Risk management in public organizations

Abstract: Uncertainty is a constant element of reality. It causes that the action strategies as well as the prediction of specific events and phenomena often fail. In the activities of organizations all sorts of risks appear which can affect their performance in different ways in the present and the future. Risk management (understood as its identification, estimation, and also the determination of appropriate responses) becomes an integral part of the activity. This also refers to public organizations.

Keywords: risk, risk management, public organization, public sector, management control

Introduction

Risk is an integral part of the action and activity. This is a constant element appearing in any decision making process. Thus, it applies to virtually every area of human activity and to the functioning of the organization – regardless of whether it is a business, public, or social organization. The risk is, however, not of a uniform character. There are action areas, as well as organizations exposed to risk to a larger degree or endangered by specific types of risk – and all of this is subject to change. Risk is always of a dynamic nature, regardless of the stability preserved in certain periods. So, in order to function properly (and make appropriate decisions), any modern organization must recognize the risk and manage it. The aim of this article is to show the essence of risk in public organizations, as well as the need to manage this risk. The organizational and legal conditions of risk management in the Polish environment will also be presented.

Scientific discourse on risk had its beginning in the mid-20th century, when the search for ways to reduce the threats of a biotechnological and ecological character and to minimize their potential effects was carried out. In the initial period the risk was treated mainly as "a possibility of failure" in existing systems. Therefore, the focus was primarily directed toward "pre-emptive" activities. Their aim was to control systems (including finding "weak links") and to prevent failures. From the point of view of risk management such an approach was referred to as deterministic, for there was an assumption that appropriate control and protection are able to reduce risks. However, with time, a deterministic approach was replaced by a probabilistic approach (assuming that it is impossible to eliminate all threats, and not everything can be verified). The change of approach stemmed, inter alia, from

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the emergence of new global risks and related to them common conflicts of values and interests, as well as from the growth of public interest in these threats. The risk started to be regarded not as a threat that can be eliminated, but as a certain inevitable situation that can occur and the consequences of which must be taken into account. This is done by attempting to estimate and to prepare an appropriate strategy in the case of specific events. However, it is worth noting that analyzing and estimating risks in today's world is not simple. This is mainly due to certain features of the present risks, which include, inter alia, an unexpected occurrence, lack of appropriate data on the nature of the potential of the hazards, a large (sometimes global) and difficult to determine the extent of the impact of the risk effects, and also the inability to neutralize these effects.

As mentioned earlier, today the risk applies to every activity and to every type of organization, including units of the public sector. Currently the risk management in the Polish conditions is one of the objectives of the management control (governed by the law on public finance\textsuperscript{2}). This means that public sector entities should treat risk as an integral part of their activity, identify it properly, analyze it and respond to it.

The risk in the public organization – the essence and the specificity

Due to the changeability of external conditions, the emerging new challenges of an economic, natural and socio-cultural character determine that the functioning of the organization is not permanent. The situations considered as optimal in a relatively short period of time can develop into situations perceived as threats (but also as development chances). This results both from the nature of the mentioned conditions, and from the actions and decisions taken by the organizations (managers). Referring to the situations considered as a threat, it should be noted that they may appear both in the case of not taking any action when certain phenomena increase, and in the situation when some activities are undertaken - but with the use of inappropriate techniques and tools, loaded with an error, overcautious or risky\textsuperscript{3}.

In an attempt to define risk for the purposes of this study, it is worth noting that this is an ambiguous and multifaceted concept. In the source literature, there are many definitions that identify the risk with the threat and danger, with uncertainty of predicting events in the future, as well as with decision-making, in which something can be lost or gained. The risk is also understood as a feature of the success of the entrepreneur or the state of the human mind.

As can be seen, there are many possibilities of an approach to the risk, but at this point it seems appropriate to draw attention to two issues. Firstly, there is a need to distinguish between risk and uncertainty, which are the terms that, in everyday language, are often identified with each other. The basis for such an approach is the belief that the risk stems from uncertainty in the operation. In fact, most of the decisions will be taken in the conditions of uncertainty, that is, the lack of sufficient information and data. However, it is important whether or not this uncertainty is subject to quantification. A discussion in this area was initiated already

\textsuperscript{2} Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. 2016, Nr 0, poz. 1870 ze zmianami.

\textsuperscript{3} Borkowski J., Rozważania o zagrożeniach, Dom Wydawniczy Elipsa, Warszawa 2014, p. 11-12.
in the beginning of the 20th century (A.H. Willet) and it resulted in making some distinctions. Essentially, the risk is treated – unlike the uncertainty – as a phenomenon of an objective character and is subject to measurement (based on the level of probability). The measurable nature of the risk was the basis of the creation by one of the researchers (F.H. Knight) of the theory of measurable uncertainty (that is just the risk) and immeasurable uncertainty (that is, uncertainty in the strict sense)\(^4\). The ability to measure the risk stems from its basic characteristics, which in addition to the event itself (a particular situation, the circumstances accompanying the event concerned) are the probability (i.e. the possibility of the event) and severity (that is, the effects of the event and the strength of their impact). The risk is a combination of instances of the event and its effects. It is "the effect of the uncertainty that is measured by probability"\(^5\).

On the other hand, it is worth drawing attention to two basic concepts of approach to the risk, differing primarily in a way of perception of the effects of the risk. The issue concerns a negative and neutral approach\(^6\). In the first case the risk is identified only and exclusively with the possibility of incurring damage or loss. It is, therefore, treated as a threat and as such requires the adoption of measures to reduce or eliminate the possibility of the occurrence or minimization of the effects of specific events. In the second understanding (neutral approach), risk means the appearance of the effect, which is incompatible with the expected and accepted previously. It should be noted that this effect can be both negative (damage/loss) and positive (opportunity/change for the better). Going forward - since the risk is associated (in certain situations) with positive effects, it is appropriate, and simply recommended to take it. Whereas risk taking is associated with the right approach and the management of this risk.

The occurrence of the risk in the case of any organization is conditioned by factors both of an external and internal character. The first ones have their source in the environment of the organization – both nearer and further. While the internal factors are related to resources and their use in the process of the implementation of the objectives of the organization.

In an attempt to categorize the risk – bearing in mind that there is no one correct systematics – it is worth pointing to a few of the most popular distribution criteria. One of the basic kinds of the risk classification makes it possible to distinguish the systematic (general) risk and the specific (particular, operational) risk. The first type of risk (the systematic risk) is associated with the influence of external factors, which are outside the sphere of influence of the organization. While the specific risk results from the specificity of the organization (structure, resources, location, etc.)\(^7\). It is also possible to talk about acceptable and unacceptable risk.

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\(^7\) Poniatowicz M., *Specyfika zarządzania ryzykiem w sektorze publicznym ze szczególnym uwzględnieniem jednostek samorządu terytorialnego* [in:] Filipiak B. (ed.), Podmioty sektora finansów publicznych.
internal and external, short-term and long-term risk\textsuperscript{8} or the risk for specific industries, sectors and areas of activity\textsuperscript{9}. One of the popular divisions of risk is also a distinction between financial and non-financial risks. At first glance, this seems to be a very simple and readable division, however, it brings about a lot of discussion. This mainly results from the conviction that in practice (especially in the case of non-public entities) all decisions lead to specific financial consequences\textsuperscript{10}. It is assumed, therefore, that the financial risk has a direct impact on financial results, and the non-financial risk influences indirectly and is harder to be measured\textsuperscript{11}.

The specificity of the activity of public organizations (meeting public needs, non-commercial activity) makes the approach to risk rather negative, it means that it is identified with a threat. The management of public sector entities in this area is aimed primarily at preventing situations that may jeopardize the proper execution of tasks.

The basic categories of risk in public organizations are closely linked to the main areas of action and management in the public sector. These areas primarily include finance, law, people, organizational structures, and information\textsuperscript{12}. By assuming this as a starting point, the risk in public organizations can be understood both objectively (resource) and functionally. On the one hand, it is possible to indicate the risks to certain resources such as people, property, financial means, internal and external communication systems, security systems, intangible and legal assets, etc. Whereas, on the other hand, all the decisions taken by public sector executives, reflected in the implementation of public tasks (provision of services), are subject to risk. The Public Sector Risk Management Manual identifies two main categories of risk that can occur in public organizations. This is a strategic risk and operational risk. The first one includes, for example, such subcategories as: political, economic, social, legislative or environmental risk. While in the group of operational risks there are inter alia: financial, legal, technological or professional risks\textsuperscript{13}.

It is worth drawing attention to – in the case of a public organization - especially to the latter, i.e. occupational risk, also called personal risk, i.e. the risk associated with human resources of the organization. Human capital is one of the basic resources of modern organizations. Its shortage or problems with its proper use can significantly affect the quality of the organization’s performance (public service delivery). It is worth remembering that in the case of some public organizations

\textsuperscript{9} Zawiła-Niedźwiecki J., Zarządzanie ryzykiem operacyjnym w zapewnieniu ciągłości działania organizacji, Wydawnictwo Libri, Kraków-Warszawa 2013, p. 41.
\textsuperscript{10} Staniec I., Klimczak K.M., op.cit., p. 24.
\textsuperscript{11} Postuła M., Aspekty zarządzania ryzykiem finansowym w sektorze publicznym w odniesieniu do tego procesu w przedsiębiorstwie [in:] Turyna J., Rak J. (ed.), Finansowe uwarunkowania rozwoju organizacji gospodarczych, Wydawnictwo Naukowe Wydziału Zarządzania Uniwersytetu Warszawskiego, Warsza wa 2013, p.526.
\textsuperscript{13} Jennison B., Zarządzanie ryzykiem w sektorze publicznym. Podręcznik wdrożenia systemu zarządzania ryzykiem w administracji publicznej w Polsce, Ministerstwo Finansów, Warszawa 2004, p. 23.
(e.g. local government units) personal risk relates both to the employees of the sensu stricto organization (as in any other organization) and to those who are elected to specific institutions (for example, the municipal council) and exercise power. In the activities of public organizations, also a financial risk often appears. It is related to the implementation of public tasks (a standard of services is required, a large group of customers, lack of payment) under conditions of limitation, or deficit of funds. The main causes of this risk are primarily the inadequacy of financial sources in relation to the tasks performed, obligatory tasks in particular\textsuperscript{14}. In this area there may also be a risk of fraud as well as a risk of corruption. Attention should also be paid to the risks that occur in the area of intangible assets, especially associated with the image and reputation of the organization. In the case of public organizations – due to their often privileged or monopolistic position – this risk seems a lesser danger than in the case of entities operating in the private sector. This causes that the risk is often overlooked or marginalized. However, this seems to be a mistake, because inasmuch as in the case of public organizations it is difficult to talk about a total "loss of reputation", there certainly may be image problems as well as a significant reduction in the level of public trust.

In the case of any organization, also a public organization, the risk (especially treated as a threat) results in specified effects. They may include, among others, adverse changes in the structure of resources and reduction in their functionality, limitation of the possibility of smooth functioning, deterioration of the relationship with the environment and weakness of the internal relationships, bearing unplanned costs, causing adverse reactions of the stakeholders of the organization and obtaining negative assessment by external entities\textsuperscript{15}. In the case of public organizations danger of corruption, loss of public trust, or global threats of global character, such as terrorist threats can be counted among the causes for which the risk should be managed.

**Risk management in public organizations**

– organizational and legal conditions in Poland

Risk management is an integral part of managing every modern organization – regardless of its sector affiliation. Source literature provides many definitions of this process. Risk management is considered as one of the basic management processes of an organization, the way the organization operates under uncertainty, the organized process of solving problems related to emerging risks, the process of identifying and evaluating risks and responding to them, as well as the decision-making process associated with selecting appropriate security measures against appearing threats.

Risk management involves several key stages, including: risk identification, assessment (measurement) and analysis of the risk, response to the risk and controlling/monitoring the risk management process. The first stage, i.e. risk identification, essentially involves identifying the risks (or opportunities) associated with


activities of a given organization. The key action is to identify two issues, namely -what the organization is striving for and how it intends to realize that. It is about goals and ways of their implementation (tools, strategies). When it is known what is to be done and to be accomplished, it is possible to determine, in a more precise way, potential threats and chances that may arise in the process. In the next step, assuming as a starting point the identified and usually categorized risks (for example financial, personal, legal), the impact of these risks on the activities of the organization (adopted goals) should be assessed. At this stage, different qualitative and quantitative techniques are used. They make it possible to determine both the likelihood of certain events (which are the cause of the threat or the chance) and to assess their potential effects. As a result of the analysis, it becomes possible to identify the risks that are important to the organization. For these risks appropriate reactions are defined, both of an active and passive character (tolerance, transfer, withdrawal, action). In addition, all risk management activities are subject to constant monitoring. It aims to identify emerging irregularities as well as new threats and opportunities.

National and international law as well as regulations adopted in a given sector, related to industry or organization are the basis of risk management in organizations. Internationally, a number of standards and recommendations have been developed for different organizations, regardless of their size or sector affiliation. Speaking about risk management in public sector entities in Polish conditions, it is worth, due to the specificity of this sector, paying attention to the legal regulations. Among the European acts, it is important to mention first of all the fundamental Treaty establishing the European Community, all the regulations relating to the functioning of the EU institutions, especially financial ones, the regulations on the protection of the European Communities' financial interests and the fight against all frauds in this area, as well as detailed guidelines for the Member States implementing European programmes. On the national basis, the basic document that addresses the problem of risk management is the Public Finance Act and other documents related to it – including the Minister of Finance’s communications on standards of management control and risk planning and management.

The need for risk management by entities operating in the public sphere has been clearly underlined in rules on the management control (2009). At the same time, it should be pointed out that the obligation of the introduction of risk management systems in public sector units already appeared several years earlier in connection with the introduction of the rules on financial control (2005).

Management control — introduced in 2009, by law — is aimed, first and foremost, at the professionalization of the management in the public sector. Among fundamental objectives of management control, the legislator indicated, inter alia, the assurance of legality of the action, the increase in the efficiency and effectiveness of activities and flow of information, the improvement of reliability of the reports, the protection of resources, the promotion of the principles of ethical conduct, as well as the risk management. The introduction of the laws relating to management control was complemented by a message from the Minister of fi-

17 Art. 68 ustawy o finansach publicznych.
Risk management in public organizations

These standards are divided into five basic categories, namely: internal environment, goals and risk management, control mechanisms, information and communication, and also monitoring and evaluation. A novelty in this group (as most areas were taken into account in the process of management of public organizations) is just risk management. As the research on the functioning of management control in Poland shows, just this area in practice causes most problems to people who conduct public finance sector entities.\(^{18}\)

Standards for risk management were combined with the standards relating to the objectives and tasks of the organization. This approach emphasizes a close link between the objectives of the activities of the organization (both strategic and operational) and the risk that may occur and which must be managed. Setting targets (including the formulation of the mission) is an integral part of the activities of each organization. However, it is worth bearing in mind that business planning (formulation of the objectives, identification of the ways to achieve them, and the measures of implementation) is not a one-time activity. This process is closely correlated with the current and future activities of the organization. So, it is of key significance for the management of this organization, including the risk management.\(^ {19}\) Due to the variability of the environment and emerging new challenges, the objectives of the organization should, in accordance with the standards – be determined in at least an annual term. Goals should be realistic, precise, specific, specified in time, as well as the measurable (with the help of fixed gauges). An important part is also the determination of resources necessary for the implementation of the defined objectives and tasks.

Identifying and understanding the purpose of the organization, including the identification of the factors affecting their development, constitutes a starting point for risk management. In accordance with the standards, three basic activities (defined in separate standards) can be indicated, which are the risk identification, the risk analysis and a response to the risk. These activities can be presented in a more detailed way as:\(^ {20}\)

- the identification of resources which are at the disposal of a given entity,
- the identification of threats that may arise during the performance of the tasks of the entity,
- the analysis of the risk, including the analysis of probability and effects of the occurrence of specific events,
- the control and monitoring of the existing security, as well as
- the determination of actions (security, procedures) necessary to be taken when certain events occur.

These actions, which have already been emphasized, are typical of all organizations, but here it is worth drawing attention to some specific features of risk management in public organizations.

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\(^{19}\) Kumpiałowska A., Praktyczne narzędzia zarządzania ryzykiem w jednostkach sektora publicznego, Wydawnictwo C.H.Beck, Warszawa 2015, p. 94.

\(^{20}\) Borucki M., Proces zarządzania ryzykiem, Wydawnictwo Wiedza i Praktyka, Warszawa 2013, p. 3.
Firstly, in terms of risk identification, a certain time frame has been adopted in public organizations. The risk identification (in relation to objectives and tasks) should be done at least once a year. This is primarily due to the specifics of public sector action (time horizon - budget year). Of course, in the case of a significant change in the operating conditions, these actions should be repeated. Secondly, the approach to risk in public organizations is definitely negative (risk as a threat). In practice, this means focusing particularly on events that may have a negative impact on the organization's tasks and objectives. As a result, activities that minimize the identified risks and bring them to an acceptable level play an important role. Due to the specific nature of public organizations, acceptable levels of risk often result from top-down limitations (timeliness of specific actions, use of specific procedures, etc.). As a result the so-called risk appetite, or the amount of risk that a given organization is able to accept, is rather limited in the case of public organizations. Obligatory rules governing the operation of public entities (legality, economy, rationality) also influence the choice of the most common forms of risk response (tolerance / avoidance combined with risk transfer).

Conclusion

The effectiveness of risk management in a public organization depends to a great extent on its preparedness to respond to certain risks. An important area of action of any public organization should therefore be taking decisions enabling the elimination of determined risks or minimization of the impact of their occurrence. Such activities include, among other things, the systematic examination and analysis of the organization's environment (from the point of view of potential threats), as well as the monitoring of the achievement of the objectives of the organization - both from the point of view of established measures and the resources needed to carry out the tasks.

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22 Babuśka E., op.cit., p. 6.


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Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. 2016, Nr 0, poz. 1870 ze zmianami.