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Legal aspects connected with the preparation of risk management mechanisms in public administration

Abstract

This paper deals with the administrative and legal elements of both the establishing and the implementation of risk management mechanisms in public administration, as well as indicating how important this process is for supporting the proper functioning of each entity in the public finance sector. At the same time, it highlights the need to constantly update the applicable formula of organisational management, especially in terms of efficiency, effectiveness and optimisation of the means to improve the quality of public services provided. The constantly growing awareness of an entity's management regarding threats to accomplishing set objectives can also be observed. Therefore, it becomes necessary to develop risk management mechanisms limiting the adverse impact of various factors on proper task implementation.

Key words: risk, risk management, management control, public administration

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Introduction

When executing their public tasks, public finance sector entities are constantly exposed to potential risks and dangers, which may stem from many factors including legislative changes, economic factors and human error. However, it is important that such entities do not remain indifferent to any emerging risks. Merely having the knowledge that a risk may occur is not sufficient enough, unless there is a properly prepared risk management system in place aimed at eliminating negative events or reducing their consequence. In order to counter such situations, it is of the utmost importance to take measures to identify, detect and manage risks. The article highlights some legal aspects of preparing and implementing appropriate risk management mechanisms in public administration, as well as protecting the entity from various dangers and difficulties in the process of performing public tasks.

The essence of risk management in public administration

Risk and uncertainty are indispensable attributes of any entity operating in the public finance sector. It is notable that the occurrence of various risks can mean that such entities achieve their intended outcomes by exploiting such opportunities. The granting of resources from the structural funds of the European Union continues to be one such opportunity. However, based on practical experience, circumstances that are difficult to foresee, such as those connected with the improper assimilation of such funds or the unpredictability of law, are often likely to arise. Such unpredictable situations may bring visible losses and may also pose a threat to the continuity and liquidity of an entity's operations.

The overriding objective of risk management in public administration is to provide reliable information on where and how processes should be protected and controlled. Another important aspect is the process-based approach, which is treated as a sequence of interrelated activities, starting with identifying the processes through to indicating their correlation and the order of occurrence. It also becomes important to establish the criteria and methods for evaluating the effectiveness of assessment procedures, for ongoing monitoring and analysis, and the introduction of appropriate corrective measures that are

desirable for achieving the expected outcomes of a public entity¹. However, the most important elements of the risk management process in public finance sector entities includes the identification and analysis of risks, along with deciding on the appropriate response to such risks related to planned task implementation and counteracting them.

In substantive administrative law, which is constantly evolving, the very concept of „risk” appears ambiguous and interdisciplinary. Risk stands for the likelihood of the occurrence of certain events (positive or negative) that may have a tangible impact on the accomplishment of the planned objectives by an entity. They can also cause deviations from expected parameters. Based on the International Standards for the Professional Practice of Internal Auditing, risks are measured in terms of their impact (severity) as well as in terms of the likelihood of their occurrence². Furthermore, the essence of risk proves that it is an extremely broad term and, consequently, it may feature a great deal of decompositions in the legal space³. The classification of risks into different groups ensures a better process of risk identification and analysis for organisations operating in the public sector where such risks can be analysed from two angles: 1) in relation to the functioning of a public organisation as a formal structure, such as its internal risks and so-called inherent risk (e.g., the resources, tools and protective mechanisms at hand); 2) in relation to a public organisation’s relations with the environment, i.e., from the perspective of changes in the external environment and their impact on the management and control system process (e.g., legislative changes, micro or macro-economic factors).

Every public administration authority seeks to implement the entrusted tasks in an efficient manner. Therefore, such entities should not only establish an action plan in a multi-year perspective, but also create risk control mechanisms at the level of their own organisation. Such an approach is consistent with implementing a synthetic risk management policy. One can assume that risk management consists of procedures and policies, as well as coordinated activities that are carried out by an entity’s management and

1 S. Wawak, *Podręcznik wdrażania ISO 9001:2000*, Gliwice 2007, p. 35–36.

2 Communication of the Minister of Development and Finance of 12 December 2016 on internal audit standards for public finance sector entities (Official Journal of the Ministry of Development and Finance 2016, item 28).

3 L. Wiatrak, *Zarządzanie ryzykiem wewnętrznym w administracji publicznej*, „Studia Ekonomiczne. Zeszyty Naukowe Uniwersytetu Ekonomicznego w Katowicach” 2016, no. 298, p. 116.

staff. These procedures and policies are implemented by way of identifying and analysing risks, and then providing appropriate responses, thus increasing the probability of accomplishing set objectives and of successfully implementing the assumed tasks. Given that the risk management process in public finance sector entities consists of numerous elements that are both interdependent and effectively intertwine, it can be called a system⁴.

Important tasks in the development and subsequent functioning of the risk management system at the level of a public finance sector entity is performed by the head of that entity. Their attitude, responsibility and involvement have a direct bearing on how risk management is perceived by other employees of an entity. Due to the responsibility borne by the head of an entity, which arises from the provisions of Art. 69 of the Act of the 27 August 2009 on Public Finance, for ensuring the implementation of adequate, effective and efficient management control, he/she must attempt to create an effective risk management system⁵. Delegating duties connected with the establishing of such a system does not release the head of the entity from the ultimate responsibility, as it is their role to ensure the proper functioning of management control⁶, as will be further discussed in the following sections of the article.

The establishing of a risk management strategy is strongly associated with the presence of numerous important areas which can be divided, in particular, into: 1) identifying risk management objectives; 2) establishing internal control mechanisms, including management control; 3) defining the main risks that are acceptable to an entity's management; 4) drawing up a list of documents to be used in the risk analysis process; and 5) adopting criteria for the monitoring of the risk system and its reporting⁷.

In doing so, one should not forget that risk management is an extremely complex process of identifying, analysing and evaluating, as well as determining, responses to risks. This process also covers ongoing risk monitoring, and the efforts and measures required in order to reduce any risk to an acceptable level. Moreover, the risk management process should be regulated by the relevant procedures adopted in a given public finance sector entity.

4 See more Communication no. 6 of the Minister of Finance of 6 December 2012 on detailed guidelines for the public finance sector as regards planning and risk management (Official Journal of the Ministry of Finance 2012, item 56).

5 Art. 69 of the Act of 27 August 2009 on Public Finance (hereinafter: the APF), (consolidated text, Journal of Laws 2021, item 305, as amended).

6 Art. 69(1) of the APF.

7 Cf. M. Bugdol, P. Jedynek, *Współczesne systemy zarządzania*, Gliwice 2012, p. 138–139.

Management control as a factor supporting the risk management process

The risk management process is one of the key areas of management of a public finance sector entity. This management is, to a large extent, aimed at increasing the probability of achieving the objectives assumed by each entity. Nonetheless, in order to manage risks in an efficient, effective and controlled manner, it is indispensable, first of all, to define and accept the implementation of those objectives which the entity should strive to accomplish in a specific period. It is also imperative to link the objectives of the entire entity, both legally and substantively, with specific objectives of specific organisational units⁸. In 2009, legislative work was conducted on amending the provisions of the Act on Public Finance. Eventually, new regulations were enacted as of 1 January 2010, introducing management control and the obligation to coordinate it in public finance sector entities, including local government units.

The legislators, under Art. 68(1) of the Act on Public Finance, indicated that management control in public finance sector entities comprises all the measures taken to ensure the accomplishment of objectives and tasks in a lawful, efficient, cost-effective and timely manner. Moreover, the purpose of management control is to ensure in particular: 1) the compliance of activities with the provisions of law and internal procedures; 2) the efficiency and effectiveness of operations; 3) the reliability of reports; 4) the protection of resources; 5) the observance and promotion of principles of ethical conduct; 6) the efficiency and effectiveness of information flow; and 7) risk management⁹.

As can be seen, risk management is an important element of management control. In order for management control to be regarded as adequate, effective and efficient, all of its elements, which are described in management control standards, should function properly in an entity¹⁰. In doing so, one should bear in mind that the responsibility for the proper functioning of management control rests with the head of the entity. More specifically, at a local government level, this competence is assigned to the village governor, the mayor or the chairman of the board of the local government unit, as appropriate.

8 I. Miciuła, *Szczególna rola zarządzania ryzykiem w sektorze finansów publicznych*, „Studia i Prace Wydziału Nauk Ekonomicznych i Zarządzania” 2013, no. 1, p. 113.

9 Art. 68(1) of the APF.

10 See Communication no. 23 of the Minister of Finance of 16 December 2009 on management control standards for public finance sector entities (Official Journal of the Ministry of Development and Finance 2009, item 84).

Therefore, the elements of management control include: 1) the internal environment; 2) objectives and risk management; 3) control mechanisms; 4) information and communication; and 5) monitoring and evaluation.

The „internal environment” domain is a pillar for the other elements of management control, as it largely concerns an entity’s management systems. In particular, the necessary professional competences of all employees, i.e., their level of knowledge, skills, competences, tasks and responsibilities, can be viewed as belonging to that area. The „risk management” domain seeks to increase the probability of accomplishing the objectives assumed by each entity by way of establishing plans and monitoring how they are implemented. In addition to these responsibilities, this domain also comprises identifying and analysing risks along with devising the remedial measures necessary to set corrective courses of action when some tangible risks arise that may compromise the accomplishment of the set tasks. Another domain, „control mechanisms”, deals with addressing specifically emerging risks. In connection with these mechanisms, public finance sector entities must properly document, record and authorise all financial and economic operations. Public administration authorities must also ensure liquidity in their operations, as well as control and protect their resources. The „information and communication” domain aims to provide each employee with the necessary information on how an entity is performing its duties, on how they are performing their own tasks, and also to ensure the efficient and effective flow of intra-organisational and external communication. The last domain, „monitoring and evaluation”, comprises activities as part of which the management control system operating in a public finance sector entity should be subject to ongoing monitoring and evaluation¹¹. In addition, it is a domain that should address emerging employee problems on an ongoing basis using self-assessment and internal audit tools. As regards self-assessment, according to the management control standards for the public finance sector, it is recommended that the self-assessment of management control systems be carried out at least once a year by the management and employees of the entity. Such self-assessment should be conducted as a process separate from ongoing operations and should be properly documented. At the same time, in accordance with Art. 272(1) of the Act on Public Finance, internal audits are an independent and objective activity the purpose of which is to support the head of an entity in implementing the

11 Cf. I. Miciuła, op. cit., p. 214–215.

objectives and tasks by a systematic assessment of management control and advisory activities¹².

Each of the aforementioned elements is equally significant and is closely related to the other areas. Their proper functioning determines, to a large extent, the effectiveness of the risk management process. Introducing a risk management system for a public finance sector entity, without taking into consideration all the elements of management control, may prove ineffective or inefficient. In addition, one should bear in mind that each public administration body is a different entity when it comes to both its legal construction and functional aspects. So, there is no universal risk management model that would be tailored to the characteristics and needs of all entities¹³.

The process of risk identification and analysis in public administration

When building a risk management mechanism in a public finance sector entity, risk identification is an extremely important process, responsible for defining the actual risks. It is an activity that involves assessing the probability of threats, but also potential opportunities. In risk identification, it becomes important to establish the degree of probability that a specific event will enunciate the magnitude of the risk. The purpose of risk identification is to diagnose threats relatively early with a view to taking appropriate action against the potential danger¹⁴. The first step in examining the possibility of risk occurrence is to identify the risks. More specifically, this allows the identifying of situations that may adversely affect the accomplishment of an entity's objectives. The risk identification process seeks to identify, recognise and record risks. If this process is fully informed and controlled by those responsible for it, it is easier to take appropriate preventive measures, given the possibility of the occurrence of potential risks.

When identifying potential risks, the functioning of a public finance sector entity should be analysed as a whole, and all possible sources of risk affecting that entity should be identified, taking into consideration the characteristics

12 See more Art. 272, para. 1–2 of the APF.

13 Cf. K. Lisiecka, *Zarządzanie ryzykiem – determinanta jakości zarządzania przedsiębiorstwem*, „Zarządzanie i Finanse” 2012, no. 3, p. 553–569.

14 T. Kaczmarek, *Ryzyko i zarządzanie ryzykiem*, Warszawa 2006, p. 98–99.

of each of them¹⁵. This process is significant as its role is to precisely define any potential threats, which are the actual sources of risk¹⁶. By indicating the main factors shaping the potential threats to the activities of a public organisation, the head of the public finance sector entity must determine which types of risks, and to what extent and at which time, may influence the way in which tasks are performed. When identifying risks, the head of the entity should also determine the risks that might, but does not have to, influence the activities of such an entity in the future¹⁷. In undertaking such activities, an initial risk analysis is conducted to prioritise the identified risks. Nonetheless, one must bear in mind that the boundaries between risk identification, risk analysis, risk assessment and the identification of potential opportunities are extremely fluid. And this warrants extreme caution and care when performing this type of work, as the involvement of persons responsible for isolating risks determines whether and how the right decisions will be made in the future.

In order to correctly assess the likelihood of certain risks occurring in a public entity, it is definitely necessary to carry out a process of identifying possible threats and dangers. Therefore, when undertaking risk assessment and risk management, such entities should use appropriate methods to identify such dangers and threats, including: 1) threat analysis as a form of identifying risks that may affect the resources of a public entity; 2) environmental analysis, which is the process of isolating risks that may affect the operational activities of a public entity; 3) „threat scenarios”, a typically specialised method of risk identification that may be applied in the case of emerging fraud, crime, security threats or under other circumstances adversely impacting the manner in which tasks are carried out¹⁸.

There are also other risk identification methods used by public administration authorities. One of them, referred to as the Delphi method, relies primarily on the opinions shared by experts invited to discuss, and to

15 Cf. M. Szczerbak, *Ryzyko strategiczne działalności przedsiębiorstwa i możliwości jego ograniczania* [in:] *Ryzyko w działalności przedsiębiorstw. Wybrane aspekty*, ed. A. Fierla, Warszawa 2009, p. 43–44.

16 A. Korombel, *Ryzyko w finansowaniu działalności inwestycyjnej metodą project finance*, Warszawa 2007, p. 84–85.

17 P. Kokot-Stępień, *Identyfikacja ryzyka jako kluczowy element zarządzania ryzykiem w przedsiębiorstwie*, „Zeszyty Naukowe Uniwersytetu Szczecińskiego. Finanse, Rynki Finansowe, Ubezpieczenia” 2015, no. 75, p. 538.

18 See more D. McNamee, *Oszacowanie ryzyka w audycie wewnętrznym i zarządzaniu*, Warszawa 2004, p. 52–54.

subsequently participate in, the risk identification process. These persons rarely meet each other and often do not even know about the people who are involved in such a process. It may also happen, and in fact this becomes an increasingly frequent practice, that the professionals involved in the risk identification process are not informed about the risks that have already been defined by other experts¹⁹. Another method, referred to as checklisting, is a technique aimed at engaging experts in identifying a number of risks to which a particular public organisation is specifically exposed. The role of experts here is to identify specific risks in detail. This is done by answering a set of questions that relate to individual aspects of the functioning of a public finance sector entity²⁰. So-called brainstorming is also employed in public administration authorities. This is the cheapest method of risk identification, involving small groups of employees of a given entity. The people involved, generally knowing one another, do not hesitate to express their ideas in an attempt to identify the potential risks that may materialise²¹.

As part of the risk identification undertaken in a public organisation, it is also extremely important to gather as much information as possible. However, this must be information with good parameters, both reliable and verified, allowing the most desirable conclusions in the context of hypothetical threats. No source of risk may be omitted because otherwise, without the appropriate knowledge of any such hypothetical threat, a public entity will not be prepared to implement mechanisms offering protection against various types of problems.

The purpose of risk analysis is to identify, in a reliable manner, the risks that are indispensable for assessing the scale of possible threats, and for planning and carrying out actions aimed at minimising these risks. Risk analysis is an extremely difficult process of estimating the potential consequences of a given risk, where the likelihood of its occurrence must be taken into consideration. Public administration authorities also carry out strategic analyses. The subject matter of such analyses mostly includes risks that arise in connection with

19 W. Rogowski, A. Michalczewski, *Zarządzanie ryzykiem w przedsięwzięciach inwestycyjnych*, Kraków 2005, p. 39–40.

20 Cf. A. Kumpiałowska, *Skuteczne zarządzanie ryzykiem a kontrola zarządcza w sektorze publicznym*, Warszawa 2011, p. 60–62.

21 A. Hiam, *Dyrektor zarządzający*, Kraków 2001, p. 384–385.

threats, concerning the fulfilment of important interests of the state, which are predestined for a quick response to their occurrence²².

When conducting risk analysis, it is also absolutely imperative for public administration authorities to remember about compiling a list of potential risks, called the risk register. This is an important thing to do, reflecting an attempt to identify the main causes and sources of risk. The risk register identifies the areas, tasks and objectives within which risks are expected to occur. When developing such a list, managers can make more informed decisions at the subsequent stages of the risk assessment and management process. One should also bear in mind that the risk register has a dynamic character and it needs to be continuously updated so as to adapt it to any ongoing needs, expectations, organisational and legal changes. During the preparation of the risk register, events or circumstances are identified that could tangibly affect the adopted objectives of a public organisation. In designing such a protective system, there must also be growing awareness on the part of an entity's managers that the process of optimal risk designation at this stage significantly increases the chances of effective counteraction and informed decision-making. What is more, any identification of risks should take place as soon as possible, because the shorter the period between detecting threats and taking protective or corrective measures, the greater the reduction of the negative consequences of the former. In this case, the moment at which the risk is identified may prove crucial for more than one objective fulfilled by a public organisation.

Conclusions

To conclude, it can be stated that the risk management process in public administration, as discussed in this article, is an activity of key importance, as it protects the entity against a range of potential risks. Obviously, the likelihood of risk occurrence is higher in public entities that are very complex in terms of their structure and personnel. However, regardless of the size of a public administration authority, efforts must be made at the right time and with the appropriate instruments to ensure the proper response to an emerging risk. In this approach, public administration authorities make a realistic assessment

22 L. Wiatrak, *op. cit.*, p. 123.

and forecast of potential risks in some of the most sensitive areas. There is also increased awareness on the part of those in charge of public entities that the role of risk management is to provide protection against various crises and threats not only to the entity but also to its employees.

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Prawne aspekty związane z przygotowaniem mechanizmów zarządzania ryzykiem w administracji publicznej

Streszczenie

Przedmiotowy artykuł, dotyczący administracyjnoprawnych elementów przygotowania i wdrażania mechanizmów zarządzania ryzykiem w administracji publicznej, wskazuje, że jest to ważny proces wspierający prawidłowe funkcjonowanie każdej jednostki sektora finansów publicznych. Obserwuje się przy tym konieczność bieżącej aktualizacji obowiązującej formuły zarządzania organizacją, szczególnie dotyczącej efektywności, skuteczności i optymalizacji podnoszenia jakości świadczonych usług publicznych. Nieustannie przy tym wzrasta świadomość kierownictwa jednostki niebezpieczeństw wynikających z osiągnięcia przyjętych rezultatów, dlatego jest konieczna budowa mechanizmów zarządzania ryzykiem ograniczających negatywny wpływ różnorodnych czynników na właściwą realizację zadań.

Słowa kluczowe: ryzyko, zarządzanie ryzykiem, kontrola zarządcza, administracja publiczna