfer to the counterparty that results in the extinguishment of the liability. The transfer could be of:*

- a) cash or other economic resources - for example, goods or services; or
- b) the entity's own equity instruments, unless paragraph 76B applies."

IAS 1.76B specifies the criteria and conditions under which a particular settlement mechanism of a liability is disregarded for the purposes of the classification as current or non-current. *"Terms of a liability that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying IAS 32 Financial Instruments: Presentation, the entity classifies the option as an equity instrument, recognising it separately from the liability as an equity component of a compound financial instrument."* Requirements introduced by IAS 1.76B are briefly explained in a chart provided by KPMG Global Corporate Reporting Institute (Figure 1).

Figure 1: Classification of liabilities that can be settled in a company's own shares



Source: Kegalj, G. (2022). *Classifying liabilities as current or non-current. IAS 1 amendments effective January 2024*. KPMG Global Corporate Reporting Institute.

1.4 Feedback and enquiries about amendments

The new amendments, given the relevance of the topics addressed, raised several concerns. In response to informal feedback and enquiries from stakeholders, the IFRIC published a tentative agenda to clarify how amendments should be applied by entities in particular circumstances. However, issues were not solved and the feedback to the tentative agenda was negative. This is why the IFRIC decided to turn the matter over to the IASB, since a revision of the amendments was required in light of the new information that was not considered in the formulation of 2020 Amendments and that emerged from the informal feedback to the tentative agenda (Deloitte IAS PLUS, 2022).

The point that raised biggest concerns was the application of new requirements to debt with future covenants. In its tentative agenda, the IFRIC discussed two specific situations (IFRS Foundation, 2021):

- *The right to defer settlement is subject to compliance with covenants within twelve months after the reporting date.*
- *The company would not have been compliant based on its circumstances at the reporting date.*

More specifically, according to 2020 Amendments an entity does not have a right to defer settlement of a liability if the entity would not have complied with covenants based on its circumstances at the reporting date, even though compliance with those covenants is required only within twelve months after that date (PWC Viewpoint – Global, 2022). Therefore, under the conditions discussed, an entity would not have had the right to defer settlement, and it should have classified the liability as current.

Thus, stakeholders' concerns were based on the evidence that, applying the 2020 Amendments, a liability had to be classified as current even when, at the reporting date, there was no contractual obligation to repay within twelve months. On this point, the IASB considered the right to defer settlement not absolute as it was impossible to determine at the reporting date when the liability would be repaid. The information provided is therefore insufficient to enable investors to understand the possible effects of covenants on the repayment date of a liability. Moreover, stakeholders were also worried about the failure of new requirements to consider certain conditions negotiated to capture company's specific circumstances. The Board supported stakeholders' concerns (IFRS Foundation, 2021), admitting that classification outcomes could not provide useful information when covenants involved are those *“designed to incorporate the expected effects of:*

- a) the seasonality of a company's business—for example, covenants that reflect the company's expected financial position immediately after its high season; and*
- b) the company's future performance—for example, covenants that become increasingly strict over the term of a liability”.*

1.5 Amendments to IAS 1 (2022)

Taking into account new information, in October 2022 the IASB decided to further amend IAS 1 to address concerns raised, publishing *Amendments to IAS 1 – Non-current Liabilities with Covenants*. The purpose of these amendments is to modify some of the requirements previously introduced and to defer the effectiveness of the 2020 Amendments. New amendments are effective for annual reporting periods beginning on or after 1 January 2024.

Provisions concerning the right to defer settlement remain unchanged, therefore, according to IAS 1.69 (d), a liability can be classified as non-current if at the end of the reporting period the entity has the right to defer settlement for at least twelve months after the reporting date. Moreover, the right must exist at the end of the reporting period and have substance, but it no longer needs to be unconditional. Classification remains also unaffected by intentions or expectations about whether the right will be exercised or not. What has been modified by the 2022 Amendments are some requirements introduced in 2020 concerning the classification of liabilities as current or non-current in some situations.

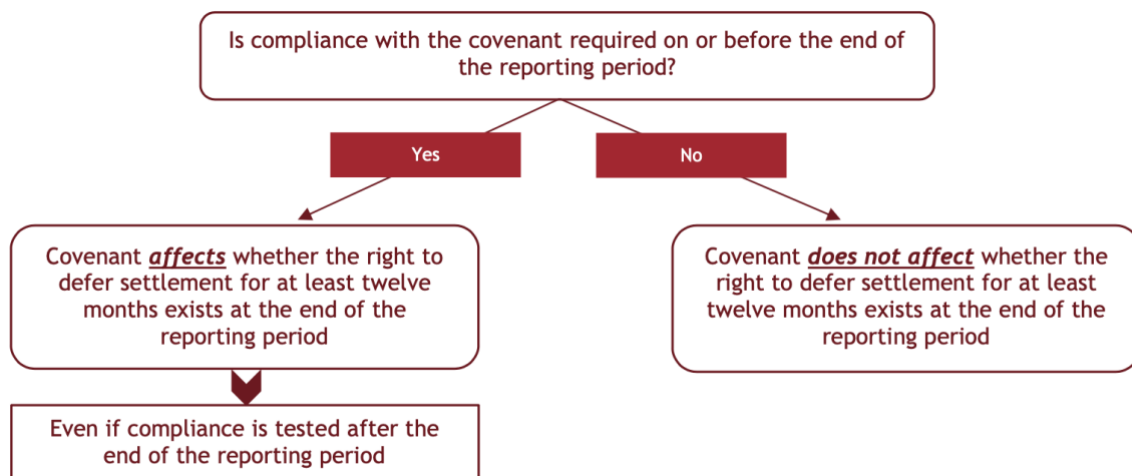
Specifically, the new paragraph 72B has been introduced to provide guidance on how to determine the right to defer settlement of a liability subject to compliance with conditions. The text of the new IAS 1.72B is the following. *“An entity’s right to defer settlement of a liability arising from a loan arrangement for at least twelve months after the reporting period may be subject to the entity complying with conditions specified in that loan arrangement (hereafter referred to as “covenants”). For the purposes of applying paragraph 69 (d), such covenants:*

- a) affect whether that right exists at the end of the reporting period—as illustrated in paragraphs 74–75—if an entity is required to comply with the covenant on or before the end of the reporting period. Such a covenant affects whether the right exists at the end of the reporting period even if compliance with the covenant is assessed only after the reporting period (for example, a covenant based on the entity’s financial position at the end of the reporting period but assessed for compliance only after the reporting period);*

- b) *do not affect whether that right exists at the end of the reporting period if an entity is required to comply with the covenant only after the reporting period (for example, a covenant based on the entity's financial position six months after the end of the reporting period)."*

Therefore, classification of liabilities is not affected by future covenants with which the company must comply after the end of the reporting period. On the other hand, if the entity must comply with covenants on or before the reporting period, the existence of the right to defer settlement is affected even if compliance is assessed after the reporting date (BDO New Zealand, 2022). The requirements introduced by IAS 1.72B are summarized by the diagram below provided by BDO Global (Figure 2):

Figure 2: Requirements of IAS 1.72B

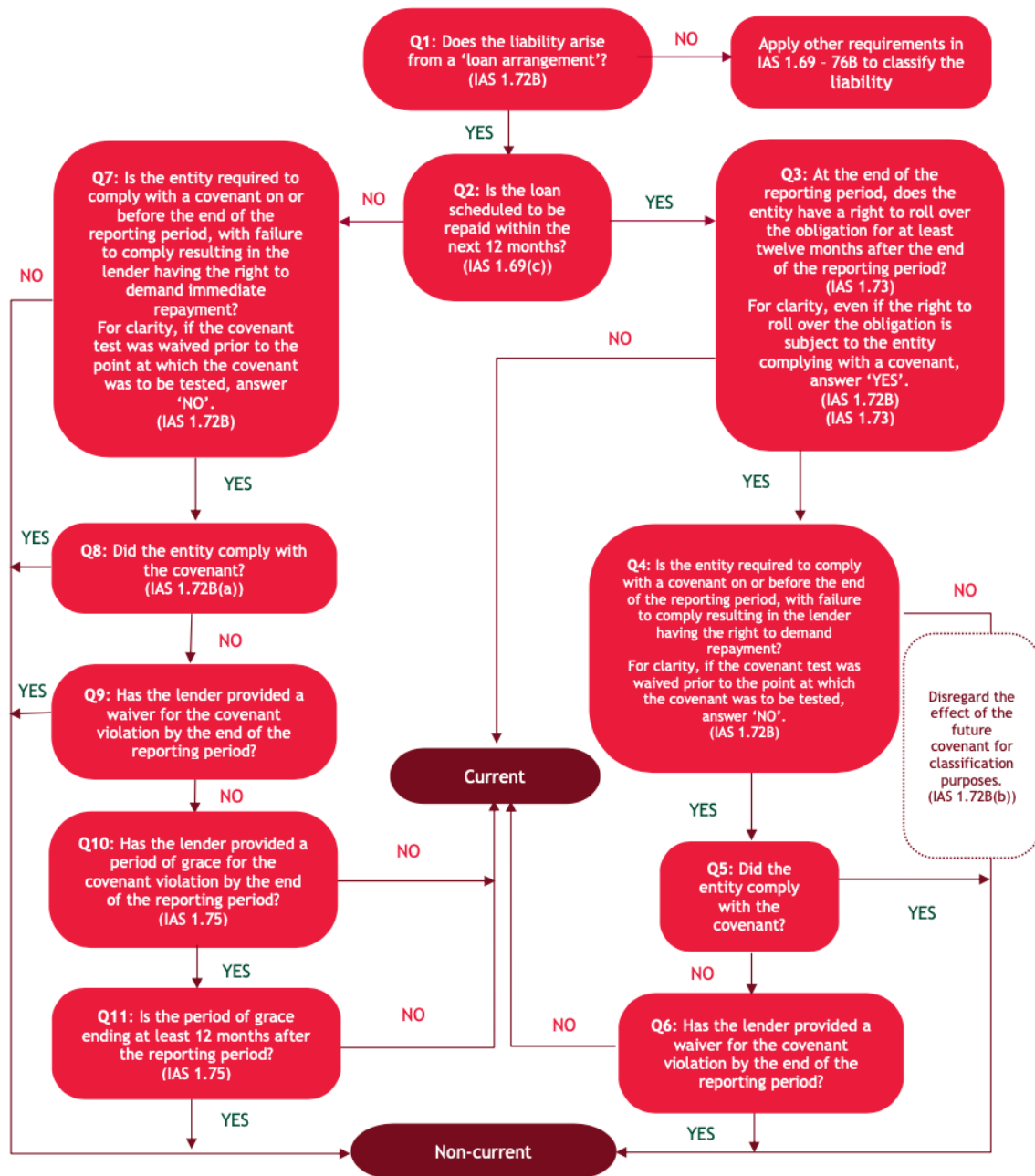


Source: BDO Global. (2024). *IFRS Accounting Standards in Practice - Classification of Loans as Current or Non-Current (2024/2025)*.

There are also other paragraphs of IAS 1 that are significantly relevant for the classification of liabilities as current or non-current, although they remain unchanged after the amendments. IAS 1.74-75 provide guidance for the classification of a liability when there is a breach of covenant. According to paragraph 74, if the company breaches a covenant on or before the end of the reporting period and the liability becomes repayable on demand, such liability is classified as current, regardless of the lender's approval not to require immediate repayment obtained after the reporting period and before the authorization of the financial statements for issue (BDO Global, 2024). In this case, at the reporting date the entity does not have the right to defer settlement for at least twelve months. However, paragraph 75 considers the case in which the lender concedes a period of grace by the end of the reporting period, ending at least twelve months after that date. During this period the entity is allowed to rectify the breach, and the lender cannot demand immediate repayment. Therefore, under these conditions the liability can be classified as non-current.

A flow chart provided by BDO Global and shown below (Figure 3) is useful to summarize the requirements for the classification of loans as current or non-current set out in IAS 1. It should be noted that it is only applicable to the classification of loans as current or non-current assuming that the settlement of the loan is in cash. Therefore, it does not address the classification of other liabilities, and it cannot be used if the settlement involves the transfer of other economic resources. Moreover, since it is only applicable to loan arrangements, the assessment of the criteria contained in IAS 1.69 (a)-(b) is not possible.

Figure 3: Classification flow chart



Source: BDO Global. (2024). *IFRS Accounting Standards in Practice - Classification of Loans as Current or Non-Current (2024/2025)*.

The last change introduced by the new 2022 Amendments is the new paragraph 76ZA, which defines new disclosure requirements for liabilities subject to future covenants. This topic will be further explained in the following paragraph as it represents a central element in the analysis conducted in this thesis.

The changes will apply to the classification of loans for the comparative period also in the first year of adoption (31 December 2024), since if a loan would have been classified differently under the new requirements, the entity would be required to classify it correctly in the comparative period (31 December 2023) (BDO Global, 2024). Moreover, in addition to restating the comparative statement of financial position at the end of the preceding period, if the amendments result in a material reclassification of liabilities, the entity is required also to restate the opening statement of financial position at the beginning of the preceding period (1 January 2023) (BDO New Zealand, 2022).

1.6 New disclosure requirements

The 2022 Amendments introduced in IAS 1 the paragraph 76ZA on new disclosure required in cases in which an entity classifies liabilities arising from loan arrangements as non-current and the right to defer settlement is subject to compliance with covenants within twelve months after the reporting period. Entities must disclose information in the notes to the financial statements to allow users to understand the risk that the related non-current liabilities could become repayable within twelve months after the reporting period (BDO New Zealand, 2024).

According to the new requirements defined in IAS 1.76ZA, disclosure about loan arrangements subject to future covenants should include:

- *Information about the nature of the covenants.*
- *When the company is required to comply with covenants.*
- *The carrying amount of liabilities affected by covenants.*
- *Facts and circumstances, if any, that indicate that the entity may have difficulty complying with the covenants. These refer to any action taken by the company during or after the reporting period to avoid or mitigate a potential breach, as well as to the fact that the entity would not have complied with the covenants if they were to be assessed for compliance based on the entity's circumstances at the end of the reporting period.*

1.7 IFRS 7 – Financial Instruments: Disclosures

As noted by some staff members at an IASB Meeting to gather feedback and recommendations about the Exposure Draft – *Non-current Liabilities with Covenants*, the new disclosure requirements introduced by the 2022 Amendments are also useful to provide information required by IFRS 7 with respect to liquidity risk, setting a point of contact and interaction between IAS 1 and IFRS 7 (IFRS Foundation, 2022).

IFRS 7 – Financial Instruments: Disclosures was issued by IASB in August 2005, and it is applied to annual periods starting on or after 1 January 2007. The objective of IFRS 7 is “to require entities to provide disclosures in their financial statements that enable users to evaluate:

- a) the significance of financial instruments for the entity's financial position and performance; and*
- b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks."*

IFRS 7 is considered as a complement of IAS 32 and IFRS 9, which establish requirements in terms of recognition, measurement and presentation of financial assets and liabilities. It shall be applied by all entities to all types of financial instruments, both recognised and unrecognised, except for those indicated in its scope (IFRS 7.3).

Disclosure should be presented by category of instruments according to IAS 39, while other disclosures are required by class of financial instruments. IFRS 7.6 states that classes are a group of financial instruments similar in terms of the nature of the information presented, taking also into account their characteristics.

The disclosure of information about the significance of financial instruments includes requirements related to the Statement of Financial Position, the Statement of Comprehensive Income and other disclosures (Deloitte IAS PLUS).

For the Statement of Financial Position, the most relevant information that entities need to disclose is the carrying amount of the categories of financial assets and liabilities specified in IFRS 9 and reported in IFRS 7.8, which can be provided both in the statement of financial position or in the notes. However, for the purpose of the analysis carried out in this work, the disclosure requirement of major interest is the one contained in

paragraphs 18-19 of IFRS 7, related to Defaults and Breaches. IFRS 7.18 specifies that *“for loans payable recognised at the end of the reporting period, an entity shall disclose details of any defaults, the carrying amount of the loan payable in default and whether the default was remedied or renegotiated before the financial statements was authorised for issue”* (CPA Australia). Moreover, paragraph 19 considers the case of a breach of loan arrangements other than those indicated in paragraph 18. The entity is required to provide the same type of disclosure if the lender is allowed to demand accelerated repayment as a consequence of the breach, unless the breach is remedied, or the terms are renegotiated on or before the end of the reporting period.

With reference to the Statement of Comprehensive Income, most relevant topics are stated in IFRS 7.20 (a), which require entities to provide information about items of income, expenses, gains, and losses, with separate disclosure of some gains and losses specified in this paragraph. Other disclosures include accounting policies for financial instruments (IFRS 7.21), information about hedge accounting, information about the fair value changes of the hedging instrument and the hedged item, and information about the fair values of each class of financial asset and financial liability (IFRS 7.25-30), except for the case in which the carrying amount is a reasonable approximation of fair value (Deloitte IAS PLUS).

To enable users of financial statements to evaluate the nature and extent of risks arising from financial instruments and how those risks are managed, entities are required to provide information about credit risk, liquidity risk and market risk, both from a qualitative and a quantitative point of view.

Qualitative disclosure is covered in IFRS 7.33, which states that *“for each type of risk arising from financial instruments, an entity shall disclose:*

- a) the exposures to risk and how they arise;*
- b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and*
- c) any changes in (a) or (b) from the previous period.”*

On the other hand, quantitative disclosure should consist of summary quantitative data about exposure to each risk at the end of the reporting period based on the information provided internally to key management personnel, disclosure about credit risk, liquidity risk, and market risk and how they are managed, and concentrations of risk (IFRS 7.34).

Information about credit risk¹ is intended to enable stakeholders *“to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows”* (IFRS 7.35B). Disclosure by class of financial instrument includes the maximum amount of exposure without considering any collateral, description of collateral and information about the credit quality of financial assets that are neither past due nor impaired.

¹ Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation (IFRS 7. Appendix A).

The disclosure about liquidity risk² is the one that is most relevant for the purpose of this thesis, since there is a close link and interaction with the new disclosure requirements contained in the amendments to IAS 1. It is addressed in IFRS 7.39, which states that “*an entity shall disclose:*

- a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities;*
- b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B);*
- c) a description of how it manages the liquidity risk inherent in (a) and (b). ”*

Market risk³ disclosure is covered in IFRS 7.40-42 and it is composed of a sensitivity analysis for each type of market risk to which the entity is exposed, methods and assumptions used and changes from the previous period with related reasons. Additional information is also required if the sensitivity analysis is not representative of the risk to which the entity is exposed. Moreover, the entity is allowed to disclose a sensitivity analysis (i.e. value at risk) that highlights interdependencies between different components of market risk instead of the sensitivity analysis previously described.

² *Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset (IFRS 7. Appendix A).*

³ *Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk (IFRS 7. Appendix A).*

In addition to paragraphs related to breaches and defaults disclosure, there are other requirements of IFRS 7 which are strictly related to IAS 1 amendments. Paragraph B10A requires entities to disclose if cash outflows could occur significantly earlier or be for significantly different amounts compared to the information provided in the summary quantitative data disclosed in accordance with paragraph 34 (a) about liquidity risk exposure. Moreover, paragraph B11F also needs to be mentioned. It includes factors that an entity should consider when providing disclosure required by IFRS 7.39 (c), among which the one with the greatest relevance is “*whether the entity has instruments that includes accelerated repayment terms (eg on the downgrade of the entity’s credit rating)*” (IFRS Foundation, 2022).

1.8 European Common Enforcement Priorities for 2024 corporate reporting

Debt covenants disclosure is a topic of absolute priority and interest particularly for companies admitted to trading on European Economic Area (EEA) regulated markets, since European Securities and Markets Authority (ESMA) has included this subject among its 2024 priorities.

ESMA is the EU’s financial markets regulator and supervisor and its mission is to enhance investor protection improving financial consumers’ ability to make informed decisions, promote orderly financial markets to support their integrity, transparency, efficiency and functioning, and safeguard financial stability strengthening the financial system and making it resilient to shocks. ESMA is part of the European System of Financial Supervision (ESFS) and it closely works in cooperation with NCAs (National

Competent Authorities) and other EU institutions, reporting regularly to the European Parliament and the Council.

In its 2023-2028 Strategy, the ESMA takes into account key risks related to the EU financial markets, as well as EU's priorities about financial services (ESMA, 2022).

The strategic priorities identified by the strategy are:

- *Fostering effective markets and financial stability.*
- *Strengthening supervision of EU financial markets.*
- *Enhancing retail investor protection.*

Each of them, as well as ESMA's mission more broadly, is guided by two thematic drivers:

- *Enabling sustainable finance.*
- *Facilitating technological innovation and effective use of data.*

For the purposes of the topics covered in this work, the enhancement of retail investor protection is undoubtedly the most relevant among the strategic priorities. Disclosure is one of the main tools through which ESMA promotes an effective protection. The rationale is to enable retail investors to make well-informed investment decisions by providing them with clear, reliable and understandable information. This would facilitate product comparison by assessing costs, risks and performance, thereby creating a safer environment to benefit from market participation.

Each year the ESMA issues a Public Statement in which the European Common Enforcement Priorities (ECEP) for annual financial reports of issuers admitted to trading on EEA financial markets are set out. Priorities represent some specific topics to which ESMA and national enforcers will give special attention in the examination of the application of main reporting requirements. Recommendations are included in the Public Statement on the basis of their materiality for the issuer's operations and should be considered in the preparation and supervision of the annual financial reports.

The 2024 Public Statement is divided in four sections. Three of them contains 2024 ECEP concerning IFRS financial statements, sustainability statements and annual financial reports, while the last one is called "*General considerations and reminders*". Even if it does not constitute ECEP, the fourth section includes some key topics to be considered to ensure best and transparent corporate reporting practices, among which the most relevant is the "*Connectivity between financial and sustainability statements*" (ESMA, 2024). The first three sections establish the following European Common Enforcement Priorities for 2024 corporate reporting:

- *Section 1: Priorities related to IFRS financial statements.*
 - *Priority 1: Liquidity considerations.*
 - *Supplier Finance Arrangements (SFA)*
 - *Covenants*
 - *Statement of Cash Flows (SCF)*

- *Priority 2: Accounting policies, judgements, significant estimates.*
 - *General remarks*
 - *Control, joint control and significant influence*
 - *Revenue from contracts with customers*
- *Section 2: Priorities related to sustainability statements.*
 - *Priority 1: Materiality considerations in reporting under ESRS.*
 - *Priority 2: Scope and structure of the sustainability statement.*
 - *Priority 3: Disclosures relating to Article 8 of the Taxonomy Regulation.*
- *Section 3: Priorities related to ESEF reporting.*
 - *Priority 1: Common errors found in the Statement of Financial Position.*

Topics covered in this thesis are included in Liquidity Considerations, which are part of the priorities related to IFRS financial statements. Briefly discussing the others points on which ESMA focuses its attention, the relevance of Supplier Finance Arrangements is related to the new disclosure requirements about issuer's exposure to liquidity risk introduced by amendments to IAS 7 and IFRS 7. Issuers are required to disclose information about both terms and conditions of the SFA and how liquidity risk inherent in the related liabilities is managed. Concerning the Statement of Cash Flows, ESMA reaffirms the importance of some requirements against which enforces detected cases of non-compliance in the past. The most significant are the gross basis presentation of SCF, the impossibility to recognise non-cash transactions in the SCF and the need to disclose non-cash investing and financing transactions in other sections of the financial statements. Moreover, the focus is also on bank borrowings, which are generally classified as financing activities, as well as on the requirement for clarity and transparency

on accounting policies and judgements made to classify cash flows and/or components of cash and cash equivalents (Jubels, 2024).

Lastly, with regard to covenants, topics covered correspond to those discussed in the regulatory introduction to this chapter. ESMA considers a priority the correct implementation of new disclosure introduced by *Amendments to IAS 1 – Non-current Liabilities with Covenants*, in addition to the requirements under IFRS 7 related to defaults, breaches or renegotiations of loan agreements (IFRS 7.18-19). In light of ESMA's objective to protect retail investors, it is clearly obvious that the emphasis is mainly on the new paragraph 76ZA of IAS 1, which requires proper disclosure of information to allow stakeholders to understand the risk that liabilities could become repayable within twelve months after the reporting periods. Another point of interest is represented by criteria established by IAS 1.69, as well as by the removal of the significance of management intentions or expectations for the purposes of classifying liabilities as current or non-current. Moreover, ESMA considers particularly relevant the disclosure of information about the timing of settlement to make the impact of the liability on financial position understandable (IAS 1.75A), as well as the reclassification of a liability as current when the entity is not compliant with covenants at the end of the reporting period even if it has obtained a waiver after that date (IAS 1.74) (ESMA, 2024).

1.9 Debt covenants: definitions and implications

To better understand the relevance of new amendments about covenants and their disclosure both for companies and investors, it is useful to briefly introduce the theory, analysing what covenants are, what is their role and what are the consequences of a violation.

Covenants can be divided in three categories according to their characteristics (Nini et al., 2012). The first type involves *affirmative (or positive)* covenants, which define actions that the borrower is required to take (provide the lender with financial information, comply with law and accounting standards, buying insurance, etc.). On the other hand, there are *negative (or restrictive)* covenants, whose main purpose is to prevent certain type of actions taken by the borrower that could be detrimental for the lender (changing the nature of the business or the control of the company, limitations on the disposal of assets, capital expenditures or payment of dividends, and other restrictions on stock issues and mergers) (Nini et al., 2012; Chava et al., 2019). Lastly, there are *financial* covenants, defined as accounting-based risk and performance limits. They are built around some key accounting ratios and the borrower is required to maintain them within predetermined limits, since they usually represent restrictions on company's leverage, interest coverage, total fixed charges, and net worth (Nini et al., 2012; Demerjian, 2007).

The financial ratio covenants most widely used in the practice can be divided in five main categories (Demerjian, 2007):

- *Minimum Coverage (Earnings / Periodic Debt-related Expenses)*
- *Maximum Debt to Cash Flow (Total Debt / Earnings)*

- *Minimum Net Worth (Assets – Liabilities = Shareholders' Equity)*
- *Maximum Leverage (Total Debt / Total Assets)*
- *Minimum Current (Current Assets / Current Liabilities)*

Although they are more frequent and set in a more detailed and tight manner in private loan agreements, financial covenants are used in all types of debt contracts. Moreover, the nature of the contract influences the frequency with which compliance is assessed. In private debt, the borrower is required to be compliant on a regular basis and covenants are tested more than once per fiscal year. In this case, financial covenants are *maintenance-based*. Conversely, in bond indentures they are typically *incurrence-based*, since they need to be respected only at the time of a specific event, like for example a new debt issue (Nini et al., 2012).

Covenants are intended to mitigate the conflict of interest between lenders and borrowers arising from the agency costs of debt. Indeed, information asymmetry and some behaviours of managers and shareholders could increase default risk, imposing agency risk on lenders (Chava et al., 2019).

It is interesting to analyse more specifically how financial covenants address this issue. For this purpose, it is useful to distinguish financial covenants in two categories, *capital covenants* and *performance covenants*, which control the conflict of interest through two distinct mechanisms (Christensen & Nikolaev, 2012).

Capital covenants (or C-covenants) are formulated only around balance sheet information about sources and uses of capital, seeking to keep the level of leverage under control. Therefore, through restrictive capital requirements to contain the level of debt, C-covenants act ex-ante on the agency problem by aligning debtholders and shareholders interests. Since shareholders are required to maintain certain amount of equity capital inside the firm, their wealth is sensitive to opportunistic managerial actions that may decrease firm value. This is why shareholders are more incentivised to monitor management's actions, making their interests more aligned with those of debtholders (Christensen & Nikolaev, 2012).

On the other hand, performance covenants (or P-covenants) are designed as ratios that express current-period performance or efficiency, and they are based on income statement and cash flow statement information, which can sometimes be combined with balance sheet data (interest coverage, debt-to-earnings, debt-to-cash flow, etc.). Implementing P-covenants in a debt contract, the agency problem is addressed with a different approach. Since they are timely indicators of poor performance, they can be considered as *trip wires* that reallocate control to debtholders when the value of their claim is at risk, allowing them to prevent suboptimal managerial actions (Christensen & Nikolaev, 2012).

It is important to investigate also the rationale behind the choice of financial ratio covenants in debt contracts. Usually, covenants are designed around borrower or contract characteristics, since they include ratios that are informative of credit risk (Demerjian, 2007). Each type of financial ratio is linked to credit risk in a different way, capturing one

of its three aspects. According to the analysis provided by Demerjian (2007), the three aspects of credit risk are “*profitability and operating performance (coverage, debt to cash flow, and net worth), total indebtedness (leverage), and short-term liquidity (current)*”.

For stable and profitable firms, most informative ratios are those measured with earnings taken from the income statement. Therefore, interest coverage and debt to cash flow covenants are more likely to be associated to borrowers with positive earnings, high profitability, and low volatility earnings. On the other hand, loan contracts of borrowers with negative earnings, low profitability, and high volatility earnings usually include net worth covenants, since they are measured with shareholders' equity that is more informative of credit risk for poorly performing and volatile firms. Moreover, leverage covenants, measuring indebtedness, are suitable for borrowers with revolving lines of credit, given the easiness with which they can raise additional debt. Lastly, current ratio covenants, which measures short-term liquidity, are frequently included in contracts of borrowers with high levels of working capital, as they are informative of credit risk in case of high current accounts (Demerjian, 2007).

Not always companies manage to be compliant with covenants. “*Violations are defined as technical defaults of financial debt covenants, regardless of the outcome*” (Bhaskar et al., 2017). The event of default triggered by the breach of a covenant gives the lender the right to seek remedies by demanding immediate repayment of the full amount of the loan balance (*acceleration right*) or by renegotiating the credit agreement to change terms of the loan or to increase monitoring, which is typically the most common approach (Nini et al., 2012; Beneish & Press, 1993).

Contractual rights that the lender is entitled to exercise following a technical violation may impose renegotiation, refinancing and restructuring costs on the borrower (Beneish & Press, 1993). Renegotiation costs refer to the costs incurred to rewrite contracts and they are usually considered the direct costs of financial distress. Refinancing costs are incremental costs of financing associated with an increase in interest rates by lenders as a consequence of technical violations, while restructuring costs arise from lenders' repayment claims and relate to the change in capital structure and modification of operations. Both of them are considered indirect costs. Evidence suggests that costs are lower for firms that can obtain a waiver, showing how they are dependent on lenders' response. However, waivers are not free of costs, since they are usually granted in return for commissions and concessions (Beneish & Press, 1993).

The reported costs are not the only consequences that a debt covenant violation (DCV) may cause. Many of them will be discussed below, starting with some implications that arise even before the occurrence of a DCV.

As demonstrated by the study carried out by Bourveau et al. (2022), managers are inclined to change their forecasting behavior by strategically altering voluntary disclosure to stakeholders when the threat of a DCV is imminent (Bourveau et al., 2022). The most common practice consists of issuing optimistic forecasts, as evinced by those issued in the quarter before a DCV, which result more optimistically biased than the others. The purpose of these actions is not to avoid a DCV, but rather to minimize related costs and to delay as much as possible its discovery by lenders. In this way, managers can buy time to take actions that benefit shareholders but which would be opposed by lenders

after a shift of control rights. Indeed, benefits for the firm and for themselves are what motivates managers to deliberately bias their voluntary disclosure. Findings highlight how this practice can be valuable to managers, since it significantly decrease their likelihood of being replaced after a DCV (Bourveau et al., 2022).

After a breach of a covenant, creditors obtain the same contractual rights as in cases of failure to repay. However, even considering a more conservative financial and investment policy implemented following a violation, lenders' control may be beneficial for companies. The analysis conducted by Nini et al. (2012) underlines an improvement in both firm's operating performance and market-equity valuation following a violation. More specifically, operating cash flow shows a strong positive reversal driven by reduced operating expenses, suggesting that changes introduced following a violation significantly improve operating efficiency of the company. Therefore, corrective actions undertaken by lenders with a strong corporate governance role can be beneficial also for shareholders of the violating company, as they can ensure a turnaround in company performance and increase the value of the firm (Nini et al., 2012).

Other costs resulting from debt covenant violations are associated with auditor actions. Violations typically increase auditors' business risk and reputational concerns. Therefore, to mitigate their exposure to risk, auditors implement three types of response that are positively associated with debt covenant violations: significant increase in audit fees, issue of a going concern opinion, and resignation from the engagement (Bhaskar et al., 2017). Positive associations are observed for both financially distressed and nondistressed firms with at least one debt covenant violation. Moreover, violations by

nondistressed firms provide more information to auditors compared to those of distressed firms, since they may signal issues about performance that are not readily detectable from the existing data. This is reflected on the impact of a violation on auditors' going-concern decisions, which is stronger for nondistressed firms (Bhaskar et al., 2017).

Information asymmetry and shareholder uncertainty are other adverse consequences of debt covenant violations. As documented by Gao et al. (2017), "*outside investors likely have less information than managers and creditors about the severity of a DCV*", resulting in significantly higher bid-ask spreads and return volatility in the quarter following a DCV. Also in this case, results are consistent even for firms with a low risk of bankruptcy (Gao et al., 2017). Furthermore, debt covenant violations result also in increased systematic and unsystematic risk, and higher financial leverage is the main driver of the change in systematic risk (Fargher et al., 2001).

As a consequence of a violation, investors are likely to have heightened scrutiny by enhancing their demand for disclosure on firm performance to make informed decisions, as they are concerned about a potential value expropriation from managers and wealth transfers to creditors (Christensen et al., 2019). Therefore, in accordance with the arguments discussed above, it appears evident the significance of the new disclosure requirements concerning liabilities with covenants to ensure that investors can make informed decision and assess risks even before that a breach of a covenant occurs.

CHAPTER 2

Research Methods and Data Sample

2.1 Purpose and structure of the empirical analysis

Disclosure can be defined as “*the communication of financial and non-financial information to the stakeholders of a firm*”, making it publicly available to potential users (Kavitha & Nandagopal, 2011). In this chapter, an analysis of debt covenants disclosure is conducted. This is a mandatory disclosure, as it “*refers to information obliged through the regulatory framework in accordance to the terms of accounting standards and principles, corporate law and stock exchange listing requirements*” (Kavitha & Nandagopal, 2011). More in detail, the work centers on the new disclosure requirements introduced by IAS 1 amendments (IAS 1.76ZA), while also addressing Liquidity Considerations related to covenants included in the 2024 ESMA priorities.

The purpose of this analysis is to assess the level of compliance with debt covenants disclosure requirements by a sample of Italian listed companies, as well as to highlight whether the same companies improved their disclosure in response to IAS 1 amendments and 2024 ESMA priorities in the first year of adoption. The first phase involves data collection by downloading the firms’ financial reports, needed to analyse sections related to debt covenants and liquidity risk disclosures. The following step is the creation of a disclosure grid to be applied to each company. The grid consists of a checklist of items to be rated in order to compute a disclosure index that highlights the level of disclosure of a firm. The last stage entails the investigation of results, which will emphasize the level of adoption of debt covenants disclosure requirements.

It is interesting to note that, despite for a mandatory disclosure requirement no difference is expected in how companies apply the same accounting standards, several studies identified divergences among companies with regard to compliance with mandatory disclosure (Lucas & Lourenço, 2014). Furthermore, previous researches show that the average levels of compliance vary between 70% and 80%, indicating that not all companies fully comply with disclosure requirements (Tsalavoutas, 2011). Therefore, considering these premises and the shortage of previous work focused on both mandatory disclosure compliance and first year of adoption (Lucas & Lourenço, 2014; Tsalavoutas et al., 2020), the analysis performed in the following paragraphs appears particularly relevant to evidence how the new debt covenants disclosure requirements have been implemented.

2.2 Sample and data collection

This study examines the disclosure about debt covenants of companies listed on the Euronext Milan market. Therefore, the FTSE Italia All-Share index can be used as a panel data set, including 193 companies as of April 2025. Due to the lack of comparability between their financial statements and those of companies operating in other sectors, 24 banks, financial services providers, and insurance companies are not considered in this analysis. Furthermore, the overall sample is adjusted by removing 3 companies that were not listed on this market in 2024 and 8 firms whose fiscal year does not end on December 31st, as well as by ignoring 11 companies that reported to have no covenants attached to their loan arrangements. A last correction is required to exclude 35 firms that had not yet publicly released their 2024 financial report as of April 24th, 2025. Thus, the final sample considered for this analysis is composed of 112 companies.

The choice to consider firms listed on the Euronext Milan market is consistent with the purpose of this thesis, since their financial statements are publicly available to investors. Moreover, all of them are supposed to comply with disclosure requirements set by IFRS Accounting Standards and to take into account ESMA priorities when preparing their financial reports.

The analysis conducted in this work consists of a survey of the annual reports of both 2023 and 2024 published by companies included in the sample, as the annual report and accounts are generally considered the most important source of disclosure (Marston & Shrives, 1991). Consolidated financial statements are available and can be downloaded from each firm's website, as well as from Regulated Information storage and disclosure systems like “*eMarket Storage*” and “*IInfo*”. Since IAS and IFRS do not specify a predetermined order to be followed in the preparation of the Notes to the financial statements, a keyword search for the terms “Covenant” and “Liquidity Risk” is employed to quickly identify sections of interest.

2.3 Disclosure index

The approach employed in this research is the application of a disclosure index, a method that has been widely used and accepted in previous literature. An index “*is a general approach to convert natural language text data into a number that can be used for further quantitative statistical analysis*”, since it provides a measure representing the level of disclosure by scoring a checklist of items (Kavitha & Nandagopal, 2011).

In order to construct an index, the first step involves the selection of a set of items to measure a company's level of compliance with identified disclosure requirements (Marston & Shrives, 1991; Kavitha & Nandagopal, 2011). Therefore, a self-constructed disclosure checklist is developed on the basis of disclosure requirements set by paragraph 76ZA of IAS 1 and by 2024 ESMA priorities related to covenants. The checklist, which is more extensively discussed in the next paragraph, is composed of the following nine disclosure items divided in three sections:

- Covenants information
 - Nature of non-financial covenants
 - Financial covenants calculation methods
 - Date of compliance
 - Carrying amount of related liabilities
- Compliance risk
 - Facts and circumstances indicating difficulties in complying
 - Compliance analysis at the reporting date
- Liquidity Risk
 - Consequences in case of non-compliance
 - Risk mitigation actions
 - Defaults, breaches and renegotiations

A further relevant issue concerns the choice between a weighted or an unweighted disclosure index. The rationale behind the adoption of a weighted disclosure index is the assumption that items included in the disclosure checklist have different levels of importance and are consistently weighted. Several criticisms have been raised against this

approach, including the tendency of different users to assign different weights, researchers' inclination to solely focus on a particular group of users, and, consequently, the significant subjectivity involved in sample and user group selection (Kavitha & Nandagopal, 2011; Abdullah & Minhat, 2013). On the other hand, an unweighted disclosure index assumes that all the items of disclosure are equally important (Cooke, 1989). The main advantage of this method is related to the simplicity of scoring. Moreover, since the assignment of weights is not biased, it helps to reduce subjectivity providing a more independent analysis. These features make the unweighted disclosure index the most frequently adopted approach in previous researches analysing compliance with disclosure requirements (Kavitha & Nandagopal, 2011; Abdullah & Minhat, 2013; Tsalavoutas et al., 2010; Chavent et al., 2006).

The most common type of unweighted index is the *Dichotomous method* (or *Cooke's method*), in which an item can be scored 1 if it is disclosed, 0 if it is not disclosed, or not applicable (N/A) if an item is not relevant to a particular company to avoid penalizing a firm for an irrelevant lack of disclosure (Cooke, 1989; Abdullah & Minhat, 2013). Therefore, as reported by Tsalavoutas et al. (2010), using Cooke's method, "*the disclosure index for each company is then calculated as the ratio of the total items disclosed to the maximum possible score applicable for that company*:"

$$C_j = \frac{T = \sum_{i=1}^n d_i}{M = \sum_{i=1}^m d_i}$$

where C_j is the total compliance score for each company and $0 \leq C_j \leq 1$. T is the total number of items disclosed (d_i) by company j and M is the maximum number of applicable disclosure items for company j that could have been disclosed".

Several researches adopted a modified version of the Dichotomous method called *Cooke's adjusted*. With this approach, the score is dependent on the completeness and the level of detail of the disclosure (Tsalavoutas et al., 2020). In their study, Lucas & Lourenço (2014) provide an example of how items are scored using *Cooke's adjusted* method: “1 if the item is totally disclosed; 0.5 if the item is partially disclosed; and 0 if the item is not disclosed”.

For the purpose of this thesis, a similar disclosure index is constructed, while the items in the disclosure checklist are scored from 0 to 3 as follows: 0 if the item is not disclosed; 1 if it is disclosed with only minimal details; 2 if it is partially disclosed but some critical details are missing; and 3 if the item is fully disclosed. Items considered as irrelevant for each company are scored as N/A and do not enter in the index.

Using the same formula applied by Lucas & Lourenço (2014), after an adjustment to the definition of numerator and denominator to make them consistent with reported scores, the disclosure index for each company is computed as follows:

$$INDEX = \left[\sum_{i=1}^j d_i \right] / n$$

where $INDEX$ = Disclosure index, d_i = score assigned to disclosure item i , which can range from 0 to 3 (or N/A) as explained above, j = number of items applicable to the company, and n = highest score achievable by the company (number of relevant items multiplied by 3). With this formula, the index is expressed as the ratio between the score assigned to each company and the highest score achievable in case of full compliance with all relevant disclosure requirements. As in the study conducted by Lucas & Lourenço

(2014), “it represents the total details given by a firm on the set of disclosure items as a percentage of the total details that each firm should disclose”. Furthermore, the closer the index to 1, the higher the level of disclosure, with 1 indicating full compliance with relevant disclosure requirements.

The disclosure grid below (Figure 4), summarizing the disclosure checklist and the scoring system, can be applied to each company for the calculation of the disclosure index. In the next paragraph, examples of disclosure are provided to clarify how each score is awarded.

Figure 4: Disclosure grid

	Disclosure Items	Score				
		N/A	0	1	2	3
Covenants Information	Nature of non-financial covenants					
	Financial covenants calculation methods					
	Date of compliance					
	Carrying amount of related liabilities					
Compliance Risk	Facts and circumstances indicating difficulties in complying					
	Compliance analysis at the reporting date					
Liquidity Risk	Consequences in case of non-compliance					
	Risk mitigation actions					
	Defaults, breaches and renegotiations					

Source: Student’s own elaboration.

2.4 Disclosure items and scoring system

This section provides an in-depth discussion of disclosure items included in the checklist for the computation of the index. For each item, an overview of what a company's disclosure must comprise in order to receive a given score is provided. Moreover, a practical example taken from financial reports of the companies in the sample is attached to every option to clarify the scoring system. For those items for which N/A is a scoring option, the circumstances under which the company is relieved from that type of disclosure are outlined.

Covenants information

a) Nature of non-financial covenants: This item measures the extent of non-financial covenants disclosure, since companies are supposed to specify requirements, limitations, and obligations to which they are subject.

- **Score N/A:** The company is not required to comply with positive or restrictive covenants.
- **Score 0:** Non-financial covenants are not mentioned in the financial report, and there is no indication that the company is not subject to compliance with them.
- **Score 1:** The existence of covenants is reported by the company, but details concerning their nature and implications are not disclosed. This rating is assigned to disclosures similar to the one of LU-VE, which states that *“a significant portion of the Group’s loan agreements include cross-default – cross acceleration clauses, negative pledge clauses and pari passu clauses”*.

- **Score 2:** Information provided briefly explains the categories of covenants imposed and their purpose, without further discussing all the requirements. Another scenario occurs when full disclosure is made on some covenants, while details on the others are incomplete. Iveco matches this description, as it affirms that *“according to standard market practice, the agreements governing debt instruments, depending on the rating status of the debtor and market conditions at the time of the execution of such financing instruments, could contain covenants restricting the Group’s ability to, among other things: (i) incur additional indebtedness by certain subsidiaries; (ii) make certain investments; (iii) enter into certain types of transactions with affiliates; (iv) sell or acquire certain assets or merge with or into other companies; and/or (v) pledge assets as security for other obligations”*.
- **Score 3:** Disclosure about the nature of each non-financial covenant is complete and provides a detailed analysis of all requirements and limitations. For this item, the highest level of disclosure is achieved by Leonardo, which provides detailed information about negative pledge and cross default clauses. In its Integrated Annual Report 2024, Leonardo informs that *“according to negative pledge clauses, Leonardo and its Material Subsidiaries (i.e. entities in which Leonardo holds more than 50% of the capital and whose gross revenues and total assets account for at least 10% of consolidated gross revenues and total assets) are specifically prohibited from creating collaterals or any other encumbrance as security for their debt comprised of bonds or financial*

instruments that are either listed or capable of being listed, unless these guarantees are extended to all the bondholders. This prohibition shall not apply to securitization transactions and to any set of assets intended for specific businesses pursuant to Articles 2447-bis and ff. of the Italian Civil Code. On the contrary, cross default clauses grant the bondholders the right to request early repayment of bonds in their possession upon the occurrence of an event of default on the part of Leonardo and/or any of its Material Subsidiaries, the result of which would be their failure to make payments above the established limits”.

b) Financial covenants calculation methods: It relates to the explanation of the parameters applied to assess compliance with covenants, such as financial ratios employed and thresholds applied.

- **Score N/A:** The company is not required to comply with any financial covenant.
- **Score 0:** Compliance assessment methods are not provided.
- **Score 1:** The source of the information used to assess compliance is disclosed by specifying whether capital or performance covenants are applied. However, financial ratios and/or thresholds are missing. The 2024 annual financial report published by Pharmanutra can be taken as an example, since it simply states that “*the loan includes a financial covenant based on the NFP/EBITDA parameter*”, without providing the relevant threshold.

- **Score 2:** The company provides details about all financial ratios with the associated thresholds to be respected, but it is not explained how elements involved in the computation are determined. This rating is well represented by the information disclosed by Tinexta for each of its liabilities subject to compliance with covenants. In its notes to the financial statements, for a specific bank loan, Tinexta affirms that *“the group has committed to respect the following financial limits: NFP/EBITDA less than 3.5 and NFP/Shareholders’ Equity less than 2.0”*.
- **Score 3:** Disclosure is comprehensive of all financial ratios, thresholds and methods applied to determine elements needed to calculate ratios. Sogefi is one of the companies with the highest level of compliance with this item. The following is an abstract of the details provided with regard to financial covenants applying to an outstanding loan: *“the ratio of consolidated net financial position to consolidated normalised EBITDA has to be less or equal to 4; the ratio of consolidated normalised EBITDA to consolidated net financial expenses must not be less than 3”*. To better explain how performance indicators are constructed, Sogefi provides relevant definitions of all the elements involved in the computation of financial ratios. Citing one of them, the company clarifies that *“Normalised EBITDA (used to calculate covenants) is calculated by summing “EBITDA” and the following expenses and revenues arising from non-ordinary operations: “Restructuring costs” and “Losses (gains) on disposal”*”. In addition, some companies also disclose the cases in which they are allowed to exceed limits. Indeed, as reported by Amplifon with

reference to the net worth ratio and the leverage ratio, “*typically, in the event of sizeable acquisitions, the first two ratios may be increased to 2.20 and 3.26, respectively, for a period of not more than 12 months, twice over the life of the respective loans*”.

c) Date of compliance: It is the disclosure item that verifies if the company discloses the date when it is required to be in compliance with covenants, as well as the frequency of the assessment of compliance.

- **Score N/A:** The company is not required to comply with any financial covenant.
- **Score 0:** No specification of compliance date.
- **Score 1:** The company declares that covenant compliance is assessed during the year, but it provides only minimal information and indirect or implicit references about the timing of assessment, without indicating the exact dates and frequency. As an example, asserting that “*at December 31, 2024 the Group respects all the reference parameters foreseen by the contract*”, Emak implicitly confirms that compliance assessment is performed at least once a year, although it does not provide a detailed timeline.
- **Score 2:** Information about the date of compliance or the frequency of assessment is disclosed. A further case occurs when full disclosure is provided only for some covenants. For instance, referring to information reported by Esprinet concerning one of its liabilities, “*the unsecured amortising 5-year loan granted to Esprinet S.p.A. by Cassa Depositi e*

Prestiti S.p.A., expiring in December 2025, for a total of 7.0 million euro in principal as at 31 December 2024, also provides for the annual compliance with a given ratio of net financial position to EBITDA at consolidated level, but also half-yearly compliance with a given ratio of consolidated net financial position to net equity”.

- **Score 3:** Detailed disclosure of the timeline of compliance and assessment frequency for all covenant categories. The best examples for this level of disclosure are represented by Prysmian, which highlights that “*the financial covenants are measured at the half-year reporting date of 30 June and at the full-year reporting date of 31 December*”, as well as by ERG, which provides a comprehensive table of financial covenants applied to its loans and project financing (Figure 5).

Figure 5: Financial parameters relating to the Group’s loans/Project Financing (ERG)

2024 Financial Statements	2023 Financial Statements	Project Financing/Loans	Financial covenant(s) deadline	Compliance with covenant(s)	Event of Default	Remedies in case of Event of Default*
✓	✓	Windpark Linda GmbH Project Financing	15/03 - 15/09	✓	HDSCR less than 1.05x	✓
✓	✓	Andromeda PV S.r.l. Project Financing	15/05 - 15/11	✓	Historical Annual DSCR and Projected Annual DSCR greater than 1.10x	✓
✓	•	Project Financing C.E.P.E. Renouvellement Haut Cabardès SAS	within 10 working days after 30/06	✓	HDSCR less than 1.05x	✓
✓	✓	Corporate Loan February 2028 EUR 130,000,000	n/a	n/a		n/a
✓	✓	Corporate Loan March 2028 EUR 100,000,000	n/a	n/a		n/a
✓	✓	Corporate Loan May 2028 EUR 100,000,000	n/a	n/a		n/a
✓	•	Corporate Loan March 2029 EUR 90,000,000	n/a	n/a		n/a

LLCR: Loan Life Cover Ratio
 HDSCR: Historical Debt Service Coverage Ratio
 FDSCR: Forecast Debt Service Coverage Ratio
 * Contractually established remedies that the company can take to avoid default.

Legenda:
 ✓ Present
 • Not present
 n/a Not applicable

Source: ERG Integrated Annual Report 2024

d) Carrying amount of related liabilities: This item refers to the carrying amount of liabilities subject to covenants. Firms should also provide a specific link between each value and the corresponding covenant.

- **Score 0:** Disclosure does not include the book value of liabilities for which compliance with covenants is required.
- **Score 1:** The total amount of liabilities affected by covenants is provided. However, it is not broken down into categories and there are no direct linkages with covenants. This is the case of SECO, which delivers the total amount of non-current financial liabilities as shown in the table below (Figure 6), asserting that *“this item refers to the medium/long-term portion of outstanding loans. In line with market practice for borrowers of similar credit standing, the main financing agreements call for meeting certain financial covenants, based on which the company is committed to meeting certain financial indicators defined by contract”*.

Figure 6: Non-current financial liabilities (SECO)

Category	31/12/2024	31/12/2023	Change
Non-current financial liabilities	(97,734)	(106,928)	9,194
Total non-current financial liabilities	(97,734)	(106,928)	9,194

Source: SECO Annual financial report at December 31, 2024.

- **Score 2:** The carrying amount of each liability is well disclosed and divided into types of financing. However, the association with covenants is missing. The disclosure provided by d’Amico International Shipping is representative of this score category. As summarized in figures 7 and 8, in addition to the total value of liabilities divided by categories, detailed

information concerning the carrying amount of each outstanding loan is given.

Figure 7: Banks and other lenders as at 31 December (d’Amico International Shipping)

US\$ Thousand	2024	2023
Banks and other lenders – <i>Non-current</i>	192,059	216,656
Financial fees – <i>Non-current</i>	(1,630)	(1,918)
Banks and other lenders – Non-current liabilities	190,429	214,738
Banks and other lenders – <i>Current</i>	26,781	29,313
Financial fees – <i>Current</i>	(550)	(614)
Banks and other lenders – Current liabilities	26,231	28,699
Total Bank and other lenders	216,660	243,437
Fixed rate	78,596	131,024
Floating rate	140,244	114,945
Financial Fees	(2,180)	(2,532)
Total Bank and other lenders	216,660	243,437

Source: d’Amico International Shipping Annual Report 2024

Figure 8: Bank loans outstanding as at 31 December 2024
(d’Amico International Shipping)

US\$ Thousand	Assets	Issue date	Maturity	2024
Skandinaviska Enskilda Banken AB US\$ 20.0m Term Loan Facility	Cielo Bianco	Dec. 2021	17 Dec. 2027	15,440
ABN Amro N.V. – Sustainability linked loan US\$43.0m Term Loan Facility	Cielo di Gaeta	Dec. 2021	23 Dec. 2026	4,559
ING Bank N.V., London Branch & S.E.B AB US\$82.0m Term Loan Facility	Cielo di Cagliari, Cielo Rosso, Cielo di Rotterdam, Cielo di New York	Jul. 2022	27 Jul. 2027	54,684
Tokyo Century Corporation US\$ 21.8m Term Loan Facility	High Challenge	Nov. 2015	17 Jul. 2027	5,527
Danish Ship Finance A/S US\$ 25.2m Term Loan Facility	High Seas, High Tide	Jul. 2022	20 Jul. 2029	17,100
Crédit Agricole CIB & ING Bank N.V. London Branch US\$ 54.2m Term Loan Facility	Glenda Meryl, Glenda Melissa, Cielo di Capri	Sep. 2022	30 Sept. 2027; 12 Oct. 2027*	24,208
The Iyo Bank US\$ 17.5m Term Loan Facility	High Explorer	May 2023	1 Jun. 2031	15,475
NTT TC Leasing Co., Ltd. 20.0m Term Loan Facility	Cielo di Londra	Aug. 2023	14 Aug. 2028	18,438
The Iyo Bank US\$ 16.0m Term Loan Facility	High Voyager	Jun. 2024	10 Jun. 2032	15,000
BPER Banca S.p.A. US\$ 16.0m Term Loan Facility	High Freedom	Jun. 2024	24 Jun. 2032	15,000
NTT TC Leasing Co., Ltd. US\$ 16.8m Term Loan Facility	High Trader	Jul. 2024	7 Aug. 2029	16,394
DnB Bank ASA US\$ 17.5m Term Loan Facility	High Loyalty	Aug. 2024	31 Jul. 2029	17,015
Financial fees				(2,180)
Total Bank and other lenders				216,660

*Only for the M/T Cielo di Capri.

Source: d’Amico International Shipping Annual Report 2024

However, covenants are not fully explained and are not directly associated with each liability. In fact, the company only declares that it “*closely monitors the ratio between its consolidated net worth, defined as the sum of its shareholders’ equity and any subordinated shareholder’s loan, and its consolidated total assets. According to covenants in most DIS’ bank loans, this ratio must remain at a minimum of 25% at all times*”.

- **Score 3:** Full disclosure of the book value of liabilities by financing class and direct relation with respective covenants. The table in LU-VE’s report (Figure 9) gives an example of comprehensive disclosure about the carrying amount of liabilities for which compliance with covenants is required.

Figure 9: Bank loans outstanding as at 31 December 2024 (LU-VE)

Bank loans (in thousands of Euro)							AMORTISED COST				
DEBTOR COMPANY	COUNTERPARTY	LOAN TYPE	TAKEN OUT	MATURITY	RATE APPLIED	FINANCIAL COVENANTS	ORIGINAL AMOUNT	31/12/2024	OF WHICH CURRENT	31/12/2023	OF WHICH CURRENT
								RESIDUAL AMOUNT		RESIDUAL AMOUNT	
LU-VE	Mediocredito Italiano S.p.A.	Unsecured loan	28/11/2018	30/06/2024	6M Euribor + Spread	NFP/EBITDA <3; NFP/SE <=1	12,500	-	-	1,298	1,298
LU-VE	Mediocredito Italiano S.p.A.	Unsecured loan	28/11/2018	30/06/2024	6M Euribor + Spread	NFP/EBITDA <3; NFP/SE <=1	12,500	-	-	1,298	1,298
LU-VE	Banca Nazionale del Lavoro S.p.A.	Unsecured loan	20/12/2018	24/09/2024	6M Euribor + Spread	NFP/EBITDA <= 3; NFP/SE <=1.25	10,000	-	-	2,047	2,047
LU-VE	Banca Nazionale del Lavoro S.p.A.	Unsecured loan	20/12/2018	24/09/2024	6M Euribor + Spread	NFP/EBITDA <=3; NFP/OWN FUNDS <=1.25	10,000	-	-	5,047	5,047
LU-VE	Banco BPM S.p.A.	Unsecured loan	16/06/2019	28/06/2024	3M 360 days Euribor + Spread	-	10,000	-	-	1,051	1,051
LU-VE	Unicredit S.p.A.	Unsecured loan	12/07/2019	30/06/2024	6M 360 days Euribor + Spread	NFP/EBITDA <=3; NFP/OWN FUNDS <=1	12,000	-	-	1,237	1,237
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	23/03/2020	23/09/2025	3M 360 days Euribor + Spread	NFP/EBITDA <= 3; NFP/SE <=1	25,000	4,178	4,178	9,850	5,671
LU-VE	Banca Nazionale del Lavoro S.p.A.	Unsecured loan	28/05/2020	28/05/2025	6M 360 days Euribor + Spread	NFP/EBITDA <= 3; NFP/SE <=1.25	40,000	5,021	5,021	15,212	10,180
LU-VE	UniCredit S.p.A.	Unsecured loan	04/11/2020	30/11/2024	6M 360 days Euribor + Spread	NFP/EBITDA <=3; NFP/OWN FUNDS <=1	20,000	-	-	5,792	5,792
LU-VE	Deutsche Bank S.p.A.	Unsecured loan	11/11/2020	11/11/2026	3M EURIBOR 360 basis + spread	NFP/EBITDA <= 3.2 NFP/EQUITY <=1.15	5,500	2,309	1,129	3,424	1,104
LU-VE	Deutsche Bank S.p.A.	Unsecured loan	11/11/2020	11/11/2025	3M EURIBOR 360 basis + spread	NFP/EBITDA <= 3.2 NFP/EQUITY <=1.15	10,000	2,007	2,007	4,060	2,052
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	31/03/2021	31/03/2026	3M EURIBOR 360 basis + spread	NFP/EBITDA <3; NFP/SE <1	30,000	9,409	7,535	17,133	7,721
LU-VE	Banco BPM S.p.A.	Unsecured loan	14/06/2021	31/03/2026	3M EURIBOR 360 basis + spread	-	12,000	3,541	2,835	6,445	2,903
LU-VE	Banco BPM S.p.A.	Unsecured loan	14/06/2021	31/03/2026	3M EURIBOR 360 basis + spread	NFP/EBITDA <= 3.0 NFP/EQUITY <=1.25	18,000	5,334	4,274	9,738	4,402
LU-VE	Unicredit S.p.A.	Unsecured loan	30/09/2021	31/03/2025	6M EURIBOR 360 basis + spread	NFP/EBITDA <= 3.0 NFP/SE <=1.0	30,000	4,302	4,302	13,013	8,680

Bank loans (in thousands of Euro)							AMORTISED COST				
							31/12/2024			31/12/2023	
DEBTOR COMPANY	COUNTERPARTY	LOAN TYPE	TAKEN OUT	MATURITY	RATE APPLIED	FINANCIAL COVENANTS	ORIGINAL AMOUNT	RESIDUAL AMOUNT	OF WHICH CURRENT	RESIDUAL AMOUNT	OF WHICH CURRENT
LU-VE	Banco BPM S.p.A.	Unsecured loan	17/12/2021	30/09/2026	3M EURIBOR 360 basis + spread	NFP/EBITDA <= 3.0 NFP/EQUITY <=1.25	40,000	18,727	10,731	29,780	11,040
LU-VE	Cassa Depositi e Prestiti	Unsecured loan	28/04/2022	05/05/2029	6M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.15	40,000	36,018	8,053	40,511	4,373
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	28/04/2022	29/03/2029	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	15,000	12,717	3,014	15,142	2,404
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	31/05/2022	29/03/2029	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	15,000	12,701	3,008	15,118	2,396
LU-VE	Banca Nazionale del Lavoro S.p.A.	Unsecured loan	22/07/2022	22/07/2027	6M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	40,000	24,192	8,048	32,542	8,144
LU-VE	BPER Banca S.p.A.	Unsecured loan	22/07/2022	22/07/2027	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	25,000	17,214	6,266	23,693	6,423
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	28/07/2022	28/07/2027	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	15,000	10,351	3,785	14,208	3,850
LU-VE	Deutsche Bank S.p.A.	Unsecured loan	25/10/2022	25/10/2028	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.15	30,000	26,615	6,694	30,261	3,601
LU-VE	Unicredit S.p.A.	Unsecured loan	24/11/2022	31/12/2026	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	25,000	12,416	6,198	18,774	6,345
LU-VE	Banco BPM S.p.A.	Unsecured loan	21/12/2022	30/09/2027	3M 360 days Euribor + Spread	NFP/EBITDA <= 3.25 NFP/SE <= 1.25	5,000	15,994	5,805	22,008	5,982
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	26/10/2023	26/10/2028	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	30,000	26,580	6,704	30,160	3,579
LU-VE	Unicredit S.p.A.	Unsecured loan	21/12/2023	31/12/2028	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.0	30,000	27,944	7,000	-	-
LU-VE	BPER Banca S.p.A.	Unsecured loan	22/01/2024	22/01/2029	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.25	30,000	29,933	5,661	-	-
LU-VE	Banca Nazionale del Lavoro S.p.A.	Unsecured loan	28/11/2024	28/11/2030	6M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.25	35,000	34,992	3,264	-	-
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	29/11/2024	29/11/2030	3M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.00	25,000	25,010	2,337	-	-
LU-VE	Intesa Sanpaolo S.p.A.	Unsecured loan	29/11/2024	29/11/2030	6M 360 days Euribor + Spread	NFP/EBITDA <= 3 NFP/SE <= 1.00	15,000	15,006	1,403	-	-
Total							382,510	119,252	368,842	118,620	

Notes:
NFP: net financial position;
SE: shareholders' equity;
DSCR: debt service coverage ratio
LR: leverage ratio (NFP/EBITDA)
GR: gearing ratio (NFP/SE)
U.L. Unsecured Loan
M.L. Mortgage Loan

Source: LU-VE Integrated Annual Report as of 31 December 2024

Compliance risk

a) Facts and circumstances indicating difficulties in complying: It refers to any possible event or condition that may increase the risk of non-compliance with covenants.

- **Score N/A:** The company is not experiencing difficulties in complying.
- **Score 0:** No information about compliance difficulties is reported, neither their non-existence is disclosed.
- **Score 1:** The risk of a potential breach of a covenant with impacts on liquidity risk is mentioned, but no details are given. Some issues related to covenants are reported by Esprinet. Considering that *“the existence of a covenant structure [...] introduces elements of instability linked to the possible violation of one or more of the threshold financial parameters”*,

the company acknowledges that *“the risk of material damage, resulting from the Group being unable to fulfil the payment commitments undertaken in a timely manner (liquidity risk), is very high in relation to [...] financial institutions due to the greater rigidity implicit in the existence of covenants on medium-long term financial payables”*.

- **Score 2:** The firm identifies factors that increase breaches and liquidity risks, but specific cases, quantitative data, and the identification of covenants whose compliance is at risk are not disclosed. To simplify, Stellantis’ disclosure can be cited, as it reports that *“the continuation of challenging economic conditions in the markets in which the Company operates and the uncertainties that characterize the financial markets, necessitate special attention to the management of liquidity risk”*, as well as that *“certain notes issued by the Company and its treasury subsidiaries include covenants which could be affected by circumstances related to certain subsidiaries”*.
- **Score 3:** Comprehensive disclosure of all circumstances and risk factors with indication of relevant quantitative data and association of each risk with the respective covenant. With regard to this type of information, the most detailed disclosure is provided by Antares Vision. In its 2023 Consolidated Financial Statements, it is stated that *“regardless of the results of the audit, the Company's Board of Directors also estimated that by adopting for the second half of 2023 the same prudent approach used in the 2024 budget when accounting of rfxcel's L5 revenue, an impact would be generated on Group EBITDA that would not make it possible to*

achieve - for all medium-long term loans and bonds - the minimum threshold of approximately Euro 29 million of EBITDA necessary to guarantee compliance with the covenants, calibrated on the NFP/EBITDA ratio at 31 December 2023. Consequently, after approval of the consolidated financial statements at 31 December 2023, based on the contractual terms, the banks could have requested early repayment of the loans for failure to comply with the covenants”.

b) Compliance analysis at the reporting date: The company is expected to provide an assessment of compliance with covenants at the reporting date, indicating the actual value of financial ratios and making a comparison with previous periods.

- **Score N/A:** The company is not subject to financial covenants compliance and provides evidence that non-financial covenants are not violated.
- **Score 0:** No compliance analysis at the reporting date is disclosed.
- **Score 1:** The firm claims to be compliant with covenants at the end of the reporting period, but details and supporting data are not provided. To give a better idea of how this score is assigned, information disclosed by TIM can be cited. In its 2024 Annual Report, TIM affirms that *“as at December 31, 2024, no covenant, negative pledge or other clause relating to the aforementioned debt position had in any way been breached or violated”*.
- **Score 2:** Disclosure of compliance at the reporting date and financial ratios related to covenants tested. Lack of historical analysis and comparison with previous period. Amplifon perfectly matches this description by providing the information presented in the table below (Figure 10).

Figure 10: Covenant ratios on 31 December 2024 (Amplifon)

	Value as at 12/31/2024
Net financial indebtedness excluding lease liabilities/Group net equity (Net Worth Ratio)	0.84
Net financial position excluding lease liabilities/EBITDA for the last four quarters (Leverage Ratio)	1.63
EBITDA for the last 4 quarters/Net financial expenses (Interest Cover)	17.77

Source: Amplifon Annual Report 2024 – Consolidated Financial and Sustainability Statements

- **Score 3:** The disclosure broadly discusses the assessment of compliance with all covenants at the reporting date, providing also a detailed analysis of the value of financial ratios, as well as a comparison with historical data. Taking Prysmian as an example, the company declares that *“financial ratios comply with both covenants contained in the relevant credit agreements and there are no instances of non-compliance with the financial and non-financial covenants”*, also providing quantitative details for both 2023 and 2024 as shown in Figure 11.

Figure 11: Actual financial ratios reported at 31 December 2024 and 31 December 2023 (Prysmian)

(Euro/million)	31.12.2024	31.12.2023
EBITDA / Net finance costs ⁽¹⁾⁽²⁾	16.06x	26.90x
Net financial debt / EBITDA ⁽¹⁾	1.93x	0.56x

1. The ratios are calculated on the basis of the definitions contained in the relevant credit agreements.

2. This covenant does not apply to the Revolving Credit Facility 2023 and all other loans taken out after June 2023 for which this requirement does not apply as long as Prysmian S.p.A. maintains a long-term “Investment Grade” credit rating.

Source: Prysmian Integrated Annual Report 2024

Liquidity Risk

a) *Consequences in case of non-compliance:* This disclosure item covers adverse implications of a breach of covenants on liquidity risk, including penalties, accelerated repayment terms, etc.

- ***Score 0:*** No information about the consequences of a violation is mentioned in the financial report.
- ***Score 1:*** The company highlights the possibility that a breach of a covenant may have a negative impact, but it does not discuss details and magnitude. Disclosures similar to the one provided by Brembo are scored in this way. Referring to liquidity risk, Brembo informs about the possibility that *“if the covenants are not met, the financial institutions can request early repayment of the relevant loan”*.
- ***Score 2:*** Negative consequences resulting from a violation are disclosed. However, the magnitude and impact on company’s health are not clear. Iveco offers a good example for this level of disclosure, as it states that *“a breach of one or more of the covenants could result in adverse consequences that could negatively impact the Group’s business, results of operations, and financial position. These adverse consequences may include the triggering of cross-default clauses whereby other outstanding debt under other credit facilities of Iveco Group existing at the time of such cross-acceleration, ultimately resulting in an obligation to redeem such indebtedness, termination of existing unused commitments by the Group’s lenders, refusal by the Group’s lenders to extend further credit under one or more of the facilities or to enter into new facilities or the*

lowering or modification of the Issuer's credit ratings or those of one or more of its subsidiaries”.

- **Score 3:** Potential negative implications related to non-compliance and their impact on liquidity risk are fully disclosed. As reported by Intercos, one of the companies with the highest level of disclosure for this item, *“the Senior Loan Agreement signed with the bank syndicate on July 31, 2024 and that signed with CDP on February 20, 2024 include certain mandatory early repayment clauses, in addition to restrictions on the operations of the Parent Company and its main subsidiaries. In particular, among other matters, the Parent Company's ability to take on further debt and pay dividends is linked, subject to certain exceptions, to compliance with a given financial covenant (Leverage Ratio*). These limitations could affect the Parent's ability to pay dividends, conduct its business, in addition to its ability to respond to market conditions and benefit from any business opportunities. Where the Group is unable to manage its level of indebtedness and other obligations and commitments, it may need to refinance its debt or dispose of assets in order to obtain the necessary resources. However, the Group cannot guarantee that such refinancings or disposals can be made on a timely basis or on satisfactory terms, or may be made at all, or are permitted under the existing debt terms”.*

b) Risk mitigation actions: This item examines every pre-emptive measure implemented by the company to mitigate liquidity risk arising from non-compliance with covenants.

- **Score 0:** Risk mitigation actions are not mentioned in the information provided by the company.
- **Score 1:** The company states that it monitors liquidity and compliance with covenants. It also affirms that risk mitigation measures have been implemented, but these are not explained. Disclosure provided by Lottomatica can be included in this score range. In its 2024 annual report, it is stated that *“the Group manages this risk by seeking to establish a financial structure that, consistent with its business objectives and defined limits: i) ensures sufficient liquidity, while minimizing the related opportunity cost; and ii) maintains an appropriate balance in terms of duration and composition of debt”*.
- **Score 2:** Measures put in place by the company to mitigate liquidity risk are indicated. However, quantitative details to understand their significance and effectiveness are not provided with sufficient accuracy. For the assignment of this rating, requirements are those contained in Emak’s disclosure. The company specifies that *“prudent liquidity risk management implies maintaining sufficient financial availability of cash and marketable securities, funding through an adequate amount of bank credit. Consequently, the Group's treasury sets up the following activities:*
 - *the monitoring of expected financial requirements in order to then take suitable action;*
 - *the obtaining of suitable lines of credit;*
 - *the optimization of liquidity, where feasible, through the centralized management of the Group’s cash flows;*

- *maintenance of an adequate level of available liquidity;*
- *the maintenance of a balanced composition of net financial borrowing with respect to investments made;*
- *the pursuit of a correct balance between short-term and medium-long-term debt;*
- *limited credit exposure to a single financial institute;*
- *the monitoring of compliance with the parameters provided for by covenants associated with loans.*

Counterparties to derivative contracts and operations performed on liquid funds are restricted to primary financial institutions. [...] The Management considers that currently unused funds and credit lines amounting to € 144 million compared to € 154 million of the previous year, mainly short-term and guaranteed by Trade Receivables, more than cash flow which will be generated from operating and financial activities, will allow the Group to meet its requirements deriving from investment activities, management of working capital and the repayment of debts at their natural maturity dates”.

- **Score 3:** Detailed analysis of liquidity risk mitigation actions with indication of all relevant quantitative data. The disclosure provided by MAIRE appears to be one of the most comprehensive. In addition to presenting relevant information concerning each liability subject to covenants, citing some abstracts taken from liquidity risk disclosure, MAIRE states that *“the Group's objective is to implement a financial structure that, in line with business objectives, ensures an adequate level*

of liquidity, credit facilities and committed lines of credit for the entire Group, granting sufficient financial resources to cover short-term commitments and fixed-term obligations, also by means of refinancing operations or anticipated funding, as well as to ensure the availability of an adequate level of financial flexibility for development programs, pursuing the maintenance of a balance in terms of maturity and composition of debt and an adequate structure of bank credit facilities. Liquidity risk measurement and control activities are carried out through continuous monitoring of the projected cash flows, the maturity profile of financial liabilities and the parameters characterizing the main bank loan agreements. [...] To efficiently control and use its liquidity, MAIRE Group relies, moreover, on cash pooling systems among the Group's main companies within the two BUs. Currently, MAIRE believes that the good availability of liquid funds and a careful and business-functional management of credit lines represent important elements of stability, sufficient to guarantee the necessary sources for the continuation of its activities. Liquidity risk management is based primarily on the strategy of containing debt and maintaining financial equilibrium. Cash and cash equivalents as of December 31, 2024, amounted to 1,153,779 thousand euros, a significant increase from December 31, 2023, and amounting to 238,278 thousand euros. Cash flows from operations reflected a positive cash flow for the year of 283,073 thousand euros, with a consistent trend of cash generation quarter after quarter. [...] Flows from operating activities also incorporate disbursements for the payment of taxes, which

amounted to 58.3 million euros in 2024. Operating cash generation more than offsets dividends paid of Euro 82.1 million [...], disbursements related to the buyback program of Euro 47.3 million, and net investments for the year totalling Euro 51.6 million. [...] The Group also estimates that thanks to the significant outstanding portfolio of orders and associated cash flows, a good level of liquidity can be maintained".

MAIRE also provides a table (Figure 12) with information on the availability of credit lines.

Figure 12: Group credit facilities and uses as of December 31, 2024 (MAIRE)

Affidamenti ed utilizzi di Gruppo al 31 dicembre 2024			
Descrizione	Ctv. Affidato (Euro)	Ctv. Utilizzo (Euro)	Ctv. disponibile
Scoperti di Conto Corrente-Revolving-Linee di Credito a Revoca	355.188.075	65.000.000	290.188.075
Anticipi su fatture - Factoring	8.000.000	892.162	7.107.838
Finanziamenti M/L -Bond	725.786.569	600.786.569	125.000.000
Totale	1.088.974.644	666.678.731	422.295.912

Source: MAIRE 2024 Annual Financial Report

c) Defaults, breaches and renegotiations: It is related to disclosure requirements concerning defaults, breaches and renegotiations established by IFRS 7.

- **Score N/A:** No defaults, breaches or renegotiations occurred during the reporting period.
- **Score 0:** No relevant information is disclosed.
- **Score 1:** At least one of the three events is mentioned, but details about consequences are not investigated. A basic disclosure is the one provided by Alkemy, which simply affirms that *“the Parent obtained a waiver for the year 2024 related to compliance with the Leverage Ratio from the two lending banks”*.

- **Score 2:** Partial disclosure, as some elements like the carrying amount of affected liabilities, remedies or terms of renegotiations are missing. Moreover, the causes that led to these events are unclear. In this case, Esprinet's disclosure concerning a waiver can be taken as an example. Its 2024 Annual Integrated Report informs that *"on 26 July 2024, Esprinet S.p.A. obtained from the pool of lending banks of the short-term Revolving Credit Facility (RCF) of 180.0 million euro (not used as at 30 June 2024 or as at 31 December 2023 and only partially used, and repaid in full according to the provisioned contractual deadlines, during the first half of 2024) the granting of a 'waiver' in relation to the violation, verified on the consolidated financial statements as at 31 December 2023, of one of the financial covenants supporting the credit line"*. To also provide an overview of the information about renegotiations required for this level of disclosure, Comer Industries' disclosure is reported. The company informs that *"at the end of 2024 the Group renegotiated its existing loan facilities, replacing them with a single medium-long term committed credit line – maturing in December 2028 – amounting to 100 million euros on improved terms compared to the previous lines due to the low leverage ratio"*, also adding that, with reference to short-term loans and current portion of medium/long term loans, *"the increase of 11,115 thousand euros compared to the previous year resulted mainly from the renegotiation of debt granted by Crédit Agricole, which enabled the Group to lengthen the duration of loans and reduce their spread"*.

- **Score 3:** Exhaustive disclosure including causes, book value, remedies and eventual terms of renegotiation. Geox achieves this score by stating that *“taking into account the Group's profitability performance during 2024, the forecasts developed by management would have resulted in non-compliance with the contractual covenants at the verification date of 31 December 2024, stipulated in the loan agreements. For this reason, as part of the preparation of the New Industrial Plan, management has also held talks with the banks, in order to ensure a balanced alignment among the planned strategic actions, available financing sources, and existing debt obligations. The Company and the banks then agreed on the terms of the refinancing plan, which provides, in summary:*

- *Rescheduling of medium- to long-term loan repayment plans, extending final maturities by 24 months and adjusting repayment schedules with specific banks.*
- *Equity contribution to the Company, amounting to Euro 30 million at the beginning of 2025 and an additional Euro 30 million in the autumn of 2026, backed by the commitment undertaken by the controlling shareholder, LIR S.r.l., as better detailed below.*

The refinancing plan, combined with the capital strengthening ensured by LIR's contribution, will fully cover the Company's financial needs, while maintaining liquidity levels adequate to support the scale and complexity of the business”.

CHAPTER 3

Main findings and considerations

3.1 Summary of results

Descriptive statistics on the levels of compliance defined by the disclosure index for both 2023 and 2024 are summarized in Table 1. The average compliance score is 42.44% in 2023 and 42.98% in 2024. These findings highlight a significantly low level of compliance with debt covenants disclosure requirements by Italian listed companies. In addition, standard deviations of respectively 15.62% and 16.45% reveal a considerable variation in compliance scores assigned to companies, which vary from 6.67% to 90.48% in 2023 and from 4.76% to 90.48% in 2024. No company reported a full disclosure.

Table 1: Descriptive statistics of compliance scores

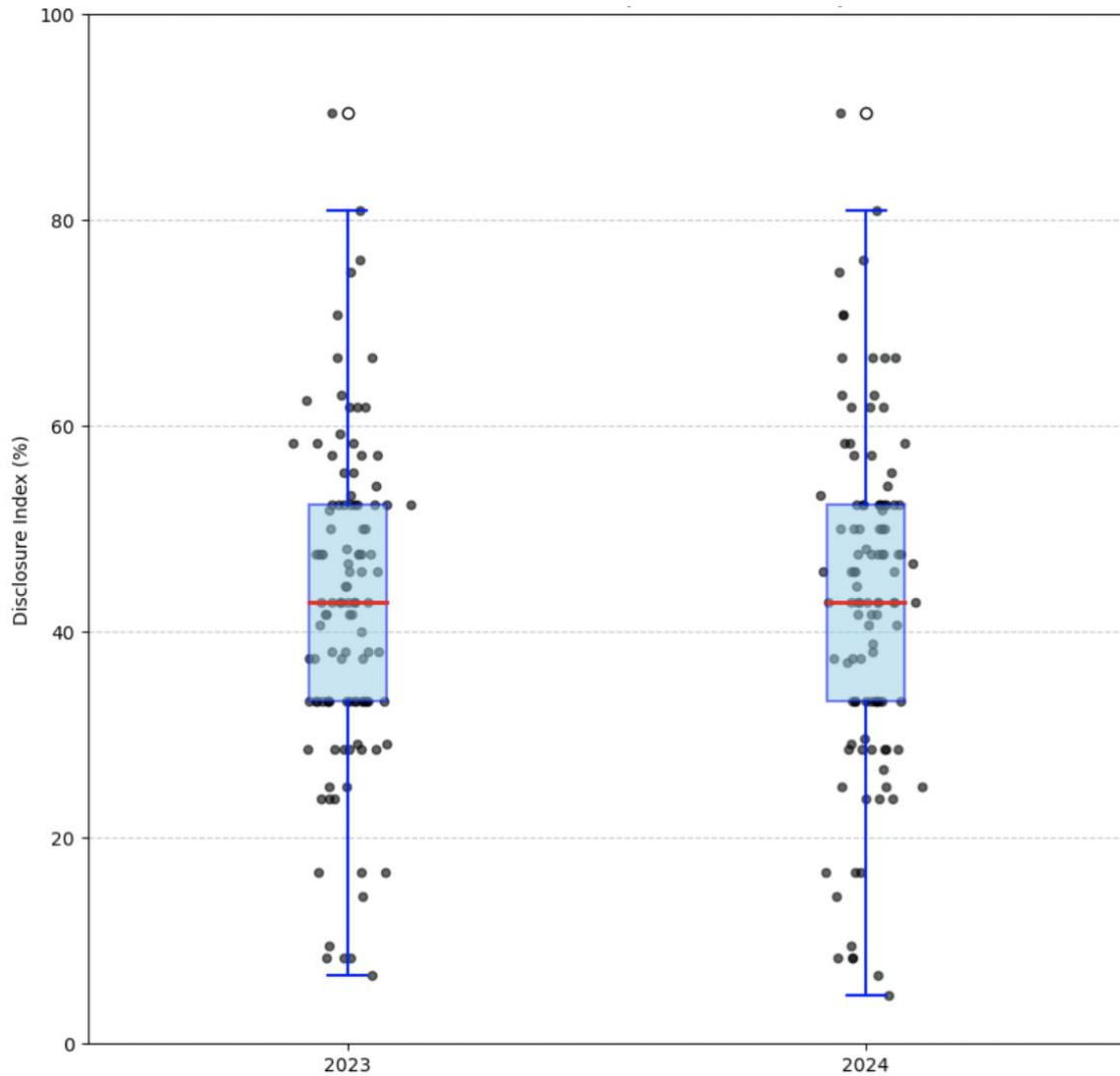
	2023	2024
Mean	0.4244	0.4298
SD	0.1562	0.1645
Median	0.4286	0.4286
Min	0.0667	0.0476
Max	0.9048	0.9048
Paired sample <i>t</i>-test	-0.8151	
P-value	0.4167	

Table 2 shows that only 2 firms achieved a score higher than 80%, while 8.93% of the companies recorded a disclosure index below 20% in 2024, in line with the previous year. Moreover, in both years most companies lie in the lower middle ranges, comprised between 20% and 59.9%. A better visual representation of the frequency of compliance scores is provided by the box plot depicted in Figure 13.

Table 2: Frequency of compliance scores

Compliance Score Ranges	2023		2024	
	N	%	N	%
80% - 100%	2	1.79%	2	1.79%
60% - 79.9%	10	8.93%	13	11.61%
40% - 59.9%	53	47.32%	55	49.11%
20% - 39.9%	38	33.93%	32	28.57%
< 20%	9	8.04%	10	8.93%

Figure 13: Disclosure Index (2023-2024 Comparison)



Source: Student's own elaboration.

The results of the paired sample t-test (Table 1) indicate that there is no statistically significant difference in the average compliance scores in the two years. Since the p-value is equal to 0.4167 and exceeds the significance threshold of 0.05, the null hypothesis cannot be rejected. This suggests that new requirements imposed by Amendments to IAS 1, as well as recommendations elaborated by ESMA, failed to enhance the quality of disclosure concerning liabilities with covenants. Consistent with previous studies, it appears that requirements imposed by legislation and enforcing bodies are not sufficient to ensure high levels of compliance, particularly in the first year of adoption, in which poor disclosure may be exacerbated by a lack of preparation and awareness by both auditors and companies (Tsalavoutas et al., 2020; Tsalavoutas, 2011).

Descriptive statistics concerning the level of compliance for each disclosure item in the year 2024 are reported in Table 3. No significant changes were observed during the two years. What is interesting to notice is the substantial difference among the average score of some items. Considering those items that are relevant for the largest number of companies (N), it can be noticed that some items, like for example “Consequences in case of non-compliance” and “Compliance analysis at the reporting date”, show extremely lower levels of compliance with disclosure requirements compared to some others, including “Carrying amount of related liabilities”, “Date of compliance” and “Risk mitigation actions”. As suggested by previous literature, requirements that are most widely respected by companies may be those for which only basic information needs to be provided, resulting in easier compliance, while it appears that items related to completely new requirements or those imposing proprietary costs appear to be the ones with the lowest degree of compliance (Tsalavoutas, 2011).

Table 3: Frequency and distribution of compliance scores for each disclosure item

Disclosure items	N	Mean	SD	Median	Min	Max
Nature of non-financial covenants	112	0.2589	0.3369	0	0	1
Financial covenants calculation methods	106	0.5094	0.3024	0.3333	0	1
Date of compliance	106	0.5283	0.3376	0.5	0	1
Carrying amount of related liabilities	112	0.6696	0.3703	0.6667	0	1
Facts and circumstances indicating difficulties in complying	38	0.0877	0.2004	0	0	0.6667
Compliance analysis at the reporting date	109	0.3364	0.2103	0.3333	0	1
Consequences in case of non-compliance	112	0.1994	0.2627	0	0	1
Risk mitigation actions	112	0.6161	0.2376	0.667	0.3333	1
Defaults, breaches and renegotiations	24	0.5556	0.2722	0.3333	0.3333	1

3.2 Further analysis

Tables 4 and 5 contain descriptive statistics related to compliance scores of companies divided into quartiles according to their market capitalization. Information about market cap is obtained from LSEG Workspace. In 2023, both groups of Mid-Cap companies recorded slightly higher disclosure index scores compared to Q1 and Q4, which refer respectively to Small Cap and Large Cap firms. However, there is no statistically significant difference ($p = 0.3432$) between the group with the lowest average score (Q1) and the one with the best result (Q2). In 2024, the quartile with the most noticeable improvement is that of Small Cap companies, which rises from 40.74% to 43.20% and aligns with the average score of companies in Q2 and Q3. Nevertheless, also in this case the difference between the average score achieved by Q1 in the two years

is not statistically significant ($p = 0.1663$). All other groups maintain similar levels to the previous year.

Table 4: Descriptive statistics by market cap quartiles (2023)

Market Cap Quartiles	2023					
	N	Mean	SD	Median	Min	Max
Q1 (Small Cap)	28	0.4074	0.1806	0.3779	0.0667	0.8095
Q2 (Mid-Small Cap)	28	0.4460	0.1133	0.4365	0.1667	0.7619
Q3 (Mid-Large Cap)	28	0.4346	0.1372	0.4434	0.2381	0.7500
Q4 (Large Cap)	28	0.4097	0.1867	0.4226	0.0833	0.9048

Table 5: Descriptive statistics by market cap quartiles (2024)

Market Cap Quartiles	2024					
	N	Mean	SD	Median	Min	Max
Q1 (Small Cap)	28	0.4320	0.1826	0.4226	0.0667	0.8095
Q2 (Mid-Small Cap)	28	0.4366	0.1282	0.4365	0.0833	0.7619
Q3 (Mid-Large Cap)	28	0.4327	0.1675	0.4583	0.0476	0.7500
Q4 (Large Cap)	28	0.4181	0.1823	0.4286	0.0833	0.9048

To analyse the level of disclosure of the companies in the sample from a different perspective, it is possible to divide them on the basis of their ability to meet their obligations using operating cash flows. “Net Debt to EBITDA” is a leverage ratio that provides a suitable measure to quantify this capability. Again, data on Net Debt and EBITDA needed to compute the ratio are taken from LSEG Workspace. Companies are divided into two categories, “Net Debt/EBITDA < 3” and “Net Debt/EBITDA $\geq$ 3”, based on the value of the leverage ratio calculated. Furthermore, companies that reported a negative EBITDA are classified in the category “Net Debt/EBITDA $\geq$ 3”, which includes firms that may struggle to repay their liabilities. In 2023, based on this ratio, there were 88 companies with a healthier financial position that reported an average compliance of

43.57%, while those included in the “Net Debt/EBITDA ≥ 3 ” group were 24, with an average score of 38.31%. It may seem that companies with more financial difficulties are also the ones with poorer quality of disclosure. However, there is no statistically significant difference between the two groups ($p = 0.0734$). In this case, the p-value is computed according to Welch’s t-test, useful to compare the mean of two independent groups with different sizes and variances. In the following year, companies in the “Net Debt/EBITDA ≥ 3 ” category experienced the greatest improvement, increasing their average score from 38.31% to 41.37%, while the others stayed on the same levels as in 2023. This time, since $t = -2.1618$ and $p = 0.0413$, the change in the average level of compliance between 2023 and 2024 for this group of companies is statistically significant. This result suggests that companies with higher financial risk may have been motivated to improve the quality of their disclosure about liabilities with covenants to provide a better representation of their financial health. However, the average level of compliance still remains extremely low.

Table 6: Average compliance scores based on Net Debt to EBITDA ratio

		Net Debt / EBITDA < 3	Net Debt / EBITDA ≥ 3
2023	N	88	24
	Mean	0.4357	0.3831
	Welch's t-test	-1.8262	
	P-value	0.0734	
2024	N	88	24
	Mean	0.4342	0.4137
	Welch's t-test	-0.6412	
	P-value	0.5244	

3.3 Content analysis of significant disclosure changes

Elements that disclosure must comprise in order to be defined as complete are analysed in Chapter 2. Therefore, this section provides some significant examples of companies that modified their disclosure from 2023 to 2024. It is interesting to note that many of the firms in the sample did not make any change in the content of their disclosure. This is the main reason why average compliance has remained almost the same even after the amendments came into effect. Anyway, there are some companies that introduced new elements of disclosure, although their scores continue to be quite low.

Geox is one of the firms showing significant improvements. In 2023, the company simply stated that *“the Group has in place five loan agreements for a total remaining amount of Euro 109.8 million maturing within the next 3 years assisted by SACE guarantees “Guarantee Italy” and “Supportitalia” on 90% of the amount. [...] Some of these agreements require compliance with financial covenants (to be calculated before IFRS 16), measured on a semi-annual basis in June and December, with reference to the Group’s consolidated figures. These parameters are the Debt Ratio (Net Financial Position/Equity) and the ratio of Net Financial Position to EBITDA. The values vary over the term of the contract and can also be possibly remedied by Equity Cure transactions. As of December 31, 2023, the covenants were found to be met”*. In 2024, since the poor information related to covenants remains unchanged, the improvement leading the company to obtain a score of 62.96% is mainly due to the high quality of disclosure related to the items “Facts and circumstances indicating difficulties in complying”, “Consequences in case of non-compliance”, “Risk mitigation actions”, and “Defaults, breaches and renegotiations”, which received a significantly low score in the previous

year due to an almost total lack of information. An abstract of the updated disclosure is the following: *“taking into account the Group's income performance, the high level of debt, as well as the assessments carried out for the New Industrial Plan, the forecasts made would have led to non-compliance with the contractual covenants at the verification date of 31 December 2024 stipulated in the loan agreements. In this context, the Issuer has initiated talks with banks to amend the current loan agreements. On 30 December 2024, a framework agreement was signed, which provided, among other things, for the modification of financial parameters. The framework agreement also provided for the rescheduling of the principal repayment of the loans, starting with the installment due on 31 December 2024, by extending the relevant final maturity by 24 months, according to new amortization schedules, attached for each loan to the framework agreement. The reimbursement of the amounts is consistent with the operating cash flows underlying the New Industrial Plan supported by the actions decided by the Board of Directors on 19 December 2024. As of the date of these financial statements, there is a risk that, should the actions in support of the New Industrial Plan not be implemented in the manner and on the terms expected or should they prove inadequate, in the absence of an improvement in economic performance, the financial parameters (anchored in economic performance and the level of Group debt) stipulated in the loan agreements will not be met at the verification dates and throughout the Plan period; this would entail, in the absence of a waiver from the banks, the consequent obligation to early repay the debt related to these loans. Should these loans be withdrawn in whole or in part as a result of the Group's failure to meet its commitments, the Group itself would be forced to find alternative forms of financing in order to meet its financial needs. In such assumptions, the Group could face difficulties in finding new sources of financing on the banking and/or financial*

market in a timely manner, also in light of the current supply of credit by the credit/financial system and the macroeconomic environment, or it could obtain them on more onerous terms and conditions than those of the previous loan agreements, with consequent negative effects on the sustainability of the Group's financial debt, as well as on its economic, equity and financial situation. The Directors in view of the financial forecasts and, in particular following the signing of the agreement with the banks and the controlling Shareholder signed on 30 December 2024, do not believe that the Group is unable to meet its payment commitments”.

A different example is represented by Biesse. While in 2023 there was no mention of covenants in its Annual Report, the following year the company declared that *“in December 2024, two long-term amortising loans in the amount of € 100.0 million were subscribed and fully disbursed. It should be noted that these loans are subject to financial covenants relating to the consolidated financial statements, defined in a ratio between the net financial position and EBITDA lower than 3; these covenants were met as of 31 December 2024”*. Liquidity risk disclosure remained unchanged. Despite the introduction of new elements, the level of compliance continues to be low at 37.50%.

However, not all companies introduced improvements. Some of them received lower scores than in 2023, failing to comply with new requirements. Technogym, with a disclosure index of only 8.33% in 2024, is one of them. The previous year, one of the loans for which Technogym disclosed information can be cited as an example: *“the medium-long term loan was granted by Cassa Depositi e Prestiti Spa on 15 June 2023 as an available line of credit totalling Euro 25,000 thousand. The loan expires on 15 June*

2028 and includes an option to use, for two years from the date of signature. If the option is exercised, the loan will be repaid until the date of expiry. Otherwise it will be closed. The loan agreement requires the Company to comply with the following financial covenant: consolidated “Net financial position/EBITDA” ratio of no higher than 3.8, verified annually. As of 31 December 2023, the option had not been exercised”. This type of disclosure, in addition to the one related to liquidity risk, which remained unchanged, allowed Technogym to receive a score of 37.50%. Unfortunately, in 2024 Annual Report this information is completely missing.

3.4 Limitations

In light of recent Amendments to IAS 1 and ESMA priorities for 2024, this study seeks to provide an objective evaluation of the disclosure related to debt covenants and of the new requirements implementation process. However, some limitations must be acknowledged to facilitate interpretation of results, as well as to provide insights and directions for future research.

A significant methodological limitation is embedded in the scoring process. As already explained also in previous studies, judgment needs to be exercised both in the development of the disclosure checklist and in the assessment of the level of compliance or non-applicability of each item (Tsalavoutas et al., 2010; Tsalavoutas et al., 2020). Despite criteria established for the evaluation of items, the lack of a standardized format requirement and the diversity of practices adopted by companies could lead to inconsistencies among evaluators.

In addition, this research is based only on 2023 and 2024, analysing compliance in the first year of adoption of IAS 1 amendments. Due to the recent introduction of new disclosure requirements, companies may still be in the phase of understanding and retrieving the needed information. This is why the implementation process may be incremental, and a survey of the level of compliance in the coming years could lead to different conclusions.

It is also important to consider that this study is limited to companies listed on the Euronext Milan market. Therefore, results may not be generalizable to other international contexts, since the implementation process and disclosure practices could be influenced by several factors and vary across countries. Future research can address this issue by focusing on other markets and comparing findings with those obtained for Italian companies.

Conclusions

This thesis contributes to the literature by assessing the level of compliance in the first year of adoption by Italian listed companies with new mandatory disclosure requirements about liabilities with covenants introduced by Amendments to IAS 1.

Through the construction of a disclosure index and the selection of nine items that are based on paragraph 76ZA of IAS 1 and on 2024 ESMA priorities and which constitute the disclosure checklist, this study provides a comparative evaluation between 2023 and 2024 of the disclosure provided in the annual reports of the companies listed on the Euronext Milan market and included in the sample.

Results highlight that the degree of compliance is extremely poor and widely varies among companies. Furthermore, no significant changes are detected between 2023 and 2024, suggesting that the coming into effect of new disclosure requirements failed to bring improvements in the first year of adoption. While some companies enhanced the quality of their disclosure, the majority made no improvements and the compliance score of some of them worsened. There is no relevant difference either among companies with different market caps, but it seems that firms with financial concerns introduced the most significant improvements.

Findings from this analysis may be informative for regulators, as it emerges that continuous monitoring of the implementation process of new disclosure requirements, which could be incremental and take several years, is needed. Moreover, since this study

is only focused on the first year of adoption in the Italian context, future research could extend the analysis to the next years in order to assess long-term trends, as well as to companies based in different countries, revealing potential geographic factors that may affect the degree of compliance.

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