**ANNEX 2: RISK MANAGEMENT**

Risk management is an integrated part of the programme/project cycle and closely linked to adaptive management. The more risky the context is the more there is need for adaptive management.

It is important to be explicit about the risk management approach, and the monitoring and learning activities underpinning risk management. MFA and partners often work in fragile and risky environments and it is important to be aware of and transparent about the risks that is involves. Risk management is about taking calculated risks. It is not only about minimising risk, but also about balancing the risks against opportunities and potential results, or alternatively the negative consequences of not providing support.

A preliminary assessment of potential risks and risk responses must be conducted as an integrated part of the programme/project development at the identification stage and be fully developed during the formulation stage. During the implementation, the risk assessments and responses are assessed by the responsible MFA unit, ideally in collaboration with partners, at least once a year during annual stocktaking.

For larger programmes with several engagements, the risk analysis must also include the project level. A risk management matrix is annexed to the project or programme document. For projects below DKK 10 mio., the risk management matrix is integrated into the project document.

Three main categories of risks must be considered: (i) Contextual risk concerning the general risk and fragility factors. Contextual risk are divided into political, economic, societal, environmental/climate and security risks (*see further description of fragility risks in the FRRAT tool*) (ii) Programmatic risk concerning risk in regard to achievement of programme objectives and (iii) institutional risks in relation to the interest of Denmark and its partners. Contextual risks are the same for all programmes and projects within that particular context (global, regional and/or nation level). Programmatic and institutional risks are at project or programme level.

The likelihood and impact of identified risks are assessed and risk response measures identified. Risk responses are only required for programmatic and institutional risk.

The template below is filled out for context risks, programme risks and institutional risks.

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risk** | **Background to assessment** |
| The risk is formulated as a headline or in one or two sentences | * Very unlikely
* Unlikely
* Likely
* Almost certain
 | * Insignificant
* Minor
* Major
* Significant
 | The risk response is formulated as a headline or in one or two sentences | The risk that remains after the identified risk response. | Brief explanation which can emphasize the risk factor itself or any of the other elements in terms of rating and responding to the risk |

Risk management should be seen as an iterative process where implementation of risk responses influences programme design and vice versa. Risk responses can lead to changes in scenarios and subsequent changes in partners, outputs, outcomes and modalities etc. Proposed risk responses should be briefly outlined in the risk management matrix during formulation and the residual risk be indicated.

The Risk Management Matrix should be reassessed and revised at least annually during the annual stock taking, but in some instances more frequently. Monitoring of risks during implementation is important in order to identify whether developments require adjustments to the programme, including use of the scenario planning options. Developments in risks could require adjustments to the results framework or to generally revisit the theory of change to ensure the relevance of the intervention logic.

**TEMPLATE: Risk Management Matrix**

***[Instruction: before finalising this annex, please delete the example provided below and the highlighted text.]***

Contextual risks

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risk** | **Background to assessment** |
| Political  |  |  |  |  |  |
|  |  |  |  |  |  |
| Economic  |  |  |  |  |  |
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| Societal  |  |  |  |  |  |
|  |  |  |  |  |  |
| Environment  |  |  |  |  |  |
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| Security  |  |  |  |  |  |
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**Programmatic risks** (for bilateral programmes at the country level, it has to be filled out for the portfolio under each strategic objective)

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risk** | **Background to assessment** |
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Institutional risks

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risk** | **Background to assessment** |
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Contextual risks

This category covers the range of potential adverse outcomes that may arise in a particular context, including the risk of harm beyond the immediate context or the country’s borders.

Individual contextual risks are defined by the particular setting, but some common types of risk outcome are lsted below. The risk factors that underlie these various categories depend on the context, but they may include governance weaknesses (e.g. the weak effective public financial management or law enforcement); competition for resources; natural hazards; and pre-existing socio-political tensions.

Here, many of the risk outcomes are themselves risk factors for other types of risk, e.g. an economic crisis may trigger conflict and a humanitarian crisis. The complex interplay among different factors makes contextual risk analysis difficult and highly dependent on good local knowledge.

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response if applicable** | **Residual risk** | **Background to assessment** |
| Armed conflict spreads to larger parts of the country | Likely | Major | Programme activities to be limited to safe areas where feasible; some activities to be suspended.Situation to be monitored closely | Short-term risks are reduced substantially due to selection of safe areas. However general risk prevail, but can be acted upon due to initiation of close monitoring  | Development of security situation is negative at present, with potentially serious implications for programme activities. No preventive measures are available to DK.  |
| Wide-spread loss of trust in authorities and democratic institutions due to corruption and misuse becoming more frequent and visible following the decentralisation reform. | Likely | Major | Dialogue with relevant central authorities on preventive measures (training of LG councillors and staff; intensified supervision, audit). | Residual risk not reduced. However, the actions taken could gradually increase trust. | Decentralisation increases availability of public funds to District authorities, with central controls probably remaining weak.  |

Programmatic risks

The term “programmatic risk” includes two kinds of risk: (1) the potential for an aid programme to fail to achieve its objectives; and (2) the potential for the programme to cause harm in the external environment. With regard to (1), the risk factors for programme failure include many of the contextual risks outlined above, as well as institutional and political factors. However, there are many other reasons for potential programme failure. These include inadequate understanding of the context or flawed assessment of what needs to be done; management and operational failures; and failures of planning and co-ordination. Risk is also associated with new or innovative programme approaches (although there may also be risk in failing to innovate).

One common reason for failure to achieve programme objectives is that the objectives themselves are simply too ambitious, either in their nature or time frames. Indeed, over-ambitious objectives seem to be a common side effect of the political search for peace dividends in post-conflict settings. With regard to (2), programme interventions may both exacerbate and mitigate contextual risks.

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risks** | **Background to assessment** |
| Water sector: The frequency of corruption increases in the sector after decentralisation  | Likely | Major | Min. of Water to be urged to intensify supervision of works at District level. Programme establish financial management unit to monitor use of funds and build capacity at local level. Possibly introduction of joint-donor value for money studies. | Long-term risks reduced substantial due to monitoring and capacity development activities.Short term risks still exist, though reduced due to regular monitoring. | Districts’ capacity and quality of governance will only increase gradually. Procurement processes and implementation may suffer. Possibilities of short-term preventive measures are limited.  |
| NGO funding facility: The space available to civil society for activism and advocacy is substantially reduced | Likely | Major | Closer coordination among donors and intensified joint pressure on the authorities to respect the rights of the civil society;  | Risk marginal lower, but risks are still likely and major. Independent of the high risk level, it is decided to continue support due to importance of issue.  | Present political trends are worrying; shrinking CSO space would seriously reduce scope for impact. Limited possibility for donors to influence the development since reduction of CSO support would be counterproductive. |

**Institutional risks**

This category includes “internal” risk from the perspective of the donor or its implementing partners. It includes the range of ways in which an organisation and its staff or stakeholders may be adversely affected by interventions.

These risks can be further categorised as follows:

* Operational security risks: e.g. threats to the safety of staff and partners or the continuity of programmes, etc.
* Operational risks linked to weak performance of the donor or partners (e.g. lack of senior management attention, delays in approvals of necessary changes, delays in provision of funds, weak or belated follow-up on reports)
* Financial and fiduciary risk: e.g. financial loss and risk of institutional liability for loss/failure resulting from corruption or financial mismanagement.
* Reputational risk: E.g., damage to a donor’s or partners reputation if they fail to achieve its objectives, or from financial/fiduciary failure.
* Political and reputational risk from engaging in countries where the appropriateness of aid support is questioned or where aid appears to support violent/corrupt groups.

Reputational risk may result from a donor failing to apply the agreed principles of good donor ship, or from running too high a fiduciary risk and being exposed to criticism as a result.

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| **Risk Factor** | **Likelihood** | **Impact** | **Risk response** | **Residual risks** | **Background to assessment** |
| Denmark gets associated with major corruption scandal in one of the sectors of the programme. | Likely | Minor | Suspension of funding during investigation; explanation to DK constituency of importance of working with national system; possibly introduction of further controls. | Reputational risks substantially reduced as plans are in place for prompt reaction and for information activities; should corruption occur. | The bulk of our support is close to fully integrated in the national systems, known to be imperfect. Impact may be more or less serious depending on duration of suspension and need for extra control measures.  |