

# Risk-Based Approach in Control and Supervisory Activities in the Field of Business

## The Concept of the Law And Problems of Its Application in Russia

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**Abstract**—The article analyzes the regulatory framework for the regulation of control and supervisory activities of business on the basis of materials of the Russian legislation and practice of its application. The authors tried to bring the general theoretical issues as close as possible to the existing problems arising in the course of the risk-based approach in the organization of state control (supervision), to give a detailed description of the warning about the inadmissibility of violation of mandatory requirements.

**Keywords**—*russian entrepreneurial law; state control; government oversight; risk-oriented approach, caution, mandatory requirements*

### I. INTRODUCTION

Today, ensuring the freedom of entrepreneurship is one of the main tasks facing the public authorities of the Russian Federation. The Russian Constitution, which was adopted by popular vote on 12 December 1993, proclaims freedom of economic activity, the right to free use of one's abilities and property for entrepreneurship, as well as the right to private property and guarantees of its protection (articles. 8, 34, 35). These constitutional norms have also been reflected in normative legal acts adopted at both the Federal and regional and local levels of government.

Currently, one of the most important for business entities is the Federal law of December 26, 2008 No 294-FZ «On protection of the rights of legal entities and individual entrepreneurs in the implementation of state control (supervision) and municipal control» (hereinafter – the Law on protection of rights). According to the researchers, the law was widely used in the development of law enforcement practices of other States, borrowed some legislative mechanisms to protect businesses in the conduct of control and Supervisory activities [1]. It was assumed that this law

was supposed to incorporate the best foreign practice, reduce state pressure on business and systematize numerous normative legal acts in the field of state control (supervision). This is evidenced by both the name of the law and the principles of protection of the rights of legal entities, individual entrepreneurs in the exercise of state control (supervision), referred to in article 3 of the Law on protection of rights.

Meanwhile, as it often happens, the practice of application of the law has shown that it does not actually fulfill the goals and objectives provided for in its adoption and aimed at limiting unjustified inspections and ensuring the rights and legitimate interests of entrepreneurs [2]. In our view, there are three main reasons for this.

First, the existence of legislative defects, especially gaps, which are skillfully used by officials of control and Supervisory bodies. Secondly, the law contains a significant number of blanket rules referring to other legislative or subordinate acts. As a result, the Law on protection of rights has become largely a framework, since the relations in the sphere of control and supervision are regulated by more than 100 normative legal acts of various levels. As a rule, the main arguments for the adoption of additional acts is an indication of the increased public importance of control powers, the inadmissibility of emergency situations of man-made and other nature. Of course, the state should not weaken its activities to ensure public and national security, but to ignore the interests of entrepreneurs in the exercise of control is also unacceptable. Third, the Law on protection of rights does not cover a significant number of types of state control and supervision. Thus, paragraph 3 of article 1 of the law specifies the types of control and supervision to which the rules establishing the procedure for organizing and conducting inspections do not apply.

In addition, article 1, paragraph 3.1, also provides for exemptions from the scope of the law. In accordance with this provision, the Law on protection of rights does not apply, for example, to the most important types of control and supervision for entrepreneurs such as: tax, currency, customs control; control over the payment of insurance contributions to state extra-budgetary funds; control and supervision in the financial and budgetary sphere; control in the financial markets; banking and insurance supervision; state control over economic concentration, etc.

## II. METHODS AND MATERIALS

The methodological basis of the present study was: general (dialectical) method of cognition, general methods of formal logic, some general scientific methods of research, as well as the actual private scientific methods of jurisprudence (formal logical method of interpretation of law, dogmatic method). Applying the specified set of methods the complex and comprehensive analysis of the investigated phenomenon was carried out, shortcomings of legal regulation were defined and offers on improvement of the legislation on control and Supervisory activity were formulated.

From the legal point of view, the most topical issues of research in the field of state regulation and control of business are the following problems (as far as it can be seen from publications in leading scientific journals).

First of all, the view that corporations should engage in socially responsible business practices, also known as corporate social responsibility, is a cornerstone. This provision has become an integral part of legislation and business. Relevant issues are the subject of a separate area of research [3, 4].

In addition, the legal literature examines the question of the admissibility of the appeal of the inaction of the state body in the development of mandatory requirements. Theoretical analysis is based on a specific case. The U.S.A. Supreme court's decision in «Massachusetts against EPA» requires the Federal government to reconsider its refusal to regulate greenhouse gases as air pollutants. Despite the importance of this type of judicial review, it has received little analysis by scholars, and the case law in the field is confused. Accordingly, there are serious questions about the nature and scope of judicial review of agency decisions not to act — with some scholars and leading judges calling for sharp limitations on this type of judicial review to protect «individual liberty» [5].

The issue of the effectiveness of state control and supervision is not unfounded. For example, researchers pose the following questions: Why has the information security law been unsuccessful in having firms in possession of personal data take precautions against data breaches? Why are data breaches becoming more devastating not with standing law enforcement? Researchers seeks an answer from the legal system's failure to draw a line between agency problems and externalities inherent in the information security market [6].

A good experience is a separate legal orders, in accordance with which the state creates first of all incentives to good faith

compliance with the mandatory requirements. State-level statutes provide firms that engage in environmental self-audits, and that self-report their environmental violations, a variety of regulatory rewards, including «immunity» from penalties and «privilege» for information contained in self-audits. Scientists studies a panel of state-level industries from 1989 through 2003, to determine the effects of the different types of statutes on toxic pollution and government inspections. They find that, by encouraging self-auditing, privilege protections tend to reduce pollution and government enforcement activity; however, sweeping immunity protections, by reducing firms' pollution prevention incentives, raise toxic pollution and government inspection oversight [7].

Unique is the study of the effectiveness of Federal and regional control in the field of labor protection in the construction industry on the example of American law enforcement. Comparative analysis has been made possible by a unique historical anomaly in the U.S.A, where some States have the right to apply protective labor standards, while in other States the Federal office of occupational safety and health applies the relevant rules [8].

In the scientific legal doctrine discusses the issues of delegation of functions of state control of state companies. As a rule, such use of government-owned or state-controlled companies to perform state regulatory functions is critically assessed [9].

## III. RESULTS

Internal and external control in the field of entrepreneurship. In the modern market economy, the system of control of entrepreneurial activity operates at two main levels – internal and external. Both of these levels should work efficiently and with minimal pressure on the business. In this regard, there are internal and external risks. In addition, for each of the selected levels, different legal regulation should be applied [10].

Internal control in the field of entrepreneurship is characterized by the following features. Article 19 of the Federal law of December 6, 2011 No 402-FZ «On accounting» establishes the norm according to which an economic entity is obliged to exercise internal control over the facts of economic life. Internal control is associated with internal risks. Their management is engaged in the economic entity represented by internal auditors (persons in the state of the organization or individual entrepreneur). To regulate the activities of internal auditors, an economic entity issues local acts. The responsibilities of such auditors include the identification, assessment of risks, as well as proposals for their minimization or elimination. If the accounting (financial) statements of an economic entity are subject to mandatory audit, it is obliged to organize and carry out internal control of accounting and preparation of accounting (financial) statements. An exception is the case when the head of an economic entity has assumed the responsibility of accounting.

The need for internal control is also related to the fact that the separation of control and ownership functions is widespread. Therefore, a small group is able to effectively control the company, although it owns a minority of rights to

cash flows. Such a control group is expected to use its position to consume excessive amounts of the firm's profits, and this is detrimental to minority shareholders [11].

External control of business is characterized by the following features. The state, represented by its Supervisory authorities, regulates external risks. The modern policy of any state that encourages entrepreneurial activity should be aimed at liberalizing relations in the field of entrepreneurship, as well as optimizing the activities of regulatory authorities. One of the directions of such policy is the application of risk-based approach in the organization of state control (supervision).

The concept of risk-based approach in the control and supervisory activities in the business. The objectives of the risk-based approach in the control and supervisory activities are:

- optimization of the use of labor, material and financial resources involved in the implementation of state control (supervision);
- reduction of costs of legal entities and individual entrepreneurs;
- improving the effectiveness of control and oversight activities.

The legal definition of risk-based approach is given in paragraph 2 of article 8.1 of the Law on protection of rights. Based on this definition, it can be concluded that the risk-based approach is that the activities of business entities (or production facilities that they use) should be attributed to a certain risk category or hazard class. The relevant hazard and risk categories are established taking into account the severity of the potential negative consequences of possible non-compliance with mandatory requirements, as well as the assessment of the probability of non-compliance with the relevant mandatory requirements (part 3 of article 8.1 of the Law on protection of rights). This is done solely for the purpose of organizing monitoring activities. In particular, this circumstance directly affects the frequency of scheduled inspections of the organization or individual entrepreneur. The higher risk category (hazard class) is checked more often, and the lower – less often.

The procedure for classifying the activities of organizations or individual entrepreneurs (or objects used by them) to a certain risk category or hazard class is established in the Rules approved by the government Of the Russian Federation dated August 17, 2016 No 806. Criteria of reference of activity of legal entities, individual entrepreneurs (or the production objects used by them) to a certain category of risk or to a certain class (category) of danger at the organization of regional state control (supervision) are defined by the Supreme Executive body of the government of the subject of the Russian Federation if such criteria are not established by the Federal law or the Government of the Russian Federation.

Note that if the activities of an organization or an individual entrepreneur (or objects that they use) can be attributed to different risk categories (hazard classes), then a higher category (class) will be assigned. In the event that a

risk category (hazard class) is not assigned, such activity (facilities) will be considered to be assigned to the lowest risk category or hazard class.

If an economic entity does not agree with the risk category assigned to it, it has the right to apply for its change to the appropriate Supervisory authority. The application should be accompanied by documents that indicate that the activities of an economic entity or objects used belong to a different risk category or hazard class. Within 15 working days from the date of receipt of the application, the relevant authority shall consider the application and satisfy it and change the risk category or refuse to do so. Within three days from the date of the decision, the economic entity shall be notified. The decision to refuse must state the reasons for the refusal. An economic entity may appeal against a decision to refuse an administrative or judicial procedure.

Scope of application of risk-based approach in control and Supervisory activities. The risk-based approach is not comprehensive in the state's control and oversight activities. On the contrary, it is used in strictly defined cases. Government resolution No 806 of 17 August 2016 approved the List of types of state control (supervision) that are carried out using a risk-based approach. The legal literature reasonably notes that the use of a risk-based approach to the planning of control and Supervisory activities is considered as an exception to the general rule. Meanwhile, it should be noted that when planning the control work, a «risk-oriented approach» is actually always implemented, even if it is not formalized and so is not called [12].

The risk-based approach is used in a sufficiently large number of inspections. Currently, this List contains 32 items, including: Federal state fire supervision, Federal state sanitary and epidemiological supervision, Federal state supervision in the field of communications, Federal state supervision over compliance with labor legislation and other normative legal acts containing the norms of labor law, Federal state control (supervision) in the field of migration, Federal state supervision in the field of road safety, Federal state environmental supervision, state land supervision, Federal state transport supervision, Federal state control (supervision) in the field of transport security, control over compliance with the legislation on the contract system in the procurement of goods, works, services for state and municipal needs, etc .

It should be noted that regional audits conducted using a risk-based approach can be established at the level of the subject of the Russian Federation by the Supreme Executive body of the state power of the subject of the Russian Federation. The government of the Russian Federation has the right to determine the types of regional state control (supervision), in the organization of which the risk-oriented approach is mandatory.

#### IV. DISCUSSION

Distinction between the concepts of «control» and «supervision». The law on protection of rights uses two unequal concepts – control and supervision, but does not disclose their content. It follows from the law that only municipal control can be exercised by local self-government

bodies, while state authorities can exercise both control and supervision.

In the scientific literature, since the Soviet period, attempts were made to distinguish these concepts. Different authors proposed different criteria for their relationship. There were also those who expressed an opinion about the identity of these concepts. In our opinion, the most common today are two concepts – «the theory of the object» and «the theory of the subject».

The first theory comes when distinguishing between concepts of the considered criterion, which characterizes the inspection object. Thus, it is concluded that in the implementation of control the range of objects, as a rule, is defined. In exercising oversight of the range of objects, by contrast, is clearly not pre-determined, though limited to the subject of the reference of the body concerned.

The second theory is the basis of the differentiation of concepts puts the characteristics of the relationship between the subjects of control and Supervisory relations. Control is carried out in respect of the subordinate bodies and individuals, while supervision, by contrast, does not imply the existence of relations of subordination.

It seems that it is necessary at the legislative level to consistently make a distinction between these concepts, which will require further determination of the functional orientation of the control and Supervisory bodies.

The legal nature of the warning about the inadmissibility of violation of mandatory requirements, as well as requirements established by municipal legal acts. Problems of protection of the rights of legal entities and individual entrepreneurs in the implementation of control and Supervisory activities of the authorities have long been discussed in the scientific and practical circles of the legal community. Amendments to the Law on the protection of rights is constantly made, however, to call these qualitative changes is not always possible. In order to reduce administrative pressure on entrepreneurs and simplify some of the verification procedures, the legislator has introduced provisions on the organization and implementation of measures aimed at preventing violations and control measures without interaction with legal entities and individual entrepreneurs. At the same time, analyzing practical implementation of these rules, it is necessary to state their problem in view of lack of necessary clarity and unambiguity of instructions.

Thus, in accordance with paragraph 5 of article 8.2 of the Law on the protection of rights, the competent authority, under certain conditions, declares to the entrepreneur a warning about the inadmissibility of violation of requirements and proposes to take measures to ensure compliance. First of all, attention is drawn to the legal nature of the warning, because of the literal interpretation of the relevant provisions of the law, it is unclear and law enforcement practice on appeal against such decisions of the authorities indicates its ambiguous understanding.

For example, the Arbitration court of the West Siberian district considers that the warning does not possess signs of

the abnormal legal act, therefore, is not that, and cannot be appealed in the order established by Chapter 24 of the Arbitration Procedural Code of the Russian Federation of July 24, 2002 No 95-FZ (further –APC of the Russian Federation). The warning does not contain power and administrative instructions, does not establish the fact of violation and does not create obstacles for implementation by the applicant of economic activity. This interpretation of the legal nature of the warning led the court to conclude that it does not give rise to an economic dispute, as it contains only a proposal to eliminate the identified violations in order to prevent possible violations (Resolution of the Arbitration court of the West Siberian district of January 14, 2019 No F07-16418/2018 in the case No A44-5719/2018). The same position is held by the Arbitration court of the Central district, pointing out that the warning «is preventive in nature and does not violate the rights» (the Decision of the Arbitration court of the Central district of October 12, 2018 No F10-4294/2018 in the case No A83-22874/2017).

Another conclusion regarding the legal assessment of the caution was reached by the arbitration courts of the East Siberian and Volga districts. According to them, the warning does not apply to the category of non-normative legal acts, but is a decision of an authority that can be recognized illegal and cancelled on the ground at the proof of the fact of violation of rights and legitimate interests of the applicant (the Decision of Arbitration court of the Volga district from June 15, 2018 No F06-33965/2018 in case number A06-5948/2017, the Decision of Arbitration court of East Siberian district from 26 February 2019 number F02-185/2019 in case number A19-13269/2018). The Arbitration court of the East Siberian district explained its position by the fact that the warning imposes an obligation on the economic entity, including affecting the possibility of further activities. In this regard, the dispute is subject to arbitration and is considered under the rules of Chapter 24 of the APC.

With the position of these courts in terms of the admissibility of challenging warnings in the order of Chapter 24 of the APC should agree, because according to the rules of Chapter 24 of the APC is allowed to challenge not only non-normative legal acts, but also decisions and actions of authorities.

There is no agreement on the issue under consideration and between the authorities. In this regard, an example is illustrative where the territorial administrations of one Federal authority defend opposing views on the legal nature of the warning. The office of the Federal service for supervision of consumer rights protection and human welfare in the Irkutsk region, acting as a party to the arbitration dispute, did not recognize the warning as a non-normative legal act, since its failure does not entail any sanctions for the entrepreneur (Resolution of the Arbitration court of the East Siberian district of February 26, 2019 No F02-185/2019 in the case No A19-13269/2018). The office of the Federal service for supervision of consumer rights protection and human welfare in the Volgograd region, on the contrary, considers the warning an act of the authority, subject to mandatory execution. In case of failure to take measures to implement the declared warning, the state control (supervision) body is

obliged to take measures to bring the economic entity to administrative responsibility for failure to provide relevant information.

So what is the legal nature of the warning? To what category of acts of authorities (non-normative legal act, decision or action) it should be attributed? The answer to these questions directly depends on the behavior of the economic entity and the authority that issued the warning.

We believe that the interpretation of the warning as an action of the authority can be immediately set aside in view of the obvious insolvency, and other positions deserve careful consideration, and, above all, the question of how the decision of the authority differs from the non-normative legal act.

As it known, a non-normative legal act, unlike a normative one, is deprived of the property of General validity, being an act of individual regulation, it orders a specific (single) relation, which is why it is not recognized, as a General rule, as a source of law, since it is adopted on the basis of existing legal norms. In the theory of law in the category of non-normative acts a special group consists of law enforcement acts [13, 14]. Such acts are, as a rule, a consequence of the need for the use of state coercion, and are therefore binding on the addressee.

The term decision in legal reality is understood in several aspects depending on the situation:

first, as the content of the operative part of the law enforcement act;

secondly, as an independent legal document, including a law enforcement act (court decision, decision of the General meeting of shareholders, etc.);

third, as a General term for administrative documents (order, order, resolution, etc.), which can be both normative and non-normative acts, including law enforcement.

Thus, in our view, the term «decision of the authority» also covers the term «non-normative legal act». But even if we do not go into a discussion about this, we can conclude that the decision of the authority and the non-normative legal act emanating from the authority may have the same legal nature of the law enforcement act.

Returning to the issue of caution, it should be noted that it is certainly a decision-a law enforcement act. Otherwise, there is a ridiculous situation in which the act of the competent authority, which contains an order to perform certain actions, can be carried out at the discretion of the addressee. It's nonsense. A similar point of view is expressed in the legal doctrine [15].

We believe that the law enforcers who consider the warning to be an act subject to mandatory execution under the threat of administrative responsibility are absolutely right. Another question, which of the compositions provided by the Code of Administrative Offences of 30 December 2001 No 195-FZ (hereinafter – the administrative Code)?

In our opinion, several formulations are applicable to the considered situation of non-fulfillment of the warning:

– article 19.4 «Disobedience to the legal order of the official of the body exercising state supervision (control), the official of the organization authorized according to Federal laws on implementation of the state supervision, the official of the body exercising municipal control»;

– article 19.5 «failure to Comply with the legal order (resolution, submission, decision) of the body (official) exercising state supervision (control), the organization authorized in accordance with Federal laws to exercise state supervision (official), the body (official) exercising municipal control»;

– article 19.7 «failure to Provide information (information)».

In our opinion, the offense under article 19.5 and 19.7 of the administrative offences code of the Russian Federation in a greater degree correspond to the present situation. At the same time, failure to comply with a warning within the prescribed period gives grounds to bring an economic entity to administrative responsibility under article 19.5 of the administrative Code, and failure to provide the competent authority with information on the execution of the executed warning – under article 19.7 of the administrative Code. At the same time, compliance with the principle of legal certainty requires clarity and unambiguity of regulatory legal acts. It seems that without making appropriate additions to the administrative Code will not do.

Another aspect that I would like to focus on is the incorrect use of terminology, as it seems to us. Article 8.2 of the Law on protection of rights uses the words « mandatory requirements» and «requirements established by municipal legal acts». When reading the question arises: the requirements established by municipal legal acts are not binding? If they are not binding, on what basis can the Supervisory authority issue a warning against their violation? This is another good example of how ambiguous language can lead to a distorted perception of the rule.

## V. CONCLUSION

An analysis of law enforcement practice and generalization of scientific works shows that the current Protection of Rights Act requires improvement. We believe that it is promising to expand the scope of the risk-based approach in the control and Supervisory activities of the state. In this regard, it is necessary to support the initiative of the President of the Russian Federation, who instructed the Government of Russia, with the participation of leading business associations of entrepreneurs, to ensure the introduction of amendments to the legislation providing for the abolition from January 1, 2021 of all regulatory legal acts establishing requirements, compliance with which is subject to verification in the implementation of state control (supervision). Instead, the President of Russia proposes to introduce new rules containing updated requirements, developed taking into account the risk-based approach and the current level of technological development in the relevant areas.

On the basis of this instruction, the Government of the Russian Federation approved an action plan («a road map»)

for the implementation of these initiatives. In particular, the plan provides for the establishment of a uniform procedure and time frame for the development of an appropriate regulatory framework. It is planned to prepare a new law on control and Supervisory activities (the Federal law «On state control (supervision) and municipal control in the Russian Federation»), a new regulatory structure for each sphere of public relations or type of control, updating and systematization of mandatory requirements, including in certain areas.

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