MINISTRY OF FOREIGN AFFAIRS OF DENMARK
Danida

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GUIDELINES FOR RISK MANAGEMENT

GUIDELINES FOR RISK MANAGEMET

IN PROGRAMMES, PROJECTS &

HARD EARMARKED MULTILATERAL SUPPORT

Version 2.0

1 Purpose and scope

The Guidelines for Risk Management provide tools for risk management that include identifying, assessing, monitoring, making decisions on and communicating risk issues in relation to development programmes and projects supported by the Danish Ministry of Foreign Affairs (MFA). Risk management is an integrated part of the MFA's programme cycle and the purpose of this guideline is to facilitate a uniform approach to Risk Management within the MFA in relation to development cooperation.

The target group of the guidelines is MFA staff and external partners working with preparation and implementation of development programmes and projects

At project level, the MFA's risk management will largely, but not exclusively, build on the implementing partners' risk assessment and management mechanisms. However, the responsible MFA unit will always have to carry out a risk assessment from the MFA perspective, including risks that are not addressed by the partner. Where feasible, the risk management should be carried out jointly with other donors, in particular in relation to contextual risks or more broadly in case of joint funding mechanisms or funding to the same partner.

The guidelines apply (with a few exemptions as listed in Box. 1) to all bilateral programmes and projects as well as hard earmarked support to multilateral organisations and trust funds. However, the extent of underlying analytical work and expected level of detail depends on the scope, complexity and overall risk level of the programme or project in case.

Likewise, though the guidelines and tools apply to all programmes and projects, the content of the Risk Management Matrix will be very different depending on objective of the programme and the context, e.g. support to a multilateral organisation in a fragile environment or a country programme in a stable partner country. Due to the diversity in Danish development cooperation, the guidelines do not offer specific advice in regard to how to respond to identified risks.

Box 1: Grants for which these guidelines are not mandatory

(Finance act accounts in brackets)

- Personnel assistance (06.32.04)
- Loans and debt relief (06.32.07)
- On-going agreements with partner CSOs (06.33)
- Information and communication about Danish development cooperation (06.35)
- Multilateral assistance through the UN (06.36)
- Development banks, funds and the EU (06.37)
- Research cooperation (06.38.02.19)
- Humanitarian funding (06.39)
- Activities where the majority of the grant is to be disbursed i.e. contracts. (other Std. Codes than 62-64)

2 Methodology and Terminology[1]

Risk management is defined and conducted by development partners in systems that vary from very simple to very complex. Also, terminology and assessment methodology vary. The Danish approach is to keep risk management as simple as possible and to adopt core principles that are applied by others. A common and standardised terminology has proved important in order to avoid misunderstandings in communication and cooperation in regard to risk management.

While the MFA's risk management will largely, but not exclusively, build on the implementing partners' risk assessment and management mechanisms as mentioned above, Risk Management can in general be summarised in the 8 steps below.

8 Steps in risk management

1) Determine the contextual risk level
2) Identify potential programmatic and institutional risks and then estimate and rate likelihood and impact of each risk
3) Prioritise and shortlist identified risks according to estimated likelihood and impact
4) Identify risk response measures to be applied to shortlisted risks
5) Qualify ratings for likelihood and impact according to expected effect of planned risk responses
6) Estimate the combined residual risk
7) Present risk assessment to granting authority as part of approval process
8) Monitor risk development during implementation and adjust risk response measures accordingly

Box 2: Terminology

Risk Management is a systematic approach to setting the best course of action under uncertainty by identifying, assessing, understanding, making decisions on and communicating risk issues. Also includes balancing risk and opportunity.

Risk – The potential for a defined adverse event or outcome to occur

Risk Outcome – The adverse event or outcome itself, i.e. the result of the risk being realised.

Risk Factor – factors that may cause the risk outcome to occur, or make it more likely.

Risk level – the combined assessment of the probability and impact of a Risk Outcome

Residual risk level is the remaining level of risk after taking into consideration risk mitigation measures and controls in place.

Risk response refers to the continuum of measures of risk mitigation or control that are developed and implemented to address an identified risk.

Core Risk Categories are used for overarching categorisation of risks as contextual, programmatic and institutional as proposed by DAC/INCAF

Risk Parameters sorts different types of risks under each of the three core risk categories

Risk Management Matrix is the template for assessing and monitoring risks at contextual, programmatic and institutional level.

It should be kept in mind that risk management is not only about minimising risk but also includes balancing the risks against opportunities and results of providing support, or alternatively the negative results of not providing support. However, it is essential to identify and address risks as it can have major consequences if risks are not properly managed. This

[1] The terminology used is based on the terminology that Denmark has proposed as a common terminology to a broad range of donors as follow-up to the High-Level Meeting in Busan.

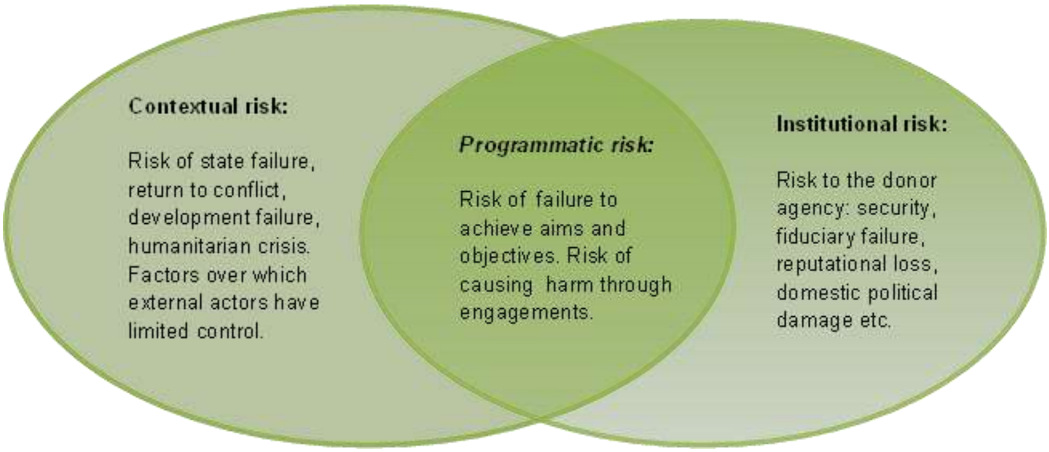
could lead to e.g. causing harm, endangering staff/partner safety, undermining support for development cooperation or damaging the reputation of the MFA/Denmark and/or the partner.

Risk management should be seen as an iterative process together with the implementing partner where i.e. implementing risk responses influence programme design and vice versa.

2.1 Core Risk Categories

Three overall core risk categories are used as the overall risk management framework.

Fig. 1 Core Risk Categories - The Copenhagen Circles[2]



Contextual Risk

Contextual Risks cover the range of overall potential adverse outcomes that may arise in a particular context and hence could impact a broader range of risks at programmatic and institutional level. The context will usually relate to a country or region but could for certain programmes also relate to a global thematic or political frame. External actors usually have very limited control over contextual risk, but would need to consider how contextual risks may be mitigated.

Programmatic Risk

Programmatic risks include two kinds of risk: (1) the potential for a development programme or project to fail to achieve its objectives; and (2) the potential for the programme or project to cause harm to particular individuals/populations or to the external environment.

With regard to (1), the risk factors for programme or project failure include many of the contextual risks. But there are many other reasons for potential programme or project 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 or project approaches (although there may also be risk in failing to innovate). One common reason for failure to achieve programme or project objectives is that the objectives themselves are simply too ambitious, either in their nature or time frames.

[2] The 'core risk categories' is a generally accepted approach originally proposed by INCAF[2] and later widely known as "The Copenhagen Circles" due to Denmark's hosting of several seminars on risk management in 2011 and 2012.

With regard to (2), programme or project interventions may both exacerbate and mitigate contextual risks. This includes the potential for aid to do damage to the economy or to the government of the country in question, or to exacerbate conflict and social divisions.

Institutional Risk

Institutional risks are sometimes also called political risks as they are closely linked to potential political damage and include "internal" (reputational) 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. Institutional risks will often be related to operational security or reputational risk parameters such as fiduciary risks or compliance with ethical and legal standards e.g. in relation to child labour, sexual exploitation, abuse and harassment (SEAH) or anti-terrorism. The perceived impact might differ considerably depending on whether the viewpoint is from the perspective of an implementing partner or a donor headquarters. It is therefore important that the MFA assessment of institutional risks is done independently from the implementing partners' assessment.

2.2 Identifying risks

Preparation and management of a risk profile is done by the MFA unit responsible for the programme or project in an iterative process with the implementing partner (in particular with regard to programmatic risks). A solid understanding of the context, as reflected in the context analysis, is an important element for identifying relevant risks, including their likelihood and impact.

Whenever possible, it is advised to seek joint risk assessment with likeminded donors in the particular context. In most cases it is possible to apply a joint assessment regarding contextual and programmatic risk factors. It may be less feasible to do a joint assessment of the institutional risk factors as individual partners often will assess risk impact differently.

Annex A provides a structured overview over a broad range of risk parameters and provides examples of risk outcomes in each of the three Core Risk Categories. The table does not amount to a complete list of risk parameters and not all parameters listed are relevant in all settings. The concrete risk outcomes will depend on the actual situation. The Annex also provides a few proposals for external sources for assessment of various risks. When feasible, it is advised to use external, independent and regularly updated sources for risk assessment as such practise eases the burden of regular reassessment and to some extent provides a neutral basis for discussing risks with partners.

2.3 Assessment of likelihood and impact of programmatic and institutional risk factors

For each programmatic and institutional risk, the likelihood of their occurrence as well as the potential impact should be determined. The risk level is the combined assessment of the likelihood that a risk factor is released and the impact of the released risk. The MFA uses a four-level scale of likelihood and impact as indicated in table 1 below. The scale for the combined risk uses the same terminology as the scale for impact.

Table 1.

Likelihood	Definition	Impact	Definition	Combined risk
Rare	May occur in exceptional circumstances	Insignificant	Minimal damage or disruption	Insignificant
Unlikely	Could occur at some time	Minor	Some damage or disruption	Minor
Likely	Will probably occur in most circumstances	Major	Serious damage or disruption	Major
Almost certain	Expected to occur in most circumstances	Significant	Massive damage or disruption	Significant

A risk factor may carry both programmatic and institutional risks; the likelihood of the risk factor occurring remains the same, irrespectively if it has programmatic and/or institutional risk, but the impact might be different at the two levels.

The methodology of combined assessments of likelihood and impact is quite universal but local and international partners can be expected to use more or less different scales and terminology. Denmark does not insist on using its own terminology in cooperation with partners but the MFA terminology is mandatory in MFA risk management matrix presented in MFA programme and project documents (Annex D) which should reflect the perspective of the MFA in assessing and managing risks.

2.4 Risk responses

An important part of risk management is to identify and implement appropriate risk responses. In general, the response can be categorised as one of the four main strategies:

1. Avoidance (do not go through with the activity or part of the activity),
2. Mitigation / Reduction (take actions that reduce the likelihood or impact of the risk),
3. Sharing or insuring (reducing risk by sharing or insuring, also called transferring), and
4. Acceptance (accepting the risk based on a cost benefit or cost-effectiveness analysis)

It should be noted that implementing a risk response might give cause to other risks, e.g. mitigating fiduciary risks by imposing additional control mechanisms could lead to failure in achieving the programme's objectives; or extensive management of security risks could limit access to beneficiaries, thus increasing the programmatic risk of not achieving objectives or causing harm; or acceptance of programmatic risk could increase the institutional risk.

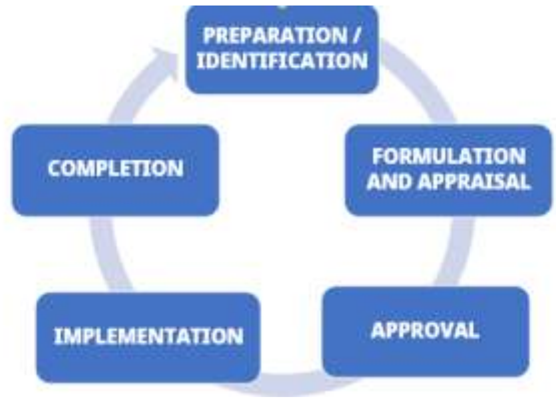
Mitigating measures can contribute to reducing risks, either by reducing likelihood of the risks occurring or by reducing the impact that they will have if they occur. The simplest form of removing a risk is by avoiding the action. However, this measure should only be applied when the risk does not justify the benefits of providing support.

Continuous assessment of risks during implementation together with the implementing partner, whether changes in identified risks or occurrence of new risks, is in itself a risk response.

Prior to adopting mitigating measures, it should be considered if the effects of the mitigating measures warrant their cost. Mitigating measures should preferably be in place prior to allocation of funds, but this might not always be feasible, in which case the establishment or development of mitigating measures might be part of the activities, preferably with a clear and reasonable deadline. An example could be having a financial accounting software system established and operationalised in a partner institution to ensure that it lives up to the requirements of effective and transparent financial management.

3 Risk Management during the programme cycle

Risk management is fully integrated in all phases of the programme cycle. Generally, risk management and use of the Risk Management Matrix should be considered an iterative process throughout the programme cycle. In the MFA programme and project documentation, there is a requirement for developing a risk management matrix at project level (Annex D), which includes risk factors seen from the MFA. The partner's format or existing risk analysis can inform the MFA risk management matrix, but not substitute this. The MFA institutional risks should e.g. always be analysed and documented by the responsible MFA unit. Considerations specific for each phase are elaborated below.



A template for the MFA Risk management Matrix and guidance for completing the template is found under Tools and Templates at Danida Aid Management Guidelines, Guidelines for programmes, Projects and Hard Earmarked Multilateral Support.

3.1 Preparation and identification[3]

Risk assessment and determination of feasible risk responses should be considered already during the identification phase. Contextual risks will in particular be relevant to assess at this point.

3.2 Formulation and appraisal

During the formulation phase, contextual, programmatic and institutional risks should be adequately analysed in close dialogue with the implementing partner using the risk management matrix including risk responses. The preliminary risk assessment is expected to inform the proposals contained in the programme/project documentation. In the MFA project document, it should be explained how the MFA will identify and manage risks if they materialise, possibly using scenario planning.

For programmes with an unusually high level of risk, the draft project documentation must include consideration regarding risk responses beyond standard measures, i.e. need for increased risk monitoring or early involvement of the MFA political level before proceeding with

[3] The MFA risk management matrix should not be confused with the self-assessment of risks for projects between DKK 20-100 million that is annexed to the Identification Note submitted for discussion at the Kick-off meeting. Format and guidance for this are found under Tools and Templates.

further preparation of the programme/project. Scenario planning may be useful in guiding the choice of action in these cases.

For programmes with underlying projects, the programme document includes a summary of major risks within the three core risk categories.

A list of risk factors including possible indicators is found in Annex A. What to do about the risk - the risk response - must also be prepared as part of this exercise.

The appraisal will include an assessment of the draft risk management matrix as well as the roles and responsibilities for overseeing and managing risks.

3.3 Approval

Conclusions of the risk assessment are incorporated in the appropriation note as part of the narrative. In extraordinary cases where the risk of a proposed programme/project is assessed to be unusually high, the frequency of the planned revisits of the risk matrix and possibly increased reporting will be proposed as part of the initial risk assessment as presented to the appropriation authority.

3.4 Implementation

As standard during implementation, the Risk Management Matrix should be re-assessed and revised at least annually in consultation with the implementing partner. Risk management will as standard be assessed as part of reviews.

An important feature of risk monitoring is that it remains flexible. This allows to adapt overall monitoring to the specific circumstances. It also serves as a risk response as the increase in risk impact can be mitigated by a closer monitoring.

During implementation, the responsible unit must report on changes in relation to the implementing partner's Theory of Change regarding the validity of underlying assumptions and risks in the Annual Stocktaking Report (mandatory for projects above DKK 20 million).

The Risk Management Matrix should be assessed and revised as appropriate on ad hoc basis in case of substantial increase in identified risks or the emergence of new substantial risks (war breaking out, political upheaval, the partnership deteriorates or major change in Danish development strategy or policy). In the event that risks gradually or momentously increase to an extraordinary high level or significant risk outcomes are realised, the responsible unit should inform the Under Secretary for Development Cooperation how the unit is responding to the situation.

Annex A

Risk Categories and Risk Parameters – an inspirational overview

The tables at the following pages serves to structure possible risk parameters and provide examples of risk outcomes in each of the three Core Risk Categories. The tables do not amount to a complete list of risks and not all risks listed are relevant in all settings. The concrete risks will depend on the actual situation.

Contextual risk

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 listed below. The risk factors that underlie these various categories depend on the context, but they may include governance failure (e.g. the failure of 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.

Contextual		
Parameters	**Risk Outcomes** (examples)	**Sources**
Security & Safety - Interstate war - Civil war - State Break-down - Violent crime, terror, piracy - Natural disasters - Pandemics	• Generally risk increase on all parameters in and around affected area	• UNOCHA sitrep's • Official travel advice • Global Peace Index (www.economicsandpeace.org)
Political & Social - Government - Government policies - Poverty reduction strategy - Partnership - Institutions - Administration - Rule of law - Stakeholders - Gender issues - Rights issues	• All planning and economic activity hampered by unstable political situation • No Poverty Reduction Strategy available • Widespread corruption	• Failed State Index (www.fundforpeace.org) • Worldwide Governance Indicators (www.info.worldbank.org/governance/wgi) • Human Development Index (www.hdr.undp.org) • Joint Assesment of National Strategies

Contextual		
Parameters	**Risk Outcomes** (examples)	**Sources**
	• Restrictions on civil and political rights	
Financial & Economical - Financial management - Corruption - Procurement - Legal framework - Finance Act Process - Audit - Fiscal and foreign trade balances - Recession, inflation	• Poor budget discipline as result of lacking independence of the Supreme Audit Institution • Non-existence of internal audit increase general risk of misuse of funds	• World Bank PEFA Assessments (www.bit.ly/wbpefa) • Transparency International (www.transparency.org) •
Conflicts - Political - Religious - Ethnic - Social class - Resources - Trade - International or internal	• Some ethnic groups are denied political influence • Two out of four boarders closed due to decade-long conflict with neighbouring countries	• Global Peace Index (www.economicsandpeace.org)
Resources - Natural - Human - Financial	• 'Brain drain' undermines development efforts • Draught reoccurs more often and for longer time • Falling commodity prices increase budget deficit	

PROGRAMMATIC RISK

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 to particular individuals/populations or to 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. But 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. This includes the potential for aid to do damage to the economy or to the government of the country in question, or to exacerbate conflict and social divisions.

Programmatic		
Parameters	**Risk Outcomes** (examples)	**Sources**
Security & Safety - Interstate war - Civil war - State Break-down - Violent crime, terror, piracy - Natural disasters - Pandemics	• Limitations in access to intervention area • Life and well-being of staff threatened • Major increase in target group • Displacement to or from intervention area • Damage to infrastructure and operational capacity • Lack of disaster or epidemic management planning	• UNOCHA sitrep's • Official travel advice • Global Peace Index (www.economicsandpeace.org)
Political & Social - Government - Government policies - Poverty reduction strategy - Partnership - Institutions - Administration - Rule of law - Stakeholders - Gender issues - Rights issues	• Sector strategy and investment plan do not materialise • Agreed objectives cannot be reached due to general bias against girls' enrolment for secondary education • Limited capacity of local partners hampers implementation • Lack of political commitment and leadership	• Failed State Index (www.fundforpeace.org) • Worldwide Governance Indicators (www.info.worldbank.org/governance/wgi) • Human Development Index (www.hdr.undp.org)

Programmatic		
Parameters	**Risk Outcomes** (examples)	**Sources**
Financial & Economical - Financial management - Corruption - Procurement - Legal framework - Finance Act Process - Audit - Fiscal and foreign trade balances - Recession, inflation	• Procurement rules accord with international standards but compliance is weak • Sector receives insufficient and falling share of state budget • Annual targets not met due to late transfers from Ministry of Finance	• World Bank PEFA Assessments (www.bit.ly/wbpefa) • Transparency International (www.transparency.org)
Conflicts - Political - Religious - Ethnic - Social class - Resources - Trade - International or internal	• Conflicts on water rights shortcuts irrigation project • One ethnic group is systematically denied access to services	• Global Peace Index (www.economicsandpeace.org)
Resources - Natural - Human - Financial	• Intervention causes damage to the environment • Partner unable to hire or retain qualified staff • Partner or third party do not deliver on financial commitment	

INSTITUTIONAL RISK

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.
- 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 reputation if it fails 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 donorship, or perhaps from running too high a fiduciary risk and being exposed to criticism as a result.

Institutional		
Parameters	**Risk Outcomes** (examples)	**Sources**
Security & Safety - Interstate war - Civil war - State Break-down - Violent crime, terror, piracy - Natural disasters - Pandemics	• Public support to intervention negatively affected after serious injury of staff member	• UNOCHA sitrep's • Official travel advice • Global Peace Index (www.economicsandpeace.org)
Political & Social - Government - Government policies - Poverty reduction strategy - Partnership - Institutions - Administration - Rule of law - Stakeholders - Gender issues - Rights issues	• Elections in y-land is presented by media as far from free and fair – campaign demands that institution draws out immediately • Governments lead discrimination against homosexuals in x-land results in widespread demand for sanctions	• Failed State Index (www.fundforpeace.org) • Worldwide Governance Indicators (www.info.worldbank.org/governance/wgi) • Human Development Index (www.hdr.undp.org)

Institutional		
Parameters	**Risk Outcomes** (examples)	**Sources**
Financial & Economical - Financial management - Corruption - Procurement - Legal framework - Finance Act Process - Audit - Fiscal and foreign trade balances - Recession, inflation	• Public support to institution damaged after massive loss of tax payers' money due to apparently unchecked corruption	• World Bank PEFA Assessments (www.bit.ly/wbpefa) • Transparency International (www.transparency.org) •
Compliance to ethical standards - Child labour - SEAH - Anti-terrorism -		•
Conflicts - Political - Religious - Ethnic - Social class - Resources - Trade - International or internal	• Repeated attacks on religious minority lead to call for withdrawal from z-country	• Global Peace Index (www.economicsandpeace.org)
Resources - Natural - Human - Financial	• Decision to tolerate potential risk to the environment by intervention is broadly considered unacceptable in constituency	