

RISK MANAGEMENT IN LITHUANIA'S PUBLIC SECTOR: STARTING POINT, CURRENT SITUATION AND FUTURE PERSPECTIVES

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Abstract. Based on the analysis of the genesis and evolution of risk management process and its current application in the Lithuanian public sector entities, this article aims at identifying the level of implementation of the risk management framework in Lithuania's public sector and assessing its potential to contribute to Lithuania's public management in future. It concludes that, though the notion of risk management has entered the Lithuanian public sector, its incorporation into the overall internal public management control system has not reached (legally and practically) the sufficient level yet. The lack of positive attitude among public sector managers and administrators also prevails from employing and benefiting from risk management to its ultimate potential. However, it is very likely that due to 'good practices' acquired from private sector and especially regulated financial sector, risk management will be more appreciated by the public sector entities in future. It actually will take some time, which could better be spent on present improvement of public management.

JEL classification: G3, K22, K23, M42.

Keywords: risk management, risk management framework, internal control, internal control system, public sector, public management.

Reikšminiai žodžiai: rizikos valdymas, rizikos valdymo sistema, vidaus kontrolė, vidaus kontrolės sistema, viešasis sektorius, viešasis administravimas.

1. Introduction

During the last two decades Lithuanian public sector overcame a series of changes, including transition from the stiff soviet inheritance to the more flexible new public management practice. In order to respond to rapidly changing financial and social

environment, increasing growth of the EU requirements and public expectations, as well as advanced development of information technology (Rudokiene, 2009), and to improve the overall performance of the public sector institutions (Backunaite, 2006), some of the best experiences from the financial sector have been borrowed along with the notion of risk management. Lithuanian authorities have set a legal background (Law on National Audit Office, 1995; Law on Internal Control and Internal Audit, 2002) for the development of the internal public sector control system, while relevant institutions have made their contribution to promote risk management framework and establish certain set of rules and methodology. However, except for the regulatory initiatives and often superficial efforts to implement risk management framework by the individual public sector entities (Stankevicius, 2005), little has been done to practically establish an overall internal public sector control system on risk management basis.

Moreover, risk management has been widely acknowledged and successfully applied by various Lithuanian financial institutions (banks, credit unions, investment and insurance companies), yet the majority of the bureaucratic apparatus still remains rather unfamiliar with it. Initially this can be explained by public sector's inherent reluctance to accept innovations or changes (Vann, 2004; Thomas, Davies, 2005). Yet additional aspects, such as natural differences between the private and the public sectors and their objectives (Mohan, Holstein, Adams, 1990; McPhee, 2005; Rowe, 2005; Woods, 2009) or comparatively limited practical and theoretical knowledge of risk management implementation in the public sector entities (Stankevicius, 2005), should also be taken into consideration. Nonetheless, the lack of interest of public sector entities to employ risk management framework may have negative implication on the sector performance and even result in the loss of its competitiveness (Rutkauskas, 2008) in terms of attracting foreign and social investments. Hence, there is a strong need for wider acceptance (institutionally and consciously) of incorporating risk management into the overall internal public management system.

Accordingly, this article aims to identify the level of implementation of risk management framework in Lithuania's public sector entities and assess its potential to contribute to Lithuania's public management in future. The article is mainly concerned with the genesis and evolution of risk management process and its current application in the Lithuanian public sector entities. Though there have been several remotely relevant studies (Stankevicius, 2005; Backunaite, 2006; VGTU, 2008) on the subject, risk management development in the public sector is rather unrevealed topic for the Lithuanian academic society, therefore this article presents comparatively new synergy between corporate and public governance studies. The article draws its conclusions based on the analysis of certain legal acts, sets of rules, recommendations, comments and proposals along with the more generic literature on either risk or public management and individual experiences in the area.

2. Starting Point

2.1. The Evolution of 'Good Practices'

Every endeavour or action is exposed to a certain set of risks that on the one hand can interfere with the achievement of its objectives or in any other way damage its performance, and on the other hand may disclose certain opportunities for further and more successful goal-seeking (Agyeman Manu, 2005). In order to reduce possible threats and maximise occasional opportunities, every endeavour should be supported with systematic risk management, which includes establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks (ISO 31000, 2009). Moreover, by assessing the probability of failure, risk management not only provides with the tools to reduce such chances, but also helps with the ways to lessen possible damage if a failure nevertheless occurs (Agyeman Manu, 2005). Hence, risk management restrains from hazards or reduces their possible negative implications and at the same time pushes towards opportunity-marked road for setting and achieving ultimate goals.

This risk management conceptualisation has been mainly revealed and then developed by various experiences and initiatives from the financial sector. As all financial endeavours by their nature reflect very high level of occupational risks and, in case of the failure, bear overwhelming implications on the whole sector and its agents, and at the same time literally strive to generate maximum profitability (Atkinson and Webb, 2005), any success in preventing from losses and benefiting from risk-taking activities is welcomed as a good practice and set of an example for the other sectors. The evolution of risk management in the financial sector has first started as an array of capital requirements and financial restrains, then developed throughout the rules and procedures of internal audit and internal control, and eventually has evolved into the management framework that enables to protect and create financial and social value (Table 1). This evolution has been mostly supported and executed by multinational and international companies, therefore is based on good practises challenged by the optimising the regulatory restrains.

Table 1. The evolution of risk management process in the financial sector

Year	Event / document	Main principles
1988	Basel Committee on Banking Supervision (BCBS) published Basel Accord (Basel I)	Basel I obliged banks with international presence to hold capital equal to 8 % of the risk-weighted assets to cover the credit default risk.
1992	Committee of Sponsoring Organizations of the Treadway Commission (hereafter – COSO) set up the Internal control Integrated framework	This framework presented a common definition of internal control and provided a framework against which internal control systems may be assessed and improved. This document is one standard that U.S. companies use to evaluate their compliance with Foreign Corrupt Practices Act (1977). According to a poll by CFO Magazine released in 2006, 82% of respondents claimed they used COSO's framework for internal controls (Shaw, 2006).

Year	Event / document	Main principles
1995	The Canadian Institute of Chartered Accountants (CICA) published Guidance on Control – COCO	COCO describes internal control as actions that foster the best result for an organization. These actions, which contribute to the achievement of the organization's objectives, centre around: <ul style="list-style-type: none"> - Effectiveness and efficiency of operations; - Reliability of internal and external reporting; - Compliance with applicable laws and regulations and internal policies.
1998	The committee chaired by Nigel Turnbull with London Stock Exchange drew up the Internal Control: Guidance for Directors on the Combined Code (Turnbull report)	The Turnbull report informs directors of their obligations under the Combined Code with regard to keeping good 'internal controls' in their companies, or having good audits and checks to ensure the quality of financial reporting and catch any fraud before it becomes a problem (FRC, 2005).
2002	U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley (R-OH) set up the Corporate and Auditing Accountability and Responsibility Act – Sarbanes-Oxley or SOX	The most contentious aspect of SOX is Section 404, which requires management and the external auditor to report on the adequacy of the company's internal control over financial reporting (ICOFR), which encouraged management to adopt internal control systems, such as COSO.
2004	COSO set up the Enterprise Risk management framework – COSO ERM	COSO ERM set up the principles for risk management how to identify particular events or circumstances relevant to the organisation's objectives (risks and opportunities), assess them in terms of likelihood and magnitude of impact, determine a response strategy, and monitor progress. By identifying and proactively addressing risks and opportunities, business enterprises protect and create value for their stakeholders, including owners, employees, customers, regulators, and society overall.
2004	BCBS published Second Basel Accord (Basel II)	The purpose of Basel II was to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial (credit, market, liquidity) and operational risks banks face.

2.2. Further Development

While multinational and international companies have been promoting various aspects and complexity of risk management, the circulation of 'good practises' was widespread to the level demanding common legal regulations. In this instance, many countries along with regional bodies have issued legislation on risk management or

internal control systems for financial institutions and processes. Yet, the majority of the newly established law has been influenced by the same principles of 'good practices'. For example, certain EU directives and recommendations derive directly from the Basel Accord I and II. Moreover, as the EU law directly affects the regulation of internal control and risk management systems in the Lithuanian financial structures, it was fully implemented in the banking sector and should be executed in the same manner in the rest of the financial sector. Though the EU regulation has been mainly devoted to risk management in the financial institutions, still, the attempt to institutionalise the framework of risk management signifies another crucial stage in the evolution of risk management and its latter transition into the public sector.

Table 2. The evolution of risk management institutionalisation in the EU (Clarke, 2011)

Year	Event / document	Main principles
2002	International Accounting Standards (IAS) Regulation (1606/2002)	It requires publicly traded companies to prepare their consolidated accounts in conformity with international accounting standards (IAS) and international financial reporting standards (IFRS) as adopted by the Commission. The latter requires that the directors' report business review include a requirement to describe the "principal risks and uncertainties" facing the company and its subsidiaries.
2004	Transparency Directive 2004/109/EC	This directive indicates that the annual financial report of listed companies has to include a description of the principal risks and uncertainties that the companies face.
2005	Recommendation 2005/162	The document recommends to establish an audit committee to assist the board in: <ul style="list-style-type: none"> - Reviewing the internal control and risk management systems - Reviewing the effectiveness of external audit process; - Ensuring effectiveness of the internal audit function It also provides that the board should ensure that shareholders are properly informed as regards the affairs of the company, its strategic approach, and the management of risks and conflicts of interest.
2006	The 8th Company Law Directive 2006/43/EC	It establishes that most public interest entities must have audit committees and imposes a duty on audit committees (or alternative bodies) to monitor the effectiveness of companies' internal control, internal audit (if any), and risk management systems.

Year	Event / document	Main principles
2006	Directive 2006/46/EC on Company Reporting	The Directive requires listed companies to include a corporate governance statement in their annual report containing 'a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process'.
2006	Capital Requirements Directive 2006/48/EC	Provides regulation for banker's remuneration policies
2009	Commission Recommendation 2009/384/EC	Elaborates on the regulation of remuneration policies in the financial services sector.

2.3. Transition to Public Management

As has been briefly stated above, there have been several attempts to adopt certain aspects of 'good practices' in public management. The initial efforts have been mainly concerned with the establishment of internal audit framework for the public sector entities (Table 2), yet the biggest breakthrough has been reached when risk management got accepted into the overall public management system and became an integral and fundamental part of the internal control system. This has been first achieved with the Australian and New Zealand Standard (hereafter – AS/NZS) on risk management (2004), which later evolved into internationally recognisable ISO 31000 series standard (2009). Though certain individual countries have tried to promote their risk management frameworks even before the AS/NZS, the latter seems to become more accessible and applicable by the majority of the public sector entities.

Yet, it is important to emphasise that in order to achieve the maximum of risk management potential in the entity, the framework must be more specific and incorporated into overall organisational structure of the entity (Agyeman Manu, 2005). Therefore, the public sector entities are advised only to base their risk management frameworks on the standard ones and further elaborate them in accordance with their needs and features. Thus, currently the adoption of risk management in the public sector has reached the level where public sector entities specify standardised risk management frameworks and issue or recommend issuing (Rudokiene, 2009) legislation that would finally institutionalise risk management in the public management system.

2.4. The Peculiarities of Risk Management Framework in the Public Sector

Though risk management has finally entered the public sector, certain aspects pertaining to the nature of the sector towards the implementation of risk management framework should be taken into consideration. First of all, as the majority of the public sector establishments aims at achieving qualitative, not quantitative, objectives, the establishment of risk management content encounters the problem of developing *risk impact* and *probability* measures (Woods, 2009). In order to solve the former segment of the problem, the

public sector entities can apply two options: either define risk measures for each qualitative criteria (eg. failing to achieve the objectives, loss of reputation, legal procedures against organisation or the management, health issues, etc.) and financial loss, in terms of important, but not always applicable measure of impact; or assign financial figures to each qualitative risk measure, so that every risk can be evaluated in the currency amounts.

As for the risk probability part, normally, it is defined from the internal or external loss event database, yet in the public sector entities loss event data is often insufficient, therefore, the alternative of assessing the level of resistance of the internal control system to the certain risk events (eg. resistance against human error) should be used instead. Though the more explicit the definition of risk measures is, the more confident and comparable risk assessment can be, it tends to complicate risk management process, which then can burden public sector entities and restrain them from their initial activities.

Moreover, due to the qualitative nature of the public sector's objectives, risk assessment has to cope with the *risk evaluation* problem (Woods, 2009), as there is the same need to set up the qualitative evaluation content. Nevertheless, risks can be measured as against the benchmark – the previously established risk tolerance. In that case, risks can be evaluated as low or acceptable and high or unacceptable, where the latter should be considered in accordance with the treatment options. The risks, which need the treatment, should also be prioritised, especially if the entity has limited resources, therefore, only those with highest priority should be considered. On the other hand, considering the complexity of the risk measures in the public sector entities, risk evaluations may be inaccurate and sometimes counterfeited (with or without staff intent). For that reason, to assure the fairness of resource allocation for the risk treatment measures, the risk assessment has to be approved internally and audited. Thus every risk evaluation has to be properly documented and substantial proof for each evaluation criteria has to be collected.

Secondly, the very essence of the public sector's existence can require providing certain services or exercise certain activities that include very high level of unfavourable risks, yet due to legal obligations and moral constraints (Rowe, 2005; Woods, 2009) the public sector entities might be prevented from avoiding them. Same obligations and constraints can also keep entities from taking even favourable and acceptable risks (McPhee, 2005), if those risks fail to comply with the prevailing image of the public sector's mission. Still, the former situation is more problematic, because it creates a tension within the *risk treatment* process, as the public sector entities are expected to put an effort to mitigate unfavourable public risks, yet, at the same time, they have to be prepared to accept those risks at their highest level. As a result, this generates too excessive focus on those risks, what eventually may draw attention from the high, but treatable risks. Therefore, it is advisable for the public sector entities to exclude those high unavoidable risks from the risk management framework at the definition stage, in order to concentrate their attention and resources allocation on the overall risk management process.

All those peculiarities and complexities reveal that risk management in the public sector entities requires more accurate approach together with additional dedication and resources, which sometime are unavailable. Yet the biggest challenge for risk management in the public sector comes from the prevailing incredulous perception towards

risk management among its executives and administrators (Anuntaakalakul, 2010). By switching their attitude from the sceptical to the more positive one and by looking for the solutions or the next best alternatives instead of the problems, the majority of those difficulties may be overcome.

3. Current Situation in Lithuania

3.1. Legal Aspirations

From the legal side, there have been two incomplete allusions launched for the development of the risk management framework within the Lithuanian public sector entities, yet none of the below has evolved into its ultimate institutionalisation. First, the Law on Internal Control and Internal Audit (2002) has been introduced, providing for the internal control system implementation in the public sector entities. Though certain aspects of the regulation of internal control could be perceived as risk management-oriented (as the two notions are sometimes used as synonyms), there is no elaboration on this matter, therefore, it is barely any salvation or achievement. Second, the Ministry of Finance has issued Internal Audit Methodology Sample (2003), Rules of Internal Auditors' Professional Ethics (2003) and Recommendations for Internal Audit (2003) in order to promote the implementation of internal control in the public sector entities with the more exhaustive set of guidelines.

Table 3. Legal institutionalisation of risk management in Lithuania's public sector

Year	Event / document	Main principles
2002	Law on Internal Control and Internal Audit	According to that Law, all public sector entities are obliged to establish and exercise an internal control system based on the peculiarities and specifications of their activities and legal regulation, while the head of the entity is responsible for setting the procedures of internal control in compliance with the purpose of control, possible risks, control permanence and other control factors. The notion of risk has been only partly acknowledged as a ground for internal control.
2003	Internal Audit Methodology Sample; Rules of Internal Auditors' Professional Ethics; Recommendations for Internal Audit	Those enactments recognise the importance of risk management framework implementation in the public sector entities, but only alongside the internal control system. They simply define risk management as a segment of the public sector entity's management process, thus applying rather narrow perception of it.

Though the aforementioned enactments provide with the acknowledgment of risk management framework implementation in the public sector and they even have

binding power towards every public sector entity (with the exception of the Bank of Lithuania), their recommendatory nature leaves it to institutions themselves to decide upon the level of risk management to be incorporated in their internal control systems. Thus, there is no common legal perception of risk management and overall implementation of its framework in the Lithuanian public sector.

In comparison, the acknowledgement of risk management in the legal regulation of financial institutions has reached much higher level. For instance, the Bank of Lithuania, which supervises all credit and payment institutions operating in the country's jurisdiction, carried out Regulation on Internal Control and Risk Assessment (Management) Planning (2008). The latter emphasises the importance of risk management framework implementation on different levels and basically pillars the whole internal control system on it. Same could be said about its Requirements of Internal Control, Risk Management and Financial Security for Payment Institutions (2009). As a result, Lithuanian financial institutions have reached almost the same level as multinational and international companies have, in terms of risk management framework implementation in the internal control system, whereas public sector institutions still struggle with the recognition of the latter (starting from the legal background).

3.2. Cases of Practical Application

Though there is no overall implementation of risk management framework in the Lithuanian public sector, there are certain individual cases, which illustrate the acknowledgement of risk management significance for improving the performance of particular public sector institutions. For instance, the Customs of Lithuania has established risk management conception for the optimisation of internal control system (Stankevicius, 2005). It mainly deals with the optimisation of customs performance, fulfilment of legal obligations and protection from various illegal, unethical and inaccurate activities along with the implementation of the EU requirements. Though it is not highly innovative or original, it still gives the institution a benefit of facing substantial challenges, such as the membership in the Schengen Area.

The Bank of Lithuania is another example of an institution that bases its activities on internal control system and risk management. Moreover, it has developed a very advanced framework of risk management in comparison to other public sector entities. For example, while managing the foreign reserves, the Bank of Lithuania considers all sorts of financial risks, and also includes less acknowledged operational risk (Main Regulations on Foreign Exchange Reserves, 2010). On the other hand, it is almost natural that the Bank of Lithuania has reached comparatively the highest level of risk management framework development as it is its primary objective to make sure that the financial institutions, falling under its supervision and operating in the jurisdiction of Lithuania, would have those frameworks developed. Hence, simply by acting in the field, the Bank of Lithuania, as well as other European central banks managed to grasp those 'good practices' and implement them to a satisfactory level, even without a legal obligation to do so. Therefore, there is a chance that, even without the elaborated leg-

isolation on risk management framework implementation in the public sector entities, certain institutions are able to use their own initiatives to optimise their management.

There are few more institutions that have established a rather developed framework of risk management, however, the majority of them are related to financial or financial control activities, such as the National Audit Office, the Ministry of Finance, the Tax Inspectorate, that is why they are greatly familiar with the notion of risk management and its potential benefits. These entities also promote the development of risk management in other branches of the public sector (Rudokiene, 2009); however, the situation has not been significantly improved yet.

As there is no overall standardised system of internal control or risk management within the public sector, the level of development of risk management framework incorporation into public management differs a lot depending on the awareness and eagerness to be aware of a particular public sector institution. Even internal audit, the most advanced section of internal control, is exposed to the lack of acknowledgement of its importance, insufficient cooperation between internal and external audit executors as well as between different internal audit branches, and the lack of diversity in the area of concern (Rudokiene, 2009). Hence, there is a lot of room for improvement in all sections of internal control along with the risk management framework.

4. Future Perspectives

In terms of the future perspectives of risk management framework implementation into the overall internal control system within the Lithuanian public sector, there are definite possibilities for future improvement, especially with the instant promotion from the highest management offices. Moreover, successful example of the Bank of Lithuania and several other institutions shows that with the spread of 'good practises' the situation may even improve on its own. Therefore, the acknowledgement of incorporation of the risk management framework into the internal control system and its importance for the achievement of effective, efficient and economical performance of the entity, maintenance of its accountability, fulfilment of legal obligations and protection of the state's assets from various illegal, unethical and inaccurate activities (Rudokiene, 2009) will eventually develop. The only problem is that it may take some time, which could better be spent for the achievement of the public sector goals, better allocation of the EU structural funds, implementation of the national anticorruption programme and establishment of strategic management within various public sector entities (Rudokiene, 2009). Indeed, risk management has a great potential in Lithuania's public sector and hopefully it will be ultimately exercised in the near future.

5. Conclusion

The evolution of risk management process has been ignited in the financial sector entities and spread to the other spheres as a 'good practise' of the newly elaborated management framework that enables protecting and creating financial and social

value. Persuaded by the EU law enforcement, acceptance of financial innovations and economic development of the country, Lithuanian public sector entities have started to develop internal risk management function. Yet the level of inclusion of the risk management framework into the overall public management control system remains rather limited (from both, legal and practical, point of view). Moreover, the majority of public managers and administrators are still too sceptical or too little aware of risk management and its benefits. As a result, the Lithuanian public sector does not employ risk management to its ultimate potential and does not benefit enough from it. Yet there is a common tendency that in the long run the Lithuanian public sector will accept and implement risk management into the overall public management system, though it may take some time that could be spent more efficiently instead. Therefore, it is advisable to continue with the promotion of risk management framework among the public sector administrators by emphasizing the 'good practises' as a psychological impulse to open up to change. Besides, further legal institutionalisation might also help with the better acknowledgement of risk management in the public sector entities.

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RIZIKOS VALDYMAS LIETUVOS VIEŠAJAME SEKTORIUJE: ATSPIRTIES TAŠKAS, DABARTINĖ PADĖTIS IR ATEITIES PERSPEKTYVOS

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Santrauka. Straipsnyje s nagrinėjama rizikos valdymo evoliucija ir įdiegimas Lietuvos viešajame sektoriuje. Pagrindinis straipsnio tikslas – nustatyti rizikos valdymo sistemos įdiegimo Lietuvos viešojo sektoriaus vidaus kontrolės sistemoje lygį ir įvertinti rizikos valdymo potencialą šalies viešosios vadybos tobulinimui ateityje. Atlikus tyrimą paaiškėjo, kad tiek teisiškai, tiek praktiškai rizikos valdymo sistemos diegimas viešajame sektoriuje nepasiekė reikiamo lygio.

Tokią situaciją dar labiau pakurstė skeptiškas viešojo sektoriaus vadybininkų ir valdytojų nusistatymas rizikos valdymo atžvilgiu, todėl rizikos valdymo potencialas ir nauda lieka iki galo neišnaudoti. Kita vertus, tikėtina, kad ilgainiui rizikos valdymas įgis daugiau paramos viešajame sektoriuje, ypač jei jo vadybininkai ir administratoriai matys daugiau gerosios praktikos pavyzdžių. Tiesa, šis procesas užtruks, o tai reiškia, kad viešojo sektoriaus ir viešosios vadybos veiklos gerinimo teks siekti ir šį procesą stebėti ilgesnį laiką.

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