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**History of Accounting, Business
Administration Doctrines and
Development of New Methods and
Instruments of Management in Italy
and in Russia**

Florence, Italy

1-2 October 2007

Workshop Proceedings

Editors

Prof. Sergio Terzani

Prof. Gennady Yakshin

University of Florence Higher School of Economics

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Table of contents

Introduction	4
<i>Luca Bagnoli, Giacomo Manetti</i>	
The social enterprise: main characteristics and key issues	7
<i>Marcella Mulazzani, Alberto Romolini</i>	
Proposals for Evolution in the Accounting Methods of Local Authorities in Italy	20
<i>Niccolo Persiani</i>	
Corporate organization of the national health service as experienced in Italy, exploratory ideas and planning suggestions	40
<i>Pavel Malyzhenkov</i>	
Corporate Social Responsibility and Sustainable Development in Russia and Abroad	50
<i>Alexey Makarov</i>	
The System of Bankruptcy in Russia and its Evolution	65
<i>Nadezhda Sirotkina</i>	
Essential problems of local budgets in the Russian Federation	80
<i>Natalia Kasatkina, Elena Suspitsina</i>	
The development of the Central bank of Russia and Russian banking system	86
<i>Gianfranco Cavazzoni</i>	
Fra Luca Pacioli: the man and his scientific way	108
<i>Francesco Giunta</i>	
From financial statements to financial reporting: some research questions	118

INTRODUCTION

The promoting of international relations is one of the main factors of universities' competitiveness in the global educational scenario and the internationalization became a key word in the evolution of the Italian university system too, representing a new dimension of the university activity. The internationalization process in the University of Florence has developed through a progressive integration of the international and multicultural dimension in the Institution's teaching and research. International agreements which aim to encourage direct cooperation between the institutions of higher learning in different countries and to promote the reciprocal exchange of teachers, researchers, students and technical and administrative staff of cultural and scientific cooperation have been signed with about 250 Universities in foreign countries.

Our cooperation with the Nizhni Novgorod Branch of Higher School of Economics (Russia) is not very long. It started in October, 2006 when the Cooperation Agreement between our Institutions was signed in Florence. Still, thanks to the enthusiasm and the willingness to cooperate of Italian and Russian colleagues, even such a small period of work led to practical results. The Workshop dedicated to the Accounting History, Business Administration doctrines and the diffusion of new managerial practices in Italy and in Russia, held in the Business Sciences Department of the University of Florence in October, 2007 represented, with no doubt, a significant step forward in the practical realization of the Cooperation Agreement between our Universities. The present essay represents the first "tangible" result of its development.

It contains the scientific articles related to the reports made by the participants of this Workshop referring to a very broad set of modern Business Administration problems: public accounting, financial management, banking, corporate social responsibility, human resource management. It is my pleasure to underline not only a high scientific level of this publication, but also its practical aspect. Our Russian colleagues gave us the opportunity to get acquaintance with a new business reality which, inevitably, has imperfections and difficulties because of its brief and virulent history of development, but in the same time it is rich of perspectives and potential, the human one above all.

I would like to thank all the participants of this Workshop for their scientific contributions and the attention, they reserved to this initiative. My special recognition goes to Prof. Gennadiy Yakshin, the Director of HSE of Nizhni Novgorod for the possibility to discover the new academic reality in Russia as well as to Prof. Maurizio Masi and Dr. Pavel Malyzhenkov whose energy and devotion made possible the realization of this meeting. I believe in success of this cooperation and I wish to all professors and students of our Universities further scientific and didactic achievements !

Prof. Sergio Terzani
Department of Business Sciences
University of Florence
May, 2008

The growing internationalization of education is a part of global processes regarding to development of knowledge-based society. International cooperation between institutions enhances the quality of higher education and research, creates new opportunities for growth at both individual and national levels.

Since the establishment of the HSE, its development has been driven by international standards of teaching and research. The HSE international activities are aimed at integration of the university into international education and research area, and its transformation to research university of international standing. The branch of HSE in Nizhny Novgorod actively contributes to the efforts of the entire HSE in achieving these goals.

The HSE enjoys partner relations with more than 130 foreign universities, international organizations and transnational corporations. In 2006 we started cooperation with the University of Florence. This fact is of great importance for us due to renewed status of the University of Florence, traditionally warm relations between Italy and Russia, significant presence of Italian business in Russia, in general, and in Nizhny Novgorod, in particular.

This Workshop is a first tangible product of our cooperation which seems to be promising. The materials included in this essay represent for us great interest and novelty both

from academic and practical points of view and I thank all Italian colleagues and particularly Prof. Sergio Terzani for the possibility to get acquaintance with them which our delegation has obtained in Florence. I also wish to thank Dr. Oleg Poldin and Dr. Pavel Malyzhenkov who contributed much to the organization of the Workshop.

I am sure that both the HSE and the University of Florence will benefit from joint activities as this meeting and the next Workshop that will be held in 2008 in Russia will also be of great interest to both Italian and Russian academics and practitioners.

Gennady Yakshin
President of HSE in Nizhny Novgorod
June, 2008

THE SOCIAL ENTERPRISE: MAIN CHARACTERISTICS AND KEY ISSUES

Luca Bagnoli and Giacomo Manetti¹

1. «Social enterprise»: the concept and its evolution

The expression «social enterprise» is often used for «an organisation that has social mission driven and trades in goods or services for a social purpose» (Borzaga C. and Defourny J., 2001, p. 7). The profit (or surplus) from the business is often used to support related or unrelated social aims, or that the business itself accomplishes the social aim through its operation, say through the employment of people from a disadvantaged community including individuals and existing business who have difficulty in securing investment from banks and mainstream lenders.

Today, the term «social enterprise» varies in different regions. In the United Kingdom, the focus is on the use of the surplus as the defining characteristic. European usage tends to add the criterion of social rather than individual ownership (Lewis J., 2004).

In North America, there is less emphasis on generating a surplus and more on the double bottom line (financial and social) nature of the enterprise (Young D., 2004). Social enterprises are generally held to comprise the more businesslike end of the spectrum of organisations that make up the third sector or social economy. A commonly-cited rule of thumb is that at least half their income is derived from trading rather than from subsidy or donations.

In 1993, Harvard Business School launched the ‘Social Enterprise Initiative’. Since then, other major American universities – including Columbia, Stanford and Yale – and various foundations have set up training and support programmes for social enterprises.

However, in the United States the social enterprise remains a very broad and often quite vague concept, referring primarily to market-oriented economic activities serving a social goal. The social enterprise is then viewed as an innovative response to the funding

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problems of non-profit organizations, which are finding it increasingly difficult to get in touch with private donations and government and foundation grants. The concept of social enterprise includes a wide spectrum of organizations, from for-profit business engaged in social activities (corporate philanthropy) to non-profit organizations engaged in mission-supporting commercial activity.

Despite, and sometimes in contradiction to, such academic work, the term social enterprise is being picked up and used in different ways in various European countries (Evers A. and Laville J.L., 2004).

In this paper we support the thesis of social enterprise as organization characterized by continuous activity of the production and/or sale of goods and services (rather than predominantly advisory or grant-giving functions) and by limited distribution of profit.

2. The EMES definition of social enterprise

Since 1996, the EMES Network² has devoted itself to the definition of a set of common criteria to identify organisations likely to be called «social enterprises» in each of the fifteen EU member countries studied. A working definition was built up in this way; it was to be considered as a «working hypothesis», not necessarily encompassing the whole reality of social enterprises, but as it turned out, this initial set of indicators proved to be fairly robust and reliable.

This working definition distinguishes between, on the one hand, criteria that are more economic and, on the other, indicators that are predominantly social. These indicators, such as they can be found in the works published by the Network (Defourny, 2001, p. 16-18), are presented below. To reflect the economic and entrepreneurial dimensions of initiatives, four criteria have been put forward:

a) A continuous activity producing goods and/or selling services

Social enterprises, unlike some traditional non-profit organisations, do not normally have advocacy activities or the redistribution of financial flows (as, for example, grant-

² EMES is the acronym of the French title of a vast research project conducted on «the emergence of social enterprises in Europe» (1996-1999). Originally referring to the network of researchers who carried out that research project for the DG Research of the European Community, this name was maintained throughout the projects on social enterprises and social economy subsequently undertaken by the Network. Today, the EMES Network represents nine research centers specialized in these topics as well as other individual researchers across Europe.

giving foundations) as their major activity, but they are directly involved in the production of goods or the provision of services to people on a continuous basis. The productive activity thus represents the reason, or one of the main reasons, for the existence of social enterprises.

b) A high degree of autonomy

Social enterprises are created by a group of people on the basis of an autonomous project and they are governed by these people. They may depend on public subsidies but they are not managed, directly or indirectly, by public authorities or other organisations (federations, private firms, etc.). They have both the right to take up their own position («voice») as well as to terminate their activity («exit»).

c) A significant level of economic risk

Those who establish a social enterprise assume totally or partly the risk of the initiative. Unlike most public institutions, their financial viability depends on the efforts of their members and workers to secure adequate resources.

d) A minimum amount of paid work

As in the case of most traditional non-profit organisations, social enterprises may also combine monetary and non-monetary resources, voluntary and paid workers.

However, the activity carried out in social enterprises requires a minimum level of paid workers.

To encapsulate the social dimensions of the initiative, five criteria have been proposed:

e) An explicit aim to benefit the community

One of the principal aims of social enterprises is to serve the community or a specific group of people. In the same perspective, a feature of social enterprises is their desire to promote a sense of social responsibility at local level.

f) An initiative launched by a group of citizens

Social enterprises are the result of collective dynamics involving people belonging to a community or to a group that shares a well-defined need or aim; this collective dimension must be maintained over time in one way or another, even though the importance of

leadership - often embodied by an individual or a small group of leaders – must not be neglected.

g) A decision-making power not based on capital ownership

This generally means the principle of «one member, one vote» or at least a decision-making process in which voting power is not distributed according to capital shares on the governing body which has the ultimate decision-making rights. Moreover, although the owners of the capital are important, the decision-making rights are generally shared with the other stakeholders.

h) A participatory nature, which involves the various parties affected by the activity

Representation and participation of users or customers, stakeholder influence on decision-making and a participative management are often important characteristics of social enterprises. In many cases, one of the aims of social enterprises is to further democracy at local level through economic activity.

i) A limited profit distribution

Social enterprises not only include organisations that are characterised by a total non-distribution constraint, but also organisations which - like co-operatives in some countries - may distribute profits, but only to a limited extent, thus avoiding a profit-maximising behaviour.

If the approach employed by the EMES Network is to be properly understood and possibly used, two additional considerations must be taken into account. First of all, while economic and social indicators can help identify totally new social enterprises, they can also lead to designate as social enterprises older organisations which have been reshaped by new internal dynamics.

A second consideration is proving even more crucial: the indicators do not represent a set of conditions that an organisation must meet to qualify as a social enterprise. Rather than constituting prescriptive criteria, these indicators describe an «ideal-type» that enables researchers to position themselves within the «galaxy» of social enterprises. They constitute a tool, somewhat analogous to a compass, which can help the researchers locate the position of certain entities relative to one another, and that will maybe enable researchers to establish the boundaries of the set of organisations that they will consider as

that of social enterprises. For example, in their first identification phase, the members of the EMES Network differentiated between a «central» (or «ideal-typical») group of social enterprises and a more «peripheral» group around this ideal-type (Defourny, 2001, p. 16-18).

3. Social enterprises between co-operatives and non-profit organizations (taken from Nyssens, 2006, p. 7-9)

Theoretically, the social enterprise concept can be seen as a tool for building bridges between distinct components of the third sector. As a matter of fact, when studying the third sector, two sources of tension appear to be recurrent and sometimes difficult to overcome.

One source of tension originates in the gap between enterprises offering their entire output for sale on the market (as do most co-operatives), on the one hand, and associations whose activities are usually deemed to have a weak economic character (such as youth movement activities) and whose resources are totally “non-market” (grants, etc.), or even non-monetary (volunteering), on the other hand.

A second tension arises between mutual interest organizations (co-operatives, mutual societies and a large number of associations) which, at least in principle, aim to serve their members, and general interest organizations, serving the broader community (such as organizations combating poverty and exclusion, or those involved in development co-operation, environmental protection and so on).

The first source of tension is represented by the coexistence of two quite distinct spheres: the left sphere represents the co-operative tradition (which has generated a specific literature and schools of thought); the right sphere represents the tradition of associative initiatives and movements (which has also inspired numerous sociologists and political scientists and found particular impetus in North American research works on non-profit organizations).

The second source of tension is found within each of the two spheres, where general interest organizations tend to be located towards the centre, whereas mutual interest organizations tend to be located either on the left or on the right of the diagram (although some advocacy non-profit organizations may, of course, be of general interest).

The unifying role of the social enterprise concept resides primarily in the fact that it generates a mutual attraction between the two spheres. It accomplishes this by attaching itself to certain organizations within each sphere; these organizations are then drawn to and included in a single group of organizations, because they are, in the last analysis, very close to each other, and whether they choose a co-operative legal form or an associative legal form depends primarily on the legal mechanisms provided by national laws.

On the one hand, compared to traditional associations, social enterprises place a higher value on economic risk-taking related to an ongoing productive activity (in the world of non-profit organizations, production oriented associations are certainly closer to social enterprises than are advocacy organizations and grant-making foundations). On the other hand, in contrast to many traditional co-operatives, social enterprises may be seen as more oriented to the whole community and putting more emphasis on the dimension of general interest. Moreover, social enterprises are said to combine different types of stakeholders in their membership, whereas traditional co-operatives have generally been set up as single-stakeholder organizations.

These two sources of tension are partly illustrated in the diagram below. The first source of tension is represented by the coexistence of two completely separate spheres: the left sphere represents the co-operative tradition (which generated specific literature and schools of thought); the right sphere represents the tradition of associative initiatives and movements (which has also inspired numerous sociologists and political scientists and found particular impetus in the North-American research works on non-profit organisations). The second source of tension is more difficult to depict: it is found within each of the two spheres, where the mutual interest organisations are rather located either on the left or on the right of the diagram, whereas general interest organisations are rather located in the area towards the centre.

The unifying role of the social enterprise concept resides primarily in the fact that it generates mutual attraction between the two spheres. It accomplishes this by attaching itself to certain organisations within each sphere; these organisations are then drawn to and included in a single group of organisations, because they are, in the last analysis, very

close to each other and whether they choose a co-operative status or an associative status depends primarily on the legal mechanisms provided by national legislations.

We also note that social enterprises do not constitute a set of organisations really distinct from traditional workers' or users' co-ops. As a matter of fact, these too can perfectly well develop social entrepreneurship dynamics such as we understood them, i.e. with a membership bringing together various types of stakeholders, and aiming at the interest of the community at large.

Lastly, by going beyond the two original spheres, the dotted sphere suggests yet another point to be considered: although most social enterprises take the form of cooperatives or associations, there is nothing to stop them from adopting other legal statuses (as is the case in Ireland or with certain «social purpose companies» in Belgium). This is even truer in countries that have designed completely separate legal frameworks for at least part of social enterprises, such as the new «community interest companies» status in the United Kingdom.

Finally, although most social enterprises take the form of co-operatives or associations, there is nothing to prevent them from adopting other legal forms. This is even truer in countries that have designed completely separate legal forms for at least some social enterprises, such as the new 'community interest company' legal form in the United Kingdom. This explains why the set of social enterprises in our diagram goes beyond the frontiers of both spheres. As to the intersection between the latter, it can be illustrated by new legal frameworks combining a limitation on the distribution of profit and the major features of the co-operative legal form (Nyssen, 2006, pp. 8-9).

4. The social enterprise in Italy

With the 155/2006 Law a definition of social enterprise has been introduced to the Italian legal system.

Although it is the result of a long academic and political debate, and will no doubt be subject to subsequent interpretation, we finally have an official definition that anyone who wishes to analyse social enterprises has (at least) to consider (Fici A., 2006).

The first general aspect that has to be highlighted is that social enterprise is neither a new legal form, nor a new type of organisation, but a legal category in which all eligible

organisations may be included, regardless of their internal organisational structure. Therefore, the eligible organisations could in theory be co-operatives (i.e. employee-, producer-, or customer- owned firms), investor-owned firms (i.e. business corporations), or traditional non-profit firms (i.e. associations and foundations) (Hansman, 1996). In this regard, Italian law is a general law on social enterprises and not a particular law on a specific (or unique) form of social enterprise. The choice not to consider the organisational structure as a condition for eligibility as a social enterprise has its roots in the aim to protect and promote pluralism in the production of social utility goods and services, especially in welfare and health. Each legal form (either a co-operative, or an association, or a foundation), in fact, does not only imply a particular organisational structure but also a distinct history, culture, and ideology.

The value of pluralism, which would have been sacrificed had a specific legal form been selected for the running of a social enterprise, is supported by the principle of «neutrality of the legal forms» adopted by the Italian Law.

In conclusion, «social enterprise» is like a legal «brand» which all eligible organisations can obtain and use in the marketplace (see art. 1, para. 1, and art. 7, Law 155/2006).

The requirements, which will be examined below, are:

- a) being a private organisation;
- b) performing an entrepreneurial activity of production of social utility goods and services;
- c) acting for the common interest and not for profit.

In order to be defined as a social enterprise, an organisation needs to simultaneously hold all the mentioned attributes.

After providing the definition of social enterprise, the Italian decree sets out rules on its internal structure, with the aim of directing the action of social enterprises towards their institutional purpose, that is pursuing the common interest.

The structure of social enterprises is subject to these general principles: correct and efficient management, transparency, «open door», participation, worker protection.

The correctness and efficiency of management should be guaranteed by art. 8, para. 3, stating that «the by-law (of a social enterprise) must lay down specific requirements of

reputation, professionalism and impartiality of the members of the organs», and by art. 11 that, in certain cases, obliges social enterprises to appoint one or more people for the control of management conduct and the audit of accounts.

Transparency is addressed firstly in art. 5 that requires by-laws drawn up in writing and in public (notary's) form, sets a minimum content for them, and prescribes their deposit in the public registry of firms; secondly in art. 7, para. 1, that imposes the use of the expression «social enterprise» in the name of the organisation; furthermore in art. 10 that obliges social enterprises to draw up and deposit in the public registry of firms annual accounts (financial balance sheets) and the so-called social report (social balance sheet), that is a document which should represent and testify to the pursuit of the goals of common interest by the social enterprise.

The principle of the «open door» arises from art. 9 that provides for the non-discrimination rule in the admission and exclusion of members and entitles rejected candidates (and excluded members) with the right to appeal to the general meeting (the assembly) of members.

Unfortunately, however, the Law does not oblige directors to motivate the denial of admittance. Art. 9 does not of course imply the right to be admitted, but recognises the interest of candidates, and protects them through the power of appeal to the assembly of members.

The principle of members' participation is laid down in art. 8, para. 1, stating that the election of the majority of organ members cannot be reserved to external subjects (i.e. non members), and above all (in this second case with regard to external stakeholders) in art. 12 that prescribes the involvement of workers and customers in the daily proceedings of social enterprises.

Art. 12, para. 1, obliges social enterprises' by-laws to provide for «forms of workers' and customers' involvement in the activity», clarifying in para. 2 what involvement exactly means. Indeed, the definition of «involvement» is so wide (any process, including information, consultation or participation, through which workers and customers can influence decisions of the enterprise, at least those directly regarding working conditions and the quality of goods and services) that one might foresee that the rule will not be in

effect implemented by social enterprises in the interest of workers and customers unless extra-legal incentives force them to adopt practices of real involvement.

The principle of worker protection is laid down especially in art. 14, para. 1, stating that the economic and legal treatment of workers of social enterprises cannot be inferior to that provided for by the applicable contracts and collective agreements.

As one could easily note, among the principles of social enterprise regulation I have not included democracy. It is a principle which – following the experience of the cooperative world – finds its widest expression in the rule «one head, one vote», i.e. in the fact that each member of the organisation has a vote and no more than one in the assembly regardless of the quantity of shares subscribed. The absence of this rule in the Italian law on social enterprises should not however surprise us, since this is consistent with the choice of the Law not to limit eligible organisations on the basis of their legal form: eligible organisations – as pointed out above – could in theory be co-operatives (i.e. employee-, producer-, or customer-owned firms), investor-owned firms (i.e. business corporations), or traditional non-profit firms (i.e. associations and foundations).

5. Further research

The EMES Network traced the most significant developments in social enterprises emerging in Europe. They established also a theory of social enterprise, seen as a «multiple-goal, multi-stakeholder and multiple-resource enterprise».

That is, they promote a new research project articulated around three main theoretical axes:

1. Social enterprises usually have a complex mixture of goals

The first hypothesis put forward in this research project regarding social enterprises' mission is that the latter would include at least three different categories of goals:

- social goals, connected to the particular mission of social enterprises to benefit the community;
- economic goals, related to the «business» nature of social enterprises;
- socio-political goals, referring to the fact that social enterprises are often rooted in a 'sector' traditionally involved in socio-political action. This last goal can be analysed in the wider perspective of 'producing social capital'.

-
2. social enterprises mobilize different kinds of market and non-market resources to sustain their public benefit mission:
 - they trade goods and services in the market;
 - public financing supports their public benefit mission;
 - and, finally, social enterprises can also rely upon volunteer resources.
 3. Social enterprises are embedded in the political context. Public policies in the field of social enterprises are the result of interactions between the promoters of the latter and representatives of public bodies.

These hypotheses propose a theoretical corpus that is really specific to social enterprises, although it still needs empirical support. They may be seen as innovative on three central points.

- First, our framework underlines the multidimensional mode of governance of social enterprises.
- A second important point of divergence between our framework of analysis and most literature on social enterprise is the fact that, in our approach, the economic dimension does not necessarily mean that the social enterprise must achieve economic sustainability only through a trading activity. On the contrary the resources can have a hybrid character and come from trading activities, from public subsidies and from voluntary resources obtained thanks to the mobilization of social capital.
- The third point is related to the nature of the production activity of the social enterprise. The production of goods and/or services should, in itself, constitute (not only indirectly, through the income it generates) a support for the social mission. In other words, the nature of the economic activity must be connected to the social mission: if the mission of the social enterprise is to create jobs for low-qualified people, the economic activity itself supports the work integration goal; if the mission of the social enterprise is to develop social services, the economic activity is the delivery of these social services, and so on. By contrast, in the US or UK conception of the social enterprise, the trading activity is often

considered simply as a source of income, and the nature of the trade does not matter.

Social enterprises mix different logics: they trade in the market, but not with an aim of maximizing the financial return on investment for their shareholders; they receive public support through public policies which they contribute to shaping; they are embedded in civil society through the development of voluntary collective action around common goals characterized by a public benefit dimension.

Due to all this, SEs are going to become one of the most important economic actors of the European community, almost being nowadays one of the biggest work-employer.

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PROPOSALS FOR EVOLUTION IN THE ACCOUNTING METHODS OF LOCAL AUTHORITIES IN ITALY

Marcella Mulazzani and Alberto Romolini¹

The local governments' Italian accounting models are traditionally cash based. The Italian reform of accounting models has to be related to enactment of ad hoc accounting standards. The Italian standard setter has already enacted some accounting standards for local entities, even if we support the adoption of IP-SASs.

1. Current Accounting Procedures in Italian Local Authorities

Public accounting systems in Italian local authorities have – always and till now – run on a modified cash basis². Actually, the main documents used in this accounting system are: a three-years and a one-year cash based budget estimate; a reporting statement that includes a cash flow statement, a statement of incomes and expenses, a statement of financial position, and a prospectus for reconciliation.

Both budget estimates are juridical authorizations for revenues and expenditures in the local authority from a cash perspective.

In the reporting statement, the statement of incomes and expenses is prepared on the basis of financial data that has been correctly integrated and rectified. Often, this is interpreted only as a formal accounting execution, that does not influence any decisional logic with respect to the data concerning the financial position.

2. New Public Management

Public management is transformed from bureaucratic to managerial model (R. Mussari, 1994, E. Borgonovi, 1996; C. Pollitt, G. Bouckaert 2000, E. Anessi Pessina, I. Steccolini,

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²Public accounting models in Italy should be defined more precisely as commitment accounting models, as they are based on the moment the relating commitment should be executed, that is when a payment has to be made or an amount is legally due. The Italian model can be included in the wider “family” of the cash basis models. This paper refers to the Italian public accounting model as a cash basis model.

2005), through the implementation of the three managerial functions: planning, high direction, and internal control.

The managerial function of planning requires the support of an adequate accounting and extra-accounting reporting system. Cash basis data alone, which have traditionally characterized Italian public accounting, do not provide sufficient support for making sound managerial decisions. In fact, choices based on cash data are not always the most favorable in an economic dimension of cost. But, Italian local authorities continue to make decisions based only on cash values. This behavior is motivated by the non-mandatory nature of the accrual basis values.

Investment choices, instead, have to be based not only on cash basis perspectives, but also on values related to the cost of all alternatives, on qualitative levels of performance in public utilities, on realization time, on correlated tariff revenues, and on environmental impacts and territorial effects. Performance, realization time, and environmental impacts of activities are extra-accounting parameters that have to be considered in the planning and control processes, as well as within the strategic-political control.

The managerial function of the internal control in local authorities needs – as first step – the determination of production costs in public utilities. These data have to be gathered repeatedly and in short periods of time, using a constant and correct method. So, they must be systemic, frequent, and coordinated as a unity within a cost accounting system.

Today, there are few local authorities in Italy that apply a managerial control process and a cost accounting system.

In local authorities where accrual accounting models, cost accounting systems, and internal control processes are not implemented, the professional role of the public manager appears incomplete and not fully actualized. In fact, without the application of adequate accounting measures, and in the absence of necessary informational support, the public

manager cannot perform the economic planning and control processes that qualify his own role.

3. Enlargement of the Financial Reporting System in Local Authorities

Enlarging the public accounting system to include accrual basis of accounting is essential for rationalizing public management choices. Decisions must be based on objective values of cost in order to implement a good economic control system (E. Anessi Pessina, I. Steccolini, 2007).

The Italian Local Authorities Act (Testo Unico per gli Enti Locali, TUEL) provides non-mandatory, or discretionary requirements regarding methods and timing for the implementation of accrual basis accounting in local authorities. Article 232, entitled “Accrual basis of accounting” states that “local authorities, in preparing their financial statements, shall adopt an accounting system that they determine most appropriate for their individual needs”.

Surely, any reform in management and control systems, as well as in the principles of the authorities’ accounting models must include a change in the culture of authorities’ management itself. However, legislation in this area - towards a more informative and effective accounting system - could be the driving force necessary for reform in management, in accounting models, and in internal control systems.

The reason we strongly support modernizing Italian public accounting models to include accrual based data, aligning Italy with other countries with more rational public management, is that a reform of public accounting would contribute to improvements in management and control systems. In turn, new public management requires the support of a modern model of accounting.

Legislator must have the courage to make accrual based accounting and cost accounting methods mandatory. Managers, instead, must have the professional skillness to make

investment and strategic decisions based on economic cost values, not just on financial values. Internal auditors of the local authorities, within their function as consultants to the City Council, will need to promote the application of more valid accounting methods and management control systems for better public administration. In turn, citizens have the right to a true and complete information about public activities.

In this way, financial reporting– which is both of a cash and accrual bases – moves toward social reporting with a political-strategic character. It would address all stakeholders and consider results as effects of administrative actions in all dimensions: financial, economic, social, cultural, territorial, environmental and civil.

4. Alternatives to Implementing Accrual Basis of Accounting

Accrual basis of accounting, even if not required by law, can be applied “*praeter legem*”. As such, there need to be incentives for these good practices, which do not go against the law, but beyond it.

We identify four ways in which a general accounting system could employ accrual basis models:

- a) An accrual basis of accounting that would run parallel to the cash basis of accounting;
 - b) The derivation of accrual basis data from cash basis data;
 - c) An integrated system of cash and accrual bases of accounting;
 - d) The substitution of cash basis of accounting with accrual basis of accounting.
- a) In the case of parallel systems, each operation would be the object of two distinct recordings: one in the cash basis of accounting method and the other in the double entry accounting system. These two accounting systems – simple and double entry - are separate and would provide duplicate data. But the diffusion of software programs would facilitate this method without much burden to accounting.

- b) The second method would allow for accrual basis data to be elaborated from cash basis data. It would not involve changes in the general accounting system that would remain cash basis in nature. Accrual basis data of costs and revenues would be derived from cash basis data, through the execution of adjustments and integrations in the reporting statement. The precision of this data would be scarce, since there does not often exist a direct link between cash basis values and elements of cost or income. Further, the derivation of accrual basis data from cash basis data does not allow for a complete evaluation of investment options, which would take into consideration all available resources, cost-effective conditions, efficiency, and effectiveness of management.
- c) An integrated system of cash and accrual bases of accounting would offer the chance to record external management operations simultaneously from an accrual and cash perspective. Registration of any operation would supply data both to the cash based accounting and accrual based accounting methods.

We affirm that this method is the most appropriate for Italian local authorities. It would allow us to understand, in a complete and continuative way, the financial aspects of activities. Moreover, it provides a way of evaluating cost-effectiveness of the activities, as well as the effect of expenditures on financial position.

An accrual basis of accounting system would also support the compilation of a consolidated financial statement for the local authority. The strong externalization of local public services has restricted the management of local authorities, along with the significance of their financial statements. Here, then, we see the need for a consolidated report, that includes management in a comprehensive way, both internally and externally.

- d) The substitution of cash basis of accounting system with an accrual basis one brings with it the problem of control of expenditures by public managers. In fact, accrual basis of accounting is not predisposed with an authorization control function, which instead is a prerogative of the financial budget reports. Accrual basis of accounting in the for-profit sector records management operations only after the fact and at years' end compiles the financial statement.

The phase of investment planning is performed by the budget. In a situation where accrual basis of accounting has replaced cash basis of accounting, it would be necessary to modify the object, meaning, and purpose of planning documents. A new way of preparing the budget would have to be introduced – that would include financial data as they relate to administrative responsibility and functions. These new budgets would assume an authorization function in management operations, and their structure would need to be set forth by law.

The budget, then, would serve a triple function: as an instrument in planning that would guide and represent managerial choices; as an authorization document for management operations; and as an instrument of internal control, through which it would be possible to evaluate at year's end the consistency of results achieved to predetermined goals.

In some foreign countries the public management system in central and local authorities includes an economic estimate. These include Australia, New Zealand, Sweden, United Kingdom, Switzerland, and Finland. Italy is not ready for this kind of substitution, given its current managerial and accounting culture.

There exist various approaches to implementing a cost accounting system. The principal ones are those involving cost centers, and those using activity based costing (ABC). The practical applications of these are few. From a theoretical point of view, ABC is su-

perior, since it can be considered an improvement on full costing, and in public management it is necessary to take into account all costs, including facilities. ABC also recognizes activities as elementary units of the process, and strengthens those that add value to services provided.

The fundamental elements of cost accounting are: services, cost centers, and administrative responsibility centers. These elements are correlated to each other since each administrative responsibility center corresponds to one or more cost centers, each administrative responsibility center corresponds to one or more services, and each service corresponds to one or more cost centers.

If an accrual basis method for budgets were developed, each administrative responsibility center would refer to a budget.

The essential principles of the cost accounting system are: accrual basis competence; the correlation between resources and goals; the comparison between results and goals.

5. Accounting Standards in Italian Legislation: the *Observatory for Finance and Accounting of Local Authorities*.

The Italian experience in defining accounting standards for local public administration is a process that presents interesting and particular aspects. In Italy there exists a standard setter dedicated to issuing accounting principles for local authorities. It is called the Observatory for Finance and Accounting of Local Authorities (Osservatorio per la finanza e la contabilità degli enti locali) and was established in 1995³ within the Ministry of the Interior.

During its activity, the Observatory for Finance and Accounting of Local Authorities (thereinafter the “Observatory”) has published opinions and recommendations, account-

³ The Observatory was instituted through Legislative Decree N. 410/1998, and then revisited in the Consolidated Act for Local Authorities (TUEL), Legislative Decree n. 267/2000, art. 154

ing standards, studies, among other things. It is important to note that accounting standards are not regulated by law, so each local authority uses its own discretion in applying them. The Observatory, up until now, has produced a framework and has formed three accounting standards. Recently, a proposal to review those standards has been brought forth, in an effort to stimulate greater involvement between the local authorities, academics, and professionals who were called upon to provide considerations, criticisms and suggestions for improving the documents produced.

The framework (Osservatorio, 2006) introduced by the Observatory recalls that of IASB and the conceptual organization of IPSASs. The choice to issue its own framework, however, represents a separation of the Observatory from the foundation laid by IPSASB, which instead, received its framework directly from IASB, which allows for the application in the public sector of accounting standards analogous to those in the for-profit sector⁴.

The Observatory then, has taken into account the differences between private companies and public entities, that are very strong in Italian context. Further, the implementation of a full accrual accounting model would not have been coherent with legislation dictated in the Italian Local Authorities Act (TUEL, decree n. 267/2000), which provides for an accrual basis accounting model to work along side the modified cash basis accounting model (S. Pozzoli, 2002, p. XIII). Conversely, Italian laws discipline only modified cash basis of accounting and responsibilities held by the controlling bodies. The option for local authorities to adopt an accrual basis accounting model (art. 232 TUEL) is merely allowed. For this reason, the only mandatory general accounting system is modified cash basis.

⁴ Recently, IPSASB starts to compile its own conceptual framework.

With respect to public accounting models, various considerations made by the Observatory all converge on the introduction of an accrual basis accounting model to work along side the traditional cash basis one. Moreover, the shift towards adopting a full accrual model in public administration is common in many western industrialized countries (A. Bac, 2001; E. Caperchione and R. Mussari, 2000; K. Lüder and R. Jones, 2003; V. Montesinos and J. M. Vela, 2002; O. Olson and J. Guthrie and C. Humprey, 1998). In accordance with IPSASB, the Observatory established a postulate for accrual basis to be integrated with accounting and financial regulations.

Regulations pertaining to local authorities already require to draw up accrual based financial statements at year's end that are economic in nature, such as the statement of incomes and expenditures, statement of financial position, and prospectus for conciliation.

The accrual basis of accounting must refer to the drafting of such documents. In synthesis, the accrual basis of accounting provides for revenues derived from market exchange, or proceeds connected to allocation activities, to be correctly ascribed to the accounting period in which the legal transaction took place.

Also ascribed to the accounting period must be costs, as negative economic elements derived from market exchange, or expenses derived from allocation activities, relative to the resources utilized in the time period considered.

Application of the cash basis of accounting, which remains useful for preparing many of the documents used in the budgetary estimates, is not sufficient. Cash basis is clearly needed in the attribution of revenues to the accounting period when collections (assessments) are to be made, or of expenditures when payments (commitments) are due. Therefore, cash basis of accounting in the Italian public sector could be called a modified accrual basis, since it is based on the criteria of juridical competence instead of on a cash basis.

Applying the accrual basis of accounting cannot be limited just to the preparation of accounting reports. It must be applied correctly in the planning activities as well, since the objective of every entity, private or public, is to reach economic stability in the long term (Osservatorio, 2006, p. 25; E. Giannessi, 1961, p. 17). Attaining cost-effectiveness, then, becomes a goal directly connected to reaching the institutional objectives of the local authority.

Among the goals attributed to the reporting system is the inclusion of information about “future plans” (Osservatorio, 2006, p. 17). In this sphere, particular emphasis is given to the information that supports managers in their decision-making process. Decisions of public intervention cannot be based exclusively on cash data; rather it is indispensable that the informative system produces accrual data and highlights the effects of actions on the financial position. In fact, “it is necessary to consider economic logic as a priority in the formulation of planning acts [...]” (Osservatorio, 2006, p. 24).

The provision for including information about social effects of public management along side financial results (Osservatorio, 2006, p. 17 and 29) is particularly interesting.

Such information needs to be inserted in the administrators’ reporting statement. Considering the notable diffusion of social reporting in Italian local authorities, the Observatory has produced a document ad hoc on this subject, entitled “Guidelines for social reporting in local authorities”. (Osservatorio, 2007).

Intervention of the Observatory is not limited just to predisposing the framework. As already mentioned, three accounting standards were formed. The first, entitled “Planning and budgeting in the reporting system” (Osservatorio, 2003), describes the path from planning and programming to management and reporting in the local authority.

The second standard, entitled “Management in the reporting system” (Osservatorio, 2004a), addresses management and underlines the concept that, to achieve success and

administrative impartiality, it is necessary to respect the parameters of efficiency, effectiveness, and cost-effectiveness. Results achieved by applying these parameters require a unified and coordinated interpretation of management operations.

The standard regarding management is founded on cash basis, but at the same time, it orients the emphasis of managerial actions towards accrual basis data. This is perfectly in line with the standards set forth by the Observatory, which place accrual basis at the foundation of the informative-accounting model of local authorities.

The third standard formed by the Observatory is entitled “Reporting of local authorities”(Osservatorio, 2004b). It concentrates on all of the applicable regulations during the period of management reporting and the documents correlated with the report: cash flow statement, statement of financial performance, statement of financial position and enclosures. Here, the aim of providing information on financial position and cash flows, as well as on the financial results, is underlined.

Successively, the importance of respecting cash basis stability in order to evaluate the actual and prospective progress of management is reaffirmed. This stability is a fundamental management principle that has to be constantly evaluated, particularly during the process of approving the financial statement. Compliance with cash basis stability alone is not sufficient for formulating a valid judgment about management in the local authority, because accrual basis aspects must be included.

Currently in Italy a reform is underway involving regulations in local authorities. Legislation up until now has guaranteed autonomy to the local authorities in deciding which accounting models are most adequate to their needs. Because of this, we notice a fairly constant consequence of not being able to compare results between singular authorities. The reform in progress seems to be an effort to harmonize, at a national, European, and international level, accounting models of local authorities.

The primary directives of this process are in line with standards of the Observatory. We would like to highlight that the reform underway could produce a strong inclination towards adopting accrual basis of accounting and cost accounting. Legislators are in fact leaning toward the introduction of accrual basis accounting along side cash basis of accounting.

Accrual basis of accounting is certainly not foreign to Italian regulators of public accounting. As early as 1995,⁵ it was introduced as an option and today some local authorities have chosen this direction. However, we believe that it is necessary to make accrual basis of accounting mandatory to stimulate those public administrations still bound to traditional cash basis logic.

The bill calling for reform of the Italian Local Authorities Act also underscores the need to guarantee consolidation of public accounts at a national level.

The introduction of greater obligation in public accounting and in reporting would produce more complex accounting data. For this reason, the bill provides for simplification for small cities (under 5000 residents), for small city associations (Unioni di comuni), and for mountain authorities (Comunità montane).

The introduction of mandatory accrual basis of accounting for larger cities and provinces – as well as the simplified version mentioned above – could constitute the informative support necessary for the successive activation of a cost accounting model.

We assert that accrual basis of accounting must be mandated for large cities as well as small – even if in a simplified version. The decision-making process of public management has to be founded on accrual and cash data in order to realize a profound change in the culture of the authorities. Only in this way can the principles of efficiency, effectiveness and cost-effectiveness be truly introduced into the decisional logic, management, and

⁵ Legislative Decree n. 77/1995

internal control of the authorities. In fact, excluding the small cities from this fundamental process of modernization would significantly limit the reference area, because in Italy small cities greatly outnumber large ones.

6. Comparing Accounting Standards in IPSASB with those of the *Observatory*.

The standards for finance and accounting in local authorities set forth by the Observatory are in some ways coherent with those in IPSASB, and in other ways diverse. For this reason, the Italian case is particularly interesting.

A first examination is of the nature of the standard setter. IPSASB is a permanent commission of IFAC, a technical body that represents the accounting profession at an international level (M. Pozzoli, 2005). The Observatory, instead, is a body that was instituted by and is recognized in Italian legislative regulations (TUEL, art. 145) for its role as a standard setter for local authorities.

Accounting standards set forth by the Observatory, then, are implicitly recognized by law – since the Observatory was instituted through the Local Authorities Act – but are not legally binding. While the nature of the two bodies is diverse (technical at an international level; regulatory in Italy), the standards they produce are similar in terms of non-mandatory nature.

Accounting professionals have an inseparable connection to the definition of international public accounting standards, since those are issued by the body that represents them. In Italy, there is active collaboration between accounting professionals and the Observatory.

Moving towards the analysis of the standards set forth in the two standard setters, one major difference is immediately noted: IPSASB has chosen not to provide its own framework, instead it refers directly to IASB; the Observatory, on the other hand, published “Objectives and postulates” that serves as a framework for national accounting standards.

This decision by the Observatory was based on its willingness to introduce simplified measures for operators who, in the case of applying IPSASs, would have had to refer also to IAS/IFRS accounting standards, which are not coherent with the Italian regulatory and operational context of traditional cash basis of accounting (G. Farneti, S. Pozzoli, p. 295)

The Observatory identifies the accrual basis of accounting as the central element in local public accounting. Here, we notice a similarity to the work of IPSASB, which is concentrated on the adoption of a full accrual model, borrowing from well established experience in the private sector. Full accrual accounting produces information that facilitates greater transparency in management of public resources, and provides support for management in the decision making process.

Additional differences emerge from a further comparison between two standard setters: IPSASB uses information derived from year-end reports; the Observatory, instead, has enlarged its scope to include planning, budgeting, management, and reporting. Moreover, it has confronted aspects of internal control, the concept of accountability, and social reporting.

In synthesis, the Observatory has addressed certain issues like planning and management that are not usually found in regulations for accounting standards, which tend to be focused on reporting. This decision reflects a willingness to provide an operational tool for local authorities that takes into account current financial and accounting regulations, as well as procedures.

Harmonizing the Italian standards with those of IPSASB would require mandatory adoption of accrual basis of accounting in local authorities. It would also require that accrual basis budgets be drafted, to include an authorization function, to work along side the yearly cash basis budget estimate.

At this point, it is clear that we must ask ourselves what impact international accounting standards would truly have on Italian local authorities. At present, it is difficult to imagine a direct application of IPSASs in the Italian context. IPSASs could represent a reference point, or “best practice” in accounting to which European and other public administrations should adhere. It remains difficult, though to imagine a quick implementation of these standards, given the wide range of country-specific regulations.

The process of reform in the accounting methods of local authorities is on its way to creating greater coherency between regulations and national and international standards, especially through the choice of a mandatory full accrual system.

7. An Empirical Analysis of Accrual Basis of Accounting and Management Control in the Tuscany Region.

In 2006 (referenced 31 December 2005) we conducted and published an empirical study of local authorities in our region concerning: application of accounting standards from the Observatory; adoption of accrual basis of accounting; use of cost accounting models; implementation of ad hoc organizational structures dedicated to management control (M. Mulazzani and M. Pozzoli and A. Romolini, 2006). We sent an anonymous survey to all of the local authorities in the Tuscany region (10 provinces, 287 cities, 20 mountain authorities).

Analysis of the data was performed by clustering the cities by number of residents: 23 small cities (under 3000 residents); 53 small to medium cities (between 3000 and 59.999 residents); 3 medium to large cities (60,000 – 249,999 residents); 1 large city – Florence – (more than 249,999 residents).

Data relative to the application – total or partial – of accounting standards from the Observatory were high. With reference to accounting standard n. 1, “Planning and Forecasting in the reporting system”, 60% of the provinces, 100% of the mountain authorities,

and 73% of the cities declared total application of this standard; 40% of the provinces and 26% of the cities indicated partial application of this standard; only 1% of local authorities (1 city) stated that it did not apply this standard at all. The highest percentage of application (78%) was found in small cities, showing a strong propensity toward correct planning of available public resources.

Data relative to the Observatory accounting standard n. 2, “Management in the reporting system” substantially confirms what was found above, with a slight increase in city administrations (total application in 60% of provinces, 100% of mountain authorities, and 81% of cities).

Data regarding the application of accounting standard n. 3, “Reporting of local authorities”, shows a decrease in the local authorities’ attention to reporting with respect to that given to the budget with authorization function. In fact, observance of this standard, with respect to n. 1 remains unvaried (60%) in the provinces, but decreases in mountain authorities (80%), and in cities (64%).

Local authorities that affirmed application of all three Observatory accounting standards had to necessarily apply the framework as well. So, according to our research, 60% of local administrations in the Tuscany Region have adopted a reporting system consistent with the accounting standards of the Observatory.

Further analysis shows that only 17% of the local authorities have adopted accrual basis of accounting (in particular: 40% in the provinces, 20% in mountain authorities, and 13% in cities). The majority of local authorities compile mandatory accounting statements through adjustments and integrations performed on cash based data at year’s end.

Results for the adoption of a cost accounting model – compared to those found for accrual basis of accounting – were even lower. Only 13% of local authorities have adopted this system (in particular, 40% in provinces, 10% in mountain authorities, 13% in cities).

Included in the survey was a question aimed at authorities who do not employ a cost accounting model, as to whether they foresee application of it in the future. 10% of authorities responded that they could foresee this application within 1 year, 46% indicated that application would take longer than 1 year, the rest either did not respond (4%) or did not make a prediction (40%).

Finally, with respect to activation of ad hoc organizational structures for management control, the results (and practices) improved. About half of local authorities affirmed the existence of an office dedicated to internal control, or 60% in provinces, 50% in mountain authorities, and 52% in cities. So, we see that there is much room for improvement.

8. Conclusions

The problem is not so much performing accrual basis of accounting, as it is understanding its meaning and utilizing the information it provides in the decision making process and management control. In fact, in many local authorities compiling financial statements remains merely an accounting execution.

Further, the logic behind management control in local authorities, both by central government, and in the sphere of the Internal Stability Agreement, is only of a cash based nature and involves observing expenditure ceilings. Even the control performed by the Regional Audit Court (Sezione Regionale della Corte dei Conti) concerns accounting and administrative (ir)regularities and sound financial management. However, for efficient public administration, the problem cannot be seen only as how to spend less, but rather, how to spend better – within good parameters of cost-effectiveness, efficiency and effectiveness.

Another problem to consider, in the event of substituting cash basis of accounting with accrual basis of accounting, is the definition of accounting standards that are uniform with the public administration for evaluating accrual based data. A valid solution may be

adopting – with opportune modifications – the IPSASs, with the prospect of an accounting accrual based model.

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CORPORATE ORGANIZATION OF THE NATIONAL HEALTH SERVICE AS EXPERIENCED IN ITALY, EXPLORATORY IDEAS AND PLANNING SUGGESTIONS

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This paper aims to offer some reflections on the new public management in the Italian Health Service. The business oriented approach in this field of public administration, has been one of the great choices made in our country in the process of reforming the National Health Service, because most of the choices on the financing, administration and regionalization of health services rotate around it. In particular, the paper analyses the main features of the process that has characterized the innovation in health management, focusing on all interventions concerning Italian legislator and the main elements of change in this matter. The purpose is to present some reflections for the reform of Health Service, so that the experience of our country can be a contribution to the current debate.

1. Introduction

The problem of controlling health expenditure in Italy has always presented two types of problem for the legislature:

- The first is of a macroeconomic nature, and involves the need to find a mechanism to allocate expenditure to the State, Regions, and Health Boards, which is no longer based on historical relevances, but on the effective provision of services and provisions.
- The other is of a microeconomic sort, which has forced the definition of a management control system for the structures providing services, which allows resources to be used in relation to the effective spending need.

Proper control of health expenditure therefore, has been considered a priority since the beginning of the reform process, and, even though with changing fortunes, has constituted an underlying theme with all the legislative measures on the subject which have followed each other since Leg. Decree 502/92.

Precisely because of this the regulations proposed by the Leg. Decree 502/92 reform, as subsequently amended, have aimed at confronting the problem of financing the Health

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Service not only as a mechanism for transferring resources from the State to the Regions, but also as a rationalization principle for their use within the structures that produce services.

It isn't therefore by chance that two fundamental innovations form the basis of the reform; the first is the corporate organization of the structures providing services, the second is, however, the introduction of an appropriate system for measuring the levels of efficiency, efficacy and cost effectiveness of the services.

This choice, which now seems irrevocable and not open to reconsideration, at a distance of fifteen years offers the possibility of a first moment to reflect and draw some conclusions.

At the same time we believe that reflecting on the merits and limits of what has happened in Italy may be an interesting study and working contribution for a country which is beginning to transform its Health Service to incorporate internal administrative welfare choices into it, and to incorporate it into the larger international system.

However, in order to understand it properly, it seems important to see the Italian corporate organization process in the context in which it developed, in that it was and is a particular choice that has been able to work because it is connected to other choices that our Country has made.

We believe, in fact, that we can say that Italian corporate organization has anticipated certain procedures of our health system, which are reproducible only on condition that its numerous aspects are taken advantage of.

Corporate organization in Italy was an answer, which at the beginning of the '90s, the system needed to give to the ever greater difficulty of running our public organizations, and to the ever more problematic management of State resources.

It has expressed itself in the adoption of corporate models into the system of service provision and in the use of management models in running health care structures.

Previously health services were provided by structures based on local bodies (U.S.L. – Italian Health Boards) by means of bureaucratic organizational models which, due to their set-up, limited on the one hand pursuing adequate levels of efficiency, efficacy and cost effectiveness, and on the other, really guaranteeing citizens' right to choose.

The financing system was essentially a per capita one which was supplemented with considerable balancing of expenses, which somehow, instead of rewarding productivity, lead to encouraging inefficiency and waste.

The option of corporate organization, on the other hand, is linked to the reform process which began with Leg. Decree 142/90, implemented in relation to health care with Leg. Decree 502/92. It has since then remained as an unchanged point of reference with all subsequent reviews of the legislation.

Corporate organization, as one has seen, specifically set itself the following objectives:

- 1) *guaranteeing the right to health by means of greater fairness, that is through citizens' freedom of choice*: it was expected to obtain this through the creation of a health care market in which both public and private providing subjects competed;
- 2) *reaching adequate levels of efficiency, efficacy and cost effectiveness*: through adopting corporate models and managerial administration systems which, as with private structures, allowed waste and privileges to be identified.
- 3) *to separate politics and management*: by means of awarding powers of direction and control to the regional subject and of service management to corporate subjects.

2. Terms of Corporate Organization of the Italian National Health Service

Having acknowledged the objectives and aims with which corporate management of the Health Service was introduced, we must note how the formation of the health boards and hospitals has radically changed the system of national health governance, and the relationship between citizen and Public Administration.

In this regard we must stress that corporate organization in Italy wasn't a phenomenon that was an end in itself, but a way of realizing a system of governance which represents one of the main trends of measures taken by the state, and one of the economic sectors of major importance in our Country.

Italian corporate organization has been, therefore, **instrumental in a course of de-regulation** of the health care market. With corporate management one has aimed at creating real competition between public and private, which can promote real freedom of choice for citizens.

Competition therefore has been seen not just as a way to achieve savings, but mainly as a selection criterion for quality and satisfactoriness.

Contrary to what is sometimes thought, Italian corporate organization, moreover, wasn't constructed with the function of privatizing all or parts of services, but was considered a great opportunity to **strengthen and improve the public health care system**.

Perhaps the greatest success of Italian corporate organization has been precisely that of strengthening and making competitive a public system which at the beginning of the reform was in a very backward state, making it capable of comparing itself with the most dynamic private structures and hospital systems of the most advanced Western countries.

The process of corporate management in our country has moreover been a very important means of **Regionalization** of the public administrative structure.

Indeed, health care was the first and most significant acid test which our Regions undertook, developing a sense of autonomy in relation to which all the recent constitutional

reform proposals define themselves. It is precisely from the Regions that proposals, ideas and administrative and governance models have emerged, which have created fruitful competition which is positively affecting other devolved sectors of the State.

A precise understanding of the process that has occurred in Italy may be obtained if one sets it within the wider definition of the specific **financing system** of the Health Service.

This is a financing system which is articulated on three levels:

1. The first level is the financing by the State of the Regions (which in the Italian model, as has been seen, have an instrumental role). This financing is based on a per capita quota principle, and determines the sums that are agreed between State and Regions on a three yearly basis, as a criterion of sufficiency for financing service levels (the so-called Essential Levels of Care) which are considered necessary to ensure the right to Health. This financing is obviously supplemented with specific rebalancing financing aimed at compensating for local imbalances, and specific financing for research and investment.
2. The second level is what the Regions award to the health boards. This also is based fundamentally on a per capita system, and allows the Local Health Boards to organize a system of local services and prevention, as well as to buy hospital services from public or private producers.
3. This is charge related financing (by means of Diagnosis-Related Group) for hospital units. The activities of both public and private producing subjects are financed on the basis of the effective production of services. That is, a mechanism of respectable competition is set in motion, on account of which the Hospitals consider their income linked to the quantity (volume of demand) that they are able to attract, and to the quality (type of service-charge) of their service.

Only a careful analysis and understanding of the previously listed particularities will therefore allow assessment of the importation of the model into Italian corporate organization.

3. The Characteristics and Prospects for Corporate Organization of the Italian National Health Service

Precisely with the aim of accompanying a reflection on the Italian health model and on its repositability (at least partial) in different contexts, it seems fitting at this point of the argument, to present the present elements of debate in our Country, and the main prospects for development of the former's model of corporate organization. These are probably the points that in future will be presented in many systems that are following the European welfare model, but which, if analysed early, may help a Country to make its choices and perhaps avoid mistakes that we have made.

These, then, are the areas on which the Italian system is working, and which our countries could find as a broad and important element of comparison and debate.

Given the time limits of this paper, we limit ourselves in this context to present the topics in points, deferring elaboration of the single topics to the specialist literature or subsequent encounters.

The main topics linked to the problem of corporate organization of the National Health Service in our Country are therefore:

- The *rationalization of the various levels of governance*: the relationship between central government (Government and Ministry of Health), Regions, and Boards, is today one of the most debated elements of the system. In fact, on the one hand, central government is obviously inclined towards limiting expenditure, and therefore towards limiting production, and on the other the Regions inevitably aim towards a type of production self sufficiency for the services produced. Finally, the boards are forced by the charge related financing

mechanism to increase their production. If the model of Italian corporate organization has stabilized, on the contrary the debate on methods of governance of the system is still in full swing. The recent State-Region agreements, Health Pact and constitutional reform proposals are proof of this.

- *Re-examination of the management system*: this aspect is strongly linked to the previous one. The emergence of boards with a monocratic management in fact intended to encourage a strict separation between political will and managerial competence. In fact, today very large boards operate in the Health Service, which are managed by single subjects to whom the whole productive structure is entrusted, as well as the health of a whole area. The debate which conversely urges the creation of corporate forms of management for boards, and models which can face even more the numerous stakeholders in an area is ever more heated.
- *Re-examination of the accounting and auditing system*: Actually having formulated a system of governance at several levels has created a very large accountability problem on the one hand, and an auditing one on the other. The new role of the Court of Accounts, the debate on instituting an auditor's certificate, and the reformulation of accounting systems at the Ministry, are the proof of a theme which today must be developed. The recent enormous deficits which some Regions have unexpectedly put on the Ministerial table have made this theme even more urgent.
- *Appraisal of the systems*. The theme of appraisal will inevitably be linked to the auditing problem. In a country where the Regions have developed specific models and particular provision structures, it is important to be able to carry out an appraisal of both the clinical and administrative results. The debate on

proper appraisal systems for the various Regional Health Services and various structures is still today very heated.

- *The trade off between a competitive system and a co-operative system.* Today it seems very instructive to compare the different emphases that the different regional systems have given to the topic of competition. There are Regions in Italy which have bet mainly on the diversification and competition of supply, and others which have instead developed models co-ordinating purchasing Boards (the LHBs) and producing Boards (the PBs – Primary Boards). Different approaches to the roles of Hospitals, General Hospitals, and area Prevention have emerged, which even though they have constituted a very interesting management workshop, must today be synthesized in a model which will allow a greater uniformity in the provision of services on the national territory.
- *The relationship between corporate concentration and concentration of functions.* A further aspect of the Italian national debate, in the sphere of management experimentation, is the size of structures. One has moved from a logic of concentrating at all costs on the pursuit of ever more extreme economies of scale (there are in Italy Regions which have formed a single LHB for the whole area), to the idea that a smaller size would better understand the particularities of the territory. A new current tendency of the debate which prompts one to see as more opportune a policy of concentrating functions rather than boards, seems interesting. In Italy one is relying on outsourcing and pooling in centralized structures (Consortiums, Agencies, ecc.), those functions which characteristically favour the advantages of economies of scale, such as purchases, centralized stocks, economic management of staff, and analysis laboratories, etc.
- *The relationship between corporate organization and clinical governance.* A final aspect worthy of consideration is the relationship between management competences linked to the process of corporate organization and clinical governance. The debate is both theoretical and practical, and concerns both aca-

demetic disciplines and the organization of services. In short, it is always important to unite an administrative model, with its rationale, models and managerial structures, with the clinical management system of health care structures and methods characteristic of a science, the latter only in a broad sense being able to be compared to an activity producing or providing corporate services.

4. Final Considerations

As we have seen in the previous pages, the prime importance of corporate organization to the Italian Health System has been recognized, in order to achieve its mission, processes of acquisition, combination and allocation of resources available from, rather guaranteed by, a corporate type management of services.

It isn't by chance, that in the light of what has been said, the following three topic areas are set as objectives for the present National Health Care Plan:

1. the consolidation of adopting the means of management;
2. the redefinition of territorial areas and other forms of institutional re-engineering;
3. the relationship with clinical management themes.

We are personally convinced that corporate organization can be a central point in the reform of the National Health Service. The debate that is underway and the documentation produced by the institutions allow one to sense that this is the course which this Country intends to travel.

If we can summarize what has been presented today in some indications and suggestions on points for attention that the reform process should consider, and in relation to which, noting what has happened in Italy may be of help, we will identify the problem of regionalization, and the problem of financing systems. It seems evident that the choices which can be made on the subject of corporate organization, may prove unsuccessful if not set in the clear context of these two points.

Precisely the relationship between the centre and periphery, public and private, hospital and territorial activity, will moreover require the formulation of a system of norms and controls within which these boards will have to operate.

CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABLE DEVELOPMENT IN RUSSIA AND ABROAD

Pavel Malyzhenkov¹

In this paper corporate social responsibility (CSR) and its extent in foreign and Russian companies are analyzed. The theoretical basis of this phenomenon and contributions to its build-up made by different scientists are considered. The CSR Concept is defined and statistical data on its application in the world business practice are given.

1. Corporate Social Responsibility in the World Practice: the Phenomenon Analysis

One of the first scientists who made contribution to the companies' social responsibility development was Milton Friedman, who suggested in 1971 the revision of the relationship between economics and ethics in the sense that as he insisted the only social responsibility of business was increase in company's profit within the bounds of legal and ethical norms. However the more important term for the understanding of the CSR phenomenon is a stakeholder concept, which is the basis for understanding of strategic planning processes in a company in general and the companies' social responsibility in particular.

First the term "stakeholder" appeared in 1963 and was proposed in the context of one of the internal reports on research activities in Stanford Research Institute². Stakeholders were defined as "groups without support of which the organization cannot exist". The term "stakeholders" is a broad one in the sense that all groups which one way or another effect the company's activity and are interested in it (state, company's personnel, customers, suppliers, etc.) may be placed among stakeholders³.

The main scientist who made an important contribution to the further development of this theory as well as to its application in the practical process of the company management was Edward Freeman. It is his merit that stakeholders became key agents in the company's strategic management process. Consequently they must be known and studied by the enterprise administration. It means to take into consideration their requirements, to assess their expectations and to monitor goals accordingly.

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² Till 1970 it was a part of Stanford University, whereupon it became an independent institute.

To achieve its aims a company must establish proper relations with society and search for a kind of “approval” of its activity, which first of all depends on the company’s ability to meet stakeholders’ expectations. For doing that the company has to perform two tasks:

- to inform on its intentions and gained results in proper time;
- to generate (and distribute) value.

In 1992 thanks to the activities of Swiss businessman Stephan Schmidheiny at the World Summit in Rio de Janeiro the term of business social responsibility appeared in its modern sense when several transnational companies united under the name World Business Council for Sustainable Development had been able to propose a self-righting program⁴. There was once more emphasized the importance of the fact that the corporations should conduct their business taking into consideration the interests of different parties concerned (stakeholders) in order to gain together the declared objective of the sustainable development.

In 1997 the founder of the Consulting Agency “*SustainAbility*” John Elkington introduced in his book “*Cannibals with Forks: the Triple Bottom Line of 21st Century Business*”⁵ the term “*triple bottom line*” expressing his idea that the company’s activity must affect the following three main aspects of the public life: economic, environmental and social ones, and all initiatives launched relating this aspects must be described in a single document addressed to all groups of stakeholders. From 1993 till 1999 the companies were preparing mainly the reports related only to environmental parameters. Since 1999 the term “sustainable development” which combined in itself all the three aspects mentioned before became common and a report on such activities was named a social report, social balance statement, sustainable development report or a report on corporate social responsibility. Notwithstanding the different names of these documents all of them stick to the “*triple bottom line*” concept and contain information on the company’s economic, environmental and social activities.

³ The term “stakeholder” is often translated as “bearer of interests” or “social interlocutor”, etc.

⁴ Concept of sustainable development was so popular that at present this Council has two headquarters: in Geneva (is in charge of sustainable development initiatives in Europe) and in Washington (fulfils the same task in America);

⁵ J.Elkington *Cannibals with Forks: the Triple Bottom Line of 21st Century Business*, Oxford, 1997;

Characteristics of this document:

- it is a separate document (it is not an alternative to traditional accounting as one could think), containing quantitative and qualitative information on how the company's activity affects the society;
- frequency of publication;
- public character of the document: it is addressed to all stakeholders, directly or indirectly involved into the company's activity.

Companies issue social reports with purpose to provide stakeholders with an overall view of social results of their activities, acquainting them with additional information needed for the company assessment, the representation of added value and its distribution as well as for the description of the company's value system, actions for the improvement of their activity and the interaction with macroenvironment. However, it is necessary to admit that whereas the requirements to reporting are usually observed by all enterprises, its strategic analysis is carried out mainly by multinational companies. Moreover, they are more active in publishing their results especially in those areas where they need to recruit high-skilled labour force and strengthen their position as employers and providers of work places. All companies are trying to conform to this level, especially large ones even when their significance is limited by the definite natural region.

The main reasons for CSR appearance are as follows:

1. Globalization and competition aggravation;
2. Increasing of companies' sizes;
3. "War for talents". The companies issue such reports with the purpose of involving, developing and motivating talented and able employees. This problem is very serious in European countries because of population ageing and lack of high-skill personnel for conducting business under difficult market conditions and necessity to always meet various and constantly growing customer needs. In the first place it affects the companies which in view of specific character of the branch have to engage high-skill, high-intellectual and creative employees. Social responsibility programs are in this case a part of the "war for a talent", a part of competition to sign on the most interesting, brilliant personalities. Just for management of such personnel, non-financial incentives are espe-

cially efficient. When employees of the company are mainly motivated by means of money the program will hardly bring advantages.

4. Increasing role of a company's intangible assets for achieving competitive advantages. For a long time the practice of using at least two different conceptions of corporate capital was consolidating in European operational experience: financial capital shown by means of traditional accounting methods and intangible capital shown by means of innovation forms, for example, a social report or a report on sustainable development. It is common knowledge that traditional financial indices do not represent any more an effective method to show the intangible component of the company's activity. One of the reasons for this is the fact that in relation to human resources, for example, all activities connected with giving employment, training and maintaining are exceptionally regarded as expenditures of current period. In addition it is necessary to take into consideration the low ability of traditional indices, for example of ROI, to stimulate the policy of human resources development because these indices show profitableness prospects for a short period of time, they do not stimulate decisions on training investments, which bring results after a longer period of time. The problem of parameter analysis for internal (management information) or external (with the objective of managing the relations with stakeholders or in particular with shareholders) reporting of such a type is also of certain interest. There are several common parameters: labour force, wages/salaries depending on sex, etc. which are used in such a reporting.

The extent of this phenomenon can be assessed using the data from the following diagrams⁶.

⁶ The data are taken from the report of KPMG International Survey of Corporate Responsibility Reporting, 2005. The survey was conducted for the 100 biggest companies from 16 countries all over the world (in the present paper only some of them are indicated) and for the 250 biggest companies world-wide, which include 100 companies from USA, 40 from Japan, 24 from France and 21 from Germany. Percentage of other companies was insignificant, in total this sampling included companies from 21 countries all over the world.

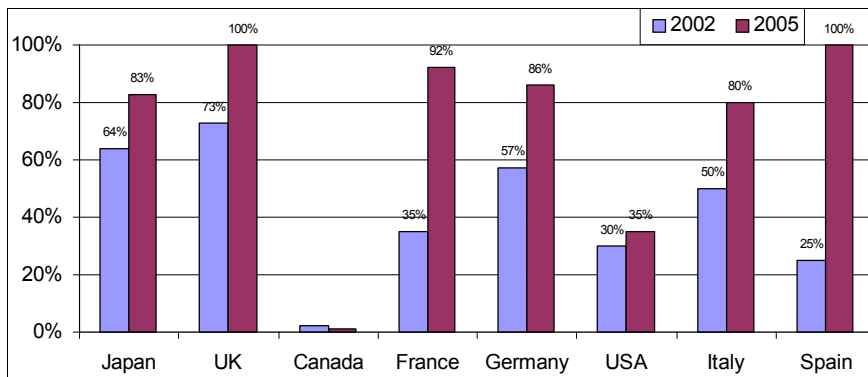


Diagram 1. CSR in the 100 biggest companies from different countries

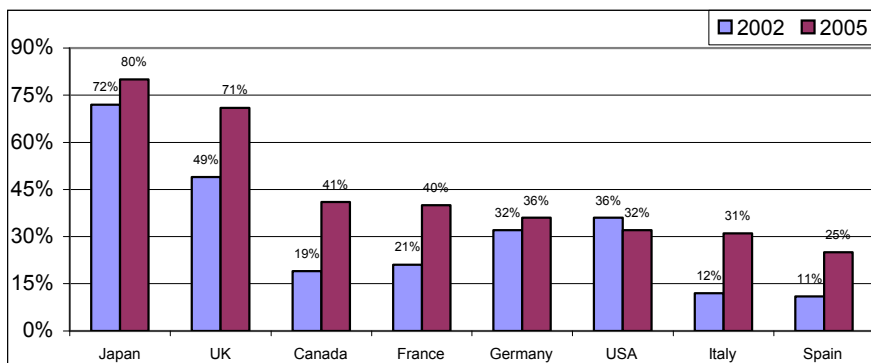


Diagram 2. CSR in the 250 biggest companies world-wide

Notwithstanding the fact that companies very often take human resources as an object for reporting other themes are also subject to it. In several countries companies have to issue such reports in accordance with legal norms with the purpose of state control of such problems as race or gender discrimination, control of work of under-age employees, etc.

Among the main factors driving the social responsibility are strengthening of trademark and building up a company's reputation, struggle for the right to be a privileged employer, retention of strong market position, gaining confidence of financial markets and increase of shareholders' income as well as innovations in development of new products

and services and creating new markets. According to the data of KPMG group for 2005⁷ companies occupy themselves with corporate responsibility in 74% of cases for economic reasons, in 53% of cases for ethical reasons and reasons connected to innovations or personnel training, and in 47% of cases the driving factor is the employees' motivation.

This data is very important because it shows that the main factor of CSR development in the companies is nevertheless the striving for improving the economic aspect of their activity and raising the economic indices. The social aspect is certainly present in corporate social responsibility, and there are many examples in history when the ideological factor influenced the country economics. One of them is abolition of slavery in the USA, which by the beginning of the civil war still remained an economically high-efficient institute. Its abolition can be explained by only one reason: gradually the immorality of ownership of human beings became clear to people⁸. However it is a mistake to think that CSR is based only on the ideological factor, and does not set improving of economic component of the companies' activity as an objective and consists only of charity programs implementation.

Therewith one more important problem is connected. A question arising with reference to all widely spread social and charity programs, as well as steady increase of the number of companies which are inspired by the CSR ideas (see graphs 1 and 2) is: are all the enterprises socially responsible or is there someone who does not need social responsibility? Several branches or markets the participants of which do not take part in all these processes remain aside from this phenomenon, namely:

- Uncertainty concerning risks or the best way out. For example, the companies of biotechnological sector connected with production of genetic modified products belong to this category. There is no sense for them in investing into social responsibility programs, instead of this it would be useful to bend every effort to prove safety of their products in principal.

- Desperately regulated business, perceived as social problem (arms production).

⁷ KPMG International Survey of Corporate Responsibility Reporting, 2005;

⁸ V. Avtonomov, O. Ananyina, N. Makasheva: Economic studies history – Moscow, INFRA, 2003, p. 682;

· Companies without well-known brands, operating in the market fragmented by many middle and small enterprises, which do not manufacture end products. Hardly any claims will ever be laid on them by the community, and even if they are laid the losses will be insignificant.

· Companies with good reputation without significant impact on the environment: internet companies, software developers, news agencies.⁹

The diagrams below show spreading of corporate social responsibility in different industrial sectors.

Diagram 3. CSR by sectors: the 100 biggest companies from different countries

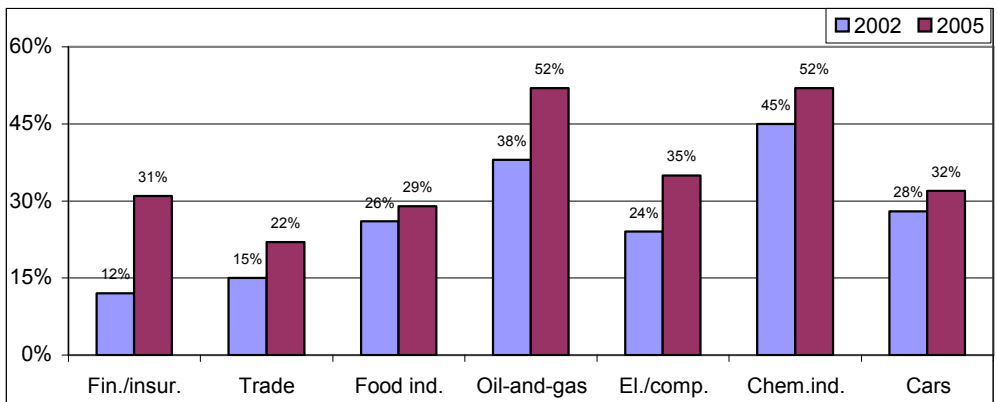


Diagram 4. CSR by sectors: the 250 biggest world companies

As we see from the above diagrams the number of companies issuing sustainable development reports is increasing in different countries all over the world as well as in different industrial sectors. This however often results in the fact that popularization of corporate social programs leads to identifying corporate responsibility with PR.

Besides, the survey has shown that the content of sustainable development reports complies in 40% of cases with the GRI¹⁰ recommendations, in 21% of cases when draw-

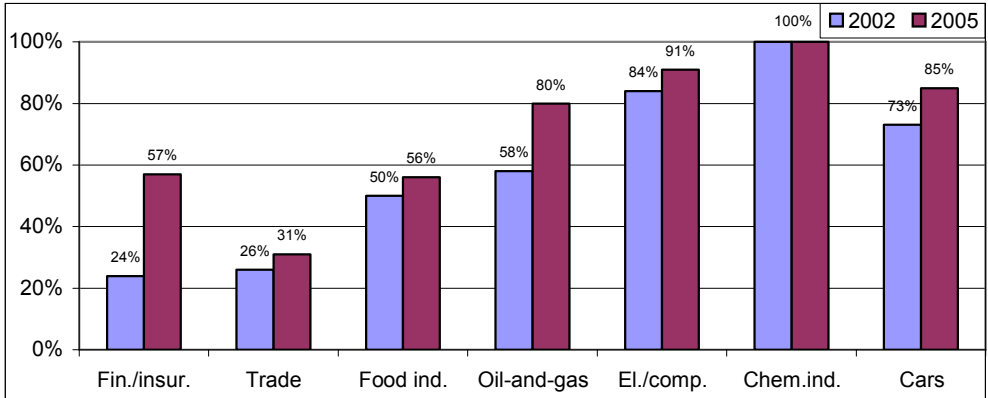
⁹ Alexey Kapyrev: Meaning and advantages of social responsibility, www.prompolit.ru

ing up reports the dialogues with stakeholders were used, and 32% of companies asked for stakeholders' opinion relating the reports.

The dialogue with stakeholders was mentioned in just 40% of reports with an emphasis on the CSR policy more than on reporting itself. In comparison with environmental problems the economic and social topics are covered much more superficially. Social issues which are discussed by almost 2/3 of companies can be divided in four main classes: basic labor standards, working conditions, public relations, charity.

However their contents remain rather sketchy because of lack of well defined social indices, and economic aspects are discussed only in few cases: almost 61% of reports contain such a financial information as income, and only 25% discuss economic influence of their activity from sustainable development point of view.

The main institutions which develop standards in the area of corporate social responsibility are Association of Chartered Certified Accountants (ACCA), European Chemical Industry Council (CEFIC), Global Reporting Initiative, International Standards Organisa-



tion (ISO), Organisation for Economic Co-operation and Development (OECD), Global Sullivan Principles of Social Responsibility. Let's partially consider GRI standard as an example and the showings included in it. GRI standard: economic aspect:

EC1: Economic value generated and distributed;

¹⁰ Global Reporting Initiative (GRI) is an international expert network from independent working groups or governmental institutions which are occupied with social reporting and developing of its

- EC2: Financial risks and opportunities;
 EC3: Coverage of organization`s obligations;
 EC4: Financial assistance received from government.

GRI standard: environmental aspect:

Materials:

- EN1: Materials used by weight or volume;
 EN2: Percentage of materials used that are recycled input materials;

Energy:

- EN3: Direct energy consumption by primary source;
 EN4: Indirect energy consumption by primary source;
 EN5: Energy saved due to conservation and efficiency improvements;
 EN6: Initiatives to produce energy-efficient products which require less energy

consumption;

- EN7: Initiatives to reduce energy consumption and reductions achieved.

GRI standard: social aspect

Community:

SO1: Nature, scope, and effectiveness of any programs and practices that manage the impacts of operations on community

Public policy:

- SO5: Participation in public policy development and lobbying;
 SO6: Value of financial contributions to political parties and institutions.

As we see the content and scheme of the standard correspond completely to the concept of John Elkington “*triple bottom line*”, which is basic and generally accepted in the theory and practice of corporate social responsibility.

To conclude: corporate social responsibility is first of all a complex of deliberate actions and measures based on certain values and views of the subject implementing social responsibility and aimed at achieving a certain objective. Deliberateness of these actions appears in the fact that, in the first place, not all companies are socially responsible and support CSR actions for a long-term profit earning. In the second place, having issued a

standards. Headquarters is in Amsterdam.

sustainable development report once, one should follow it constantly securing the frequency of its publication. A break in publication of such reports can cause a negative attitude of society toward the company. In the third place, CSR implementation involves additional expenses.

Besides, corporate social responsibility is always based on values and conviction in close connection between social functions of the company and long-term business interests. And, finally, CSR has specific objectives and tasks which are an achievement by a company of its stable position by means of stakeholders' assent and generating and distribution of added value.

Thus corporate social responsibility can be defined as the companies' policy based on understanding of close connection between social functions of a company and long-term business interests and aimed at reaching an agreement between stakeholders.

2. CSR in Russia

Russia overpasses the way of corporate social responsibility introduction in the companies' practice rapidly. In 2005 CSR became a part of the agenda of many companies although several years ago the majority of them did not have a clear idea of it.

Today Russian business community realizes that social activity of the companies can cause an economic effect. Russian entrepreneurs after their foreign colleagues admit CSR to be an efficient instrument of financial risk management. Progressive part of business community does not think any more that corporate responsibility is a charity or the companies' investment in their own PR. Today CSR is understood as a risk management system within a long-term business development strategy, which is a big step forward¹¹.

At the same time there is a process of institutionalization of CSR principles. Business community representatives draw up documents which will regulate the implementation of corporate responsibility in practice. Over last years this work was actively done by Russian manufacturers and entrepreneurs union (PCIII). "Social charter of Russian business" published by the union at the beginning of 2005 became a serious step towards mutual understanding of the term itself as well as of its place in Russian practice. In the document social mission of the commercial sector is formulated in full accordance with Western ex-

¹¹ O.Aksyenova: "Corporate social responsibility: results and forecasts", www.soc-otvet.ru.

perience as an achievement of “sustainable development of independent and responsible companies which meets long-term business economic interests, promotes achievement of social peace, safety and well-being of citizens, environment protection, observance of human rights”. In 2005 about 150 organizations employing more than one million people joined the charter.

At the end of 2005 one more initiative was started. Attached to the Federal Agency for Technique Regulation and Metrology a Technical committee for standardization (TC) “Social responsibility” was founded, its scope is to develop national standards in the area of CSR, to reduce terminology and principles to a common denominator, to regulate information exchange, etc. A proper approach to social reporting was proposed by the Russian Chamber of Commerce and Industry. It developed its own standard “Social reporting of enterprises and organizations registered in the Russian Federation. Guidelines”. As it is claimed in the document it was prepared “taking into account the principles of international standards of corporate social reporting” AA1000 and GRI.

In the standard of the Russian Chamber of Commerce and Industry it is indicated that “the most important element of preparing the topics for a social report is organization of constant dialogue with all stakeholders of the company”. The document offers seven topics: “Securing high quality and competitive ability of goods and services”; “Consolidation of honest and civilized business principles”; “Strategy and tactics of business activities in the social field”; “The company’s concern for welfare of its employees”; “Creation of safe working conditions, strengthening of population health”; “Participation in development of intellectual and spiritual potential of the society”; “Contribution to environmental protection”. There are recommendations for each topic as to which issues should be covered in it. Besides in the preamble it is proposed to speak “about the company’s history, main business directions and results, principles of doing the business”¹².

The Association of Managers adheres to the following definition: corporate civil responsibility is a behavior philosophy and a concept of building up the activity by business community, companies and separate business representatives with the emphasis on the

¹² “Who and on what topics should report according to standard of Russian Chamber of Commerce and Industry?”; www.soc-otvet.ru

following reference points: production of high-quality products and services for customers; creation of attractive work positions, payment of legal wages and investments in development of human potential; strict adherence to the legislation requirements: tax, labour, ecological legislation, etc.; establishing conscientious relations with all interested parties; efficient business conducting aimed at added value generation and growth of its shareholders' welfare; taking into account public expectations and generally accepted ethic norms in business practice; contribution to formation of the civil society by means of partner programs and projects of local community development¹³.

The year 2005 became a turning-point for non-financial reporting in Russia. Till that time social reports or reports on sustainable development were issued only by a few companies, operating in the Russian market. The pioneer of the movement was "British American Tobacco Russia", which started the reporting process in 2003, and in 2005 it published already a third report in accordance with the international standard AA1000. In 2004 reports on their contribution to society development were given by several companies: Oil Company "YUKOS", "Northwest timber industry company", "FIA-Bank" (Togliatti), "Alpha-Bank", "Russian public utilities" and "Sibneft". In 2005 according to the experts' assessments more than two tens of public non-financial reports of big companies were published, among them – "LUKOIL", "RUSAL", Mining-and-metallurgical integrated works "Norilsk nickel", "Tatneft", "Ilim Pulp". The company "British Petroleum" first published its report on sustainable development in Russian (minor version). The social reporting process was started by "Unified Energy System of Russia" JSC, "Vimm-Bill-Dann Food", "Siberian coal energy company", SUAL and others. F. Prokopov points to the fact that many reports are now done by the organizations of medium business. Some companies used in the process of report preparing a new tool for Russian practice – dialogues with stakeholders.

Russian entrepreneurs are convinced that a sustainable development report results in improving a company's reputation in the society's opinion, it is useful for investors when assessing the activity of the company, conducting comparative analysis and, finally, tak-

¹³ S.Litovchenko: "Corporate responsibility is an integral part of forecasting and risk management system", www.soc-otvet.ru;

ing correct investment decisions. According to Sergey Litovchenko, executive director of the Association of Managers, in order to put the social reporting into business use it is necessary to form the “critical mass” of companies and organizations which determine demand and supply for such a reporting. As for the form of social reporting at this stage in Russian practice one should observe the free-will principle of sharing the information on realization of corporate responsibility principles in practice.

The fact that the companies which started giving reports earlier than others continued this work also in 2005 is of big importance. One must not stop after one report. Reporting is a continuous process, in every further document the company should show how it reacted upon the stakeholders’ proposals uttered in the previous period.

We have said more than once already that social responsibility of companies is connected with their sustainable development. It is necessary to proceed from the fact that the company which conducts business badly is economically non-efficient and financially unstable cannot be responsible. However, we should add to that company’s management of its own social risks, internal (for example, connected with personnel) as well as external risks (relations with local population, authorities, etc.). From this we conclude the second important point: social responsibility is often understood not simply as a moral obligation to poor people (such interpretation can often be heard), but as a civil responsibility¹⁴. Any company is an integral part of the society and like every other citizen it assumes certain obligations. The companies’ obligations are far beyond charity limits and include the whole complex of issues connected with economic stability, relations with suppliers, customers and personnel, products quality, environmental safety, human rights, cooperation with local communities including charity.

According to the data provided by the Perm STU in 2003-2004 only 5 of 100 Russian biggest companies published separate reports on environmental or social problems. Another 20 included such information in their annual reports. In any case this reporting was still far from generally accepted international standards.

¹⁴ F. Prokopov: "The company which conducts its business badly and is not economically stable cannot be socially responsible", www.soc-otvet.ru;

The main driving factor of CSR development in Russia is the need for reliable information for key stakeholders in particular for foreign investors which are skeptical about management quality and ethics in Russian enterprises. The experience of foreign companies with reference to CSR can serve as the basis for Russian enterprises. If the report is prepared in accordance with international recommendations it must be based on dialogues with stakeholders. A company strives to clear up the expectations of interested parties and act in accordance with them. As a result such reports became for a company an instrument of corporate management, management and reputation improvement, business risks minimization, predicting new tendencies and, finally, contribute to increase of business efficiency on the whole¹⁵.

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THE SYSTEM OF BANKRUPTCY IN RUSSIA AND ITS EVOLUTION

Alexey Makarov¹

1. The history of the development of bankruptcy system in Russia

The history of bankruptcy in Russia has long roots. Though the word “bankruptcy” appeared in Russian law much later there are articles concerning bankruptcy in the “Russian Pravda”, which is one of the first legislative acts that operated in ancient Russia in XI—XII centuries.

Before the revolution of 1917 the legislation about bankruptcy was revised several times and the practice of commercial courts dealing with the cases of bankruptcy was constantly improved as well. The results of the research of the legal regulation of bankruptcy before 1917 show it’s high level of development even in comparison with foreign systems of bankruptcy. At that time legal regulation of bankruptcy was considered as one of the key elements of regulating market economy.

The revolution of 1917 introduced its changes into the law-making process. Major modifications were made in the area of state law. However, the issues of bankruptcy were reflected in the reform of legal relationships envisaged by the state law.

Since 1930-s legal relations concerning bankruptcy of enterprises were not regulated. Official doctrine did not recognize the system of bankruptcy. It was argued that bankruptcy can not exist in the command economy. Moreover, the rules of bankruptcy were completely excluded from the USSR legislation.

After a long period of time started the process of restoring legal relations concerning bankruptcy of the debtor. The first to be adopted was the law of the Russian Federation “About bankruptcy of enterprises” dated November 19, 1992. The Law of 1992 was an attempt to unite in an eclectic way the elements of various systems of bankruptcy acting in different countries. Law-makers offered parties the possibility of applying elements of various systems of bankruptcy to the debtor, without providing any details.

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Later some other acts were passed to fulfill the Law of bankruptcy of 1992. The latter defined the criteria for recognizing the organization of the debtor as bankrupt and envisaged measures aimed at financial support provided to the organization before termination, as well as the procedure of termination.

The national Law №6-ФЗ “About bankruptcy” dated February 8, 1998 was to a greater extent aimed at defending the interests of creditors. One of the key innovations of the second Law about bankruptcy was the requirement to the arbitration manager to have a special license.

New national Law “About bankruptcy” passed by the state Duma on September 27, 2002 and signed by the President of the RF on October 26, 2002, represents the third stage in the development of the legal settlement of relations connected with bankruptcy of organizations and citizens, which can be characterized as the continuation and development of the reform of legislation about bankruptcy started in 1998.

The new Law about bankruptcy of 2002 differs from its predecessors by a greater number of articles. The Law of 1992 consisted of 51 articles, the Law of 1998 – of 189 articles, while the new Law includes 213 articles. It is more detailed and has some conceptual changes in the legal settlement of bankruptcy.

To be more exact, the approach to defining criteria and external features of bankruptcy remained the same, while some procedures of bankruptcy were clarified, such as surveillance, external management, competitive production, and out-of-court settlement.

New systems appeared, such as the procedure of financial revival, self-regulating organizations of arbitration managers, checking at the hearing whether the claimed requirements have grounds so that the procedure of supervision could be introduced, transfer from competitive production to external management, and bankruptcy of strategic organizations.

According to the new Law competition creditors and authorized bodies. In fact, authorized bodies, as well as competition creditors, are the third to get the satisfaction of their demands, and authorized bodies take part in voting on the issue of settling the lawsuit out of court. The amount of claims of creditors to debtors – juridical persons has

been increased as the condition of taking legal action about bankruptcy. At present bankruptcy lawsuit can be initiated by arbitration court on condition that the claims to debtor, who is a juridical person, are not less than 100 000 rubles.

The procedures of holding the meeting of creditors and the committee of creditors, authorities of arbitration managers, and the way of hearing bankruptcy cases have been described in more detail. This, no doubt, increases the guarantees and legal interests of all sides participating in a bankruptcy case.

The law contains a number of other novelties and upon the whole can be assessed as a high-quality legislative product.

At present the system of bankruptcy is developing and is to a great extent focused on preventing the termination of an enterprise by undertaking certain economic and organizational measures.

But as practice shows, there are cases of competition selling implying termination. Previous procedures aimed at financial revival of the enterprise are often inefficient. Experts maintain that the basic reason for this is that bankruptcy system does not include the component responsible for the collection and analyses of information about the enterprises that are likely to go bankrupt. The development of this element can significantly improve the efficiency of the financial revival procedure, which nowadays is introduced too late to be able to save the enterprise.

2. Modern methodology for evaluating bankruptcy

According to the first version of the Law about bankruptcy the government of the RF adopted a Decree № 498 “About some measures aimed at implementing the Law of about bankruptcy of enterprises” dated May 20, 1994. Next, Resolution of the National Board on bankruptcy № 31-p dated August 12, 1994 approved methodological provisions for evaluating financial condition of enterprises and establishing unsatisfactory balance structure. The given documents identified criteria for evaluating unsatisfactory balance sheet structure and bankruptcy of a company, defined the order of indices calculation. In spite of the fact that these indices for evaluating bankruptcy of organizations are not used at the moment, this methodology is and will be of interest both historically and logically.

Documents containing financial reports of a company serve as key sources of information for calculating indices and evaluating bankruptcy. Without giving peculiarities of Russian financial reports we would maintain that upon the whole their structure, format and content meet international requirements to a great extent. These requirements have been implemented in RF since 1998.

The system of criteria, which allow to define companies with either satisfactory or unsatisfactory balance sheet structure, includes the following indices:

1. Current ratio (CR);
2. Percentage of current assets coverage by equity (CACE);
3. Coefficient of restoring (loss) of solvency SR(L)C.

CR is calculated as the current assets divided by current liabilities. It is one of standard criteria, which shows the situation with liquidity.

CACE shows to what extent active assets of a company are provided with owner's sources. CACE is calculated as the ratio of difference between equity and fixed assets to the total current assets.

Coefficient of restoring (loss) of solvency SR(L)C is indices that characterize the capability of a company either to restore or to lose solvency during a certain period of time are coefficients of restoring or losing solvency.

Solvency restoring coefficient (SRC) for the period of six months is calculated in case one of the following conditions is true by the end of accounting period:

- * Current ratio is less than two ($CR < 2$);
- * Percentage of current assets coverage by equity is less than 0,1 ($CACE < 0,1$).

Solvency restoring coefficient (SRC) indicates the possibility that an insolvent company will be able to restore solvency during six months after the analysed period.

In case CR exceeds or equals 2, and CACE exceeds or equals 0,1, coefficient of losing solvency (SLC) is calculated for the period of three months. SLC characterizes the relativity of losing solvency by a solvent company during three months after the period under analyses.

Below are formulas for calculating SRC and SLC:

$$SRC = \frac{CRe + \frac{6}{T}(CRe - CRb)}{2}$$

$$SLC = \frac{CRe + \frac{3}{T}(CRe - CRb)}{2}$$

where:

CRe/b – current ratio at the end/beginning of the period under analysis;

T - is the duration of the period under analyses (in months).

It is noteworthy that the period under analyses can include several accounting periods.

If SRC < 1, it indicates that there is no real possibility to restore solvency in the coming six months. If SRC >= 1, it is believed that a company has possibility to restore solvency in the coming six months.

If SLC >= 1, this indicates that there is possibility for a company not to lose solvency in the coming three months.

Decision whether the balance structure is unsatisfactory and the company insolvent, is made according to the conditions given in Table 1.

The given methodology was widely used in 1994-96 when making decisions about bankruptcy. Its main drawbacks were insufficient flexibility, limited criteria, and tough norms. From our point of view due to these factors it was replaced by another methodology. Development of bankruptcy system contributed to it to a great extent.

According to the Decree № 33-p of the Russian National Service dealing with bankruptcy and financial revival dated October 8, 1999 criteria of presence or absence of signs of fictitious and deliberate bankruptcy were introduced.

In order to evaluate fictitious bankruptcy it is necessary to find out the coverage of short-term liabilities of a debtor with his current assets, which is calculated as the ratio of current assets to the amount of short-term liabilities (similar to CR). If this index equals or exceeds one, it indicates the signs of fictitious bankruptcy, and if it is less than one, the signs of fictitious bankruptcy are absent.

For revealing the signs of deliberate bankruptcy progression of the following indices should be studied:

- Coverage of liabilities by all types of assets;
- Coverage of short-term liabilities by current assets;
- Net assets.

Table 1. Decisions for Unsatisfactory Balance Structure

CONDITIONS	Rules					
	Yes					
1. CR>=2; CACE>=0,1; SLC>=1						
2. CR>=2; CACE>=0,1; SLC< 1	Yes					
3. CR< 2; CACE< 0,1; SRC>=1			Yes			
4. CR< 2; CACE< 0,1; SRC< 1					Yes	
5. CR>=2; CACE< 0,1; SRC>=1					Yes	
6. CR< 2; CACE>= 0,1; SRC>=1						Yes
ACTIONS	1. Recognising balance structure as unsatisfactory and company as insolvent is postponed for the period up to six months			x		x
	2. Decision about recognizing balance structure as unsatisfactory and company as insolvent can't be made	x				
	3. Decision about recognizing balance structure as unsatisfactory and company as insolvent is not made, but the company is registered in the federal bankruptcy Board			x		
	4. Balance structure is recognized as unsatisfactory and company as insolvent					X

When the indices deteriorate considerably the evaluation of all the deals of a debtor should be carried out. The purpose of evaluation is to reveal (uncover) unfavourable conditions for concluding them that eventually resulted in bankruptcy.

It is possible to speak about the signs of fictitious bankruptcy when there are grounds to suppose that actions of debtor's management such as concluding deals on unfavourable conditions have lead to significant deterioration in the indices under analyses as well as to debtor's bankruptcy.

The Federal Service of Russia dealing with financial revival and bankruptcy passed Order № 16 dated January 23, 2001, which ratified "Methodological guidelines for conducting analyses of financial condition of a company". These guidelines were recommended for carrying out evaluation and making conclusions, for monitoring financial state of organizations aimed at getting real assessment of their solvency, financial stability, business and investment activity, and operation efficiency. Criteria for evaluating financial condition of a company recommended by methodological guidelines are presented in Table 2.

It is important not only to determine bankruptcy, but also to predict it. In Russia in order to evaluate and predict bankruptcy such well-known multifunctional criteria as Altman's Z-score is used. The efficiency of evaluation and prediction is limited due to the weakness of the Russian security market, and insufficient transparency of financial reports of many companies.

3. Bankruptcy procedures and measures aimed at financial revival of a company.

According to the Bankruptcy Law when the case about bankruptcy of a debtor the following bankruptcy procedures can be used:

- Monitoring (observation);
- Financial revival;
- External management;
- Competition production;
- Out of court settlement.

The Law about bankruptcy describes the contents and use of each procedure mentioned above, as well as the actions of people applying these procedures. Financial re-

vival is one of bankruptcy procedures that are used for restoring debtor's solvency according to the schedule of liquidating debt.

Table 2

Financial Statement Analysis Criteria

Criteria Group	Criterion
1	2
1. Common Criteria	1.1. Average revenue per month
	1.2. Cash revenue percentage
	1.3. Average number of employers
2. Solvency and Sustainability Criteria	2.1. Common range of solvency
	2.2. Bank debt ratio
	2.3. Other organization debt ratio
	2.4. Fiscal system debt ratio
	2.5. Internal debt ratio
	2.6. Current liabilities coverage by revenue
	2.7. Current ratio
	2.8. Current assets financed by owners
	2.9. Percentage of current assets coverage by equity
	2.10. Finance independence ratio
3. Effectiveness of current assets using	3.1. Current assets turnover
	3.2. Inventories turnover
	3.3. Receivables turnover
	3.4. Return on current assets
	3.5. Return on Sales
	3.6. Revenue by employer
4.PPE effectiveness and investment activity Criteria	4.1. PPE turnover
	4.2. Ratio of Investment Activity
5. Taxes and other state fund payments criteria	5.1. Taxes payments ratio
	5.2. Other state fund payments ratio
	5.3. Pension fund payments ratio

Basic measures aimed at restoring debtor's solvency envisaged by the Law include the following:

- Changing the production profile;
- Terminating unprofitable production lines;
- Collecting accounts receivable;
- Selling debtor's enterprise or part of his possessions;
- Transfer of rights for claims on liabilities;
- Carrying out debtor's liabilities by property owner, founders (participants) of a debtor or by a third party;
- Increasing shareholders' capital of a debtor due to payments made by participants or third parties, issuing additional ordinary shares of a debtor;
- Replacement of debtor's assets;
- Other measures.

Selling debtor's property must not result in his impossibility to conduct economic activity. In order to restore debtor's solvency the plan of an external manager can envisage increase in the shareholders capital of a debtor, who is a joint stock company (JSC) by issuing additional ordinary shares. Replacement of debtor's assets is carried out by setting up one or several joint stock companies on the basis of debtor's property.

4. Examples of practical evaluation of the signs of fictitious and deliberate bankruptcy of companies

Let's consider the examples of evaluation of signs of fictitious and deliberate bankruptcy using the examples of Russian companies.

Company 1 operates in the sphere of constructing and servicing motorways. Its activities have certain peculiarities that caused further bankruptcy of the company:

For a long time payments for motorways construction were made in the natural form, i.e. by supplying materials, clearing of mutual claims. Thus, for getting financial resources the company had to resort to selling of assets that were not always high-liquidity ones. Road-constructing works have a strongly pronounced seasonal character and must be completed before winter. Financing company usually made payments at the end of the year.

Coefficients characterizing debtor's solvency are the grounds for initiating the first stage of determining bankruptcy indicators. (see table 3).

Table 4 presents the results of how significant deterioration of financial coefficients is. As it can be seen from table 4, there is significant deterioration of two and more coefficients in the following periods:

- Since January 1, 2003 till March 31, 2003
- Since July 1, 2003 till September 30, 2003
- Since January 1, 2004 till March 31, 2004
- Since July 1, 2004 till September 30, 2004
- Since January 1, 2005 till December 31, 2005

The analysis has not revealed any deals that were concluded being aware of the conditions unfavourable for the debtor.

According to the analyses of progression of coefficients that characterize debtor's solvency and debtor's deals, it can be concluded that there are no signs of deliberate bankruptcy.

Indices of current liquidity in the analysed period are less than one (Table 5). This also points at the absence of signs of fictitious bankruptcy. Actual insolvency of a debtor stipulates the choice of competition selling procedure. Selling available assets can satisfy creditors' demands.

According to Definition of Arbitration court of Nizhny Novgorod region dated December 13, 2005, the Claim about recognizing Company 2 (JSC Ltd.) as bankrupt was received from one of the creditors of this company. It should be noted that in this example there are no grounds for carrying out evaluation aimed at revealing signs fictitious bankruptcy.

Calculation of indices essential for deliberate bankruptcy evaluation is presented below in tables and charts.

Table 3
Liquidity and Solvency Ratios (Company 1)

Ratio title	Date												
	01.01.03	31.03.03	30.06.03	30.09.03	31.12.03	31.03.04	30.06.04	30.09.04	31.12.04	31.03.05	30.06.05	30.09.05	31.12.05
Quick ratio	0,01	0,00	0,01	0,01	0,01	0,01	0,00	0,00	0,01	0,01	0,01	0,01	0,01
Current ratio	0,65	0,63	0,97	0,70	0,89	0,69	0,71	0,00	0,81	0,74	0,18	0,11	0,04
Current ratio (included long-term debt)	0,74	0,69	1,03	0,76	0,94	0,74	0,76	0,05	0,86	0,80	0,24	0,17	0,15
Current liabilities coverage by revenue	3,18	3,78	2,84	3,50	3,59	6,05	7,32	7,72	6,65	9,57	15,30	22,55	28,47

Table 4. Ratios growth rate

№	Ratio title	Average quarter growth rate	Date												
			01.01.03	31.03.03	30.06.03	30.09.03	31.12.03	31.03.04	30.06.04	30.09.04	31.12.04	31.03.05	30.06.05	30.09.05	31.12.05
1	Quick ratio	0,001	0,014	0,000	0,011	0,006	0,009	0,005	0,004	0,006	0,007	0,006	0,006	0,006	0,006
	Decreasing		0,014	-0,011	0,05	-0,003	0,004	0,000	-0,001	-0,001	0,000	0,000	0,001	0,001	X
	Current ratio	0,051	0,653	0,628	0,975	0,889	0,692	0,711	0,004	0,814	0,740	0,179	0,113	0,036	
2	Decreasing		0,025	-0,347	0,276	-0,189	-0,019	0,707	-0,810	0,074	0,561	0,066	0,077	X	
	Current ratio (included long-term debt)	0,049	0,741	0,688	1,035	0,942	0,736	0,760	0,048	0,861	0,797	0,241	0,175	0,149	
3	Decreasing		0,053	-0,347	0,272	-0,179	-0,024	0,712	-0,812	0,064	0,556	0,066	0,026	X	
	Current liabilities coverage by revenue	2,108	3,180	3,778	2,836	3,595	6,051	7,323	7,722	6,650	9,570	15,304	22,545	28,474	
4	Decreasing		0,60	-0,94	0,66	0,10	1,27	0,40	-1,07	2,92	5,73	7,24	5,93	X	

1) Coverage of debtor's liabilities with all his assets

By the end of 2005 balance cost of debtor's assets becomes less than the sum of his liabilities (Table 5).

Table 5

Liabilities coverage ratios 2004 – 2005

Ratio title	2004			
	Q1	Q2	Q3	Q4
Liabilities coverage by all type of assets	1,81	1,42	1,88	1,99
Ratio title	2005			
	Q1	Q2	Q3	Q4
Liabilities coverage by all type of assets	2,04	2,02	1,32	0,96

According to accounting reports dated January 1, 2006, debtor's assets cover only 96 % of accounts payable (debt to creditors).

2) Coverage of debtor's short-term liabilities with current assets (Table 6)

Table 6

Liabilities coverage ratios 2004 – 2005

Ratio title	2004			
	Q1	Q2	Q3	Q4
Liabilities coverage by current assets	0,99	0,89	1,00	1,11
Ratio title	2005 год			
	Q1	Q2	Q3	Q4
Liabilities coverage by current assets	1,20	1,17	0,78	0,54

The reduction of the index under consideration is caused by the increase in accounts payable.

3) Amount of net assets

A company is on the verge of financial bankruptcy. All key financial indices (liquidity, financial stability, profitability) prove this. During the period 2004-2005 the amount of net assets dropped by more than 13 mln.rubles (Table 7).

Table 7

Net assets 2004 – 2005, thousand roubles

Ratio title	2004			
	Q1	Q2	Q3	Q4
Net assets	12 050	9 509	11 985	14 912
Ratio title	2005			
	Q1	Q2	Q3	Q4
Net assets	16 648	18 531	8 035	-1 270

Analysis of debtor's deals has revealed the following:

1. Prices of material values are artificially high and exceed market prices. For example, in 2004 lime road stone was supplied at the price of 501,01 rub. per ton. At the same time other firms supplied the same stone at the market price of 267,91 rub. per ton.

2. Starting with the middle of 2004 bitumen, oven fuel and petrol were supplied by an external company, while Debtor has his own fuel station. The prices of the supplied products exceed average market prices by 25-30% in the same time period.

3. A debtor has leased two cars, but they are used by another company without any agreement with the debtor. The Head of this other company is also deputy to the General Manager on financial issues in the company which is debtor.

All the facts mentioned above make it possible to speak about malfunctions of Debtor's management. According to the results of financial analysis it can be concluded that the signs of deliberate bankruptcy of Company № 2 are present. Decision was made to apply to it some of the considered measures of financial revival.

To conclude, calculation of potential payments without giving any details of the scheme of financial revival, designed according to acting legislation, is presented in Table 8.

As the result of implementing measures aimed at restoring solvency considerable increase in financial flow and improvement of financial condition of the company upon the whole should be expected.

Table 8

Cash inflows and outflows forecasting (Company 2), th.rbl.

	2006	2007 (six month)	Sum
Cash inflows (all sources):	54 941,8	23 446,6	78 388,4
From sales	52 941,8	23 446,6	76 388,4
From banks (credit)	2 000,0	-	2 000,0
Cash outflows (all sources):	48 553,5	22 943,0	71 496,4
Inventory purchasing	15 830,4	8 909,0	24 739,4
Electricity	5 859,3	3 019,5	8 878,9
Repairment	1 290,0	-	1 290,0
Transportation	765,0	355,0	1 120,0
General and administrative payments	6 000,0	2 352,0	8 352,0
Wages	10 015,8	4 947,7	14 963,5
Social payment (from wages)	3 697,9	1 639,7	5 337,6
Tax payments	2 810,1	1 720,0	4 530,1
Payments on credit and interests payments	2 284,9	-	2 284,9
Net cash inflow	6 388,3	503,6	6 892,0

ESSENTIAL PROBLEMS OF LOCAL BUDGETS IN THE RUSSIAN FEDERATION

Nadezhda Sirotkina ¹

Russia, a huge and complex country, has been undergoing a process of fiscal and administrative decentralization.

The decentralization that took place in the Russian Federation in the course of economic and political reforms of the 1990s was a spontaneous process. There was no clearly defined strategy. However, nowadays it has some significant achievements. One such achievement was that local authorities were granted the right to plan their respective budgets on their own.

First, it is important to realize that there are many different types of local government in Russia. In 2003 the idea of two-level local government and unified system of local government across the country was introduced by Law No. 131-FZ

The two-level system of local government was necessary because the community level was given life-support and betterment functions, and the district level was created to address inter-community issues and as a level capable of assuming state functions.

The numbers on the figure refer to the amount of local governments of different types in the RF

Local self-governments of settlements are in charge of such essential services as hot and cold water supply, water disposal, heating, electric power, gas and fuel supplies, area improvement within municipal boundaries, and domestic waste disposal.

A municipal rayon should focus on inter-settlement powers that govern health care, general and supplementary education, pre-school education, guardianship and custodial care, provision of equal budget revenue supply among settlements etc. Municipal rayons were granted powers to arrange electric power and gas supplies within the boundaries of municipalities and powers to arrange recycling and processing domestic and industrial wastes.

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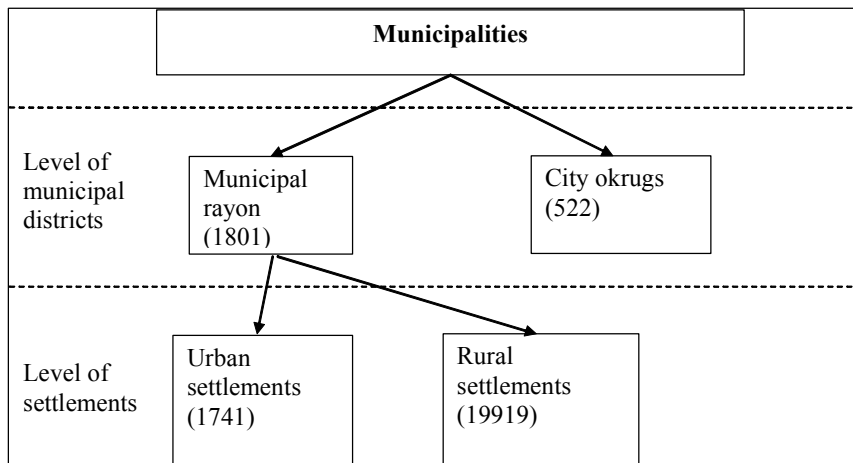


Figure 1. Types of municipalities according to Law No. 131-FZ «On the General Principles of the Organization of Local Government in the Russian Federation»

The formation of new municipalities (at the level of settlements and municipal districts) presupposes the redistribution of powers, cash flows and property objects. All this will create an entirely new reality. Unfortunately, local governments are not prepared to this reality either financially, or organizationally, or in HR terms.

Since the implementation of decisions requires financing, the local budget can be considered the vehicle of the municipality's policy.

Local municipal governments have two primary sources of revenue. The first are revenues that they collect themselves including local taxes, service charges, fees and rental income from buildings and facilities, , as well as income from sales of municipal assets. The other major source of revenues includes regional government transfers.

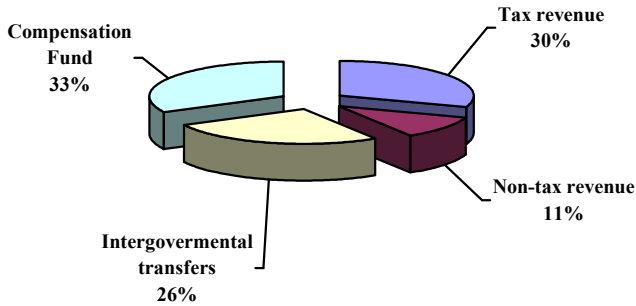


Figure 2 Structure of local budgets revenue in the RF in 2006

As for tax revenue, individual income tax comprises 66 % of total amount of tax revenue, and the rest is made from property and land taxes.

Revenue structure is not uniform in different local governments, because some local governments have more tax-raising or legislative powers than others.

Over half of municipalities are characterized as highly subsidized: the share of subsidies varies from 50 to 100% of the total amount of local income. This means that local budgets of municipalities (most of them are settlements) don't get enough income from local taxation and non-tax income according to their newly obtained responsibilities.

So, it is essential for local municipal governments to accelerate the growth of their own-source revenues. It seems to me it is common problem for many countries.

Now let's turn to Public expenditures. Judging by the data in Figure 4 one may conclude that spending on education and health care is heavily decentralized in Russia. The same applies to expenditures on sports, culture and arts, transportation, road construction and maintenance and communications.

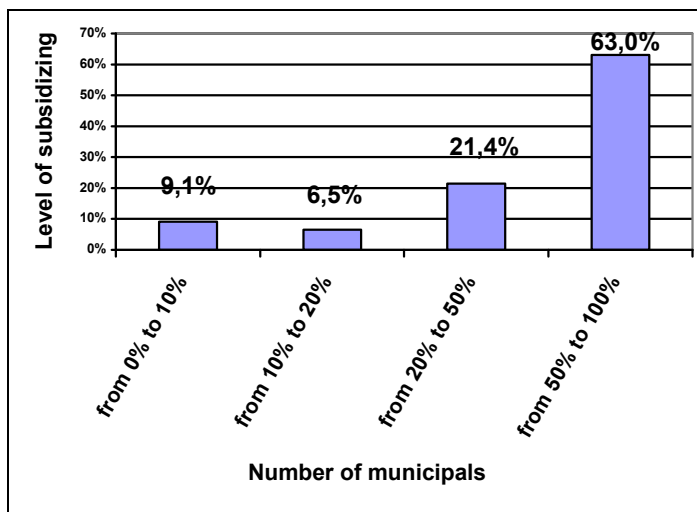
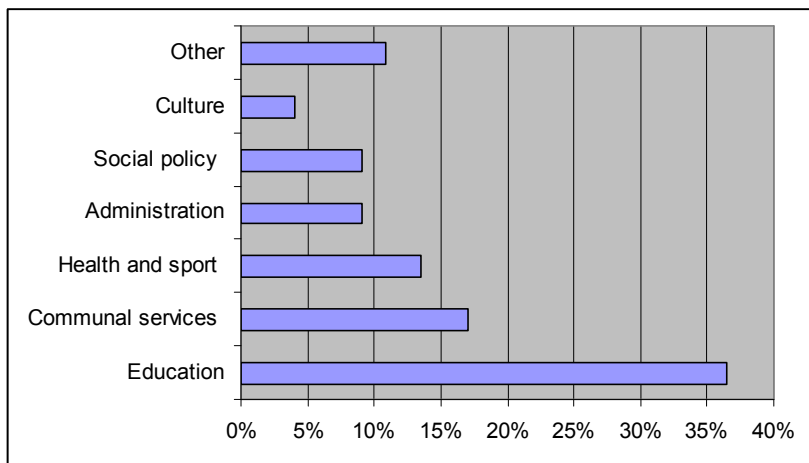


Figure 3. The level of subsidizing of municipalities in the Russian Federation

Table 1. Structure of revenue of regional and local budgets in European countries

<i>Country</i>	<i>Local taxes</i>	<i>Service charges, fees and rental income</i>	<i>Intergovernmental transfers</i>
Germany	80	10	10
Finland	50	20	30
France	44	20	36
Russia	30	11	59
Italy	13	8	79
Great Britain	12	16	72
Nederland	8	20	72

Figure 4. Structure of local budgets expenditures in the RF in 2006.

But the right to spend money did not always mean that local governments have the discretion to do as they think fit. Expenditures of lower governments were tightly regulated by laws adopted by higher governments, and there was no real spending independence.

Local governments in Russia were under tight legislative regulation regarding practically all kinds of public expenditures.

Municipalities in the RF should closely monitor and control budget expenditures especially in the sphere of public purchasing.

Procurement methods are common for all levels of budget.

1. Procurement may take place:

1) Through a tender in the form of bidding or auction, including the electronic auction;

2) Without a tender (a request for quotation from the single supplier (contractor, provider) at a commodity exchange). As for commodity exchange it does not work in practice.

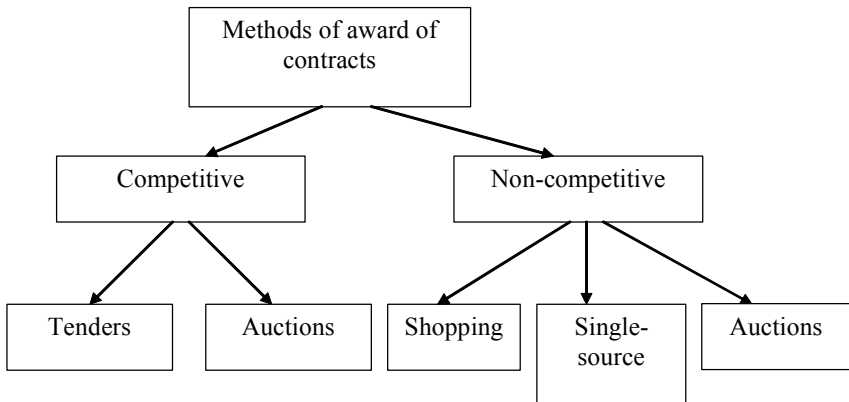


Figure 5. Methods of award of municipal contracts in the RF

Formally, there is no basic procurement method but, in fact, the auction is going to be the one since this summer. I know it looks unusual and Italian legislation do not use this method of public procurement. Russian authority says it is the way to avoid corruption and to increase transparency. I am not sure it is the right way, but we have to stick to it.

The major directions of budget reforms in the RF are following:

1. Decentralization of operating functions.
2. Budget transparency is the key. Since 2007 In Russia has been a requirement for three-year forward estimates and for reporting of budgetary versus actual budgetary allocations.
3. Modernizing municipal budgeting practices implies a shift away from control orientation and budgeting inputs to focus on outcomes (results) and accomplishments.
4. Each municipality is committed to particular fiscal targets and institutes measures that enforce the achievement of these targets.

This provides an opportunity for more responsive and participatory local budget making.

THE DEVELOPMENT OF THE CENTRAL BANK OF RUSSIA AND RUSSIAN BANKING SYSTEM

Natalia Kasatkina, Elena Suspitsina ²

This paper is devoted to the peculiarities of the historical development of Russian Banking System and the role of Central Bank in implementing monetary policy. Banking system is known to be the special indicator of economic situation in the country. That is why it is very important to find out the core financial instruments used by Bank of Russia and commercial banks for organising and controlling currency circulation.

1. The brief historical information of the development of the Central Bank of Russia and Russian banking system

The Central Bank of the Russian Federation (Bank of Russia) was founded on July 13, 1990, on the basis of the Russian Republic Bank of the State Bank of the USSR. Accountable to the Supreme Soviet of the RSFSR, it was originally called the State Bank of the RSFSR.

In November 1991, when the Commonwealth of Independent States was founded and Union structures were dissolved, the Supreme Soviet of the RSFSR declared the Central Bank of the RSFSR to be the only body of state monetary and foreign exchange regulation in the RSFSR. The functions of the State Bank of the USSR in issuing money and setting the ruble exchange rate were transferred to it. The Central Bank of the RSFSR was instructed to assume full control of the assets, technical facilities and other resources of the State Bank of the USSR and all its institutions, enterprises and organizations until January 1, 1992.

On December 20, 1991, the State Bank of the USSR was disbanded and all its assets, liabilities and property in the RSFSR were transferred to the Central Bank of the RSFSR (Bank of Russia), which several months later was renamed the Central Bank of the Russian Federation (Bank of Russia).

In 1991-1992 an extensive network of commercial banks was created in the Russian Federation under Bank of Russia guidance through commercialization of the specialized banks' branches. The disbandment of the State Bank of the USSR was followed by

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changes in the chart of accounts, the establishment of a network of Central Bank cash settlement centers and their provision with computer technology. The Central Bank began to buy and sell foreign currency in a special market it established and to set and publish the official exchange rates of foreign currencies against the ruble.

New banking system had developed in a complex and contradictory way. 1413 commercial banks had already operated by the beginning of 1992, 767 among them were based on former specialized banks and 646 was formed newly. But, essentially, the majority of them (73%) comprised the small banks, authorized capital of which varied from 5 million to 25 million ruble. There were only 2% of the largest banks (authorized capital is more than 200 million ruble). Sberbank and Vnesheconombank had been the main large banks. That time the peculiarity of banks was instability, the reasons of which were insufficient qualification of staff, shortage of capital, wrong interest rate policy, high risks and low liquidity. All of these factors led to the bankruptcy of many banks.

In December 1992, as a result of the establishment of a single centralized federal treasury system, the Bank of Russia was no longer required to provide cash services for the federal budget.

In 1992-1995, to maintain stability of the banking system, the Bank of Russia set up a system of the commercial banks supervision and a system of foreign exchange regulation and foreign exchange control. As the agent of the Ministry of Finance, it organized the government securities market, known as the GKO market.

In 1994 the banking system was considered quite stable. There were 2019 commercial and cooperative banks with 4539 branches and 414 credit institutions. Total capital of banks also increased. The most banks became universal. The first mortgage banks, which offered long term mortgage loans, were founded in 1994. They are Joint Commercial Bank "Moscow Mortgage Bank", Mortgage Standardbank, St.-Petersburg Mortgage Bank.

In order to overcome financial fallout of 1998 the Bank of Russia implemented the policy of banking system restructuring aimed at improving operation of commercial banks and increasing their liquidity. According to the legislation, insolvent banks were drawn from banking service market. The most important impact for the recovery of the banking

activity in a post-crises period was establishment of the Agency for Restructuring Credit Organizations (ARCO) and Interagency Banking Promotion Coordination Committee of Russia (ICC). In the middle of 2001, as a result of effective actions of the Bank of Russia, ARCO and ICC the banking sector of economy almost overcame fallout consequences.

Monetary policy of the Bank of Russia focused on supporting financial stability and forming prerequisites for stable economic growth of the country. The Bank of Russia responded to change of real demand for money quickly; supported growing economy and reduction of interest rates, inflation expectations and inflation rates. As a result, some consolidation of real ruble exchange rate and stability of financial markets were reached.

As a result of deliberate monetary policy and exchange rate policy implemented by the Bank of Russia, gold and international reserves of the Russian Federation were enlarged; no rapid fluctuations of exchange rate were observed.

The activity of the Bank of Russia in the development of a payment system was focused on increase in its safety and efficiency aimed at providing stability of financial sector and economy of the country. In order to improve information transparency in a payment system, the Bank of Russia introduced financial reporting of the credit institutions and local branches of the Central Bank which considered international practice, methodology and practice of payment system monitoring.

In 2003 the Bank of Russia initiated implementation of the project on improvement of banking supervision and prudential reporting by introducing the international standards system (International System of Financial Reporting - ISFR)

A number of measures will be implemented: provision of accurate accounting and reporting of credit institutions, strict requirements for the content, scope and periodical basis of publishing information. Besides, information on real owners of credit institutions will be disclosed, their financial status will be monitored, and more strict requirements will be imposed on credit institutions officials and their goodwill.

In April 2005 the Government of the Russian Federation and the Central Bank of the Russian Federation accepted the "Strategy of banking sector development in the Russian Federation for the period till 2008."

According to this document the main objective of banking sector development for the midterm (2005-2008) is improvement of its stability and efficiency.

The main tasks of banking sector development are:

- Strengthening protection of investors' interests and other bank creditors;
- Increase in efficiency of banking sector activity in terms of financial resources accumulation and their transformation into credits and investments;
- Increase in competitiveness of the Russian credit institutions;
- Preventing usage of credit institutions for illegal businesses (first of all financial terrorism and legalization of illegal incomes);
- Development of competitive environment and provision of transparency of credit institutions activity;
- Confidence-building to the Russian banking sector.

First of all, the Bank of Russia monitored credit organizations to check how they observe the banking regulations. As a result, licenses were recalled from the banks dealing with illegal business or services that are not specified in the Federal Law "On the Banks and Banking Activity". That is why, the number of commercial banks significantly decreased in comparison with 2003.

For the moment here is the list of the five largest commercial banks of Russia³:

№	Name of bank	Net assets on 01.01.07, million ruble
1	Savings bank of Russia	3 470 973.5
2	Gasprombank	713 273.4
3	VTB	774 341.2
4	Alpha-Bank	358 502.9
5	Bank of Moscow	355 136.0

³ An official website of the Central bank of Russia www.cbr.ru

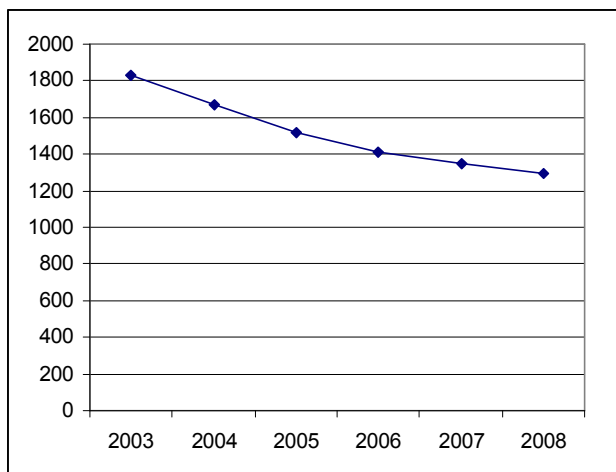


Fig.1 Dynamics of the number of commercial banks in Russia, units1.

The reforming of the Russian banking system contributes to realization of a social and an economic programs in the midterm (2005-2008). First of all, it will be focused on overcoming primary direction of the Russian economy by realizing competitive advantages and rapid diversification. At the next stage (2009-2015) the Government of the Russian Federation and the Bank of Russia will consider an efficient positioning of the Russian banking sector at the international financial market as a priority task.

2. The status of the Central bank of the Russian Federation

The Russian banking system represents the two-level system and includes the Bank of Russia, credit organizations, filial agencies and also representative offices of the foreign banks.

The Bank of Russia is the main regulator of the banking industry. It is responsible for issuing banking licenses and setting rules of banking operations and accounting standards. The bank serves as a lender of last resort for credit organizations.

It is responsible for the country's monetary policy, including the level of the shortest interbank interest rate. By influencing the ruble interest rate, it also influences the price of the ruble in terms of foreign currencies.

 Chairmen of the State Bank of Russia ⁴

Name	Year
Georgy Matyukhin	1990-1992
Victor Gerashchenko	1992-1994
Tatiana Paramonova	1994-1995
Alexander Khandruyev	November 8 to 22 1995
Sergey Dubinin	1995-1998
Victor Gerashchenko	1998-2002
Sergey Ignatiev	2002 – present

The Bank of Russia acts in the role of the central bank of the country, and the main functions are monopolistic currency issue, the bank of banks, the bank of the government, and also regulating and controlling functions.⁵

At the same time its status, goals, functions and principles of activity as a public organization are determined by the Constitution of the Russian Federation, and also by the federal law “On banks and banking activities” and other laws.

According to the Russian legislation the Central bank is a state bank (that has historically formed from the moment of its creation), its registered capital is a federal property at the rate of 3 billion rubles⁶, and the Bank of Russia brings into action the power of the possession, use and order of the property.

An important element of the status of the Central bank, as well as other central banks, is its independence, which means that the Central bank is not included in the structure of the federal agency of the government, but is a juridical person and acts as a subject of the public law.⁷

⁴ The legal status of the Bank of Russia is determinate by The Law “About the Central bank of Russia (the Bank of Russia)”, accepted in 2002.

⁵ Article №2 in The Law about the Central bank of Russia (the Bank of Russia)

⁶ Independence of the status of the Bank of Russia is reflected in articles 1,2 and 5 in The Law about the Central bank of Russia (the Bank of Russia).

⁷ The Library of Economics and Liberty, March 31, 2006. www.econlib.org

The Bank of Russia accomplishes its expenses due to own profits, don't register in tax administrations that reflects its financial independence, has a stamp with a representation of the State Emblem of the Russian Federation and the name.

3. Monetary policy: objectives and tools

Monetary policy is the process by which the government, central bank, or monetary authority manages the money supply, or trading in foreign exchange markets. Monetary theory provides insight into how to craft optimal monetary policy.

Monetary policy is generally referred to as either being an expansionary policy, or a contractionary policy, where an expansionary policy increases the total supply of money in the economy, and a contractionary policy decreases the total money supply. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rate, while contractionary policy has the goal of raising interest rates to combat inflation (or cool an otherwise overheated economy). Monetary policy should be contrasted with fiscal policy, which refers to government borrowing, spending and taxation.

Monetary policy uses a variety of tools to control one or both of these, to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment. Where currency is under a monopoly of issuance, or where there is a regulated system of issuing currency through banks which are tied to a central bank, the monetary authority has the ability to alter the money supply and thus influence the interest rate (in order to achieve policy goals).

Objectives of monetary policy:

- stable rate of growth national production;
- stable prices;
- high level of employment of population;
- equilibrium of the balance of payment.⁸

There are several monetary policy tools available to achieve these ends. Increasing interest rates by fiat, reducing the monetary base, and increasing reserve requirements all have the effect of contracting the money supply, and, if reversed, expand the money supply.

⁸ An informational portal Bankir.Ru

Monetary base

Monetary policy can be implemented by changing the size of the monetary base. This directly changes the total amount of money circulating in the economy. A central bank can use open market operations to change the monetary base. The central bank would buy/sell bonds in exchange for hard currency. When the central bank disburses/collects this hard currency payment, it alters the amount of currency in the economy, thus altering the monetary base⁹

Reserve requirements

Monetary authority exerts regulatory control over banks. Monetary policy can be implemented by changing the proportion of total assets that banks must hold in reserve with the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. By changing the proportion of total assets to be held as liquid cash, the Federal Reserve changes the availability of loanable funds. This acts as a change in the money supply.

Discount window lending

Many central banks or finance ministries have the authority to lend funds to financial institutions within their country. By calling in existing loans or extending new loans, the monetary authority can directly change the size of the money supply.

Interest rates

The contraction of the monetary supply can be achieved indirectly by increasing the nominal interest rates. Monetary authorities in different nations have differing levels of control of economy-wide interest rates. In the United States, the Federal Reserve can set the discount rate, as well as achieve the desired Federal funds rate by open market operations. This rate has significant effect on other market interest rates, but there is no perfect relationship. In the United States open market operations are a relatively small part of the total volume in the bond market.

In other nations, the monetary authority may be able to mandate specific interest rates on loans, savings accounts or other financial assets. By raising the interest rate(s) under its control, a monetary authority can contract the money supply, because higher interest rates

⁹ Encyclopedia on-line Wikipedia

encourage savings and discourage borrowing. Both of these effects reduce the size of the money supply.

The central bank influences interest rates by expanding or contracting the monetary base, which consists of currency in circulation and banks' reserves on deposit at the central bank. The primary way that the central bank can affect the monetary base is by open market operations or sales and purchases of second hand government debt, or by changing the reserve requirement. If the central bank wishes to lower interest rates, it purchases government debt, thereby increasing the amount of cash in circulation or crediting banks' reserve accounts. Alternatively, it can lower the interest rate on discounts or overdrafts (loans to banks secured by suitable collateral, specified by the central bank). If the interest rate on such transactions is sufficiently low, commercial banks can borrow from the central bank to meet reserve requirements and use the additional liquidity to expand their balance sheets, increasing the credit available to the economy. Lowering reserve requirements has a similar effect, freeing up funds for banks to increase loans or buy other profitable assets.

A central bank can only operate a truly independent monetary policy when the exchange rate is floating. If the exchange rate is pegged or managed in any way, the central bank will have to purchase or sell foreign exchange. These transactions in foreign exchange will have an effect on the monetary base analogous to open market purchases and sales of government debt; if the central bank buys foreign exchange, the monetary base expands, and vice versa. But even in the case of a pure floating exchange rate, central banks and monetary authorities can at best "lean against the wind" in a world where capital is mobile.

The debate rages on about whether monetary policy can smooth business cycles or not. A central conjecture of Keynesian economics is that the central bank can stimulate aggregate demand in the short run, because a significant number of prices in the economy are fixed in the short run and firms will produce as many goods and services as are demanded (in the long run, however, money is neutral, as in the neoclassical model). There is also the Austrian school of economics, which includes Friedrich von Hayek and

Ludwig von Mises's arguments, but most economists fall into either the Keynesian or neoclassical camps on this issue¹⁰

In general, activities of the Bank of Russia in the field of monetary policy are directed to:

- The use of stabilization fund as a regulate of money supply overflow;
- The use of controlled floating exchange rate;
- Dedollarization of Russian economy;
- Expanding the access of credit institutions to refinancing tools of the Bank of Russia;
- The priority of the inflation reduction.

Table 1. Indexes of the monetary statistic of the Central bank of the Russian Federation

Analytical group of accounts of the banking sector (million rubles)	01.02.2008
Net foreign assets	10 142 531,8
Internal credit:	8 038 880,8
Net credits by agency of State administration	-5 402 679,3
Claims to non-financial state organizations	305 151,9
Claims to the public and organizations of the privet sector	12 775 163,4
Claims to other financial institutes	361 244,8
Monetary base:	14 356 112,9
Including money in cash in circulation	3 465 663,3

3. Analysis of the balance sheet structure of the Central bank

As a matter of fact, getting a profit is not the main goal of the Central bank. But it develops active financial activity for supporting the liquidity of banking system.

To identify the basic tools the Central bank uses it's necessary to analyze its balance sheet structure.

¹⁰ Encyclopedia on-line Wikipedia

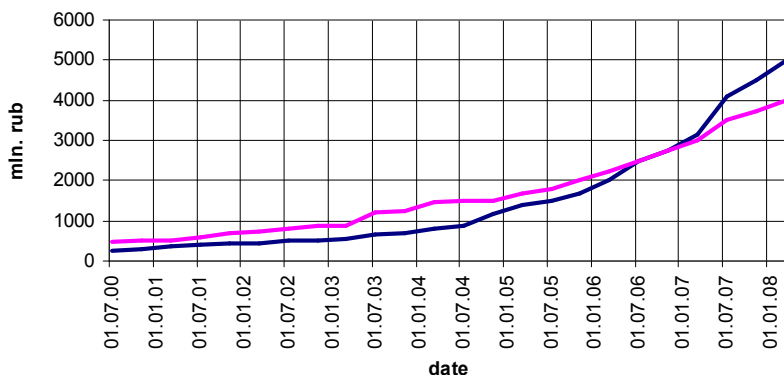


Fig. 2. Dynamics of gold and currency reserves of the Central bank of Russia and monetary base

Comparative analysis of the assets and liabilities of the Bank of Russia is represented in tables 2 and 3.

Therefore, we can conclude that the Bank of Russia keeps its assets generally in securities of foreign emitters. The matter is that the Russian stock market, being inefficient in reflecting information about emitter, can't guarantee safety of financial resources and that means can't provide with liquidity to the whole banking sector.

One of the alternative investments could be government bonds of the Russian Federation. But there is the range of barriers. First of all, the government of the Russian Federation won't issue such quantity of bonds due to the surplus of the government budget. Secondly, financing the government is not the aim of the Bank of Russia. It should take care of the support and development of banking sector.

Table 3. Liabilities of the Bank of Russia (Million rubles)

Liabilities	01.01.2006	01.01.2007	Specific weight, %		Absolute deviation	Relative deviation	Rates of growth, %	Rates of increment, %
			2006	2007				
1. Cash in circulation	2 199 180	3 066 355	38,22	37,38	867 175	-0,84	139,43	39,43
2. Central Bank funds	3 184 259	4 787 552	55,34	58,36	1 603 293	3,02	150,35	50,35
— The government of Russia	1 905 206	3 317 090	33,11	40,43	1 411 884	7,32	174,11	74,11
— credit institution residents	684 148	959 115	11,89	11,69	274 967	-0,20	140,19	40,19
3. Accounts receivable	19 293	31 014	0,34	0,38	11 721	0,04	160,75	60,75
4. Other liabilities	141 151	195 593	2,45	2,38	54 442	-0,07	138,57	38,57
5. Capital	210 373	84 156	3,66	1,03	-126 217	-2,63	40,00	-60,00
6. Profit for accounting year	0	39 197	0,00	0,48	39 197	0,48	-	-
Total liabilities	5 754 256	8 203 867	100,00	100,00	2 449 611	0,00	142,57	42,57

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Nevertheless, we can't identify the Bank of Russia as absolutely independent, because it is responsible for tasks, provided by the government, that not always coincide with its own goals. It has led to the fact that total assets of the banking sector in Russia can be compared only with assets of a large European bank. Also Russian banks can't compete with foreign ones, offering high lending rates and low deposit rates because of high costs of the resource base development. That's why on the one hand Russian banking sector is attractive for foreign investors. On the other – it is noncompetitive. In order to avoid such a problem the government limits access for foreign banks and for the participation of international capital in the Russian credit institutions.

The activity of the Bank of Russia in the sphere of crediting the commercial banks is also ineffective. The matter is that the high inflation makes keep the refinance rate at a level of more than the interest rate on the alternative resources. Up to date the refinance rate is 10,25% and a landing rate between banks is in 2 times lower.

As for liabilities of the Bank of Russia, they are generally consisted from the cash in circulation, and also from credit institutions' accounts, which include the reserve requirement fund, correspondent accounts and accounts of the government of the Russian Federation.

5. The analysis of the financial statement structure of the Savings bank of Russia.

The Savings bank of Russia is one of the largest banks in the country. It includes 17 branches that in its tern have a wide local net. Controlling block of shares of the Savings bank belongs to the government of the Russian Federation.

Comparative analysis of the assets of the Savings bank of Russia is represented on the table 4.

Therefore, credits and advance fees for clients prevail in the assets of the Savings bank of Russia.

The investments in securities occupy an insignificant part due to the undeveloped stock market in Russia which can't provide banks with liquidity and high returns. The matter is that the banks can invest only in highly reliable and riskless securities, such as government bonds of the Russian Federation. But they don't produce high profits for

banks. Moreover, the bank has to observe the normative standard of the capital sufficiency, determined by the Central Bank of Russia. That's why the investments in risky and profitable securities, that raise the total risk assets, will make banks to increase the share capital, which is the most expensive financial recourse.

That's why the main source of the profit for the Savings bank is still the credits, and the major part of that source is the consumer crediting.

The loans that have been made for a term of more than 30 days belong to the group of assets with increased risk (100%). The major rate of a credit portfolio is represented in balance sheet of all Russian commercial banks. That's why the average risk of assets is at least 90%. It means the lack of liquidity in banking sphere. Moreover, the number of loans rises every year. In order to observe the normative standard of liquidity, at the end of the financial period commercial banks have to move the part of financial resources from highly risky assets to assets with 0% (government bonds of the Russian Federation and accounts in the Central Bank) risk and 2% (cash and commodities).

Comparative analysis of the liabilities of the Savings bank of Russia is represented in table 5.

The analysis has shown that the basic financial recourse of the Savings bank of Russia is public deposits. Their contributions are not stable course. One of the reasons is the lack of confidence to banking sector. Also banks can't provide public with such deposits rates that will be bring desirable income because of high inflation. Maximal result we can archive using banking deposits is to save money from inflation, but not to increase the capital. That's why, to attract people for using deposit services in the terms of growing inflation become more and more complicated. More over, banks incur extra loses except interest costs:

Table 4

Assets, million €	01.01.2007	01.01.2006	Specific weight, %		Deviation		Rates, %	
			2007	2006	abs	rel	of growth	of increment
Money and their equivalent	4894,01	3555,66	4,90	4,91	1338,35	-0,01	137,64	37,64
Required reserves of the Central Bank of Russia	2245,62	1637,31	2,25	2,26	608,30	-0,01	137,15	37,15
Trading securities	6070,96	3799,09	6,08	5,25	2271,87	0,83	159,80	59,80
Other securities	6855,07	6550,55	6,86	9,04	304,53	-2,18	104,65	4,65
Financial funds in other banks	1189,63	747,40	1,19	1,03	442,23	0,16	159,17	59,17
Credits and advance fees for clients	73252,84	51512,05	73,32	71,12	21740,78	2,20	142,21	42,21
Debit debt on REPO deals	-	47,81	-	0,07	-	-0,07	-	-100,00

Table 4 (Continued)

Assets, million €	01.01.2007	01.01.2006	Specific weight, %		Deviation		Rates, %	
			2007	2006	abs	rel	of growth	of increment
Fixed capital	3608,89	3079,56	3,61	4,25	529,33	-0,64	117,19	17,19
Investment securities withheld before redemption	755,06	818,50	0,76	1,13	-63,44	-0,37	92,25	-7,75
Fixed capital	3608,89	3079,56	3,61	4,25	529,33	-0,64	117,19	17,19
Other assets	1042,12	683,82	1,04	0,94	358,31	0,10	152,40	52,40
Total assets:	99914,20	72431,74	100,00	100,00	27482,46	0,00	137,94	37,94

Table 5

Liabilities, million €	01.01.2007	01.01.2006	Specific weight, %		Deviation		Rates, %	
			2007	2006	abs	rel	of growth	Of increment
Liabilities:								
Financial funds of other banks	1292,23	718,00	1,29	0,99	574,24	0,30	179,98	79,98
Public deposits	58969,49	43644,23	59,02	60,26	15325,26	-1,24	135,11	35,11
Financial funds of companies	22561,04	15759,69	22,58	21,76	6801,35	0,82	143,16	43,16
Issued debt securities	3566,04	2504,29	3,57	3,46	1061,75	0,11	142,40	42,40
Other borrowings	3093,45	1814,71	3,10	2,51	1278,75	0,59	170,47	70,47
The postponed tax obligation	103,87	67,15	0,10	0,09	36,72	0,01	154,68	54,68
Other liabilities	661,28	416,81	0,66	0,58	244,46	0,09	158,65	58,65
Subordinated loan	774,72	847,15	0,78	1,17	-72,43	-0,39	91,45	-8,55
Total liabilities:	91022,12	65772,02	91,10	90,81	25250,10	0,29	138,39	38,39

Table 5 Continued

Liabilities, million €	01.01.2007	01.01.2006	Specific weight, %		Deviation		Rates, %	
			2007	2006	abs	rel	of growth	Of increment
Capital:								
Authorized capital	2305,16	604,70	2,31	0,83	1700,46	1,47	381,21	281,21
Issue income	288,67	288,67	0,29	0,40	0,00	-0,11	100,00	0,00
Fund of buildings reassessment	442,23	457,48	0,44	0,63	-15,25	-0,19	96,67	-3,33
Retained income	5856,01	5308,86	5,86	7,33	547,14	-1,47	110,31	10,31
Total capital:	8892,08	6659,72	8,90	9,19	2232,36	-0,29	133,52	33,52
Total liabilities and capital:	999 14,20	7243 1,74	100,00	100,00	27482,46	0,00	137,94	37,94

Expenses that are connected with legal reserves:

Normative standards of legal reserves (reserve requirements), established by Bank of Russia	%
Under liabilities of credit institutions to deposits of banks-non-residents in currency of the Russian Federation and in a foreign currency	5,5
Under liabilities to public in currency of the Russian Federation	4,5
Under other liabilities of the credit institution in currency of the Russian Federation and in a foreign currency	5

Insurance expenses (insurance bonus is 0,15% from the average rate of total deposits of public, that paid quarterly)

Another financial recourse is accounts of companies. However, the extent of stability of such source is not high. Companies every day make sale operations. That's why money on the company's accounts is not always available for the bank.

Capital also occupies an insignificant part in liabilities of the Savings bank. It is connected with the high value of that financial resource.

Thus, we could pick out three main problems of banking sectors:

- The lack of capital;
- The shortage of long-term financial resources;
- Monopolistic administrative supervision of the Central Bank of the Russian Federation.

The solution of the first problem could be the simplification for banks the security-emission procedure and exemption from the taxation of such part of profit, that raise the capital.

The development of the refinancing system of the Central Bank will help to avoid another weakness of banking system – the problem of short-term financial resources.

The third main problem of banking sector is high level of costs that banks have to incur as a result of administrative load. That is why it is necessary to weaken control for the banks and their subsidiaries at the local level. Also it is possible to delegate authority to other institutions.

6. Conclusion

Banking system is one of the most important and integral structures of the market economy.

Banks credit the economy through monetary operations, act as agents in redistribution of capital, essentially raise the overall productive efficiency, and contribute to the growth of social labor productivity.

Today the structure of banking system becomes complicated: have been established new types of financial institutions, have been introduced new credit tools and methods of service system.

The foreign banking practice is of interest for a new economy system developing in Russia and other CIS countries which is transferred from the managerial highly monopolized state banking structure to a dynamic, flexible system of credit institutions based on private and collective property and focused on commercial success and profit-making.

At present, optimal forms of credit system institutions, effectively working mechanism of capital market and new methods of service system for commercial entities are being searched and established. There are being improved existing service system of individuals and attraction of their funds. Establishment of a steady, flexible and effective bank infrastructure is one of the most important (and, at the same time, extremely complicated) tasks of economic reform in Russia.

Such bank mechanism can be built only by recovery of lost rational operation principles of credit institutions which are accepted in the world and based on multientury experience of financial market structures.

Establishment of effective banking system is one of the most important tasks of economic transformations in Russia.

At the same time the Russian banking system goes through difficulties related to the feature of the present stage of economic reforms. Many Russian banks which started their activity in a high inflation period were not ready for effective work with stable national currency, sharp competition and improved economic law.

In the near future development of banking system and economy as a whole will depend on a change of external economic activities and direction of capital flow. At high

world oil prices and steady (strengthening) ruble currency rate, the bank system will grow steadily despite of some structural problems: low capitalization, less-developed regional capital markets, high concentration of credit risks.

Rapid growth of banking system at strengthening ruble makes it more attractive for foreign investments. Analysts believe that many Russian banks are high-yield but very risky objects for direct investment, therefore in the nearest two years we can expect growth of strategic and portfolio acquisitions of the Russian banks by foreign investors.

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FRA LUCA PACIOLI: THE MAN AND HIS SCIENTIFIC WAY

Gianfranco Cavazzoni¹

Today, we have a mass of biographic information about Pacioli drawn by archives². This news notably enrich those of his numerous works we have received. Although some periods of his life are obscure, it was possible to put together only the events³.

Pacioli was born in Sansepolcro, an old village in Alta Valle Tiberina that unifies Umbria and Tuscany, around early forties of XV Century; even now we don't know the exact date of his birth and we have not much information about his family.

The initial period of life of our Master is, after all, confusing. We know that, certainly, he, almost adolescent, was a guest in Messer Folco de' Bifolci's house, where he received first algebra and arithmetic precepts by Piero della Francesca, with whom Pacioli remained together afterwards.

He goes, young, to Venice at family of Antonio Rompiasi, a merchant, wherein he teaches his sons. Moreover, in Venice Pacioli studies at the School of Rialto, where he learns much about the art of merchant. In 1470, Pacioli writes his first work, the "*Trattato di Venezia*", an unknown didactic manuscript, dedicated, as acknowledgement, to the Rompiasi's sons: Bartolo, Francesco and Paolo. This work shows some notions about mathematics, algebra and geometry, that he considers important for future young Rompiasi's activities.

At the beginning of 1471, he's at Rome where his relationship with Leon Battista Alberti, a famous mean of learning, a Florentine humanist devoted also to figurative arts, is documented. After staying at Rome, probably, he gets in the religious order of St. Francesco's Frati Minori of Sansepolcro.

¹ Gianfranco Cavazzoni is a Full Professor of Business Administration at the Faculty of Economics in the University of Perugia.

² For an exhaustive reconstruction of Pacioli's life it remand to G. CAVAZZONI, *Tractatus mathematicus ad discipulos perusinos (Parte I)*, in Atti del Convegno Internazionale straordinario per celebrare Luca Pacioli, Venezia, 1994, Ipsoa, Milano 1994, p. 39 e ss.

³ Cf. S. CASTRUCCI, *Luca Pacioli da'l Borgo San Sepolcro*, 1999.

In 1475 he's had up by some noblemen for teaching in Perugia. The Master may be represented as *«il creatore ... di quella scuola che prima gli consentì di ascendere alla cattedra e di rivolgersi a quei giovani, cui nel 1478 dedicava, con sentimento di affetto, il suo primo trattato di algebra e di geometria»*⁴: the “*Tractatus mathematicus ad discipulos perusinos*”⁵.

On October, 14th of 1477, for the first time priors of Perugia assign Pacioli to teach at *Studium Generale*, with the annual wage of 30 fiorini and, after certified the opportunity of having a *«similem magistrum doctorum et expertum ad docendum»*, they renew the assignment for other two years up to June, 1480⁶. His mathematic teaching at an important university like the University of Perugia makes ourselves certain *«da un lato della fama del prescelto e dall'altro dell'importanza fondamentale che le attività del cambio e della mercanzia avevano assunto nella vita economica del libero Comune»*⁷.

The “*Tractatus mathematicus*” is a manuscript of 396 papers, written in “*volgare*” and conserved in Vatican Library at number 3129, that has been laboriously translated for 12 years. Pacioli starts this work at St. Lucia's day (December, 13rd) of 1477 (*«Incepi tam in vigilia sancta Lucia Virginia»*) and then finishes the manuscript in April, 29th of 1478 (*«In vigilia ascensionis fuit finis inpositus»*).

His didactic commitment is so full that he writes *«solo la notte m'era bisogno a scriverlo»*. The *Tractatus*, divided in parts, is anticipated by a *proemio* (preface) in which he prides to *«gentilomini perugini»* for bringing the mathematic discipline at the University of the *«augusta ed inclita città»* of Perugia. Luca draws up his work with the purpose of teaching all the persons who want to dedicate themselves at the merchant's art; from here the need of examine *«regole generali e particolari»* that rule the merchant activities

⁴ Compare to G. ERMINI, *Storia dell'Università di Perugia*, p. 586.

⁵ G. CALZONI, G. CAVAZZONI (a cura di), *Tractatus mathematicus ad discipulos perusinos*, Città di Castello, 1996.

⁶ Cf. G. ERMINI, *Storia dell'Università di Perugia*, p. 586t hat remind that Pacioli creates a university school that “gli consente di ascendere la cattedra e di rivolgersi ai quei giovani cui nel 1478 dedica, con sentimento di affetto, il suo lavoro di algebra e di geometria”.

⁷ Compare to G. CALZONI, *Tractatus mathematicus ad discipulos perusinos (parte II)*, in *Atti del Convegno Internazionale straordinario per celebrare Luca Pacioli*, Venezia, 1994, Ipsoa, Milano 1994, p. 51.

so that through them the merchant *«possa pervenire a notizia de' lecita e giusta mercantia in la quale spessissime volte casca in fraude e peccato solo per non intendere el modo de ragione»* borns. The aim of Tractatus is clear: the application of mathematic and geometry *«regine di tutte le altre scientie commo testificano tuti degni filosofi»* at merchant's art, because similar disciplines suggest the first step of obviousness. Only through the complete knowledge of these arguments the merchant is able *«a presso l'onore»* to make *«d'utile»* in management of his affairs.

In this work Pacioli represents a little anthology of anecdotes i.e. *«vol più punti a fare un mercante che a far un dottore de' leggi»*; *«in mercato vanno più pelli de' volpe che pelli d'asino»*; *«gli studenti comprendono meglio un caso su cui riflettere più che se tu desse a loro mille letioni»*. He compares the merchant with *«gallo quale è fra gli altri il più vigilante animale che sia, e d'inverno e d'estate fa le sue notturne vigilie»* and his head *«ad una che abbia cento occhi che ancora non gli bastano né in dir, né in fare»* and he writes that at the merchant *«bisogna altro cervello che Beccaria»* although *«chi non fa non falla e chi non falla non impara»*.

Pacioli demonstrates also some amuse mathematic game, for giving his students a bit of rest and distraction. For not feeling the weight of repeating arithmetical and geometrical calculus, he presents, in addition, some interesting *«bolzoni»*, the solution of which is not through *«regole generali, ma per regole particolari, le quali hanno a servire solamente a esse, e ancho de molte altre domande se po' in mille modi soddisfare»*. In practice, he patterns simulated affairs and he foresees a sort of business games, the solution of which the human mind is in a thigh spot, because it has to orientate to find relative, exchanging and contingent rules. Therefore, the economic *«provando e riprovando»* has his importance only for the possibility of error, failure and beginning again. But this is exactly what Pacioli wants, testing his determinations and so guaranteeing their full success⁸.

Among questions, some of them cover particular interest for their punctual solution; others, instead, emerge for curious situations described. In particular, the *«bolzone»* of

⁸ About Pacioli's game, compare to G. CAVAZZONI, *Luca Pacioli e Leonardo da Vinci "De ludis mathematicis"*, in Rivista "Summa", Torino, 1992, pag. 23 e ss

thirty Jewish and two Christian merchants is amuse. They are in a same ship that is dipping and therefore it must be lightened «*de qualche persona a ciò che tutti non perissero. Ma in simili chasi avvenga ci fossero giudei, non di meno ciaschuno teme Dio e non voliano far torto a persona de bugliarlo a forza in aqua e li pover mercantanti cristiani si vediano a mal partito perché avian paura de coloro che li sforzasse perché erano pochi e meno di loro. La qual cosa commo è ditto non fecero, ma bene se mosse un di quelli giudei e dici a la brigata ch'è meglio che perischa qualcuno che tutti e che se debia meter le sorti fra loro de chi prima dev'esser butato fora de nave. Unde pensando costoro che sorte dovesser fare se levò su uno dei mercantati cristiano, qual era bonissimo ragioniere, e disse, commo pronto a volere la comune salute: facciamo un tondo de noi a gomengiamo da uno contando fino a 9 e a chi tocharà 9 quello tale sia gitato in aqua, la qual cosa ognuno confermò. E de subito questi doi cristiani, perché erano d'una fede, se strensero insemi e questo tale gomenzò a contare e contò per tal modo che sempre lo 9 venne sopra de li giudei e mai tochè a loro, onde tutti li 30 giudei forono butati in aqua e li doi cristiani soli remasero in nave. Dimandasse dove e a che modo ingomenzarono a contare a ciò non li tochasse mai 9 a loro. Sapi che questo è un utilissimo tastone per colui che lo trovò per prima, ma non è si bella cosa commo sia più volte che non invilescha. Breviter dico che gomenzò al quinto sopra di lui e venne contando verso lui per modo che tochè al nono, e appresso dell'altro cristiano rimase un giudeo aponto, e poi sempre sequitando a quella medema via, e vederai che tocharà a li giudei e soli li cristiani remarranno in taula. E farai un cerchio ordinato purché tu cognoscha li cristiani da l'altri, et sic de aliis».*

After stay at Perugia, it comes a period characterized by frequent movements. In 1481, Pacioli is at Zara, where he composes his third algebraic work: the «*Trattato di Zara*», a lost papery manuscript that contains some mathematical rules better than his previous works. Pacioli writes about his possibility of acquiring, in that flourishing Dalmazia's town, a good commercial culture thanks to contacts with the merchants' world and of facing situations «*più suttili e forti*». In 1487, he's in Florence and in the same year, another time he's had up by noblemen of Perugia, another time in the county town.

In 1490 he's in Naples, where he teaches mathematic at the public «*ginnasio*», then in Padua and another time in Florence, then in Venice in 1494, on the occasion of publication of “*Summa de arithmetica, geometria, proportioni et proportionalità*”; the most important work of our Master that allows to study the accountability outside the business area.

The “*Summa*” is a very broad work, where many arguments - algebra, mathematics, accountancy, merchant writings and geometry – are discussed.

The great spread of the work is testified by one reprint in 1523. The notoriety among the researchers of accounting – and not only – is attributed to the presence in first part of the work of *Tractatus XI, “De computis et scripturis”, Distinctio IX*, dedicated to the art of accountancy and merchant writings. It's, in fact, the first official diffusion through the press of the double-entry accounting method⁹.

This *Distinctio* is completely dedicated to administration problems and accounting method, that are already subjects presented by Pacioli in his previous work. Pacioli explains in logical and correct sequence: company, agistment and location contracts; barter and monetary exchange; interest and discount rate; alloy and metal monetary exchange; determination of merchant's gains or loss during his travels and practice about this; note about account; price about burden, measures and exchange rate.

So, «*dalla lettura degli argomenti si può notare che il Tractatus XI, senza dubbio il più famoso, conosciuto e divulgato è parte di un contesto sistematico, ed è pertanto riduttivo isolarlo ed estrapolarlo dall'insieme. La Distinctio IX costituisce, infatti, nella sua unità un manuale teorico-pratico di economia mercantile, sviluppato come parte di una “somma” di principi di matematica pura, ed a dimostrazione della sua utilità pratica nella vita commerciale di quei tempi*»¹⁰.

At the beginning, Pacioli addresses those who intend to undertake the complex merchant activity, notifying that three characteristics are required: to possess «*pecunia numerate e ogni altra facultà substanziale*» to invest in personal property through equity or

⁹ About paternity of tractatus it remains to G. CAVAZZONI, *Tractatus de computis et scripturis di Luca Pacioli – Angelo Riera*, Cacucci, Bari, 1994, p. XV e ss.

¹⁰ Cf. A. AMADUZZI, *Frà Luca Pacioli e la Summa de arithmetica, geometria, proportioni et proportionalità*, Venezia, 1994, p. 15.

capital on loan; to be «*bono ragioniere et pronto computista*», to know the technique of editing of the bookkeeping writings (*computista*) and to reason about management of business and to take the most appropriate decisions “*ragioniere*”¹¹; to keep in «*bello ordine tutte le sue faccende disponga*», for a correct administration of the activity. The merchant must know how to manage monetary resources; therefore, he’s not only a dealer, but first of all an investor and also an administrator that uses accounting for monitoring business and measuring his own profit.

Pacioli explains the editing mode of the inventory – historically, defined «*quaderno del ragionamento*», from which derives the «*saldi delle ragioni*» (result economic of period). It is necessary to point out all the possessed goods on a specific sheet or book, beginning from the things of great value or riskier to lose, with date, place and name of goods, and within an only day to avoid errors and omissions. In his opinion, the inventory concerns all goods, including own goods without indication of the value, to exception of the debts.

In describing the technique of accounts editing, Pacioli refers to «Venice manner»: «*e serviremo in esso el modo de Vinegia, quale certamente fra gli altri è molto da commendare, e mediante quello in ogni altro se potrà guidare*». There are three essential books: “Memoriale”, “Giornale” and “Quaderno”. We can suppose that at the moment in which he explains the method, this reaches a good level of elaboration.

Then he describes the process of authentication of the books, according to the routine in Perugia, recalling the numeration and the stamping of the pages, to avoid the diffused practice of the merchants to have two books: one, for creditors, one, for debtors.

The Master criticizes this practice; «*merita sumamente essere commendata, e così li luoghi che la osservano*».

In the memorial – denominated also “*vacchetta*” or “*squartafoglio*” – every operation is described in the analytical way. Also it’s possible to report the goods inventoried even if he dissuades it because all those people who work for the merchant have free access to memorial, and it’s not opportune to make to know the goods of their proprietor.

¹¹ Cf. E. PERRONE, *Il linguaggio internazionale dei bilanci*, Cedam, Padova, 1992.

This book can also be compiled by whoever, also by women provided that are able to write.

Pacioli explains the double-entry accounting method with a specific language. In particular, he specifies the use of term “*per*” to designate debtors, and the term “*a*” to designate creditors. The first writing concerns money owned, using account “Cassa” and “Cavedale”

			Distinctio nona. Tractatus xi^o. De scripturis
Debitore	1		
Creditoze	2		
		X linea vel biculare	
			Forma d' metter i giornale.
			M.D.CCCC.LXXXIII.a. vi. s. nouẽbre i venegia. p. 1 ^a .
			Per cassa de contanti. A cauedal de mi tale zc. p. contanti mi trouo i qilla al pñte. fra oro e mo
			nete. argento e rame d' diuerfi cogniti. de ape i lo foglio delo inventario posto i cassa. zc. i tutto
			du. l. iari. oro. E monete du. l. tanti val i tutto al modo nro venetiano. a oro. cioè a grossi. 24
Debita 2 ^a pesa viraj cofi			per du. l. e piccoli. 32. per grosso a 8. a oro. zc.
			2 ^a . 8 p 5 p

«Per Cassa di contanti: A Cavedal de mi tale, ecc., che di contanti mi trouo in quella al presente, fra oro e monete, argento e rame di diversi conti, commo appare nel foglio dell'inventario posto in cassa ecc., in tutto ducati tanti d'oro, e monete ducati tanti, valgono in tutto, al modo nostro veneziano a oro, cioè grossi 24 per duc. e piccoli 32 per grosso a lira a oro”... dove: Per la Cassa s'intende la tua propria ovvero borsa, per il Cavedal s'intende tutto il monte corpo di facultà presente».

Only at the time of goods's recording from inventory to the «journal» it's possible to attribute values.

Pacioli recommends to take a highest value to increase gain («*Ponendoli tu per te un comun pregio e fallo grasso più presto che magro, cioè se ti pare che vaglino 20 e tu di 24, aciò che meglio te habia reuscire el guadagno*»). This statement has been variously criticized. The term “*valore più alto*” seems to be legacy to the concept of “better” reliability of the yield of exercise. Moreover, «la valutazione a comun pregio suggerita dal Pacioli, che anticipa di oltre 500 anni il criterio del *fair value*, conduce ad apprezzare taluni beni patrimoniali ad un valore che si discosta dal tradizionale parametro del costo

storico, comportando l'inevitabile iscrizione nel bilancio di periodo di utili non considerati secondo il principio di competenza, bensì rilevati in momenti precedenti»¹².

He furnishes some indications for the correct accounting of the operations, like “fair value” (*«comun pregio»*) and the use of single currency.

To indicate accounts, Pacioli supplies the rule: *«E in questo modo sempre vengano incatenate tutte le partite del ditto Quaderno grande, nel qual mai si deve mettere cosa in dare che quella ancora non si ponga in havere, e così mai si deve mettere cosa in havere che ancora quella medesima con suo ammontare non si metta in dare»*.

Pacioli provides some examples: trading of goods, payments with banking orders and with the exchange, financial entries and exit, ecc.

The “*chiusura dei conti*” is formal, descriptive and lacking of capital assets valuations. It isn't a real final balance sheet but rather a “verification balance sheet” built only to check accounts. Pacioli deals with the holding techniques of “*Quaderno*”, the question of changing year, the corrections of errors, the control of corresponding accounts between *Quaderno* and *Giornale*. To control accounts there's need of two persons to verify, respectively, the accounts on *Giornale* and *Quaderno*, checking values, sections and subjects and to delete errors.

Pacioli introduces the “*Pro e danno*” (revenues and expenses) account. It compares only on *Quaderno* because it represents the summary of the whole transactions. The “*pro e danno*” account is loaded only by accounts representing concluded sales so it doesn't produce evaluation problems. The account could also be loaded with house expenses and with commercial expenses.

The “*Pro e danno*” account is closed to “*Capitale*” (capital) account (*«da quale è l'ultima de tutti i quaderni e per conseguente receptaculo de tutte le altre, comme intenderei»*), that is transferred to the new year accounting by two different ways: a) evidencing the net value of the account sections; b) account for account, that is possible for the lack of a final inventory recognition (*«E questa del cavedal del quaderno croci salderai*

¹² On the point, G. CAVAZZONI, *Alla ricerca dei prodromi del bilancio nell'opera di Luca Pacioli*, in Atti dell'VIII Convegno Nazionale di Storia della Ragioneria, Teramo, 2005.

ancora e portarala come le alter nel quaderno A in resto e summa, o voi a partita per partita, ma si costuma farla in summa, perché prima volta tutto tuo inventario appare»).

On a different paper is necessary to verify the identity of the sum of the values wrote on the two sections “*dare*” and “*avere*” (*Summa summarum*); if the values are the same, it evidences the absence of errors on accounting registrations and on books draw up; on the other hand, if the values are different, it suggest to make a work of recognition to find and delete the error.

In a posterior period between 1496 and 1499, Pacioli is at the court of Ludovico Sforza to which he dedicates the work “*De divina proportione*”, completed in Milan on the 14th of November, 1497 and printed in Venice in 1509 by Paganino Paganini. About this work, three manuscripts copies exist: the first one, completed on December, 1498 and dedicated to Ludovico Sforza is kept at Public Library of Geneva; the second one, offered by Pacioli to Giangaleazzo Sanseverino is kept at Ambrosiana Library in Milan; the third one, offered to Piero Soderini has been lost even if this is probably the copy used to realize the printed work (this could explain the dedication to Soderini of the whole work “*De divina proportione*”).

In “*De divina proportione*” Pacioli presents the propositions of the 13th book of Euclide, the study of properties of regular prisms and the description of semi-regular prisms, offering a standing of maths that he considers the base to understand the other sciences, and recommends the use of Elements of Euclide as necessary guide.

Pacioli thinks that the “gold section” is divine because it represents a manifestation of God. On the strength of this, every value can be divided in two parts so that the minor stays on the major one as the latter stays on the whole quantity. The objective “gold” depends on the characteristics of the special number that replies the different characters of the divinity. It’s unique on his specie, it’s triune because composed by three elements, it’s undefinable because both irrational and invariable.

He follows the platonic idea of a correlation between nature elements and prisms: the “*tetraedro*” and the fire; the “*ottaedro*” and the air; the “*cubo*” and the earth, the “*icosaedro*” and the water; the “*dodecaedro*” and the universe. In the Master opinion the regular

prisms are five and he find the values of their sides on the base of the circumscribed sphere and explains how and when it's possible to inscribe one of them in the others.

In “*De Divina proportione*” there are sixty pictures of Leonardo Da Vinci representing solid figures. The attribution of the pictures to Leonardo is made by Pacioli who asserts that in every figure there is «*facto in piano con tutta perfezione de prospective, commo sa el nostro Lionardo Vinci*».

Later, the Master writes the “*De viribus quantitatis*”, a manuscript written in “*volgare*” probably between 1496 and 1509 and filed at University Library of Bologna. Pacioli illustrates a lot of mathematical and physical-technical games, problem of amuse solutions and geometrical questions, with also proverbs, recipes, riddles and anecdotes.

During those years, he draws up also “*De ludo schacorum*”, a manuscript found in 2006. The 48 papers of the book contain 114 demonstrations of chess game with notes for their solution and the figures are coloured by black and red.

Another version of the Elements of Euclide written in Latin by Pacioli is printed in Venice in 1509 and dedicated to Cardinal Francesco Soderini. The Master also makes a translation of Elements of Euclide written by Giovanni Campano from Novara and printed in Venice by Ratdolt in 1482.

A reproduction of the *Summa, Tractatus – Distinctio IX*, titled “*La scuola dei mercanti*” (School of merchants) is in Venice in 1504. The work could have been printed by an editor without the master's consensus cause the deadline of the Pacioli's “*copy right*”.

On February 22nd of 1510 Pacioli becomes the Chief of San Sepolcro's convent and in 1514 is in Rome as Maths teacher at papal Court of Leone X. Finally he comes back in Sansepolcro. There is no certainty about the date of his death happened, probably, in 1517.

Pacioli is a science man, is a lover of communication and diffusion of knowledge. He reflects the greatness of his mind, one between the most genial in XV Century. The master represents the Renaissance ideal, that is able to move between different disciplines to find unity between nature, art and science.

FROM FINANCIAL STATEMENTS TO FINANCIAL REPORTING: SOME RESEARCH QUESTIONS

Francesco Giunta¹

I've the duty to close this international workshop. In my speech I just want to show you the main aspects of my present research. I study financial accounting. In particular, I'm concerned with financial statement analysis.

As you know, the aim of the financial statement analysis is to determine the fundamental or intrinsic value of a firm or of an entrepreneurial project.

Fundamental analysis is necessary if we want investors to make rational decisions. And rational decisions are essential for the development of an efficient financial market. Both our countries need to create an efficient financial market to bolster the growth of their economies.

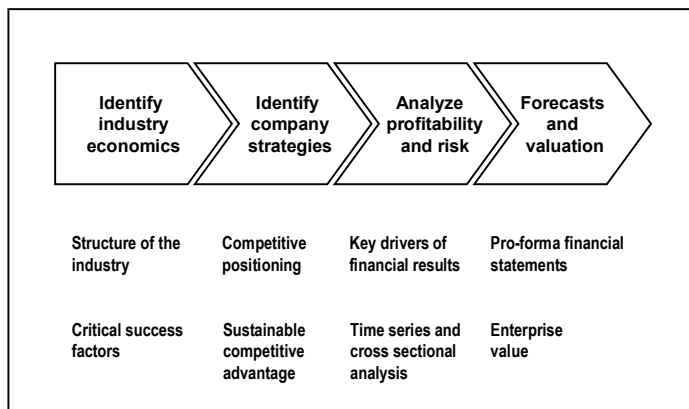
To develop fundamental analysis, financial statement analysis has to be seen as a step of a process. Financial data are just numbers if they are not read with the right framework (see table 1).

So, to interpret financial data, first you have to understand the economics of the industry where the firm we are analyzing lives. The features of this environment play a key role in determining the types of financial statement relationships an analyst should expect to observe.

The next step concerns company strategies. Strategies are the ways in which the firm behaves in the industry in order to create a sustainable competitive advantage.

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Table 1 – The fundamental analysis process



Having this background, we pass to the third step where we analyze the financial statement figures in depth. Using ratios, time series and cross sectional analysis, common-size statements and other analytical tools we evaluate the profitability and the risks of the firm in the recent past and we provide useful information to begin forecasting future financial statements.

Forecasting is the end and the core of the process, the key step of the fundamental analysis where we prepare the pro-forma financial statements and we use them to measure the enterprise value which is the goal of the fundamental analysis.

To run the main steps of the process I've briefly reminded you of, we need information, information on good authority.

So, the first research question is: where can we find out all the information we need?

For sure, neither in the primary financial statements nor in the notes. Primary financial statements are financial numbers, and as we have said, you can't interpret financial numbers using the same financial numbers. Notes also provide an investor with information which has to do once again with measurement, recognition and representation of financial numbers.

We need much more. What we need is another document prepared by the management itself to disclose other information necessary to help investors with the evaluation of the firm by means of the fundamental analysis.

The importance of this additional document has long been recognized by regulators and standard setters of many countries. In the United States, for example, firms have to present to investors a package of financial information consisting of financial statements and Management Discussion and Analysis (MD&A). MD&A is a document approved by the board and it's audited.

The IASB also is working on a project called Management Commentary (MC). On the IASB's website a discussion paper devoted to MC is available.

Considering all these proposals, we are in front of an evolution of information disclosed to investors: evolution from the financial statements to the financial report (see table 2).

If we share the idea of a financial reporting, there are many topics that are worthy to be investigated.

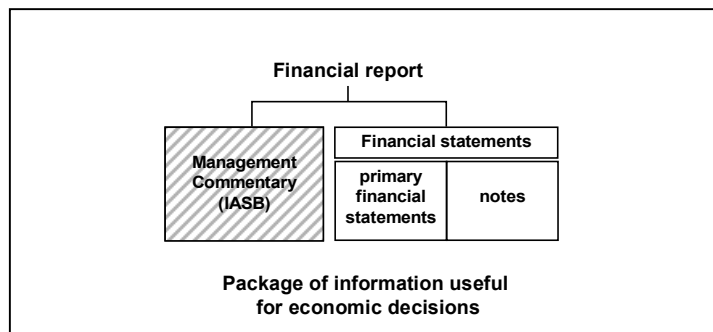
I want to remind you of just three of them:

- The characteristics of a high quality MC;
- The MC content;
- How to implement a MC.

Let's consider the second point.

We have to find an answer to many relevant questions.

Table 2 – Beyond the financial statements



IASB assessment suggests that, to meet the objective of financial reporting, an entity should disclose in the MC information on its business, its strategies, its resources and the risks it has to cope with, and the results the management has achieved (see table 3).

Table 3 – The hypothetical chapters of the Management Commentary



Let me point out just two of these hypothetical chapters of the MC.

First chapter: MC has to inform about strategies.

At present we are getting more and more acquainted with the idea of business model as a wider conceptual framework to present and interpret the strategic be-

havior of a firm along with its operating processes. Looking at the business model, the second research question is: Is the business model a concept that could be useful for structuring a section of the MC? What do analysts and managers think about it?

Only serious research can find out empirical evidence to answer these questions.

Second chapter: performance measures and indicators.

Through financial statement analysis we want to measure the profitability and the risks of a firm. This is the starting point to forecast future financial statements.

But, in order to obtain reliable forecasts, classical measures expressed by the well known financial ratios are not enough. Ratios as ROE, ROI are very important but they are built using financial data. We have to go ahead, we have to uncover the key drivers of the financial data.

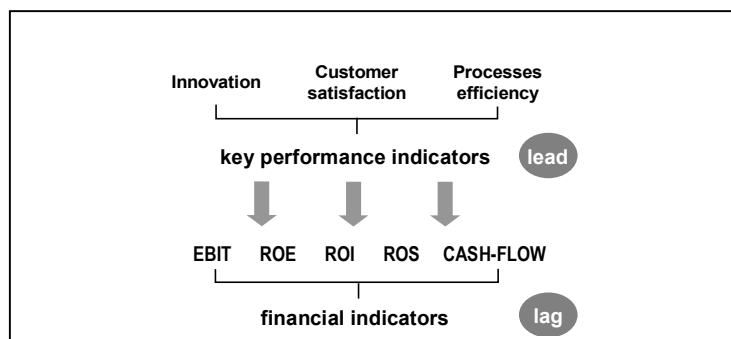
The drivers of the financial results depend on the firm performances in three main areas of management:

- Innovation;
- Customer satisfaction;
- Processes efficiency.

This kind of performances can be measured only using non-financial indicators, the Key Performance Indicators (KPIs) which are well known in the managerial accounting studies and practice.

KPIs are fundamental as they are lead indicators that give us precious hints which are useful for forecasting. On the contrary, the typical financial ratios are just lag indicators which speake about the past not about the future (see table 4).

Table 4 – The drivers of financial performances



Considering KPIs, the third research question is: Do we have to show KPIs in the Management Commentary?

If we answer: yes, we do, then we have to pay very close attention to several aspects. In particular to:

- the metric we use to measure the numerator and denominator of these indicators;
- the consistency in the presentation of the indicators;
- the comparability of the indicators we work out. Comparability is necessary for time series analyses and for cross sectional analyses.

I really think these topics are a sort of challenge for our research and I dare say even for our countries.

It's not by chance that international literature is rich in studies concerning disclosure and the role of financial reporting.

Even practitioners have been experimenting with new solutions in this field. The most interesting of them can be found visiting these two web sites: www.ebr360.org; www.pwc.com.

Visiting these sites we find a lot of hints useful for our research.

I think that if we work seriously on the Management Commentary we'll have the opportunity to make the information that we find in the financial statements more concrete and useful for investors.

Everybody knows the quotation from A. Brillhoff, the famous accounting scholar, who said: Financial statements are like fine perfume: to be sniffed but not swallowed. Maybe in the future, thanks to the MC, this quotation will have to be changed as we'll be able to do more than sniffing.