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## **РАЗВИТИЕ В НАПРАВЛЕНИИ ЦЕЛОСТНОЙ ПЕРСПЕКТИВЫ СТРАТЕГИЧЕСКОГО ФИНАНСОВОГО УПРАВЛЕНИЯ В ГОСУДАРСТВЕННОМ СЕКТОРЕ**

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### **Аннотация**

В работе исследуются основные концептуальные и институциональные изменения в финансовом управлении государственным сектором, происходящие в мире в последние десятилетия. На основании анализа литературы и опыта работы авторов в работе очерчиваются перспективы для внедрения целостного стратегического финансового управления в государственном секторе стран с формирующейся рыночной экономикой. Рассмотрены специфические для таких стран трудности в определении организации государственного сектора, в частности связанные с неясными правовыми и институциональными границами, подотчетностью и экстерналиями. Авторы исследуют влияние масштабного глобального переосмысления ролей и предназначения государства, делающего упор на его роли в качестве поставщика услуг и более масштабных ожиданиях в части его соответственной подотчетности по отношению к пользователям государственных услуг, заинтересованным группам и обществу в целом, и исследуют соответствующие фундаментальные изменения институциональных структур. Объясняется действие механизма стратегического финансового управления для повышения эффективности и результативности деятельности государственного сектора. Результаты позволяют сделать выводы, что интегрированное финансовое управление и интегрированная отчетность в государственном секторе могут стать важным фактором целостного рассмотрения интересов и потенциала развития общества, что будет способствовать обеспечению широкого спектра прав, интересов и возможностей сообществ в странах с формирующейся рыночной экономикой.

### **Ключевые слова**

Государственные финансы, стратегическое финансовое управление, реформа управления государственным сектором, институциональная динамика, целостный подход, интегрированная отчетность, подотчетность

## **DEVELOPMENTS TOWARDS HOLISTIC PERSPECTIVE FOR STRATEGIC FINANCIAL MANAGEMENT IN THE PUBLIC SECTOR**

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### **Abstract**

This paper investigates the major conceptual and institutional developments in the public sector financial management, which have been taking place worldwide in the recent decades. Based on literature review and the authors' insights, the paper outlines the perspectives towards implementation of holistic strategic financial management in the public sector of the EM countries. EM-specific challenges for definition of a public sector entity, such as those related to unclear legal and institutional boundaries, accountability and externalities are investigated. The authors explore the impact of an extensive global rethinking of the roles and purpose of government on emphasizing its role as a provider of services and greater expectations in terms of its respective accountability towards users of the public services, stakeholder groups and society in general and investigate the respective substantial changes to institutional structures. The mechanism of strategic financial management for improvement of performance of the public sector is explained. The findings allow concluding that integrated financial management and integrated reporting throughout the public sector may become important factor for holistic viewing of community interests and development potential contributing to safeguarding a wide spectrum of community rights, interests and opportunities in the EM countries.

### **Keywords**

Public finance, strategic financial management, public sector governance reform, institutional developments, holistic approach, integrated reporting, accountability

## **1. Introduction**

Major global political and economic developments of the recent decades supported by breakthrough advancements in data-processing and communication technologies and dramatic metamorphoses of societies and communities had resulted in redesign of the public sector worldwide and emerging of 'new markets'. The strive for economy, efficiency, effectiveness and greater transparency and accountability of public sector in 'traditional' economies accompanying by borrowing and further implementation and dissemination of their practices and techniques by their former colonies and other countries has determined the landscape and the agenda for further transformations of governments both in terms of their role and their shape.

## **2. Backgrounds of cash-flow driven decision-making**

Until the very recent decades, the financial information and reports available in the public sector worldwide had mainly been the products of cash based ac-

counting systems, while the areas with modified accrual or full accrual systems had been quite narrow.

The most common rationale for that has been the belief that costing information and information about financial performance had limited relevance throughout the public sector. Cash flow fetish was strongly supported by the idea of a visible much greater importance of availability of cash flows over the issues of timing of recognition of revenues and expenses [1]. Accordingly, financial management was widely understood in 'life environments' as a cash-flow management, leaving accountability for performance and accountability for resources at the outskirts of financial management routines [2; 3; 4].

This cash focus in public administration evidently resulted in a substantial gap between the financial accounting and reporting systems and the accountability for performance [5]. In vast majority of cases the two universes lived their separate lives.

The main reasons for reluctance of the public agencies and service units to issue accrual accounts are the following:

- general public / communities / stakeholders at large do not request or are unable to request preparation of accrual accounts by governments, agencies and service units;
- cash-based accounts and cash-based decisions are much easier to manipulate for political reasons; to conceal fraud and misappropriation, operational inefficiencies or failures and unsustainability of programmes, policies and operations; to impose unnecessary borrowings; to divert funds from current expenditure to capital projects, where they can be easier misappropriated; and to exclude financial impact of risks, sustainability and long-term effects from decision-making;
- lack of accounting professionals or reluctance to employ accounting professionals. While accrual accounts need accounting professionals with abilities and skills to make judgments, estimates and forecasts for their preparation, this is not a requirement for cash-based accounts;
- lack of a statutory requirement/mandate to prepare accrual accounts / legal framework does not allow to produce accrual accounts;
- cost/financial implications are not a material concern;
- overall lack of integrity / corrupt or weak institutional environment / criminal control over public entity;
- lack of ability/proficiency to understand financial information;
- lack of resources to prepare accrual accounts.

It is notable that students are usually instructed in introductory economics textbooks on importance of understanding the differences between ‘accounting costs’ and ‘economic costs’ [6; 7; 8]. Though at that stage the students normally have a very little idea (if any) of what ‘accounting cost’ may mean, they are, nevertheless, taught that the main difference is that only economic costs are relevant to decision making.

### **3. Entity definition challenge: boundaries, accountability and externalities**

Another common problem, which is particularly acute in EM countries, is that it is often uneasy to identify the legal, institutional and financial boundaries of a public agency, a public service entity, as well as those of national, sub-national and municipal governments themselves [9]. Equally uneasy it may be to make clearly a cut-off between public and private sector transactions, assets and liabilities. In the context of broadening legal opportunities for raising off-balance sheet funding for public service delivery [10], PPPs and increased sophistication of institutional arrangements for major infrastructure and development projects in the recent years, this problem has created further challenges to establishing sound accountability and suitable record-keeping, control and reporting systems.

This is even further sophisticated with the reality that most of the value created by public sector operations may hardly be measured and accounted for within traditional recognizable accounting and reporting methods. Even though the most critical matters had been attempted to keep accounted via performance measurement systems incorporating non-financial performance indicators, we clearly face the issue of the challenge to provide concise and generally acceptable definitions of what is ‘healthy’, ‘well-educated’, ‘sustainable’ and of other qualities of typical public sector ‘products’, which requires a broad consensus among stakeholders on conceptual matters [11]. Not just on what is ‘good’ and what is ‘bad’. The consensus on conceptual matters among stakeholders may be particularly troublesome to achieve among the stakeholders in communities in transit, where interests and values of one stakeholder groups are often neglected to the favour of other stakeholder groups with a very little (if any) institutional room for a dialogue [12].

Through the intrusion of private sector profit / revenue / capital growth - seeking approaches to delivery of public services we inevitably face the ingress of philosophies of measuring and reporting performance in the ways similar to those of the private sector. In turn, this results in respective focus of strategic financial management on the targets formulated in terms of profitability, growth of capital and viability (understood mainly as liquidity/solvency in various time horizons).

The same is widely used as a rationale for providing businesses (mainly the biggest ones) with a guarantee of risk-free sustainable returns and ‘reasonable’ profits either directly from the public funds, or via setting charges/rates at respective levels (acting virtually as privately collected taxes) or both, as a consideration for the private moneys invested in development of infrastructure or other capital-intensive service delivery projects. This means higher general level of taxation imposed on the respective community, whereby taxes are not recognized as such, but represented as ‘user charges’. I. e. the funds, which otherwise had to be collected from the same community in the forms of usual taxation. This ‘non-tax’ burden on the communities has a potential for a particular increase in EM-countries in the coming decades due to austerity-driven implementation of new forms of funding public service delivery against the background of weak and immature institutions.

One of the most important consequences of these schemes is imposing commitments on future funds of the communities (often being the funds of future generations), which are not adequately accounted for and are not reported as such within any recognizable financial reporting systems [13]. Equally, the costs of these operations are not anyhow recognized as ‘public costs’.

Similar commitments are driven by some major purely private sector development projects, which impose large-scale needs for development of public infrastructure and other investments of public funds to cope with the externalities caused by the private sector projects and not needed otherwise. In EM countries this is often supported by loose city planning practices and codes and weak institutions, where environmental and landscape protection rights of the communities are not recognized and mechanisms for their safeguarding are missing. Accordingly, no due regard to these issues may be found in the public financial reporting and financial management practices in the EM countries, while in developed countries financial management systems are focused on and often built around strategic community environment development and building up community capitals.

In this sense the integrated thinking and the integrated reporting framework are capable of becoming an important step to articulation of these matters and to proceeding with their incorporation into strategic financial management networks. This may imply development of mechanisms for comprehensive assessment of the externalities imposed by private sector on community interests, their quantification and reporting the impact in monetary terms in short-term, mid-term and long-term horizons. Such recognition will provide further opportunities for establishing formal system of financial and non-financial indicators to be used as a tool for financial management and for public reporting within integrated reports or otherwise.

#### **4. Impact of technology advancements**

For centuries, financial information was somewhat of a luxury. While it required a robust organization and a great deal of diligent and highly skilled labour to administer and manage recordkeeping and preparation of reports, reliability and relevance of these reports to decision making, control and accountability for stewardship were limited.

Thanks to recent advances in computer and communication technologies, data collection, processing, storage and reporting has become much cheaper, easier, faster and smarter. This has opened unprecedented opportunities for substantial enhancements in accountability and control, as well as a great potential for performance improvement, thus forming the basis for both demand for and supply of notorious developments in accounting, financial management and public administration.

#### **5. Rethinking of government**

Recent decades were the years of an extensive global rethinking of the roles and purpose of government, which has resulted in emphasizing its role as a provider of services and greater expectations in terms of its respective accountability towards users of the public services, stakeholder groups and society in general. In turn, this required substantial changes to institutional structures, laws and public administration arrangements and procedures [14]. While these processes took place globally, they had particularly notable effect on the countries with so-called ‘transitional economies’ (or EM countries in contemporary terminology), where they have reshaped the entire landscape of the public service delivery. Within their transit processes these countries have been extensively borrowing and adapting a wide spectrum of tools and mechanisms of public administration applicable in the ‘developed market economies’ and pursued the ways of implementing elements of the most recent advances in financial management, performance assessment and reporting.

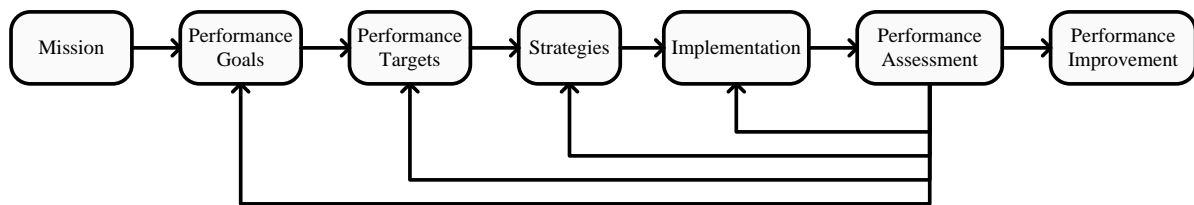
Identification of government as a provider of public services implies formulation of missions of public agencies in terms of delivery of services, which have to be sustainable, effective, economic, efficient, safe, secure, and etc. The missions give rise to development of performance goals and performance targets, which are then usually codified in laws and regulations and form the basis for agencies and service units on which they develop strategies for achievement of the targets in the short- mid- and long-term perspectives. This framework implies that financial management function in public sector has to be focused on ensuring ongoing improvement of the agency’s or the unit’s capacities to achieve the goals by meeting

the targets. This has become known as ‘strategic financial management’, or ‘strategic finance’.

### **6. Strategic finance framework – focus on value creation**

Strategic finance is a fairly recent concept in financial management of both private and public sector entities. It represents an important milestone on the way to pursuing a more integrated approach to both accountability and identity of an entity. In a broad sense this approach is based on designation of identity of an entity through its mission.

We may outline the following operational scheme for this ongoing performance improvement mechanism:



Within this framework the comprehensive system of formal and informal performance assessment both from within and from outside the entity shall serve as a triggering mechanism for taking timely corrective actions to introduce changes (at appropriate levels) to the implementation processes, the strategies, the performance targets, or the performance goals in order to ensure ongoing performance improvement within the mission.

This framework has vested the financial management function in the public sector with much broader responsibilities than ever before.

The transition from understanding financial reports solely as a control tool in administration of public agencies and service units as hierarchical structures to understanding financial reports in the context of accountability towards a broad range of stakeholders and beneficiaries with diverse interests and different information needs has resulted in investigating opportunities for adaptation of financial reports to interests of various model ‘user groups’, preparation of bespoke versions of financial reports tailored for specific tasks or interests and level of proficiency of model target user groups and for implementation of continuous reporting in addition to the concept of periodic accounts. Continuous reporting may proceed substantially beyond just smarter, faster and smoother closings and well-known benefits provided by state-of-the-art ERP systems to a philosophy of a real time accountability and performance improvement. This may imply online providing ‘re-

al-time' or near 'real-time' data and analysis that will allow initiating data-triggered actions to improve/adjust performance, targets and strategies and a more efficient allocation of resources. The intelligence capacities of these kinds are able to contribute substantially to improvement of the role and significance of financial management functions throughout the public sector. However, it should be particularly warned that the implementation of such novelties at the level of standard setting, development of accounting policies and establishing new practices for administration of record keeping and reporting will require careful consideration and management of the issues of potential trade offs between reliability and relevance as well as a diligent cost-benefit analysis.

### **7. Building institutional basis for holistic financial management**

Further important milestone on the way to improved public sector accountability was the establishment in 1997 of the International Public Sector Accounting Standards Board (IPSASB) within the International Federation of Accountants as a global professional standard setting body with a mission of developing and promulgating high-quality public sector financial reporting standards. These standards generally follow (to the extent possible and relevant) the International Accounting Standards and the International Financial Reporting Standards, which are applicable in the private sector. In 2014 the IPSASB issued its first global conceptual framework for public sector entities. The IPSASB encourages governments and intergovernmental institutions to adopt the accrual basis of accounting that is capable of providing information about financial performance and financial position. In order to ensure applicability and relevance of the standards, IPSASB operates in close co-ordination with key stakeholders and such agencies and institutions as the World Bank Group, IMF, OECD, the International Organisation of Supreme Audit Institutions, and many others. These institutions also encourage their members to adopt the IPSAS or, at least, to prepare blueprints for convergence. Though it is clear that these aspirations may not necessarily mean that the governments throughout the world will immediately agree and proceed to the adoption of the IPSAS, there is a substantial probability for gradual transition of at least some of the EM countries towards the IPSAS in the longer term perspective, or to use of the IPSAS as a reference and a model for development or improvement of their national standards.

The most recent development in the world of public sector financial management concepts is the approach based on strongly focusing the performance and the financial management of a public sector entity on creation of value. This approach has become known as 'integrated thinking'. It implies a transition to a so-

called ‘integrated reporting’, which means going far beyond comprehensive financial statements to holistic presentation of how the agency’s strategies and plans, governance and performance lead to sustainable creation of value by the agency in all time horizons [15].

‘Integrated thinking’ or ‘holistic’ approach has been developed by the International Integrated Reporting Council (IIRC) in co-operation with the Chartered Institute of Public Finance and Accountancy (CIPFA) and the World Bank. It is based on the idea of aligning resource allocation and overall agency performance to wider goals of financial stability and sustainable development through the cycle of integrated reporting and thinking [16]. It is striving to introduce much higher level of transparency to ensure and to demonstrate the effective use of resources and value for money. Integrated reporting also encompasses presentation of how six kinds of capitals within the integrated reporting framework (namely, financial, manufactured, intellectual, human, social and relationship, and natural) are involved in creation of value.

The diversity of reporting frameworks and standards has necessitated developing practical approaches to management of entities’ responses to these requirements and coordinating the standard setting pipelines and frameworks between the standard setters themselves. This drive has led to convening of a discussion body named ‘The Corporate Reporting Dialogue’ (CRD), which engaged major standard setters, including IIRC, Global Reporting Initiative (GRI), Financial Accounting Standards Board (FASB), IASB, Sustainability Accounting Standards Board (SASB), Climate Disclosure Standards Board (CDSP), and ISO. The CRD has outlined a mapping tool to show the links between reporting initiatives to assist in navigating the different standards.

## **8. Conclusions**

The described trends and developments shall mean a great potential for extensive efforts and challenges in reforming and improving public administration and financial management, reporting and accountability functions for EM governments to keep up with the pace of the advancements. These processes encompass substantial underlying changes to public administration and reporting cultures and routines. Comprehensive statutory/legal and regulatory frameworks for public accountability, governance and administration shall be the cornerstone for the whole system. The forthcoming efforts would require considerable long-term investments in establishing and developing recognisable national public finance professions. In turn, such developments may result in breakthrough performance improvements, thus, building the basis for further rethinking and reshaping of governments and

tailoring them to smarter and more effective levels of delivering public services. Integrated financial management and integrated reporting throughout the public sector are capable to become an important factor for holistic viewing of community interests and development potential, contributing, therefore, to safeguarding a wide spectrum of community rights, interests and opportunities in the EM countries.

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## **ПРОБЛЕМЫ ОПРЕДЕЛЕНИЯ ВЕРОЯТНОСТИ В ФИНАНСОВОЙ ТЕОРИИ И ПРАКТИКЕ**

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### **Аннотация**

Развитие финансов происходит между хаосом и порядком, поэтому в финансовой теории важной задачей является поиск определенности и установление механизма, регулирующего порядок на рынке. Состояние финансовой определенности соотносится с финансовой безопасностью, а финансового хаоса – с ее нарушением. В статье предпринята