What's Special About Public Entity Risk Management?

Risk management in the **public sector**, which consists of governmental entities and their agencies, differs from private sector risk management of profit-seeking business firms in the same ways that public administration of governmental units differs from general management of any typical business firm. Some of the ways that **public administration**, the management of governmental entities and their agencies, differs from private business management are summarized here and elaborated later in this and other chapters. These differences include the following:

1. **Essential government functions.** Public entities are responsible for many governmental functions (such as law enforcement, fire protection, and public sanitation) that must continue because they are essential to an orderly and reasonably safe society; unlike private business managers, who are more free to change the basic missions of their nongovernmental organizations, public administrators do not have the option of discontinuing these essential public services.
2. **Scope of exposures.** The wide and often expanding scope of governmental functions usually generates a greater variety of loss exposures for many public entities than all but the largest private organizations face.
3. **Special legal requirements.** Public entities are exempt from some laws (statutes and common law doctrines) that apply to private organizations and individuals, and are subject to other legal requirements (such as in city charters and state constitutions and statutes) that restrict the actions of governmental bodies but not private entities; consequently, public administrators have some powers and duties, as well as some limitations on their range of choices, that managers of private organizations do not have.
4. **Public interest, nonprofit objectives.** Public entities typically are not profit-seeking but instead strive to achieve specified public interest or governance objectives (such as public education, sanitation, justice, crime prevention, or an adequate standard of living for all residents) within budget constraints.

5. **Power to tax.** Public entities generate revenue through taxation and fees and by charging for goods and services that they provide; private organizations generally do not have the power to tax and can generate revenue only by selling goods or services.
6. **Political scrutiny.** The general management procedures of public entities are typically subject to more widespread, and often more partisan, scrutiny than are the comparable procedures of most private organizations, frequently leading to shorter-term planning and budgeting, and more public accountability for public entities.
7. **Special tax status.** Public entities are generally exempt from the income and sales taxes that most private organizations must pay; consequently, tax considerations are not as relevant to managerial decision making in the public sector.
8. **Differing accounting and budgeting procedures.** Public entities follow somewhat different accounting procedures than do private organizations to recognize the budgeting, investment funding, and tax considerations that public entities face.

These differences between public and private administration—between good management of governmental not-for-profit organizations and good management of private, typically profit-seeking organizations—are the root causes of most of the differences between good public sector risk management and good private sector risk management. In the context of the five steps of the risk management decision process, the contrasts between public and private administration have the following general implications for public entity risk management:

- **Identifying and analyzing loss exposures.** The exposures to accidental and to business losses that a public entity faces are likely to differ from those of a private entity because of their differing activities, legal environments, and organizational objectives.
- **Examining risk management alternatives.** The range of risk control and risk financing alternatives that are feasible for a public entity is often different than for a private one because of the legal requirements for public entities and the political realities within which they function.
- **Selecting among risk management alternatives.** A public entity's selection of risk management techniques is likely to be influenced by public interest goals, constitutional requirements, charter provisions, budgeting processes, tax laws, insurance market conditions, and political considerations that have little relevance to private sector risk management choices.

- **Implementing chosen risk management techniques.** A public entity's implementation of risk management techniques may differ from a private entity's implementation of the same techniques because of the procedural requirements and political considerations to which public administrators must give attention.
- **Monitoring and improving the risk management program.** The standards and procedures by which a public entity monitors and evaluates the performance of its risk management program tend to differ from a private entity's standards and procedures because most public entities give high priority to specific organizational objectives and measures of performance that may be of lesser importance or irrelevant in the private sector.

The risk management process is a specialized version of traditional problem solving. It addresses the set of business problems that deal with loss exposures. Risk management involves the administrative processes of planning, organizing, leading, and controlling an entity's activities in order to reduce the incidence and costs of losses. Risk management professionals must use these processes to identify and analyze loss exposures, examine alternative risk management techniques, select appropriate loss mitigation techniques, implement the techniques, and monitor the results.

Some exposures are readily identified. A high risk of injury and property damage is inherent in activities such as driving vehicles, lifting and transporting materials, and performing duties necessary for law enforcement and fire protection. However, with less apparent exposures, identification becomes more difficult. But once noticed, these exposures become apparent. For example, workers may suffer from common ailments, but after several instances of repetitive movement syndrome have been reported, the risk factors that can cause it can be identified.

The risk management process works best when the risk management professionals are very familiar with all of an entity's activities. Ideally, entities need to include risk management professionals in discussions of risk early when considering new activities. Additionally, risk management professionals should be out of their offices and moving around the organization to further their understanding and recognition of risk. Because risk management is an ongoing process, risk management professionals can help mitigate the organization's overall losses by early involvement and ongoing participation in the entity's programs and activities.

A common problem in the public sector is that risk management departments are decreasing in size as their workloads and responsibilities are increasing. Some view this as a sign that risk management is no longer important to senior officials or that the officials simply do not understand the complexity of risk management. However, this trend could be seen as a step in transforming risk management into an integrated function of the entire organization. Risk management professionals are already responsible for planning, organizing, coordinating, and directing the risk management function throughout an organization. Although risk management departments may decrease in size, the importance and stature of the risk management function are increasing.

Any level of loss becomes significant to public sector entities because losses compromise their ability to carry out organizational purpose. Furthermore, the public sector serves citizens who have expectations of programs and services that either are legally mandated to be provided or are necessary for the community.

Effective risk management generates many benefits for a public entity, the community it serves, and the economy as a whole. For the entity, risk management can reduce the cost of risk and the negative effects of losses. For the entire economy, it helps prevent waste of resources and direct resources toward more productive activities. Public entities are sometimes indistinguishable from the communities they serve. Any loss for the entity is a loss for the community and its citizens. Therefore, risk management programs that benefit the entity also benefit the community and the general public.

Steps in the Risk Management Process

Regardless of the type of their organization, risk management professionals begin by identifying and analyzing potential loss exposures that their organization face. Then they must examine feasible alternatives for treating and managing those exposures, and select a technique or a combination of techniques in an effort to ensure that losses would have a minimal effect on the organization. Once the measures have been selected, they must be effectively implemented and monitored to ensure ongoing effectiveness.

Identifying and Analyzing Loss Exposures

The first step in the risk management process is to identify as clearly and as completely as possible the exposures that have a potential for loss in an organization. All possible losses by categories can be identified through experience and by years of observing the organization and how it operates. Identifying variations in actual losses with a great degree of accuracy is not possible, nor is identifying every combination of events that may cause a loss.

The process of risk identification involves determining the types of value exposed to loss, the perils that could cause a loss, and the potential consequences of a loss.