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## Institutional Tool of Financial Policy: Contractual Policy

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Nadezhda N. Makarova<sup>1</sup>, Ekaterina I. Zubko<sup>2</sup>, Larisa I. Bestuzheva<sup>3</sup>, Ivan A. Chusov<sup>4</sup>, Viktoria V. Surkova<sup>5</sup>

**Abstract:**

*Under the market conditions, the most important role in economic subject belongs to the financial aspect – therefore, effective decisions at the micro-level are pre-determined by financial policy, as realization of the strategy in the tactics of finances management is not possible if there's none.*

*Finances of economic subject are a component of the financial system of the Russian Federation. Together with the state financial policy, which is aimed at overcoming of consequences of the global financial crisis, there is financial policy of separate economic subjects and corporate structures.*

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<sup>1</sup> Doctor of Economic Sciences, Associate Professor, Russian University of Cooperation Volgograd Cooperative Institute (branch)

<sup>2</sup> PhD, Associate Professor, Russian University of Cooperation Volgograd Cooperative Institute (branch)

<sup>3</sup> PhD, Associate Professor, Russian University of Cooperation Volgograd Cooperative Institute (branch)

<sup>4</sup> PhD, Associate Professor, Chair of accounting and audit, Russian University of Cooperation Volgograd Cooperative Institute (branch)

<sup>5</sup> Senior Lecturer, Chair of accounting, analysis and audit, Russian Presidential Academy of National Economy and Public Administration (Volgograd branch)

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## **Introduction**

For the purpose of study of financial policy, the authors deem it expedient to clarify the definition of “policy”. According to M. Weber, policy is “striving for participation in authority or influencing the distribution of authority, be it between states or within a state between groups of people” [3].

Up to this time, financial and economic science and practice haven’t had a unified approach to generally accepted definition of financial policy of economic subject. Despite active use of this category in modern scientific society, the issue of its sense is still debatable.

Some authors think that financial policy of an economic subject is developed according to the corporate ideology. A vivid representative of such approach is H. Ulrich, who thinks that the stages of formation of financial policy “are formulation of financial and economic goals, determination of enterprise’s potential, and development of strategies of development” [10, p. 139].

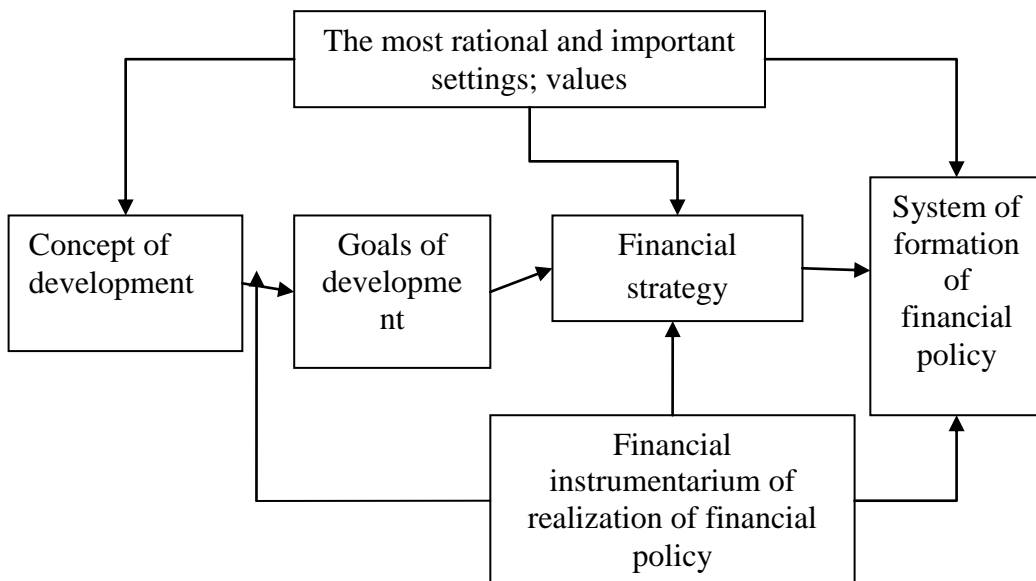
## **Rationale**

According to E.S. Vylkova and M.V. Romanovskiy, the main elements of financial policy are accounting policy, credit policy, policy of money assets management, costs management policy, and dividends policy [4].

Other authors connect financial policy to the form of management of a certain complex of measures for targeted formation and use of resources. In particular, A.S. Makarov defines financial policy as “methods and models of management of organization’s finances, tools of realization of managerial decisions at various stages of subject’s functioning” [7, p. 54-55].

These treatments of financial policy show in homogeneity of definitions. Based on the notions of financial policy, given by various authors, it is possible to conclude that effectiveness and realization of financial policy is determined by its elements and total actions on finance management.

According to the authors, financial policy should denote concepts of development (the most rational and important settings; values) and envisage main directions of the use of finances of economic subject, development of specific instrumentarium, oriented at achievement of the set goals. Figure 1 shows components of the model of formation and realization of financial policy of economic subject.



*Figure 1 - Generalized model of formation and realization of financial policy of economic subject*

The financial strategy of entrepreneurial activities, denoted by the owner and other stakeholders, predetermines selection of one of the two following directions of financial policy:

- satisfaction of short term material needs of the owner, i.e., increase of net profit for payment of the maximum of dividends (interest) in each covered period;
- stabilization of functioning in the long term, attraction of additional financial resources for the purpose of development of economic subject, strengthening of its competitiveness, etc.

Entrepreneurial activities could be presented in the form of incoming flow of financial (investment) resources of creditor and investors, which is transformed into capital and labor, with the help of which the issues of financial products is ensures, and goods, works, and services are formed into outgoing flows of financial resources with the help of the concluded deals. These flows are distributed among creditors and investors, and then are returned into the turnover.

Modern financial policy of economic subject must include consideration of contractual policy. In this subject area, institutional issues of formation of contractual policy are very important. While studying contractual policy as an object of institutional analysis, special attention should be paid to its institutional structure.

The micro-institute of contractual policy consists of three components: formal rules, for which a contract is concluded; informal limitations and practices which influence the facts of coordination of formal rules by economic agents; mechanisms of coercion to execution of liabilities for the contract.

Formal rules mean that effectiveness of contractual policy of economic subject is determined not only by corresponding laws but a capability of an economic subject to perform liabilities. According to Article 8 of the Civil Code of the RF, contracts and other agreements, envisaged by the law, and contracts and agreements that are not envisaged by the law but that do not contradict it create civil rights & obligations and legal arrangements of the deal members.

However, at the everyday level, motives of this micro-institute are related to transaction costs that emerge in the process of contractual relations (Fig. 2).

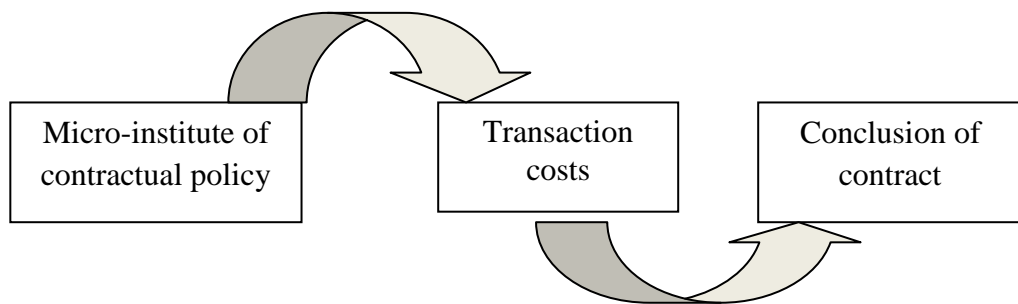


Figure 2 – Process of emergence of contractual relations

According to R. Coase, who introduced the notion “transaction”, “in order to perform a market transaction, it is necessary to determine who to conclude the deal with and which conditions to conduct negotiations under, as well as prepare a contract. Collect data in order to make sure that the contract terms are performed, etc.” [6, p. 59].

“Transaction is not an exchange of goods, but estrangement and acquisition of ownership rights and liberties created by society” [9, p. 652]. A large role in this case belongs to market transaction which supposes the unified legal status of its contractors. In order to perform a transaction, there should be voluntary consent of the parties – i.e., exchange of ownership rights for the goods which emerge as a result of voluntary consent of the parties of the transaction.

All the above costs do not belong to accountings, as most of them have probabilistic, or predicted, character – despite the fact that they are realistic, like the costs confirmed by the initial documents. The sense of contractual policy consists in creation of the system of actions for coordination and application of documents

passed by an economic subject within private normative regulation of contractual relations (both internal and external application).

The studies by the authors allowed defining the notion of contractual policy, regulated by accounting policy, as a possibility for alternative selection by economic subject of the type of contract, partner, and terms of economic contracts for achievement of the desired financial result.

At present, contractual policy in economic subject sets the character (type) of legal regulation of contractual relations as coordinating legal regulation. The type of contract by which the facts of economic activities are registered influences the order of their reflection in business accounting and tax accounting and, as a consequence, the final financial result.

The forms of market structure could be various institutes – “rules of the game”, normative level of relations and systems that realize them: laws, various codes of behavior, types of relations, and interdependence of economic relations. Civil law is the most important sphere of life of the modern society which could be called economic foundation of practical activities of people. Contractual law is a part of law of obligations, as a branch of civil law, and it is also a legal system that influences the regulation of contractual policy.

According to the Clause 420 Sub-Clause 1 of the Civil Code of the Russian Federation (hereinafter – the CC of RF), the contract is deemed an agreement between two or more parties on establishment, change, or termination of civil rights and liabilities. The term “contract” is used as other notions, as well. Thus, a contract means legal relations that emerge from the parties’ agreement. A contract is also the document containing the terms of agreement concluded orally.

The liabilities that emerge from the contract are applied with the general provisions on liabilities, unless otherwise envisaged by the general rules on contracts and rules on particular types of contracts (Clause 420 Sub-clause 2 of the CC of RF).

Principles of contractual law play an important role in market relations and, accordingly, in contractual policy. They stimulate performance of entrepreneurial activities. In our opinion, it is expedient to distinguish the following principles of civil law that have direct relation to contractual policy, namely:

- 1) principle of autonomy of freedom and liberty of contract;
- 2) principle of optionality;
- 3) principles of execution of liabilities.

Studies of theory and practice show that the principle of autonomy of will and freedom of contract is one of the important origins of civil law that determine its subjects’ possibility to set – autonomously, by their own will, and by their own

interest – their own rights and liabilities according to the current laws. Its sense consists in the following [8]:

- civil turnover members' right to make a decision regarding the conclusion of the contract and, while concluding the contract, to choose the right to be applied to the contract;
- coercion to conclusion of the contract is inadmissible;
- provision to parties of contract the wide possibility of choice for determination of its terms;
- right to choose a partner during conclusion of a contract;
- right of the contracting parties to decide which contract to conclude – the one envisaged by the CC of RF or not envisaged by it;
- right to select the type of contract and a possibility for mixed contract, containing elements of various contracts.

According to the Clause 434 of the CC of the RF, freedom of contract is based on the parties' right to conclude the contract in any form and choose the method of conclusion of the contract; on the possibility to change or terminate the contract by the parties' consent and according to the Clause 450 of the CC of the RF; on the right to choose the means of provision of execution of liabilities, based on the Clause 23 of the CC of the RF, etc.

One of the main conditions of effectiveness of market relations is competition between economic subjects. Only independent subjects of market economy can compete. For the purpose of regulation of property relations in the market economy, most of the norms of the CC of the RF have optional character.

The presence of the principle of optionality is determined by contractual law, where behavior of the parties is regulated mostly by imperative and optional norms. Optional norms of law are “norms which provide to the subjects of law the possibility to make a decision regarding the volume and character of their rights and liabilities. If this agreement is absent, the regulations that they contain comes into effect” [2, p. 373].

According to Clause 422 Sub-clause 1 of the CC of the RF, the contract should correspond to the rules, mandatory for all parties, set by the law and other legal acts (imperative norms) which are effective as of the time of its conclusion.

Imperative norms of law are “norms of law which contain authoritative orders, no deviations from which are allowed” [2, p. 373]. In the opposite case, when the contract terms differ from the imperative norms, the contract might be held invalid. This, the contract must correspond to the rules set by the laws and other legal acts which were effective as of the time of the conclusion of the contract.

Imperative regulations of the law are the following: limitation of actions and the order of their estimation cannot be changed by the agreement of the parties based on

the Clause 198 of the CC of the RF; ownership right for real estate property, emergence of these rights, their transfer and termination are subject to state registration in the unified state register according to the Clause 131 of the CC of the RF, etc.

According to the Clause 421 Sub-clause 4 of the CC of the RF, of the term of the contract is envisaged by the norm which is applied to the extent that otherwise is not envisaged by the agreement of the parties (optional form), the parties may exclude its application by their agreement or set the term, different from the one envisaged. If there is no such agreement, the term of the contract is determined by the optional norm.

Therefore, having performed imperative norms of the law regarding the form and content of the contract, the contract parties (economic subjects) may independently assign to the typical forms of the contracts that are not mandatory any content without violating the imperative norms. In practice, contractual policy should fix certain schemes of contracts in view of peculiarities of specific economic situations.

One of the objects of financial and tax accounting is liabilities. Reflection of liabilities in accounting is possible due to information of the facts of economic life on the sources of emergence of liabilities (debt receivable and loan payable) according to the contract's terms. Liabilities emerge from the contract according to the current law, regardless of any progress with its performance.

The Civil Code of the RF does not have a definition of execution of liabilities. The large legal dictionary provides the following definition: "Execution of liabilities consists in creditor and debtor performing actions that are the content of their rights and liabilities, namely: transfer of item, payment of money, execution of works, etc." [2, p. 236].

### **Principles and Rules**

Execution of liabilities is based on general rules which constitutes the principles of execution of liabilities and must be applied in contractual policy for reduction of the risk of non-execution of liabilities on the deals. They include:

- principle of proper execution of liabilities;
- principle indissolubility and invariability;
- principle of real execution;
- principle of rationality and conscientiousness.

***Principle of proper execution of liabilities*** is set legally in the Clause 309 of the CC of the RF, which sets that liabilities are to be executed properly, according to the terms of liabilities and requirements of the law and other legal acts, and in case of absence of such terms and requirements – according to the customs of business

turnover or other commonly applied requirements. This principle is applied properly to the subject of liabilities, appropriate subjects, appropriate place, and appropriate time. Therefore, execution of liabilities in time is set as one of the conditions of the principle of proper execution of liabilities. In civil turnover, it is necessary to take into account the Clause 315 of the CC of the RF, according to which premature execution of liabilities related to its parties' performance of entrepreneurial activities is not always in the interest of the authorized person and is allowed if not specified otherwise by the law or the contract or if it is not implied by the sense of the liabilities. Therefore, premature violation of terms of execution of liabilities is the foundations for application of measures of civil responsibility.

The requirement to abide by the law and other legal acts properly is imputed before the terms of liabilities. "The rule on various ratio of imperative and optional norms to the terms of contracts, set in the Clauses 5 and 421 of the CC of the RF, is applied to all liabilities, regardless of foundations of their emergence" [5, p. 558].

***Principle of indissolubility and invariability*** is expressed in the presumption of inadmissibility of one-sided refusal from execution of existing liabilities, and for contractual liabilities – also in refusal from one-sided change of their terms by any party. Non-compliance with this principle is viewed as a basis for applications of responsibility measures. It is formulated in the Clause 310 of the CC of the RF. Based on the rules of this Clause, the one-sided refusal from execution of liabilities and one-sided change of their terms are allowed only in special cases envisaged by the law. Examples of such exceptions are found in Clause 523 Sub-clause 1 of the CC of the RF which say that one-sided refusal from execution of contract of supply (full or partial) or one-sided change are allowed only in case of significant violation of the contract by one of the parties. Regarding the liabilities related to both contractors' conducting entrepreneurial activities, it is possible to envisage in the contract the foundations for one-sided refusal from their execution or one-sided change of their terms. Clause 450 Sub-clause 1 of the CC of the RF does not envisage any limitations in contracts that are not related to entrepreneurial activities, but one-sided refusal from execution of liabilities and change of terms of the contract "does not deprive another party of the right to litigate the legality of such refusal or change" [5, p. 559].

***Principle real execution of liabilities*** means the necessity for a debtor to perform the actions (or restrain from performing them) that consist its subject. This requirement implies the inadmissibility of replacement of the envisaged execution of liabilities by money compensation (compensations of losses). Therefore, in case of improper execution of liabilities, the debtor is not excused from the liability of its further execution specifically, unless otherwise envisaged by the law or the contract according to the Clause 396 Sub-clause 1 of the CC of the RF. If the debtor didn't executed liabilities of the creditor, the payment of penalty excuses him from execution of liabilities specifically. Debtor is also excused from execution of



liabilities specifically if this execution is of no more interest for the creditor due to its expiration, or the latter agreed to compensation on the basis of Clause 396 Sub-clause 3 of the CC of the RF.

It's obvious that under the modern market relations the principle of real execution of liabilities has some limitations. Therefore, unless otherwise envisaged by the law, the creditor has a right to envisage in the contract the terms under which the debtor is excused from execution of the liabilities specifically with the payment of corresponding compensation and the terms under which the responsibility for execution of liabilities is preserved.

Therefore, it is very important to envisage in certain contracts the responsibility not only for improper execution of a contract but also for its non-execution, specifying at that what exactly would be deemed to be non-execution of the contract.

According to Clause 10 Sub-clause 3 of the CC of the RF, execution of liabilities is subject to the presumption of the *principle of rationality and conscientiousness* as one of the general principle of execution of civil rights and execution of liabilities. This principle in the CC of the RF is not elaborated.

According to the principle of rationality, it is expedient to assume that circumstances will be executed in "reasonable time", when the precise time frames of their execution is not set and cannot be specified by the terms of the specific circumstance; a creditor has a right to transfer the execution of liabilities to a third party for a "rational price" by means of invalid debtor and take "reasonable" measures for reduction of losses done by the invalid debtor.

Conscientiousness of the members of civil relations is presumed and is far from total liability of conscientious execution. At that, the principle of conscientiousness predetermined imperative norms of contractual liabilities.

Principle of rationality and conscientiousness of actions of civil turnover members should be effective at all times, not only when the law puts protection of civil rights in dependence on whether these rights were performed rationally and conscientiously. Therefore, the principle rationality and conscientiousness could be equaled to non-abuse of the law. Thus, timely and complete execution of liabilities (proper execution) helps to achieve their aim, i.e., satisfaction of rights and interests of creditors and termination of liabilities.

Execution of a contract with realization of interests that were pursued during conclusion of the contract by contractual relations members is the main goal of these members. Contractual policy is based on the skill to provide the execution of deals with such contracts that would guarantee the most favorable conditions for an economic subject. This implies that contractual policy is a methodological

mechanism which allows economic subjects to achieve the best values of financial indicators in view of all principles of contractual law.

Having studied institutional aspects of contractual policy, the authors come to the conclusion that it should be assigned not to the types of financial policy of economic subject but to the tools of it formation.

## **Conclusion**

Contractual policy in entrepreneurial activities provides development and implementation of new models of behavior on the basis of concluded contracts and emergence of new norms without state participation, which allows responding to changes of economic realia and speak about appearance of rational and adapted rules of behavior. Thus, contractual policy as a tool of financial policy is an element of localization of institutes and a “ballast” of sustainable type of behavior or a system of norms, the source of normative regulation, and the mechanism of economic coordinated interaction.

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