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The proper factors that determine the risk

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Abstract: It appears that generally limitations in achieving objectives are caused by the next realities: (1)leader's judgment in making decisions is not always the best, if there are not regarded all the circumstances; (2) risks can occur because of simple error or misconduct; (3) decisions on risks and internal controls implemented do not take account on costs and benefits; (4) in many cases the implementation of internal controls is ignored as a result of agreements between public enterprise management and some employees or third parties, which increases the risk and possibility of control.

Key words: management risk, local public enterprises

JEL classification: L32, M40

The economic argument of risk

From the research performed, in the local business activity field, it was found that risks are identified in their entirety, but shall be subject to evaluation and treatment only those considered major risks. Thus, public company management believes that goals or achieving the intended results is influenced only by those risks.

In our opinion, on local enterprise level, there are more categories of risks, controlled or uncontrolled, which have influence on achieving objective.

As it can be seen, public enterprise generally identifies risks associated to the objectives, but there are some risks that they can't identify. Risk identification degree depends on some factors like: organizational culture upon risk, training and knowledge in the field, methods and tools used for identifying and evaluating risks, complexity and volume of procedures and activities developed by the public enterprise or the quality of the risk management procedure implemented on public enterprise level.

The factors that determine the risk exposure of the public enterprise can be identified as they follow:

- the transformation of public enterprise, structural changes, major changes produced under internal decisions;
- compliance with received financial resources, which are increasingly limited, with effects on achieving the objectives;
- limited staff training and the lack of motivational programs
- establishing tasks and performing activities that are not consistent with the nature and qualifications of required position by employees;
- inadequate procedures or lack thereof.

The analyses the typology of risk

The risks identified in a public enterprise can be included into two categories, namely inherent risks and residual risks.

Inherent risks are risks which normally exist in any activity developed and are defined as being “the existent risk before applying internal control measures for reducing it”, or “the totality of risks of an enterprise/ organization and they can be internal or external, measurable or non-measurable risks (Vasile Emilia, Popescu, 2004)”. Thus, it is considered that inherent risk represents the possibility of error or irregularity occurrence in management and financial states, before the impact of internal control measures.

Residual risks represent “exposure cause by a certain risk after taking measures to mitigate it. Risk mitigation measures belong to internal control. This is why residual risk is a measure of effectiveness of internal control, reason why some countries replaced the term residual risk with control risk”. Thus, residual risk is considered as being the risk that remains after applying internal control measures. Applying internal control measures should limit the inherent risk to a level accepted by the public enterprises, as an effect. Residual risks are being monitored and are pursued to be kept at acceptable levels.

Residual risks are also known as vulnerability or exposure of the enterprise, namely the risk that remains after control measures were implemented in order to mitigate inherent risk. These risks are not subject of the evaluation and treatment processes made by the public enterprise, but they are kept under observation, in order to see if they change, if they modify their level or structure becoming uncontrolled.

Inherent and residual risk is considered as being two stances of the same risk. Thus, inherent risks exist before the introduction of internal control tools, and residual risks exist exist after the introduction of internal control tools. Thus, if internal control tools implemented at some point, reporting to a certain risk, have as consequence a bigger exposure to risk than the toleration limit, residual risk in considered an inherent risk.

Considering that inherent risk are those risks that the enterprise still can’t control, it is imposed for these to be assumed and to establish actions in order to mitigate the, to minimize their probability of manifesting.

Control risk is the probability that the control system may not operate and thus can not prevent or correct existing dysfunctions, respectively the risk that the company's internal control system to fail to timely prevent or detect errors, irregularities or fraud. Those risks can occur in the sold of an account or in a transaction category and can be individually or cumulatively significant. Control risks are errors and irregularities which are not discovered on the inspection.

Non-detection risk represents the risk that a certain event or threat to not be identified or managed, respectively the risk that effectuated internal audits tests to not identify the possible significant errors or irregularities. Those risks are voluntarily excluded by the enterprise, because it isn’t aware of their existence. Still, the public enterprise has the responsibility to monitor the objective-attached activities and to also track the existence of other risks, especially in the context in which the activity-realizing way is changing, which can generate the occurrence of new risks.

Risk appetite or risk toleration is considered as being the risk exposure that the public enterprise is willing to accept. This is different from an enterprise to another, from a functional compartment to another, depending on the organizational environment, quality and implication of staff.

Risk toleration level is established by the public enterprise and it is known by all workers, and they act to perform the activities empowered in so as to keep risk within acceptable limits.

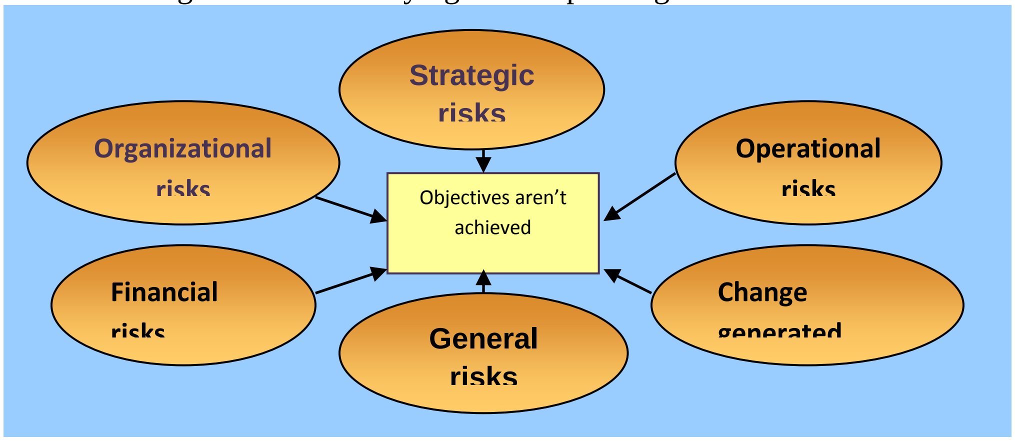
In relation to the above, we believe that the risk is an uncertainty, an event that has not occurred, but which, while that is not well controlled, may occur and may affect the achievement of objectives. This represents a permanent reality in the local public enterprise and is associated to all activities and actions performed. The manifestation of risk has a negative effect depending on the impact this has on the objectives.

Considering the fact that, risk can't be avoided or eliminated, field-specialists' opinion is that "public enterprises should be concerned with the evaluation of risks and maintaining them in the limits that they can accept and tolerate".

In practice, public enterprises are facing a variety and a complexity of risks, but these are different from an entity to another. The leadership must be preoccupied with identifying and classifying risks depending on their probability of manifestation and their impact on the enterprise, in case they manifest.

Depending on nature of the operations risks generate, they can be classified as it is presented in the next picture.

Figure no. 1 Classifying risks depending on their nature



Source: Authors view according with Roman Constantin, 2006, Financial management of public institutions. Accounting of public institutions, Issue II, Economic Publishing House, Bucharest;

Strategic risks are directly related to the development strategy of the public enterprise and they ate associated with the strategic objectives;
Organizational risks are associated with the organizational process, carrying out activities and operational procedures;
Financial risks are caused by the change of interest rates, inflation rates, insurances, taxes and fees, perfectionist policies, regional policies, need of reducing losses;
General risks are directly related to fields of activity and are associated with general objectives;
Change generated risks are caused by legal changes, professional ethic, staff's culture and training level, staff's needs and necessities and also by staff's fluctuation;
Operational risks are directly related to functional compartments of the enterprise and are associated with defined specific objectives in this section;
Operational risks are defined based on cause-event-effect relationship and on existing control within an event, in order to prevent its occurrence.
Organizational changes, the existence of a law professional trained, unmotivated, inexperienced staff, as changes in work field or in performance of activities lead to an increased exposure to operational risk.
Operational risk management is the responsibility of both the functional structures of the enterprise management and the personnel operating within them. Operational risk is the responsibility of lower levels management because it is associated with specific objectives

that are defined in the functional structures.
In approaching operational risks are distinguished following approaches:
procedural approach involves consideration of the characteristics and requirements for achieving operational processes, management processes, processes that characterize the enterprise support functions, activities or actions;
causal approach involves consideration of changes in the structure of human resources, staff training, defined performance measurement indicators structure and the application of intern provisions of the enterprise. This approach also takes into account how to ensure business continuity and the relationship between risks associated objectives and exposure to operational risks.
For the operation risk to be minimized and controlled it is imposed that intern/managerial control system to be adapted to nature and complexity of developed activities and to assure at least following actions (Iovu, 2005): delegation of power and responsibility, separation of functions, safeguarding of assets and the internal audit function.

Also, to these can be added the situations in which the enterprise leadership makes decisions without the existence of a substantiation of them, especially regarding establishment of implementation and measure and ensuring the needed resources for implementing them.

In our opinion, risk characteristics can be classified as follows:

- *Exposure to risk*, different ways of risk exposure of the enterprise, such as personnel, assets or organizational environment;
- *Risk factors* related to characteristics of the enterprise or are determined by the characteristics of national economy, politic system, or legal environment applicable to public enterprise. These determine a significant increase of exposure to risk and in certain conditions they can lead to the occurrence of negative events for the enterprise;

Potential financial impact of the loss, represents consequences for the enterprise as a result of risk manifestation. These may be direct losses that can not be assessed with certainty, property damage or human losses.

Taking into account that the risk represents "the threat that an event or action to negatively affect an organization's ability to achieve the set objectives" (Iovu, 2005), in our opining, achieving the set objectives by the public enterprise are uncertain, given that management decisions and actions taken to implement them disregard the realities and existing risks.

Conclusion

Also, given that risk is assessed in terms of probability and impact, management's responsibility is to identify, evaluate and treat risks and depending on the results to determine appropriate control tools and to implement them in order to limit risks and maintain them at acceptable levels.

Effective risk management involves ensuring balance between existent residual risk and the risk that public enterprise is prepared to tolerate. Ignoring certain circumstances, lead to the existence of uncontrolled risks which may affect failure targets.

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