

# AusGuideline

General guidance

## 6.3 Managing risk

### **Associated 'General guidance'**

AusGuideline 6.1 *Preparing terms of reference*

AusGuideline 6.2 *Planning and managing in-country missions*

AusGuideline 6.4 *Promoting practical sustainability*

AusGuideline 6.5 *Activity quality standards*

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# 1 Managing risk in the AusAID context

## 1.1 Introduction

Delivering the aid program is inherently risky, involving multiple relationships, complex contractual arrangements and difficult development problems. Risk management helps recognise and prepare for a range of possible future outcomes. Hence managing risk is an integral part of AusAID's approach to activity preparation and management. It is also an important part of the Australian public sector reform agenda and of the accountability requirements of AusAID.

Ongoing changes in AusAID's policies, activities and practices mean AusAID's risk management policies and practices also need to evolve. AusAID's overall risk management policy and risk management guidance is set out in AusAID Circular No.29 *AusAID Risk Management Policy*, 8 November 1999 and is being updated for release in 2006.

In AusAID, managing risk has three dimensions

- at the activity level
- at the portfolio level, involving managing risk across a diverse range of activities primarily from the post's perspective and requires preparation of a Portfolio Monitoring Plan (PMP), the successor to the Country Portfolio Risk Assessment and Monitoring Plan (CPRAMP)
- managing risks and fraud that might occur within AusAID itself, involving use of the Post Risk and Fraud Management Plan (RFMP) tool.

This AusGuideline 6.3, *Managing Risk*, primarily covers risk management at the activity level, though also touches on the other two dimensions. Risk management during the various stages of an activity's life is also covered in other parts of AusGuide, particularly AusGuide Part 4 *Activity Implementation*.

At the activity level, risk assessment starts at the beginning of the activity identification process and goes all the way through to activity evaluation. Risks that are identified in activity identification and assessment or at the activity preparation stage need to be managed during activity implementation. At appraisal, an assessment needs to be made whether an activity design correctly identifies risk and proposes adequate measures to deal with it. Risk profiles and the priority risks to be managed change as activity development proceeds, resulting in an updating of the risk management matrix (See Annex 1 *Risk management matrix for an activity*). Thus risk management needs to be continually monitored and periodically re-

assessed over the life of the activity. Risk management does not end once an activity is completed. One of the tasks of evaluation is to draw lessons on how risks were managed over the life of the activity.

## 1.2 What is risk?

For AusAID, risk is defined as the chance of things happening that could have an impact on AusAID, on the outcomes it achieves, or on the objectives of the various functions it undertakes.

Risk arises out of uncertainty. When deciding on a course of action, there is a need to manage the risks arising out of this uncertainty. Two elements of risk to be considered are:

- the likelihood of something desirable or undesirable happening and
- the likely consequences if any one or all of the things that could happen do eventuate.

Risks can arise from both internal and external sources. They could include:

- adverse change in economic factors such as exchange rates
- incorrect assumptions regarding activity logic or sustainability considerations
- client dissatisfaction or unfavourable publicity
- a threat to physical safety or breach of security
- mismanagement
- failure of the partner government to meet its contributions to the activity
- failure of equipment
- a breach of legal or contractual responsibility and
- fraud and deficiencies in financial controls and reporting.

More detailed listings of various risk categories and sources of risk are set out in Annexes D and E.

While it is not possible to have a totally risk-free environment, it may be possible to avoid, reduce, eliminate or transfer some of the risks. In fact, if the risks to successful outcomes identified at design are too high and cannot be adequately treated, an activity might not proceed. This emphasises the importance of initial risk assessment at the design stage.

## 1.3 What is risk management?

‘Risk management’ consists of a systematic process of assessing and then dealing with risk. This is described in more detail in the following diagram. The process entails consideration of the context, followed by identification, analysis, evaluation, and treatment of risks. It is an

iterative process that also involves monitoring and review, and can usefully encompass a dialogue with stakeholders along the way.

Risk management provides structured systems for identifying and analysing potential risks, and devising and implementing responses appropriate to their impact. The responses generally draw on strategies of risk prevention, risk transfer, impact mitigation or risk acceptance (see Step 3 below for more details on each type of response). Within a single activity or proposal, a mix of each of these strategies may have application for different individual risks.

## 1.4 What are the benefits of managing risk?

The benefits of managing risk at the program level are:

- more effective strategic planning as a result of increased knowledge and understanding of key risk exposures
- fewer costly surprises, by preventing what is undesirable from occurring
- better outcomes in terms of program sustainability, effectiveness and efficiency and
- greater openness and transparency in decision-making and ongoing management processes.

The benefits of managing risk at the activity level include:

- activities are more efficiently and effectively managed because advisers and stakeholders understand the activity's vulnerability to risk and take adequate preventative or mitigation measures
- fewer costly surprises in activity implementation
- more likelihood of activities attaining their objectives because constraints are minimised and opportunities maximised
- more likelihood of outcomes being sustainable and
- greater openness and transparency in activity decision making and management processes.

Effective risk management contributes to improved governance, which can be a development objective in its own right.

## 1.5 Risk management and the activity stages

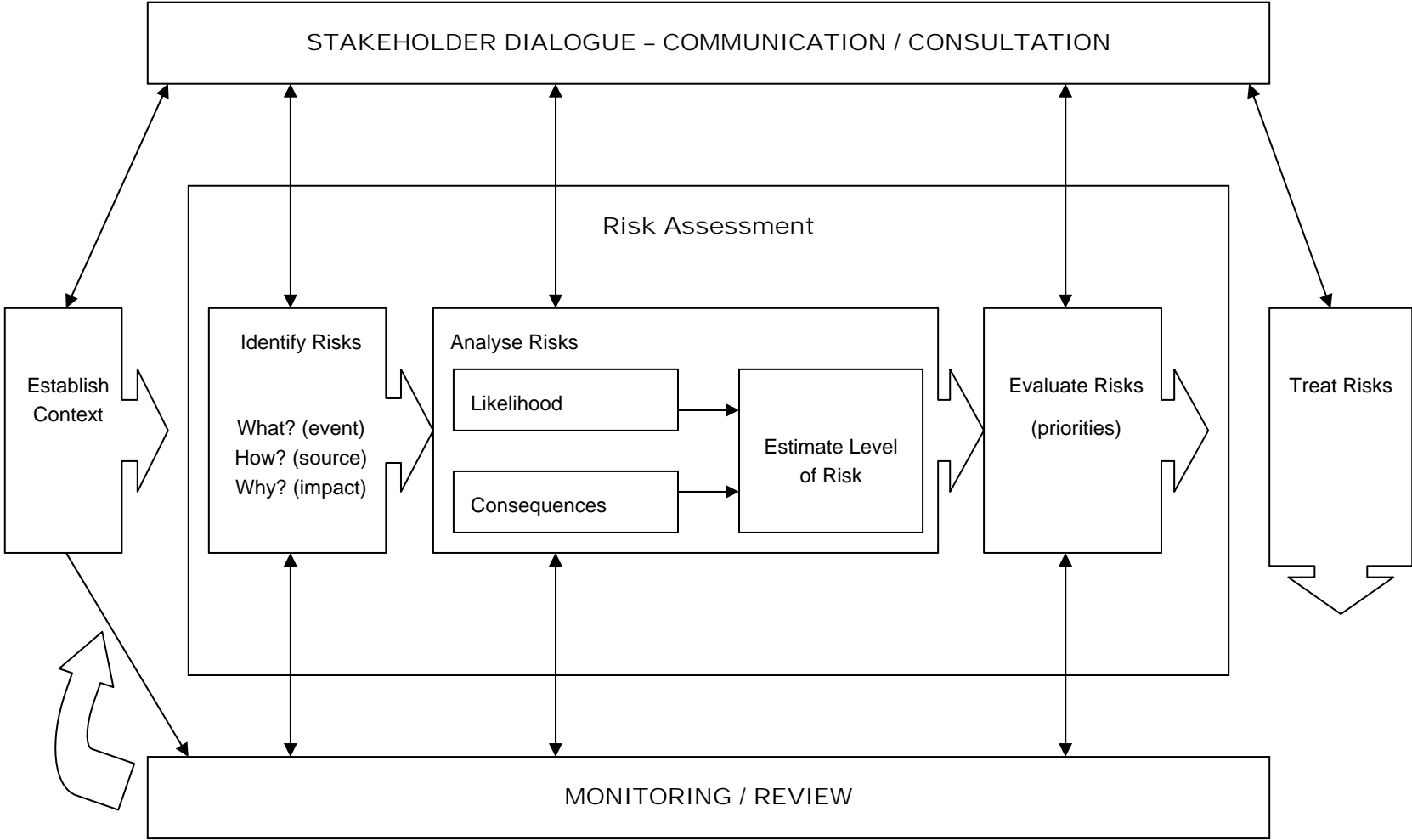
AusAID requires a risk management approach to be developed for all stages of the activity's life. Individual guidelines for each stage contain information on the risk management strategies implicit in the stage. Broadly, risk management takes place at:

- Activity identification and initial assessment. Activities identified can be based on a program or country strategy that includes risk management considerations.

Activities with obviously unacceptable risk levels will be screened from the pipeline. Otherwise major risk areas will be identified.

- Preliminary activity preparation. A preliminary identification of likely risk areas and assessment of their importance is made.
- Detailed activity preparation. A full risk assessment is developed which can be used by implementers in managing risk.
- Appraisal. The risk assessment is verified either through desk or field appraisal activities, and risk management strategies are assessed for their plausibility. The design is assessed for its ability to cope with risks as identified.
- Implementation. The risk assessment is updated and refined, and a full risk management plan formulated. Risk monitoring occurs periodically and when contingencies require. Risk management strategies are implemented.
- Review. The success of the risk management strategy and plan in dealing with contingencies is gauged and suggestions are made for changes or refinements. In extreme cases, activities may be terminated based on this assessment and
- Evaluation. The risk management plan and strategy are evaluated and their overall efficiency in dealing with risk is measured against risks known to have occurred. Lessons are drawn from this for future activities.

Risk management cycle



## 2 The risk management process

As shown in the diagram above, the risk management process is itself a repeating cyclical process that can be adapted and applied at various stages of the activity's life. For example, consultation with stakeholders on risk can be a very useful mechanism for assisting stakeholder dialogue on activity matters more generally.

Identifying risks commences with activity identification and assessment. At this stage, it would be expected that only major or obvious risks have been identified. If the overall level of risks is too great, the activity or proposal may not proceed further in activity preparation. See AusGuide Part 3A *Identification & assessment of initiatives*.

For an activity design to proceed to implementation, AusAID needs to be assured that risks that have been identified can be managed satisfactorily. Risk assessment and initial risk management planning are therefore an important part of the activity preparation process. An expected outcome of prefeasibility studies is a preliminary identification of likely risk areas and an assessment of their importance and controllability as set out in AusGuideline 3.4 *Undertaking a prefeasibility study*. If there are significant, unmanageable risk areas, AusAID may decide not to proceed.

At the feasibility and design stage, missions are expected to develop a full risk assessment, which can later be used for managing risk. See AusGuideline 3.5 *Undertaking a feasibility and design study*. For small activities, the risk management plan should be developed as part of the design process by the design team.

For large, complex activities that may be perceived to carry significant risk, or as a routine means of gathering stakeholder views, risk management workshops can be held as part of the activity design process. A professional facilitator may be employed to manage the workshop and produce the risk management plan. A risk management workshop can be convened:

- as part of a feasibility and design study (AusAID would need to pre-arrange this with the partner government);
- after the draft activity design documentation has been submitted and before appraisal commences or
- as a result of the appraisal process and before the activity is submitted for tender.

A variation of this approach is to have the design team identify the activity risks. A list of the activity risks is then included in the tender documentation and a risk management plan is submitted by contractors as part of their bid. The risk management plan is evaluated by the

technical assessment panel (TAP) in the selection process. Under this approach, it is advisable to ensure that a range of views is taken account of somehow at some stage (including target beneficiary, partners and contract delivery perspectives). If not, the assessment may miss some important aspects of risk.

The end result of this process is that for each activity, risks will have been identified and appropriate responses planned prior to commencement of implementation.

The risk management process is presented below as a five-step process in the life of the activity. The AUSAID model (above) also envisages monitoring and review, and stakeholder consultation and communication, are options that may assist at each stage.

The five steps commence at the activity design stage. Steps 1 to 3 may be completed before activity implementation. Step 5 includes a review loop whereby the risk assessments and responses can be periodically re-evaluated.

The implementing contractor or other delivery organisation should then have the opportunity to update the risk assessment and risk response planning during the first phase of activity implementation. The risk management plan should be approved, either as part of the tender approval process or as part of the preparation and approval of the first annual plan.

The tendering and contracting strategies need to be determined in conjunction with the Consultancy Support Group (CSG). AusAID will sometimes identify risks prior to tender and at other times ask the bidders to identify risks in the request for tender (RFT). Prospective contractors may be given opportunity to input on an exposure draft of the design brief. The emphasis on inputs or outputs as the basis for the contract and other factors such as probity and tendering issues will determine the participative process adopted.

As a general rule, it is desirable that, at some stage, the views of implementing contractors or other delivery organisations be reflected in the risk identification and assessment. The contract should provide for regular review and consultation on risks to the activity and include clear communication on respective risk management responsibilities.

The steps outlined below should serve as a guide, but may be adapted to suit the needs of individual activities.

<b>Step 1</b>	<b>Step 2</b>	<b>Step 3</b>	<b>Step 4</b>	<b>Step 5</b>
<b><i>Familiarity with activity design</i></b>	<b><i>Risk assessment</i></b>	<b><i>Risk response planning</i></b>	<b><i>Reporting</i></b>	<b><i>Implementing</i></b>
Consider strategic objectives and context. Consider performance indicators Consider key elements or components.	Identify risks. Analyse risks. Rank risks. Screen minor risks.	Identify responses to risks. Select best response.	Write risk management plan.	Implement risk management plan. Monitor and communicate risks. Review and re-evaluate.

## Step 1 Familiarity with activity design and logframe

As a preparatory step to risk assessment and management, it is important to develop familiarity with the proposed activity and identify the key parameters and assumptions. This will be facilitated if the design team also undertakes the risk assessment. At design stage, risk assessment can often commence with the activity's logical framework. Guidance on developing a logical framework is provided in AusGuideline 3.3 *The logical framework approach*. Guidance on designing activities is provided in AusGuide Part 3B *Preparing activity designs*.

### Consider the activity's objectives

This involves becoming familiar with the nature and scope of the activity, its key objectives, and how the activity fits within higher-level program or sector objectives. This means examining the activity goal and purpose levels of the logical framework. This step links risk management into AusAID's main strategic plans for a country program area, into the national, regional or sectoral policies and into the policies and programs of the partner government. Some strategic areas are more risky than others for the implementation of development activities. Understanding this variability is a precursor to managing risks for development programs and activities.

### Consider performance indicators

The assessment criteria for a program or activity are concerned with how well its objectives will be met and the appropriateness of these objectives. They will reflect the principal purposes of the activity and its means of execution and assist in defining key elements. Assessment criteria are the performance indicators chosen to monitor an activity. Any risk to achieving the desired performance targets therefore represents a risk to achieving the activity's objectives.

The indicators chosen can also include indicators of risk itself. If, for instance there is a high chance of problems with budgetary allocations for an activity, performance indicators should be included that measure the timeliness, availability and completeness of promised contributions. If there is a high chance of technical failure of an element of an activity, performance indicators should be included to ensure that management is alerted to problems before they can become significant.

Understanding performance indicators is an essential prerequisite to understanding risk. Risk assessment may also provoke changes or refinements to performance indicators in the logical framework.

#### Consider key elements or components

The logical framework approach usually results in an activity in which a number of components have been identified. Component structure usually reflects sub-sectoral, institutional or functional sets of activities. Understanding the component structure and the outputs the activity aims to achieve is a prerequisite for accurate risk assessment.

A broad view of the activity at this stage is more appropriate than a detailed one to avoid a loss of focus on the main issues and to establish a balanced framework for the analysis.

#### Consider context

The situational analysis undertaken as part of the logical framework approach can include both the internal (strengths and weaknesses) and external (opportunities and threats) environments. A short and simple SWOT analysis can be an excellent means of initially considering context of the risk assessment. For example, it can be used as a brief introductory session at stakeholder workshops convened to assess risks.

#### Consultation and communication with stakeholders

An important aspect of risk management is to ensure appropriate communication and consultation with stakeholders. Stakeholders will have perceptions of risks that can be useful in the risk assessment stages. In developing risk responses, it is also desirable to consider communication strategies for both internal and external stakeholders.

A stakeholder analysis undertaken as part of the logical framework analysis is an important part of risk management. AusAID's Risk Management Policy (Circular No.29 of 8 November 1999) defines 'stakeholder' as including people or organisations who may affect, be affected by, or perceive themselves to be affected by, a decision or activity. External stakeholders for the aid program can include partner governments, delivery agencies, contractors, and beneficiaries. *Consultation* on risks is especially important in risk

assessment (Steps 1 and 2) whilst *communication* about risks is important in risk treatment (Steps 3 to 5).

Consider logical framework assumptions

With a broad understanding of the risks involved in achieving objectives, the component structure and associated performance indicators, activity designers are in a good position to carry out a full risk assessment. The key element of the logical framework is now the assumptions column.

Assumptions refer to conditions which could affect the progress or success of the activity, but over which the activity manager has no direct control. They form the right hand column of the logical framework. Risks are the negative statement of assumptions. AusGuideline 3.3 *The Logical Framework Approach* includes a discussion on the relationship between assumptions and risks, and on undertaking situational and stakeholder analyses.

Not all activity risks necessarily have links to the logical framework. However, turning assumptions into risks is one key part of risk identification given the logical framework approach aims to include those key assumptions which affect the performance of the activity at the various levels (from input to activity to output to outcomes (purpose and goal)).

## Step 2 Risk assessment

The risk assessment process consists of three steps. These are:

- identifying risks
- analysing their likelihood or consequences and
- ranking risks against priority criteria.

Risk assessment initially occurs during preparation and will be tested during appraisal.

During implementation, it will be incorporated into a risk matrix and activity risk management plan and regularly updated.

### Identifying risks

The assessment will consider the risks that might affect each key element of the activity. The aim is to generate a comprehensive list of the relevant risks and document what each one involves. As suggested in Step 1, a key part of the identification process is to consider the logical framework assumptions.

In addition to using the logical framework, there are various other ways in which risks can be identified that should also be considered. For example,

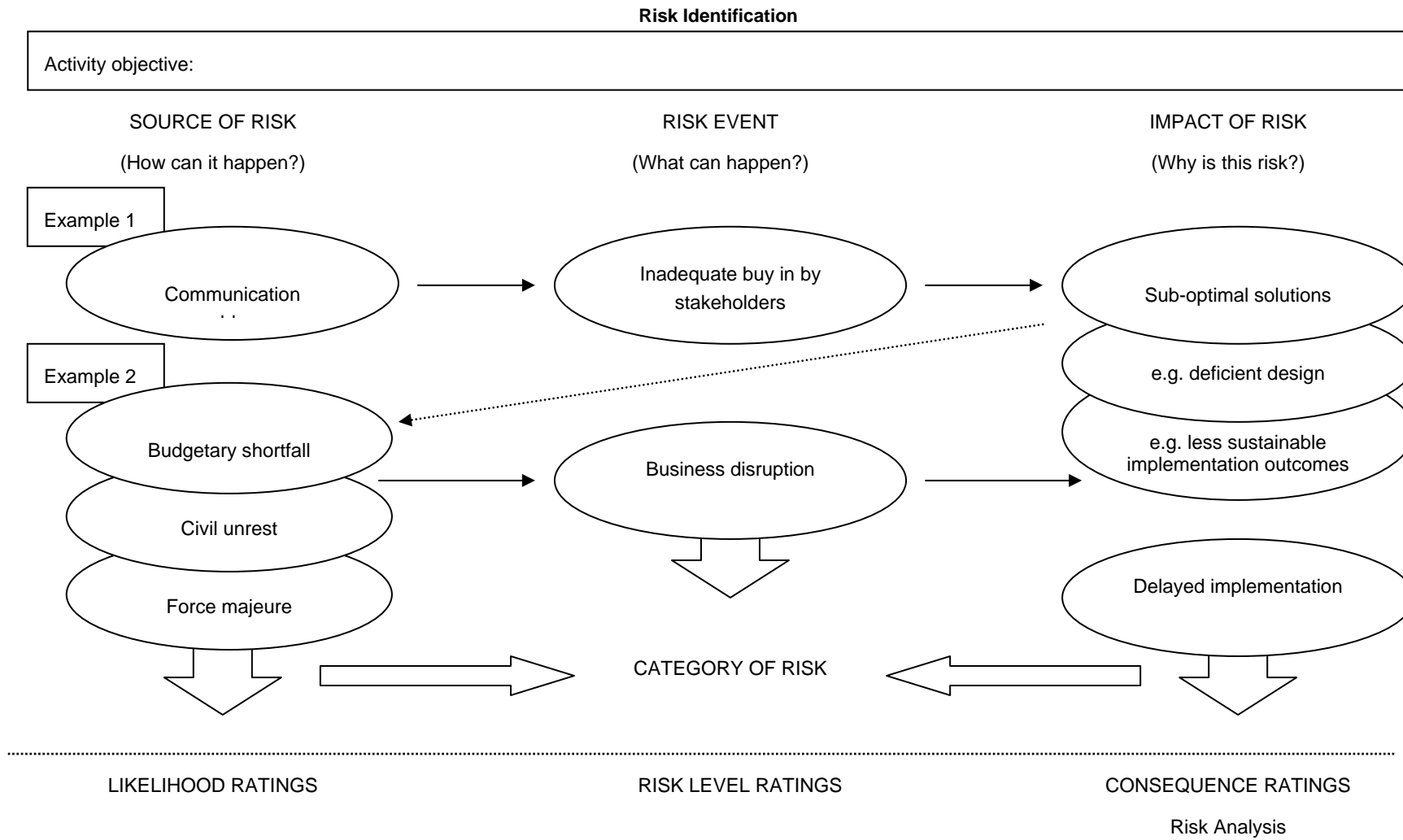
- Risk checklists provide a useful starting point for some activities. Program staff carrying out many similar activities can construct their own checklists based on their experience or activity databases, and/or draw on information from specialist industry, research, insurance or management expertise. Indicative checklists of sources and categories of risk are attached to this guideline as further explained below
- Examining similar current or previous activities, risk assessments, lessons learned or activity evaluations is another valuable way and
- Brainstorming may be valuable for activities involving new or unusual risks, innovative management arrangements or to develop initial checklists. This may be a useful element of risk management workshops.

Considering the strategic context, for example at program level or for the specific activity under Step 1 above, consultations with stakeholders at some stage is a vital part of risk identification. In consulting with stakeholders it is important to have as wide a spread of interests as possible.

Risk identification will usually be the initial responsibility of the activity design team. A separate risk management workshop approach may be used after design. It is worthwhile to use for this purpose a management team consisting of people with multidisciplinary backgrounds, such as in understanding risk management processes and facilitating workshop sessions.

The logframe approach to risk identification is mainly used for assessing risks in terms of the process of moving from inputs and activities to outputs and outcomes. A range of other risks including reputation risk, risk to efficient output delivery or to capability must also be considered - see Annex D *Categories of risk* which is attached to this guideline. In addition, an indicative checklist of some of the main risk areas appropriate to different stages of the activity is attached to this guideline - see Annex E *Examples of sources of risk*.

A risk is an event (i.e. what could happen) that for consistency should be distinguished from identified sources of the risk (i.e. how each risk could arise) and impacts (i.e. why it is a risk). In developing the risk matrix, it may be useful to identify the risk in these terms (as per the attached diagram). This technique lends itself to consultative sessions of various team members and stakeholders. Because it distinguishes source and impacts, it is a useful lead in to the next stage of analysing likelihood and consequences, and ultimately, of developing the best form of response.



## Analyse risk likelihood and consequences

The next step of the risk assessment is to determine or estimate both the likelihood of a risk arising and its potential consequences.

All available data sources should be used to understand the risks. These may include: historical records, procurement experience, industry practice, relevant published literature, test marketing and market research, experiments and prototypes, and expert and technical judgement and independent evaluation.

The risk analysis involves:

- an estimate of the likelihood of each risk arising. This might be done initially on a simple scale from 'rare' to 'almost certain', or numerical assessments of probability might be made. A simple rating scheme is proposed below in Table 1 and
- an estimate of the consequences of each risk. This might be done initially on a simple scale from 'negligible' to 'severe', or quantitative measurements of impacts might be used. Again, refer to the rating scheme in Table 1.

Analysis of risk levels can be conducted on the inherent risks (assuming no controls are in place) or on residual risk (that remaining after considering existing control strategies). The former 'zero-based' approach would be appropriate at the outset of an activity or when considering a possibility of revising controls. The latter would be appropriate when monitoring management action or reviewing implementation.

## Poverty reduction and risk management

Poverty reduction requires strong risk management. Poverty reduction outcomes largely accrue in the medium to long-term. Poverty is often caused by difficult and long-standing problems of access to assets and resources, education and health care. There can also be problems of remoteness, cultural barriers and governance. We may therefore need to think of poverty reduction activities less as discrete interventions in themselves, but more as phases in a long-term program.

Broader capacity building programs that are based on principles of partnership and ownership may be an effective way of addressing many of the underlying causes of poverty. Forms of aid such as sector-wide approaches can also complement more traditional approaches and achieve greater impact by improving overall policy settings and the allocation of resources for poverty reduction.

Potential longer timeframes and additional challenges can make direct poverty-orientated activities more risky than many other types of activity. The increased risk must be appropriately managed when planning, designing and managing poverty activities. Risk

management of poverty activities may require increased management resources as well as acceptance of longer timeframes.

### Environment and risk management

If an activity is located in an environmentally sensitive location, or if it involves an environmentally sensitive sector, then strong risk management is required. The *Environment Protection and Biodiversity Conservation Act* (1999) requires AusAID to ensure that all activities likely to have environmental impacts are properly assessed and managed.

The detailed environmental impact assessment (EIA) identifies and forecasts possible risks to the environment (or environmental risks to the activity). The environmental management plan (EMP) outlines actions for managing the likely environmental impacts. These environmental risks should be incorporated into the risk management plan.

For certain types of activities, risk management should include a plan to respond to potential environmental emergencies. These plans may be stand-alone documents, but should be summarised and described in the risk management framework. See the *Environmental Management Guide for Australia's Aid Program*.

### Sustainability and risk

Sustainability is related to risk because many of the risks to achieving the objectives are also risks to achieving the sustainability of benefits. However, some risks to sustainability will not be risks to achieving the objectives. Examples include the failure to plan for financing the recurrent costs and asset maintenance post-activity, and not preparing local language training materials and the means to update them.

The significant difference between managing risk and sustainability is that sustainability makes us consider the long-term outcomes beyond the direct influence of activity management, whereas risk analysis and management are about threats to implementation and the achievement of objectives within the defined period of the activity. It is recommended that risk management be broadened to incorporate risks to the sustainability of benefits as well as to activity implementation.

Like risk management, the sustainability strategy requires a systematic process of assessing and dealing with uncertainty. Both are iterative processes that involve monitoring and review. Because of their similarities, the risk management plan and the sustainability strategy should be presented together in the design document and annual plans. See AusGuideline 6.4 *Promoting Practical Sustainability*.

### Determine significant risks

The objective here is to identify significant risks that must be managed, and to screen those minor risks that can be accepted and so excluded from further consideration.

To compare risks, a ranking mechanism is used. For straightforward risks, qualitative assessment can be used to estimate the likelihood and impact of each risk, and to set cut-off points for the determination of risk level, whether extreme, high, medium or low.

A priority listing of risks is a simple instrument for ranking risks and is based on scaling and then combining the likelihood of a risk and the severity of its impact. A risk will be high if the risk is likely to occur or its impacts are large, and highest if both are present.

Table 1 illustrates a simple technique for calculating a priority listing of risks. Given the stepwise nature of the matrix there, some judgement and flexibility is needed when categorizing risks that lie close to the defined boundaries.

**Table 1 – Analysing and ranking risk levels**

Likelihood	Almost certain (5)				Extreme Risk (E)
	Likely (4)				
	Possible (3)	Medium Risk (M)		High Risk (H)	
	Unlikely (2)	Medium Risk (M)			
	Rare (1)	Low Risk (L)			
	Negligible (1)	Minor (2)	Moderate (3)	Major (4)	Severe (5)
	Consequence				

*Likelihood*

Almost certain - expected to occur in most circumstances

Likely - will probably occur in most circumstances

Possible - might occur at some time

Unlikely - could occur at some time

Rare – may occur only in exceptional circumstances

*Consequences*

Severe - would stop achievement of functional goals and objectives

Major - would threaten goals and objectives; requires close management

Moderate - would necessitate significant adjustment to the overall function

Minor – would threaten an element of the function

Negligible - routine procedures sufficient to deal with the consequences

#### *Risk level*

Extreme risk - most likely to occur and prevent achievement of objectives, causing unacceptable cost overruns or schedule slippage.

High risk - could substantially delay the activity schedule or significantly affect technical performance or costs, and requires a plan to handle.

Medium risk - requires identification and control of all contributing factors by monitoring conditions and reassessment at activity milestones.

Low risk - normal control and monitoring measures sufficient.

These terms are defined in terms of particular activities. Definitions can be similarly framed at the level of particular functions, strategies or programs. For example, each activity in a country program could be ranked in terms of the threat to aims of the overall country strategy.

A priority listing of risks provides a basis to set cut-off points to determine which risks may be discarded (minor) or identified as major and further considered. It is suggested that low-level risks can simply be documented and accepted. Higher-level risks should be incorporated into an action plan. As a working definition:

- Low risks can be accepted given normal monitoring and control measures;
- Medium risks have likelihood and/or consequences that require control and monitoring. Management responsibility should be specified for all medium risks; and
- High risks require a higher level of management attention. Extreme risks are those risks with both a significant likelihood of arising and a large impact. High and extreme risks will require close management attention, and the preparation of a formal risk action schedule.

It is advisable to validate the assessed risk level in terms of these implications for commensurate level of management monitoring and reporting.

### Step 3 Risk response planning

Risk response planning consists of the identification of feasible responses to risks that have been identified and the selection of the best response.

## Identify feasible responses

Options to be considered in terms of feasibility and cost effectiveness in planning risk treatment strategies can include:

- ***accept the risk*** – this is appropriate where the remaining risk levels are insufficient to justify potential treatment options or where it is not possible or is uneconomic to treat the residual risk. It is not possible or cost effective to eliminate all risk attaching to aid activities. Monitoring may nevertheless be appropriate and should be recommended in these circumstances;
- ***avoid the risk*** – where the level of risk is unacceptable and means of control are either not viable or not worthwhile, the risk could be circumvented, e.g. by not proceeding with an activity or component that could generate the risk. It should be noted that inappropriate risk avoidance could result in significant cost penalties, diminished efficiency and impair the achievement of outcomes;
- ***reduce likelihood of the risk occurring*** – risk controls could include, for example, selecting alternative proposals, design and engineering changes, quality assurance procedures, asset utilization studies, operations review, regular audits and checks, preventative maintenance, and education and training;
- ***impact mitigation*** – action to reduce the consequences of risk through efforts to ameliorate and deal with the impacts (e.g. contingency planning, evacuation plans, business resumption plans). This may be more appropriate for example for a high consequence/low likelihood threat such as force majeure; and
- ***transfer (allocate) risk*** – responsibility for treating risk can be allocated to parties best able to manage it. In AusAID, this transfer can often occur through contracting or other arrangements with a third party. In some circumstances, risk transfer can raise difficult issues, for example of accountability for risk, and may result in higher costs. Risk communication can be a very important element of this option.

In procurement, contracts and agreed procedures entered into between an agency and its contractors or suppliers, are the primary means of allocating risk between the parties involved.

The specific terms of a contract also provide a means of transferring risk. The aim is to place or neutralise significant sources of risk via contractual measures between the agency, the prime contractor and insurance providers.

A general principle of risk management is that risks should be the responsibility of those best able to control them. Equally, reward should be commensurate with accepting risk responsibility.

The risk assessment process can provide the initial guide as to which party is best able to manage risks and the most appropriate form of contract. This information comes from identifying how risks might arise. The analysis also identifies the potential impacts, and so may aid in determining a fair price for taking the risks involved.

Most risk transfer strategies require decisions to be taken very early in the life of an activity, almost certainly in the pre-tender phases.

#### Select the best response

Selecting the best mix of responses involves trade-offs between the potential benefits of implementing a response and the actual costs of doing so. Established practice may assist in selecting alternatives but the overall objective is to recognise which risks to address and which risks to accept, and to confidently select the best value response.

As part of this process, it is useful to examine risks at the activity or program level in order to develop wider decision rules for controlling and managing risk at a strategic level. The aim is to identify common risks and general responses that occur in more than one circumstance or that have wide potential effects.

### Step 4 The activity risk management plan

Formal reporting is an important phase of the risk management process. At the implementation stage of an activity, the implementing contractor or other delivery organisation will be responsible for updating the risk matrix produced during design and for finalisation of the consequent activity risk management plan. AusAID and the partner government will need to be consulted. A risk management plan is a helpful formal way to report on designated or major undertakings. It summarises the results of the risk management process, action strategies and implementation framework. In particular, it describes the risk management measures to be implemented to reduce and control risks. For major risks, risk action schedules should be prepared to assign individual responsibilities and time frames and identify those who are responsible for follow-up.

The risk management plan includes provision for implementation and ongoing reporting. Annex B *Risk management plan: typical format* (attached) provides a typical format for an activity risk management plan based on Annex A *Risk management matrix for an activity*.

### Step 5 Risk management implementation

The most important task in risk management is implementing the risk management plan and allocating management resources - this should be followed by monitoring the effectiveness of

these measures over time. Planning for implementation requires particular attention to be given to resources required, management responsibilities and timing of tasks.

Monitoring of risks and risk management effectiveness should be a routine and recognised activity. The frequency of monitoring and the responsibility for it should be specified in the risk management plan.

Ongoing review of the activity and the re-evaluation of risks are essential to ensure a risk management plan remains relevant. As the activity proceeds and the focus changes from strategic concerns to more operational ones, different forms of risk assessment and risk management may be needed. The risks that assumed a high priority in the design stages may become of lesser priority relative to other risks. In addition the external environment may change over time and give rise to a different risk profile. As a general rule, a more volatile risk environment may require closer monitoring and more frequent review. The review process should be specified in the risk management plan.

### **3 Portfolio risk and fraud management at posts**

#### **3.1 Portfolio Monitoring Plan**

Each year the post develops an annual monitoring program for its portfolio of development activities. This program is based on risk assessment and risk management across the post's portfolio. It is the basis for allocating the post's limited personnel to key post functions.

The results of the planning process are recorded in the standard Portfolio Monitoring Plan (PMP), which is a simplified version of the former Country Portfolio Risk Assessment and Monitoring Plan (CPRAMP).

The PMP assesses and records the individual level of risk over the planning year for each activity in the total portfolio of Australian development activities for which that Post is responsible. On this basis, the PMP identifies and briefly outlines a proposed regime of monitoring by the Post for each activity.

The PMP is a mandatory AusAID program management tool, although its format can be adjusted to local circumstances. Each post must have a current PMP as it is a central tool in the management of activity implementation risks by the post.

The PMP is not used to assess risks to the implementation of individual activities which arise from the Post's own tasks and functions in activity implementation (see below). Rather, the PMP focuses on risks to activity implementation arising from

- the circumstances in which the activity is implemented, and
- the tasks and functions carried out by the other implementation partners who are working with AusAID (that is, the delivery organisation, the counterpart agency and the partner government's central coordination authorities).

The PMP presents in summary form:

- a risk rating for each activity and
- a schedule for the planned monitoring regime, including indicative timings for key events such as receipt of the draft annual plan, JMC meetings, monitoring visits or discussions with the delivery organisation's team leader, six-month progress reports, SMT preparation, reviews and TAG visits.

### 3.2 Post Risk and Fraud Management Plan

AusAID has developed another tool, the Post Risk and Fraud Management Plan (RFMP) Information Package, to help Post managers assess and manage the risks inherent in the tasks and functions carried out by AusAID itself, using its own staff or the contractors in the Program Support Unit.

The Information Package will assist managers at the post to analyse the risk profile of program management tasks and administrative functions directly undertaken by AusAID personnel at the post, and to develop Risk and Fraud Management Plans for these tasks and functions. Selective use of the package by post managers will help assure them that the key business processes of their post are efficient and that essential controls are in place.

Each RFMP will cover a wide range of management and administration tasks undertaken by the Post. Most of these are not part of activity implementation. Nevertheless, all the activity implementation tasks directly undertaken by the Post are included. For example, the RFMP will cover each Post's annual coordination work in relation to draft annual plans for the portfolio activities.

### A Risk management matrix for an activity

Source/s of risk (how?)	Risk event (what?)	Impact/s of activity (why?)	L	C	R	Risk treatment/s	Responsibility	Timing

It will be useful to arrange risks in priority order and/or group risks by category or sources (e.g. see below).

Key (refer Table 1 Ranking Risk Levels)

L = Likelihood (5= Almost certain, 4= Likely, 3= Possible, 2= Unlikely, 1= Rare)

C = Consequence (5= Severe, 4= Major, 3= Moderate, 2 = Minor, 1= Negligible)

R = Risk level (4= Extreme, 3= High, 2= Medium, 1= Low)

## B Risk management plan: typical format

For all bilateral aid proposals, a risk management plan must be prepared and submitted as part of activity approval procedures. A typical format for a risk management plan is presented below.

### Risk management plan

#### 1. Introduction

Activity description

Activity status

#### 2. Risk assessment

Risk identification - methods, list risks, description of source and impact

Risk analysis - likelihood, consequences, and risk levels

Risk evaluation – prioritise risks in terms of strategic context.

#### 3. Risk management

Management responses to major risks

Schedule of accepted minor risks

Communication strategies

#### 4. Implementation monitoring

Resources and responsibilities

Implementation monitoring plan

Review and evaluation plan

## C Glossary of risk management terms

<b>Risk</b>	The chance of things happening that could have an impact on AusAID, on the outcomes it achieves, or on the objectives of the various functions it undertakes. Risk is measured in terms of likelihood and consequence/s.
<b>Risk acceptance</b>	An informed decision to accept the consequence/s and likelihood of a particular risk.
<b>Risk analysis</b>	A systematic use of available information to determine how often specified events may occur and the magnitude of their consequences.
<b>Risk assessment</b>	The overall process of identification, analysis and evaluation of risk/s.
<b>Risk avoidance</b>	An informed decision not to become involved in a risk situation.
<b>Risk evaluation</b>	The process used to determine risk management priorities by comparing the level of risk against controllability or other criteria.
<b>Risk identification</b>	The process of determining what can happen, how it could occur, and why it is a risk.
<b>Risk management</b>	The systematic process of assessing and then dealing with risk in a way that effectively manages potential opportunities and adverse effects. The process entails consideration of the context, followed by identification, analysis, evaluation, and treatment of risks. It is an iterative process that also involves monitoring and review, and can usefully encompass a dialogue with stakeholders along the way.
<b>Risk transfer</b>	Shift some or all of responsibility for treating risk, and the burden for any loss, to another party. In AusAID this allocation can often occur through contracting or other arrangements with another party.
<b>Risk treatment</b>	Selection and implementation of appropriate controls and options for dealing with risk.
<b>Stakeholders</b>	People or organisations who may affect, be affected by, or perceive themselves to be affected by, a decision or activity. It can include interested parties as either internal or external stakeholders. The latter can include for example, partner governments, delivery agencies, contractors, and aid beneficiaries.

## D Categories of risk

Within four broad categories the following list indicates, through not exhaustively, the type of sub-categories that may be relevant to AusAID. Risk assessments should be sensitive to these types of risk for AusAID, as well as risks specific to a particular task.

### Risk to reputation / goodwill

#### International standing

- multilateral/donors
- bilateral partners/institutions and
- recipients/beneficiaries.

#### Support in Australia

- community support
- Parliamentary support
- Government endorsement and
- interest group support e.g. business, NGOs, etc.

### Risk to effective and sustainable aid outcomes

#### Strategic orientation / programming

#### International coordination

#### Partner stability / governance

#### Macro factors in country

- social context; and
- general economic movements.

#### Other sustainability aspects

- internal (design/implementation) factors and
- policy/technical/financial/institutional/social/skills/environment.

#### Poverty reduction risks

#### Environmental risks

#### Gender, equity, cultural sensitivity

#### Activity quality factors

Targeting / design

Risk to output delivery / efficiency

Activity performance /value for money

- quality / fit for purpose;
- timeliness, cost and
- accountability / compliance.

Contractual / delivery arrangements

- terms / performance criteria; and
- legal risks / disputes / variations.

External impediments / hazards

- logistics / supply constraints;
- social / institutional impediments
- force majeure.

Procurement / selection

- fraud risks / viability / probity and
- capability / availability.

Risk to capability

coordination / strategic coordination

governance / accountability

ethics / probity

occupational health / safety

knowledge / skills / motivation

productivity / efficiency

budgetary risk / economy

assets / financial management

fraud risks

business continuity / security

legal compliance / liabilities

business systems / quality systems

information management

## E Examples of sources of risk

### Planning and feasibility stages

#### Commercial and strategic

- competition
- market demand levels
- growth rates
- technological change
- stakeholder perceptions
- market share
- private sector involvement
- new products and services and
- site acquisition.

#### Economic

- discount rate
- economic growth
- energy prices
- exchange rate variation
- inflation
- demand trends
- population growth and
- commodity prices.

#### Contractual

- client problems
- contractor problems
- delays
- force majeure events
- insurance and indemnities and
- joint venture relations.

#### Financial

- debt/equity ratios

- funding sources
- financing costs
- taxation impacts
- interest rates
- investment terms
- ownership
- residual risks for government and
- underwriting.

#### Poverty

- weak governance
- remoteness
- low incomes
- gender inequalities
- social and ethnic inequalities
- low education
- poor infrastructure
- weak institutions
- inadequate policy framework and
- human rights infringements.

#### Environmental

- amenity values
- approval processes
- community consultation
- site availability/zoning
- endangered species
- conservation/heritage
- degradation or contamination
- environmental emergencies and
- visual intrusion.

#### Political

- parliamentary support

- community support
- government endorsement
- policy change
- Sovereign risk and
- Taxation.

#### Social

- community expectations and
- pressure groups.

#### Activity initiation

- analysis and briefing
- functional specifications
- performance objectives
- innovation
- evaluation program and
- stake holder roles and responsibilities.

#### Procurement planning

- industry capability
- technology and obsolescence
- private sector involvement
- regulations and standards
- utility and authority approvals
- completion deadlines and
- cost estimation.

#### Activity delivery stages

##### Procurement and contractual

- contract selection
- client commitment
- consultant/contractor performance
- tendering
- negligence of parties

- delays - weather, industrial disputes
- damages and claims
- errors in documentation
- force majeure events and
- insurance and indemnities.

#### Construction and maintenance

- build ability
- contractor capability
- design and documentation
- geotechnical conditions
- latent conditions
- quality controls
- equipment availability and breakdowns
- obsolescence
- industrial action
- materials availability
- shut-down and start-up
- recurrent liabilities
- health and safety
- accident, injury
- occupational health and safety procedures
- contamination
- noise dust and waste
- disease
- irradiation and
- emissions.

#### Human factors

- estimation error
- operator error
- sabotage and
- vandalism.

#### Natural events

- landslip/subsidence
- earthquake
- fire
- flood
- lightning
- wind and
- weather.

#### Organisational

- industrial relations
- resources shortage
- scheduling
- operational policies
- management capabilities
- management structures
- personnel skills and
- work practices.

#### Systems

- communications or network failure
- hardware failure
- linkages between sub-systems
- software failure and
- policies and procedures.