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Development Assistance and Approaches to Risk in Fragile and Conflict Affected States

THE DEVELOPMENT ASSISTANCE COMMITTEE:
ENABLING EFFECTIVE DEVELOPMENT

Foreword

By Fiona Davies

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Engaging in fragile and conflict-affected states inevitably involves risk. In these states, the politics are volatile, institutions weak, and security often precarious. It is now well recognised that risks exist on a number of levels: contextual, institutional and programmatic. It is also increasingly understood that donors must be willing to address risks in their programming and take steps to mitigate them, instead of developing programmes that are based on risk avoidance. The risks of not engaging – of avoiding government institutions, of only working in areas that are easiest to access, of only tackling issues where short-term results are guaranteed – can exacerbate fragility in the long-run.

This report demonstrates that there is no universal 'blue print' for effective risk management in fragile states. The risks that are faced differ from country to country, and require context-specific mitigation measures. However, it points to a number of fundamentals that need to be in place if donors are to manage risk effectively. First of all, donors need to ensure that their understanding of risk is in fact grounded in 'country realities.' Where they understand the operating context, donors feel more comfortable taking and managing risks. Where country context is less well understood, this report shows that there is a greater chance of lapsing into programming based on risk avoidance.

Second, it is important to get the balance right between the different types of risk, and to understand the interaction between mitigation measures. For example, measures taken to mitigate fiduciary risk may lead to heightened programmatic risk (failure to deliver), if the entity responsible for programme implementation lacks the capacity to manage the stipulated fiduciary safeguards.   Measures taken to limit programmatic risk - for example, by only partnering with tried and tested institutions or only working with populations that have had previous exposure to donor programmes - may contribute to heightened contextual risk in the form of marginalisation, and ultimately undermine the higher goals of peacebuilding and statebuilding.

Third, donors need to be aware that they are not the only players in the risk environment, which is generally comprised of a complex political economy, involving competing agendas, interests and perspectives among local (and even regional) stakeholders. Often, these stakeholders interact with each other in a fragmented legal and institutional environment, sometimes against a backdrop of informality. Donors need to understand how their proposed mitigation strategies play into risk perceptions amongst other stakeholders. For example, they may be perceived as undermining recipient sovereignty or confronting powerful vested interests. Donors need to navigate these competing agendas and develop their mitigation measures carefully, in order to safeguard the potential success of their programmes.

These fundamentals point to a further intuition. Flexibility is essential to successful risk management. No single set of risk mitigation measures can possibly address all eventualities in advance, particularly not in a fast-moving context of fragility. As programme implementation gets underway, donors need the capacity and flexibility to adapt their risk frameworks and their programme design to changing conditions on the ground. This requires both innovative thinking about risk and the right incentives amongst donor staff to manage them as they emerge.

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This report provides an overview of how donors have approached risk management in a number of fragile and conflict affected states, drawing on case studies of Democratic Republic of Congo, Nepal, Somalia and South Sudan. The findings highlight that risk aversion is a common tendency under certain conditions - when donors face reputational and political pressures from within their own country, where their knowledge about the partner country is limited, and when institutional incentives favour short-term activities over long-term results. Yet the report also shows that there are ways of working that overcome these hurdles, and provides a number of examples of informed risk taking in situations in extreme fragility.

With this report, the OECD-DAC International Network on Conflict and Fragility (INCAF) is gathering and showcasing a growing body of evidence on measures for tackling risks, hoping it will inspire others to adapt their ways of analysing and managing risk when engaging in fragile states.

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List of Acronyms

ARTF	Afghanistan Reconstruction Trust Fund
BOGs	Basic Operating Guidelines
CBTF	Capacity Building Trust Fund (South Sudan)
DDR	Disarmament, Demobilisation and Reintegration
DFATD	Department of Foreign Affairs, Trade and Development (Canada)
DFID	Department for International Development (UK)
DRC	Democratic Republic of Congo
EDF	European Development Fund
HACT	Harmonised Approach to Cash Transfers
IGAD	Intergovernmental Authority on Development (East African Regional Organisation)
INCAF	International Network on Conflict and Fragility (OECD-DAC)
G7+	Grouping of fragile and conflict affected states
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)
I4S	International Security and Stabilisation Support Strategy for Eastern DRC
ICT	Information and Communication Technologies
JICA	Japan International Cooperation Agency
M23	Rebel group in North Kivu Province, DRC
MDTF	Multi-Donor Trust Fund (South Sudan)
MONUSCO	Mission de l'Organisation des Nations Unies en République Démocratique du Congo (UN Organisation Stabilisation Mission in DRC)
NATO	North Atlantic Treaty Organisation
NGO	Non-governmental Organisation
OCHA	Office for the Coordination of Humanitarian Affairs
ODA	Official Development Assistance
OECD-DAC	Organisation for Economic Cooperation and Development – Development Assistance Committee
ORAF	Operational Risk Assessment Framework (World Bank)

PFM	Public Financial Management
SSR	Security Sector Reform
RMO	Risk Management Office (Nepal)
RMU	Risk Management Unit (Somalia)
STAREC	Stabilisation and Reconstruction Plan for Eastern DRC
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund
UNMISS	United Nations Mission in the Republic of South Sudan
USAID	United States Agency for International Development

Executive Summary

This report presents a comparative study of donor approaches to risk management in fragile and conflict affected states. The aim is to document risk management processes that have been applied in practice. The findings are based on evidence from four country case studies: Democratic Republic of Congo, South Sudan, Somalia and Nepal (and additional examples drawn from Myanmar, Afghanistan and Haiti).

How do providers of development assistance respond to various categories of risk?

Risk and risk assessments have been widely discussed among development assistance providers. In these discussions, a categorisation system known as the "Copenhagen Circles" emerged. The different risk types are contextual risk, programmatic risk and institutional risk. Development agencies react differently towards these types of risk.

In practice, during the period of the study, development agencies showed a propensity to avoid institutional risk, frequently opting for low-risk programmes. Evidence shows that this comes as a consequence of programmatic risks and pressure for short-term results. Donors have to balance these short-term interests against long-term goals such as statebuilding and peacebuilding. Providers of development assistance can often choose programmes that are less suited to supporting the long-term goals. In addition, in order to reduce fiduciary risk, development agencies refrain from using country systems to manage aid funds. Both of these practices can limit development agencies' ability to focus on mitigating contextual risks and reducing longer-term development risks by supporting state functions. Instead, providers of development assistance may unwittingly undermine government institutions by establishing parallel systems.

Numerous exceptions were discovered in contrast to these general trends. These exceptions show that variety does exist. They can serve as building blocks towards more intelligent risk-taking. Examples of higher risk programming (which potentially offer higher rewards) include the payment of government salaries in Somalia, large-scale support for institution building in Afghanistan, and increasing focus on institutional reform in Haiti.

What factors explain why providers of development assistance respond to risk in these ways?

Risk behaviour is influenced by various factors that push donors in different directions. Risk aversion appears to be strongest under these circumstances:

- where development agencies face strong domestic reputational and political pressures;
- where their country knowledge is limited; and
- where organisational incentives within donor organisations create pressure to demonstrate short-term results.

Under certain circumstances, providers of development assistance work towards long-term success in peacebuilding and statebuilding, even where high short-term risks would normally discourage them to do so. The following factors encourage this behaviour:

1. A foreign policy with international security pressures and humanitarian imperatives that favour political stabilisation and institution building;
2. Donor commitments to support cross-cutting objectives such as gender equality, justice and human rights, which broadens their perspective beyond short-term results;
3. Investment in country analysis and knowledge (including appropriate staff training and valuing staff's country knowledge);
4. Long engagement and experience in the country; and
5. Risk sharing between development agencies in the context of pooled funds and other coordinated approaches.

Recommendations

Experiences uncovered in the case studies revealed many examples of specific practices, tools and instruments used by donors to manage risks. The following recommendations emerged from the research which will assist providers of development assistance to develop effective risk management processes.

- ✓ **Strengthen the analysis of contextual risks,** ensuring improved understanding of how programme performance may be affected, and how best to mitigate risks.

- ✓ **Pilot joint risk assessment methods** to identify common interests; design and implement programmes that reduce socio-economic and political tensions; and ensure donors respect the principle of "do no harm".

- ✓ **Require stronger coordination and joint working between development, humanitarian and UN peacekeeping missions** by creating synergies and enhancing the collective impact of mitigation strategies.

- ✓ **Adapt aid instruments to ensure greater programming flexibility**, using fast disbursing instruments in combination with longer-term development programming.

- ✓ **Make greater use of pooled funds** to share and manage risks collectively.

- ✓ **Adopt an incremental and collective approach to using country systems**, building confidence in systems by using transition compacts and mutual accountability frameworks under the New Deal.

- ✓ **Use third-party services to monitor corruption and fiduciary risks, and security conditions**, in cases where using these services brings access to specialist expertise.

- ✓ **Develop more robust remote management systems** that ensure good risk management in cases of limited access, while addressing typical challenges of remote management systems, including weak monitoring.

- ✓ **Develop tools for portfolio based approaches to risk management** to better manage potential trade-offs.

- ✓ **Adopt good practice for risk sharing** between development agencies and implementing partners by engaging frequently with them, and responding flexibly to operational needs.

- ✓ **Provide evidence of the results of different approaches** to support fragile and conflict affected states, by enhancing measuring and monitoring capacity.

- ✓ **Communicate more effectively with audiences in donor countries** in order to mitigate reputational risks.

Guest Introduction: On balancing risk

By Stefan Dercon

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'The purest treasure mortal times afford is spotless reputation; that away, men are but gilded loam or painted clay.'

(Richard II, Act I, sc. I)

Everything providers of development assistance do is risky, and a good understanding of risk management principles ought to be at the core of their business. A project is risky if its outcome cannot be known with certainty in advance. For most, the downside risk is what matters, although effective risk management considers both situations: projects that turn out worse *and* better than expected. Risk management relates to the actions taken beforehand to ensure that the overall risk aligns with the overall appetite for risk. In this introductory note to the study on donor approaches to risk management in fragile states, I reflect on two things: 1) why risk management is important for development actors, particularly in fragile states, and 2) where we can start to improve development agencies' risk management. I argue that bilateral and multilateral development agencies need to take risks intelligently, while at the same time balancing different types of risk.

Risk in development

Donors take huge risks every day. Just as in any government department or business, development assistance providers are not in control of their environment: stuff happens. Donors probably face more risk than most branches of government. There are some very obvious downside risks. Bilateral and multilateral development agencies expose their staff to higher personal risks than most departments: at times, their staff are sent to places that are outright life-threatening. Development agencies work through lots of third parties, including other governments, and enter into many deals that would not be governed by the same quality of legal institutions or business norms that could be enforced in advanced economies. Development agencies also operate in environments with poor skills, or simply poor business practices, and these factors create the risk of delays and corruption. And development agencies often work within a very poor information environment. Observing and monitoring what is going on can be challenging, and unlike in advanced economies, there is often a lack of local scrutiny by official bodies, the press or civil society to provide information that can help to fine tune efforts. It is often difficult to judge the success of a project, even towards the end of a cycle. There are also upside risks that providers of development assistance take: some programmes could be and have been extremely transformational, and their results have outstripped in terms of value for money the kind of change one would expect for a similar project in a developed country. Development success can save and transform lives at a scale that most public spending could not. In short, development is a risky business, with many downside and some large upside risks.

So how can bilateral and multilateral development agencies begin to make sense of the complexity of their risks? One approach is a categorisation known as the Copenhagen Circles. This system categorises risk according to *what* is at risk. There are three of these categories. First, risks like state failure, a return to conflict, development failure or a humanitarian crisis are considered **contextual risks**. Second, if an agency's programme fails, or causes harm, we would call these **programmatic risks**. Third, **institutional risks** are risks to the agency. Examples of this type of risk are security breaches, fiduciary failure, domestic political damage and reputational loss.

What motivates all development actors to take risk, and what justifies risk taking, are the potential gains when risk taking pays off and improves living conditions. In fragile states, basic human needs are a main focus; but core functions of the state are also important, such as providing security. Development agencies can achieve these goals with substantial commitment from their staff, even in an environment that is hostile. But working towards development objectives in *fragile* states means putting the staff's security at risk, as well as the organisation's integrity. However, withdrawing staff and reducing the organisation's involvement might jeopardise the broader development goals: having no staff on the ground means no progress, and sometimes deteriorating conditions. With dwindling resources and weaker support, governments might provide fewer and fewer services to their citizens, and the sequence of events might lead ultimately to state collapse. In short: contextual risks are up against the organisation's risks; providers of development assistance may prioritise managing risks to their own organisation, and lose sight of the original goal of preventing outcomes like state collapse.

So, one way or another, risks are often seen as worth taking – and risks are indeed taken. The question is then *how* to take risk, and which one. Development agencies know how to take risks. Risk management is not about the elimination of risk, but about finding the right balance between risk and reward, and clarifying the nature of risk sharing between different actors involved in a particular project. No rule or system of control can be designed to entirely eliminate the possibility that 'bad things' may happen. In fact, too many controls and rules could also result in failure as they increase transaction costs and might render processes more cumbersome. Development agencies inevitably take risks that in turn reward their spending. And there will always be 'residual risk' – the risk that remains after all efforts have been made to mitigate and counter it. As will be stressed further, good risk management requires decisive leadership on how to balance risk, and a culture that offers a clear sense of who bears responsibility for residual risk.

Reputational risk

Another unspoken but important element of the different risk categories is reputational risk. Fear of developing a bad reputation is at the core of development agencies' considerations about risk. This fear spans the types of risk detailed above, and is a risk in itself. The failure of programmes and increased conflict between countries can all reflect poorly on a development agency's reputation, even if the agency is not at fault. Ultimately, these adverse events might shed a negative light on the next programme, despite its potential to succeed. A good reputation fosters positive opinions that enable agencies to carry out their work, like "With this agency, government money is well spent"; "This development agency can do the job"; and "They know what they are doing". Without it, development agencies will face the insurmountable challenges of a lack of support, funds, or legitimacy with their constituency and citizens.

Allow me to illustrate what I mean. The simplest form of risk management is to engage in a diversified portfolio of projects. Suppose a development agency has two projects – each equally risky and with the same average return – and the agency has the choice to engage in both, or only one at double the scale. Other determinants being equal, it is always better to choose to do both, as long as the risks of both projects are not perfectly correlated, which means that bad and good outcomes would

not occur in exactly the same circumstances. The risk is lower as it is diversified. This is what an investment bank would do. A bank encourages its employees to take risks, within specific principles of active risk management for individual investors, while keeping an eye on its overall exposure through the portfolio.

Providers of development assistance are quite different from an investment bank. Their profit – in terms of development, not money – is not the only yardstick of success; they are more like a high street business which trades on its reputation. Since they use public money or donations, development assistance providers are rightly scrutinised by political processes and by the press. They are also easily exposed to criticism from opponents, not always fairly or properly contextualised. To counteract this particular exposure, however, bilateral and multilateral development agencies cannot manage risk by applying a portfolio approach alone. In a textbook example, Gerald Ratner, a 1980s jewellery mogul, declared at an after-dinner speech that a cut glass sherry decanter selling prominently in his chain of shops was "crap". Within days, sales in his jewellery empire collapsed.[1] Even if he had previously said 100 times that these products were brilliant, this single unguarded declaration was enough to have an effect. No risk pooling – usually a sure-fire way to hedge risk by combining elements with different risk in a portfolio – can handle this.

This is why reputational risk is so important in development. Development agencies are naturally aware of risks that foster scepticism of development assistance. This could be anything, and includes specific cases of corruption, theft, blatant mismanagement, or other matters that sound scandalous; but also includes failure to deliver on objectives, such as preventing state collapse. Even small transgressions can become a major scandal if taken out of context. The presence of these risks is never the scandal itself – the scandal only follows if things go visibly wrong. Importantly for development agencies, the financial and development consequences of exposed corruption or mismanagement are typically small in relation to the whole portfolio, but the reputational damage can be much greater.[2]

Behavioural economics and why it is so difficult to balance risk

At this point, it is useful to stop and reflect on why risk presents us with such a challenge. Behavioural science offers some rather bleak insights into our ability to manage risk well in organisations. In summary, humans struggle to understand the likelihood of risk correctly. **Hindsight bias**, **loss aversion** and **ambiguity aversion**, all discussed below, impact on our ability to manage risk as well.

Human nature is such that we tend to get risk wrong. Many researchers have shown that we tend to overestimate unlikely events and underestimate likely events. For example, studies have shown that US citizens strongly overestimate the probability of violent death. This could be attributed to "framing effects" – in other words, the context in which information comes to us affects how we process it. In this situation, an unlikely event such as violent death gets a lot of attention in the media, which shapes our own thinking about risk. Another (related) phenomenon is "hindsight bias" – once something has happened, we cannot remember what our perspective was before it happened. For example, we usually overestimate the risks of things that have happened recently, and underestimate those risks that have not happened for a long time. We respond excessively to things that went wrong recently, for instance by setting up risk registers that collects all risks to an organisation.

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[1] Day, J. (2005, 27 April) "Ratner: I still haven't got over 'crap' PR gaffe", *The Guardian*, www.theguardian.com/media/2005/apr/27/marketingandpr.

[2] One mechanism is through exemplification: an example is presented as one typical case among many, while in fact it may be a one-off, atypical event.

Biases like these lead to some thorny issues in setting up risk management systems. These systems are designed to help managers to avoid biases, and to ensure a proper assessment of the true risks, not only those linked to the recent past. They need to be forward looking. It is difficult to avoid biases during a crisis, especially when reputational risks materialise. Suppose an employee detects an ingenious fraud that was not picked up by the risk management system. The typical reaction is to re-design the system to avoid reoccurrence of this type of fraud. While this seems to be a rational response, to prescribe a re-design without further analysis would not necessarily be the right response; it reflects hindsight bias. It may be that the system, weighing costs and benefits including in terms of time and possibly even in terms of reputation, was designed to pick up 95% of fraud cases. It may be the right decision not to invest in a very expensive system that would pick up the remaining 5% of complicated cases – and use other systems instead, such as random forensic audits or the four Cs described below – to manage scandals resulting from such cases. In the eye of the storm, the best strategy is to be transparent and truthful, telling it all with the four Cs. They are: Concern – acknowledge and accept responsibility; Commitment – commit to fixing it; Control – show that you and other leaders are in control, and are fixing systems; and Communications – ensure those within and outside the organisation are informed truthfully and transparently. Not changing a perfectly good risk management system in such circumstances would require strong leadership, and many organisations would probably not dare to go this admittedly risky route for reputational reasons.

General behavioural biases also create some serious incentive problems when it comes to risk. **Loss aversion** is one observed (and not necessarily "rational") trait. Here, humans typically respond differently when making decisions that may result in losing something we have, as opposed to gaining something we do not have. In short, we place greater value on losing something we have acquired than the value we attach to acquiring it. One consequence of factoring risk aversion into a risk assessment is that it closes our eyes to opportunities: our behaviour becomes more risk averse, and we can become obsessed with mitigating risks. But once we have acquired something, loss aversion may also lead us to take extreme measures to preserve what we have – in effect taking too much risk, and exhibiting behaviour akin to gambling. One example of extreme measures is "sunk-cost bias", or the "gambler's fallacy": the failure to reset expectations (or the chances of success) based on the current situation. A gambler, in a streak of bad luck, expects that soon an exceptional win will make up for all the "bad" cards he or she has received. Similarly, when a project is going badly, it is commonly observed that even good managers seem to behave as if "luck will surely turn" and become far too optimistic that the project will turn around. They may opt to continue the programme when it is clear that closing it would be the better option.

Another important trait for development actors is **ambiguity aversion**: an aversion to uncertainty that makes us cautious about taking on opportunities. One outcome is that we do not explore other, potentially better, options. A concrete example is the response of development staff to the vast array of rules that guide their daily work. Often these rules do not seem consistent, nor do we know them all: we are somewhat uncertain about what is allowed and what is not allowed in a given situation. To counter this, we go for established patterns of behaviour that seem acceptable, without exploring all the other options we can take.

These individual biases influence the activity of any organisation, and providers of development assistance are no different. When development agencies structure their work and their systems, they need to take these biases into account. Development agencies also need to be aware that they are risk averse – in any engagement, in any country, in any developmental state. Risk aversion is entrenched in development agencies. Results are the driving factor for these agencies; in order to justify large expenses beyond domestic territories, results have to be delivered quickly. In fragile states, results are slower to be achieved and a focus on measurable, quick results will exacerbate the

problem. The irony for development agencies is that the failure to take risks in aid delivery has sometimes been at the cost of taking the much greater and potentially much more expensive risk of renewed conflict. In environments that hinder progress, projects may receive negative evaluations from an audience that expects faster progress. In this case, a number of risks in programme oversight occur. Failure might be attested too fast– and potentially too early. It may be possible to turn a failing project around, but the louder the critique gets, the more difficult a turn-around becomes. Declaring failure too early will jeopardise a project that may not be really dead. At the same time, our behavioural tendencies (think of the behaviour I described as sunk cost bias or gamblers' fallacy) might prevent us from turning the project around as well. We are not learning fast enough, remaining with current processes, hoping that we can achieve our goal with a little more patience. The tension between these two risks is a perennial dilemma for development agencies.

Better risk management in development assistance

It is one thing to make textbook statements about risk management and behavioural biases, or to make agreements to focus more on risk. It is another thing to translate this into concrete measures for development actors. Different aspects of risk management are relevant for development agencies: the authorising environment; the design of the overall portfolio and the project itself; and the communication structure. Any organisation setting up or improving its risk management system must ask whether the systems, rules, norms, culture and incentives are in place to ensure the right information is collected, and that it is acted upon. It would be wasteful to collect information without any incentive to act on it, or to base decision-making processes and management on irrelevant information. Behavioural science suggests that only clear, simple, internally transparent risk management systems are effective, with clear incentives to reveal "the truth" about what is happening and what can be done; and clear lines of decision making on who should act under what circumstances.

One of the foremost challenges for development agencies in the context of risk management is to shape the authorising environment of the organisation in such a way that intelligent risk taking is encouraged. Good risk management does not aim for zero risk: for a good return on investment, a degree of risk taking is important. There are rarely zero or very low risk opportunities. Therefore, risk taking must be part of planning – and with that comes a need to adjust expectations to accept that risks can become a reality. In a development context, allowing for risk to materialise means allowing for projects to fail. To make intelligent risk taking possible at the individual level, "bad luck" or "factors beyond our direct control" should not result in individual consequences for the project manager involved. Furthermore, there is a need to accept that it is impossible to achieve perfect information for managing risk. Monitoring and information gathering cost time and money. The more time and money development agencies devote to monitoring and information gathering, the more accurate and detailed their risk management system will be; yet even the information generated by an optimal risk management system will still be incomplete.

Good design before beginning the project is central to effective risk management throughout a project – and to the entire portfolio. First, a truism: if you can find a way to do something at the same cost, with the same return, but with less risk than the alternative – surely you should do it. This would imply that during a project's design stage, development agencies should think carefully about *what* they are trying to do and *how* they are trying to do it. Slightly different ways of contracting and managing projects can remove a lot of risk, leaving less residual risk. This can be done by offering better incentives for less risky implementation, such as ensuring that partners invest in information, or by providing better ways of revealing information early on so the organisation can act on it. The key here is a good understanding of the risks but also of the incentives for both donors and their implementing

partners to act in ways that manage these risks sensibly. Good practice would also offer clear ways of stopping projects or changing direction once new information becomes available.

The New Deal

For providers of development assistance, risk is not a self-contained entity that is easy to understand and grapple with. This is particularly true when development agencies engage in fragile contexts. Fragility can have different façades, and affects a variety of countries and economies. Its symptoms include conflict of different types; long-term instability; recurring crises; and high levels of crime and violence. Those countries that are most affected by fragility are also those that are weakest in terms of development, making the least progress towards the Millennium Development Goals. An ever growing share of the world's poorest is concentrated in fragile states, and the OECD monitors financial flows to these countries. Due to the nature of fragility described above – violence, crime, instability – fragile states are probably the most challenging environments to engage in from a risk perspective.

In this context, institutional risk (and particular reputational risk) is at the other end of the scale from contextual risks. Development actors face not only the risk that development efforts fail, but worse – that fragility persists. Wasn't this what they set out to eliminate? And wouldn't they face reputational risk if they let a state plunge into chaos? One way to tackle the dilemma of balancing different types of risk is more active risk management. This awareness crystallised in the New Deal for Engagement in Fragile States in 2011, presented at the Fourth High Level Forum for Aid Effectiveness in Busan, Korea, and endorsed by over 42 countries and organisations. The New Deal sets new guidelines for supporting fragile states during their transitioning phase. Risk and risk management have a central role in the agreement, for the reasons detailed above. The New Deal acknowledges that there are risks to engaging in fragile states, and sets out the need to account for prudent risk management. Donors commit to conducting joint risk assessments and managing risk jointly as principles of the New Deal. This helps identify strategies to mitigate the risks specific to fragile states, and assess the risks of reaching a certain goal relative to the value of the goal itself.

It is easy to hedge risk by opting against a project or by pooling risk. Tackling risk is daunting. Risk management and risk mitigation requires staff and analyses; it requires expenses that produce no direct, measurable result. And it also requires political co-ordination, since the findings can cause tensions among the parties involved. It is encouraging that development agencies have already developed apt tools for managing risk; they just don't use them. In endorsing the New Deal, donors have committed to managing risk prudently – and actively. With the New Deal donors have an opportunity to take stock of the need to apply the tools they have developed in order to take risk. To facilitate best practice this report details a few of these tools, in the hope that they will be replicated and lead to new initiatives.

Take Action

In short, as this report argues, providers of development assistance can learn both from colleagues who have succeeded and those who have faced difficulties in risk management. The following ideas are based on my experiences, and complement the recommendation of the overall report:

Responsibilities need to be well defined. Senior management should ensure that risk management systems are set up properly, with sufficient attention to those operational risks that lead to reputational risk. Clear communication and a culture of shared reasonable expectations are required to ensure that these systems do not lead to poor choices and risk aversion.

Communication and information. For better and leaner risk management processes, it is crucial to define clearly the tolerance level for specific risks, given that many risks can be handled via good project management and overall risk pooling. Reasonable expectations ought to be clearly communicated to project managers: What does a good system look like? What are the stress points for reputational risks? And so on.

Set up effective authorising environments. Development agencies should have processes in which risk taking is encouraged – to an extent – with a proper concept around it, as outlined in the previous two recommendations. But it is also crucial to focus on the necessary part of risk that development agencies cannot mitigate away without jeopardising their very goal: making a difference in risky environments. Individual managers should be *responsible* for setting up risk management systems correctly and reasonably before they start a project, and for maintaining them. These systems must provide information that can be used to manage the project and as a basis for taking action, including project closure. Control systems can play a role here to ensure that all is done in line with *reasonable expectations*. Senior management throughout the system should define these reasonable expectations, and share responsibility for individual project failure when the risk management system, set up in line with those expectations, did not spot the risk of failure.

This introduction intended to set the stage for a discussion of risk management in fragile states: Exploring the general mechanisms behind risk management and human behaviour illuminates why risk management is particularly relevant in fragile contexts. The following chapters will explore the practical implications of these mechanisms for development work in fragile and conflict affected states.

1. Overview: risk management and fragile states

Over the past decade development agencies have focused a significant share of their assistance to fragile and conflict affected states.[3] This trend has inevitably exposed donor organisations and their implementing partners to a greater magnitude and variety of risks. To achieve a positive impact in these countries, providers of development assistance must manage a broad spectrum of risks. Some of these risks can be reduced and mitigated, but others cannot be avoided if donors are to seize opportunities to promote statebuilding, peacebuilding and development. Interest by development agencies in mitigating risk, whilst ensuring that longer-term development objectives are met, has led to international commitments in this area. This report intends to detail risk management practices used by donor organisations in a selection of case study countries.

This report is based on country research in 2013 in the Democratic Republic of Congo (DRC), South Sudan, Somalia,[4] Nepal and Myanmar, as well as remote research on Afghanistan and Haiti. It examines the risk management practices employed by bilateral and multilateral agencies, and identifies factors that have enabled or obstructed development agencies' ability to manage risk successfully. The report responds to the recommendation in earlier work that more evidence was needed on innovative practices in this area. It is intended to contribute to the development of policy recommendations for development agencies in their management of risk in fragile and conflict affected states. The findings are also relevant to testing the concepts and assumptions underlying the risk management literature.

The report provides many examples of effective approaches to risk management, and identifies good practice along with the reasons why good practice has been adopted. The report also highlights weaknesses in risk management that compromise the effectiveness of development cooperation. In identifying room for improvement, it seeks to highlight practical and feasible steps that can enable more effective risk management in different country settings.

Following this overview chapter summarising background, relevant concepts, as well as key findings and recommendations, the report examines case study evidence on each of the three research questions set out further below.

1.1 The New Deal and risk management

At the Fourth High Level Forum on Aid Effectiveness held in Busan in 2011, providers of development assistance committed to a New Deal for Engagement in Fragile States centred on the Peacebuilding and Statebuilding Goals. The New Deal is built on the five TRUST principles, which directly relate to risk management. These include **T**ransparency, **R**isk sharing, **U**sing and strengthening national systems, **S**trengthening capacities and **T**imely and predictable aid. These principles are expected to encourage development agencies to address the risks associated with weak donor coordination, aid volatility and avoidance of country systems. They also highlight the benefits of risk sharing practices including joint risk assessment and joint mechanisms to reduce and better manage risks.

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[3] In 2011, fragile states received USD 53.4 billion in ODA or 38% of total ODA. Following a peak in 2005, ODA to the 51 fragile states followed a downward trend-falling by 2.3% in 2011. ODA from DAC development agencies to fragile states was reduced by 0.7%. See OECD (2014) *Fragile states 2014: Domestic Revenue Mobilisation in Fragile States.*

[4] For security and logistical reasons it was not possible to conduct research in Somalia. Interviews were conducted in Nairobi where many development agencies and INGOs working in Somalia are based, as well as by email and phone.

There is increasing recognition that achieving long-term, transformational results in fragile and conflict affected states requires appropriate risk taking, and that the avoidance of risk will be harmful to development results. Recent OECD guidance states that "*International engagement in fragile and transitional contexts presents significant risks for donors and implementing partners, but holds the potential for even higher rewards in terms of improved results and outcomes. Importantly, the risks of failing to engage in these contexts outweigh most of the risks of engagement.*"[5] This recognition has led to the development of policy frameworks for donor engagement in fragile and conflict affected states emphasising the importance of well-designed risk management strategies that balance risk and opportunity, and are rooted in a solid understanding of the country context.[6] There are an increasing number of risk management procedures in use by providers of development assistance that support these aims (see Box 1).

The various tools that are being used to implement the New Deal are also important for risk management. Country-led fragility assessments, which provide an analysis of country context and contextual risks, are used for the development of national transition plans that define how governments intend to promote statebuilding and peacebuilding. Development agencies support these plans through a "transition compact" linked to a mutual accountability framework, monitoring mechanisms and political dialogue. All of these mechanisms are intended to reduce risks by strengthening confidence in the mutual commitments of governments and donors.

Although there has been a clear change in development agencies' discussions of risk at a policy level, there is limited evidence of how providers of development assistance manage risk in practice in different country contexts. Responding to this gap, the International Network on Conflict and Fragility (INCAF) Task Team on Implementation and Reform commissioned this comparative study of donor approaches to risk management in fragile and conflict affected states. The approach is based on country level findings that respond to three research questions:

1) How do providers of development assistance act in response to various categories of risk, and how does this affect the impact of aid programmes?

2) What factors explain why they respond to risks in these ways?

3) What examples can be found of effective risk management practices in different countries, and what explains their success?

1.2 Understanding risk

Development organisations are confronted by a wide variety of risks when working in fragile and conflict affected states including the failure of aid programmes, the potential to cause unintended socio-economic, political and environmental damage, and the possibility that the organisation and its staff may face harm. In order to gain clarity on the wide variety of issues covered under a risk perspective, this section briefly presents key concepts and definitions, which will be used throughout this paper.

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[5] OECD (2011), *Aid Risks in Fragile and Transitional Contexts: Improving Donor Behaviour*, http://www.oecd.org/development/incaf/47672264.pdf.

[6] See OECD (2011), *Managing Risks in Fragile States: the Price of Success?*, http://dx.doi.org/10.1787/9789264118744-en; OECD (2012), *International Support to Post-Conflict Transition: Rethinking Policy, Changing Practice*, DAC Guidelines and Reference Series, http://dx.doi.org/10.1787/9789264168336-en

Risk is commonly understood as the potential for a defined adverse event or result to occur.[7] It is typically measured against two dimensions: the **probability** of the risk occurring, and the **severity** of the outcome. It is also useful to distinguish between **risk factors**, which affect the probability and severity of risks, and **risk outcomes**, which describe what happens if the risk occurs.

Risk assessment refers to the use of tools to estimate the probability and severity of risks. This can be used to determine the priority attached to addressing particular risks. Some risks can be assessed accurately where risk factors are understood and the probability and severity of risk outcomes is known (**predictable risks**). However, more commonly there is a high degree of uncertainty about risk factors and outcomes (**unpredictable risks**). Consequently, risk assessment requires the exercise of informed judgement, and there is always an element of subjectivity.

From the perspective of aid management, risks can be grouped into three overlapping categories, referred to as the 'Copenhagen Circles' (figure 1):[8]

- **Contextual risk** refers to the range of potential adverse outcomes that may arise in a particular context, such as the risk of political destabilisation, a return to violent conflict, economic deterioration, natural disaster, humanitarian crisis or cross-border tensions. Development agencies have only a limited influence on contextual risk in the short-term, but they seek to support interventions that create conditions for reduced contextual risk in the long-term, for example by promoting statebuilding and peacebuilding processes, strengthening disaster risk management and promoting economic reforms that increase resilience in the face of shocks.

- **Programmatic risk** relates to the risk that donor interventions do not achieve their objectives or cause inadvertent harm by, for example, exacerbating social tensions, undermining state capacity and damaging the environment. Programmatic risks relate to weaknesses in programme design and implementation, failures in donor coordination, and dysfunctional relationships between development agencies and their implementing partners.

- **Institutional risk** refers to the range of potential consequences of intervention for the implementing organisation and its staff. These include management failures and fiduciary losses, exposure of staff to security risks, and reputational and political damage to the donor agency. Current risk management practices are predominantly focused on institutional risk reduction.

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[7] The discussion of risk has tended to focus on negative risk outcomes. However, risk can also be understood in broader terms to cover a range of positive and negative outcomes. Under ISO31000:2009 risk is broadly defined as "*the effect of uncertainty on objectives.*", and these effects may be either positive or negative.

[8] *Managing Risks in Fragile States: the Price of Success, op cit.*

Figure 1 - The Copenhagen Circles

Contextual risks:

State failure, conflict, economic crisis, natural disaster, humanitarian crisis, etc.

Programmatic risks:

Programmes fail to achieve objectives or inadvertently do harm.

Institutional risks:

Risks to the aid provider: security, fiduciary and reputational risks. Political damage in home country.

Lower   Extent of donor control in the short-term   Higher

Adapted from: OECD (2011), *Managing Risks in Fragile States: the Price of Success*.

The Copenhagen Circles help to specify different categories of risk, but also draw attention to connections between risk categories. One category of risk may affect another. For example, the outbreak of conflict is above all a contextual risk outcome, but also heightens programmatic and institutional risks by limiting access to conflict zones and affecting staff security. As highlighted throughout this report, donors' responses to one category of risk have a significant bearing on their ability to manage other types of risk.

1.3 Risk management in practice

The purpose of this report is to document actual risk management practices used by donor organisations in the case study countries. ***Risk management*** can be defined as an approach to setting the best course of action in areas of risk and uncertainty by identifying, assessing, understanding, acting on and communicating risk issues.[9] In some cases, risk management may be systematically conducted using purposefully designed tools, some examples of which are described in Box 1. Most commonly these tools are applied at programme or project level to assess and manage risks occurring within the scope of a single donor intervention. Typically this involves the identification of risks and mitigating measures in log frames or other planning matrices, reference to risk ratings in financing decisions, reporting on risks in regular project reports, and analysis of risk levels and risk management strategies in programme reviews and evaluations. Less commonly, some providers of development assistance have adopted tools for the monitoring of risks at portfolio level that assess levels of different categories of risk across the country programme and define portfolio level responses (see Section 4.10).

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[9] Risk Management definition as used by the Government of Canada in various forms of risk analysis. This definition is considered particularly useful.

Box 1 – Selected examples of formal risk assessment and management tools used by providers of development assistance

The World Bank's comprehensive Operational Risk Assessment Framework (ORAF) is the basis of its risk assessment processes in country programmes, sector portfolios, and for project development. The tool includes a range of risk categories broadly in line with the 'Copenhagen Circles'. However, a 2011 review of the ORAF process found that completed frameworks tended to highlight fiduciary risks to funding flows more successfully than other risks that potentially affect project implementation.[10]

Canada (Department of Foreign Affairs, Trade and Development, DFATD) has a well-developed set of risk management tools that are applied at portfolio and programme level. Its country programming teams complete a country-level risk profile on an annual basis (or more frequently when the situation warrants). The risk profile is based on a country analysis, where the Department assesses the political context, development challenges, and partner capacity (both implementing partner and local counterpart). An integrated gender equality and governance lens enables conflict-sensitive programming. In the country context review and initial risk assessment stages, DFATD encourages the involvement of implementing partners, beneficiary government, DFATD sector specialists and other development agencies to ensure a comprehensive assessment. This country risk profile is one of several strategic tools reviewed when designing a country programming strategy. This enables the allocation of funding to 'lower' and 'higher' risk programmes in accordance with the programmes' appetite for risk, with proper risk response measures for each risk identified. Additionally, an investment risk profile (or risk register) is completed for each individual project under the country programme. The investment and country risk profiles are complementary when planning and monitoring investments in a country.

Denmark (Danida, Ministry of Foreign Affairs of Denmark) explicitly recognises that risk is an integral part of development work. Rather than aiming to minimise risk, it states that it is willing to accept the high levels of risks associated with experimentation or difficult environments, while working systematically to assess and prevent risks across its work. It is working on the development of a single Risk Assessment Form to be trialled through a pilot study of Danish contributions to the Common Humanitarian Fund in Somalia. Emphasis is placed on categorising and measuring the significance of identified risks, and highlighting where action needs to be taken to mitigate risks.

The United Kingdom's Department for International Development (DFID) has conducted a range of risk assessment studies and devised briefing papers, some with specific relevance for conflict-affected environments. Rather than applying a universal framework, DFID follows a decentralised approach to risk management. Fiduciary risk assessments monitor specific financial risks, but other risks (risks to DFID staff and resources, risks to the delivery of international development, risks faced by poor people) are addressed through a range of tools employed by programme planners and policymakers at different levels.

Sources: World Bank (September 2010), *Guidance note on the Operational Risk Assessment Framework (ORAF): Risks to achieving results*, Operations Policy and Country Services.

DFATD (May 2013), *Guide - developing risk management profiles for programmes and initiatives*.

Toft, E./Danida (19 October 2011), *Background Note on Development of Risk Assessment Form for Danish development assistance,* Draft.

DFID (2010) Working Effectively in Conflict-affected and Fragile Situations, Briefing Paper H: Risk Management.

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[10] World Bank (October 2011), *Risk-Based Approach: FY 11 Implementation Report*, Investment Lending Reform, Operations Policy and Country Services Division.

This report adopts a broad view of risk management practices, which are seen as cutting across aid management functions. While development agencies may use formal risk management tools at particular moments in the programme cycle, their day-to-day decision making on programme and project management is also influenced by risk management concerns. Risk management cuts across all aspects of donor work, including programming, monitoring and evaluation, financial procedures, managing relationships with partners, engaging in research and knowledge gathering, sourcing technical assistance and communicating results. In short, providers of development assistance are constantly engaged in risk management, whether or not they refer to it as such.

Taking a broad perspective of risk management, the report aims to understand donors' actual practice including the use of formal tools and mechanisms for risk management, and more general treatment of risk that arises through a range of aid management practices.

Approaches to risk management can be placed into the following broad categories:

- *Risk avoidance* refers to the practice of refraining from activities associated with high levels of risk. In many circumstances risk avoidance is a rational risk management practice. Yet, it becomes counterproductive when it results in development opportunities being missed. In some of the literature on risk there is a general assumption that development agencies are *risk averse,* meaning that they prefer to fund safer interventions with a lower probability of failure even where the expected benefits (taking all potential outcomes into account) are lower than alternative higher risk interventions.[11]

- *Risk mitigation* refers to the use of specific measures to reduce risk. This can be directed at addressing risk factors so as to reduce the probability and severity of risk outcomes. Alternatively, risk mitigation may include adaptations to the design and management of programmes so as to limit their vulnerability to disruption in the face of particular risk outcomes.

- *Risk sharing* refers to the agreement of several actors to expose themselves to risk and to spread the burden of potential losses. An important example is the use of pooled funds (see Section 4.5).

- *Risk transfer* refers to situations where exposure to a particular type of risk is transferred from one party to another. Insurance against natural hazards is an example of risk transfer, which involves the insurer taking on the risks of the insured in exchange for the payment of a premium. Another example occurs in situations of remote aid management where development agencies limit their presence in insecure zones, and transfer implementation, management and monitoring responsibilities to NGOs and other partners.

- *Risk acceptance* refers to the decision to accept or tolerate a level of risk. Often providers of development assistance will try to reduce risk through various strategies of risk mitigation, sharing and transfer, but will be left with a level of *residual risk* that they will need to accept in order to operate.

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[11] *Aid Risks in Fragile and Transitional Contexts: Improving Donor Behaviour*, op cit.

Each of these approaches can be applied in different ways to the categories of contextual, programmatic and institutional risk. Table 1 below explains what each approach to risk management entails in relation to the management of contextual, programmatic and institutional risk.

Table 1 How can each risk management approach be applied to contextual, programmatic and institutional risk?

	Contextual risk	Programmatic risk	Institutional risk
Risk avoidance	Development agencies can avoid contextual risk by not investing in fragile or conflict affected states, or by selecting programmes that are unlikely to be affected by contextual risk.	Providers of development assistance cannot completely avoid programmatic risk, but may restrict activities to low-risk programmes that are more likely to deliver on objectives, demonstrate value for money and avoid doing harm.	Donors can avoid fiduciary risk by taking full control of financial procedures and setting up parallel systems. Providers of development assistance can avoid security risks through heavy protection, reduced mobility, or using systems for remote aid management.
Risk mitigation	Development agencies can reduce contextual risks in the long-term by supporting statebuilding and peacebuilding programmes, disaster risk management and economic reforms. Providers of development assistance can reduce the effects of contextual risk outcomes on programme performance by design adaptations, for example by building in contingencies and flexibility.	Development agencies can mitigate programmatic risk through sound programme design, appropriate setting of targets, regular monitoring and evaluation, effective donor coordination and management of relationships with government and implementation partners. Providers of development assistance can mitigate the risk of doing harm by using conflict sensitive programming tools.	Providers of development assistance can mitigate fiduciary risks by imposing strong financial controls and limiting the use of country systems, as well as helping countries to strengthen their fiduciary systems. Donors can mitigate reputational and political risk by carefully communicating and explaining their actions to key constituencies in the donor and beneficiary country. They can also engage independent evaluators to assist in reviewing institutional risks. Development agencies can mitigate security risks by designing suitable security procedures including improved community relations and communication
Risk sharing	Providers of development assistance can share information on contextual risk through joint risk assessments. Development agencies can share contextual risk by participating in multi-donor programmes.	Donors can share programmatic risk by participating in multi-donor programmes.	Providers of development assistance can share fiduciary and reputational risks by participating in multi-donor programmes. They can also pool resources for fiduciary risk management and thereby achieve economies of scale.

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Risk transfer by development agencies to implementing partners	Development agencies cannot fully transfer contextual risk to implementing partners	Providers of development assistance can partly transfer programmatic risks by making implementing partners responsible for results. They can fully transfer programmatic risks using 'payment on results' modalities.	Providers of development assistance can transfer security risks to implementing partners who are required to work in insecure zones on the donor's behalf. Providers of development assistance can also transfer fiduciary risk to implementing partners where they demand repayment of their funds in cases of corruption.
Risk acceptance	Development agencies have limited influence over contextual risks, meaning that they must accept some exposure to contextual risks when working in fragile and conflict affected states.	Acceptance of programmatic risk requires providers of development assistance to recognise that some programmes will fail and some may do harm.	Acceptance of institutional risks is often very limited.

1.4 Selected case studies: how development agencies act on risk

The case studies highlight the varied and complex ways in which providers of development assistance respond to different categories of risk. In many cases development agencies have avoided high risk programming choices required to support statebuilding, peacebuilding and other forms of transformational change, and have instead opted for safer programmes concerned with direct service delivery. There appear to be two main explanations: (1) aversion to programmatic risk and pressure to demonstrate short-term results and value for money, and (2) aversion to fiduciary risk that has dissuaded donors from using country systems to manage aid funds. These tendencies limit agencies' ability to address the challenges of statebuilding and peacebuilding. Furthermore, the avoidance of using country systems creates risks of doing harm by undermining government institutions and public accountability. This demonstrates the important connections and trade-offs between different categories of risk. Essentially donors' aversion to institutional and programmatic risk is making it more difficult to support statebuilding and peacebuilding programmes that help to mitigate contextual risks. Ultimately this is likely to undermine the long-term impact of aid.

This finding supports the conclusion of previous studies that "donors are unduly risk averse in their aid engagement in fragile and conflict affected states."[12] However, the patterns observed in the case study countries suggest that donor behaviour towards risk is more varied than previously assumed. Several examples were found of providers of development assistance supporting interventions with high programmatic risk, including the payment of government salaries in Somalia, large-scale support for institution building in Afghanistan, and the increasing focus on institutional reform in Haiti.

Risk behaviour appears to be influenced by numerous factors that push development agencies in different directions. Risk aversion appears to be strongest where development agencies face strong domestic reputational and political pressures, where their country knowledge is limited, and where organisational incentives create pressure to demonstrate short-term results. Other factors can encourage providers of development assistance to engage in more calculated risk taking that can

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[12] *Aid Risks in Fragile and Transitional Contexts: Improving Donor Behaviour*, op cit.

enable greater engagement in processes of peacebuilding and statebuilding that are likely to offer greater results in the long-term. The most important of these risk enabling factors include:

    (1) foreign policy, international security pressures and humanitarian imperatives that cause donors to take a greater interest in political stabilisation and institution building,

    (2) clear appreciation of the risk of increased fragility and state collapse,

    (3) donor commitments to cross-cutting objectives such as gender equality, justice and human rights, which appear to broaden their perspective beyond short-term results,

    (4) investment in country analysis and knowledge (including appropriate staff training and valuing staff's country knowledge),

    (5) long engagement and experience in the country,

    (6) risk sharing between donors in the context of pooled funds and other coordinated approaches.

Table 2 provides an overview of the selected case studies, and the applied key risk management themes as identified and outlined by the researchers. The case studies were selected after expert review, but represent the political economy review and summary of the researchers.

<p style="text-align:center">Table 2 - Risk profile and research focus for the case study countries</p>

	Risk profile			Case study focus
	Contextual risk	**Programmatic risk**	**Institutional risk**	
Democratic Republic of Congo New Deal Pilot country Main donors studied: UK, Germany, Belgium, UNDP, EU	Significant political risks: weak government capacity, lack of public accountability and limited reform commitment. Ongoing conflicts and humanitarian crisis in eastern DRC.	Programmatic risks created by problematic relationships with government agencies and national NGOs. Substantial risks of doing harm where development projects heighten local tensions.	High security risks in eastern DRC. Working through government systems carries a particular risk of loss of funds through misappropriation, procurement fraud and other consequences of weak PFM. Providers of development assistance face potential reputational damage through association with a regime commonly perceived to be corrupt and abusive of human rights.	1) Managing and reducing conflict risks. 2) Managing risks associated with working through country systems. 3) Managing security risks.
South Sudan[13] New Deal Pilot country Main donors studied: UK, Norway, Denmark, Netherlands, UNDP, EU	Political tensions reflecting ethnic divisions and varied experiences of conflict. Serious clashes along the Sudan-South Sudan border in 2012. Several local conflict hotspots within South Sudan. Reliance on oil production and export through the Republic of Sudan leading to volatility in revenues. Shutdown of oil	Programme objectives may be underachieved as a result of insecurity, cost overruns, weather related inaccessibility, administrative obstacles and difficulty securing commitments from local partners. Programmes working with government counterparts face high programmatic risks arising	Security problems currently experienced in Jonglei, Upper Nile, Lakes, Unity, Warrap and Eastern Equatoria. Most donor aid is channelled through international NGOs or UN agencies because the fiduciary risks of working through government systems are very high in the absence of well-established PFM and procurement systems.	1) Managing contextual risks surrounding the oil shutdown and border skirmishes. 2) Managing risks associated with working through country systems. 3) Managing risks through donor coordination and pooled funding. 4) Donor actions to address the operating risks of NGOs. 5) Need for a more integrated approach to development and

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[13] Note this research was undertaken in the summer of 2013 prior to the 2013/2014 conflict in South Sudan.

	production in 2012. Large influx (500,000+) of returnees and refugees since 2010.	from weak capacity and management systems and uncertain government commitment. Substantial risk that development programmes working selectively with particular target groups can exacerbate local tensions and inequalities.		peacekeeping.
Somalia New Deal Implementation recently launched in May 2013; compact signed in September 2013. Main donors studied: Denmark, UK, Germany, Australia, Belgium, Switzerland, Canada, US, World Bank, EU, UNDP	Continued conflict and violence, weak capacity and authority of newly established Federal Government of Somalia, limited legitimacy, low accountability, ongoing external interference. Risk of further humanitarian crisis. Unclear relationships between local and national levels, including autonomous regions.	Programme impact is affected by sometimes mixed levels of government commitment to development and statebuilding, personalised politics, rent-seeking incentives, and extortion. Weak government systems and lack of engagement with local political systems affect interventions aiming to move from humanitarian to development approaches. Incentives for NGOs to report accurately from the field were restricted by rigid anti-corruption approaches applied by development agencies.	Donor involvement is driven by international security concerns about the need for stabilisation in Somalia. Corruption has become a major issue given concerns about aid money inadvertently funding 'terror' groups. Access and security risks affect programme delivery. Remote management techniques allow continued engagement, but with limited monitoring and evaluation.	1) Using country systems and strengthened public financial management 2) Managing fiduciary and corruption risks using specialised risk management services 3) Remote aid management systems
Nepal Main donors studied: UK, Switzerland,	Presence of a range of challenges, including a lack of government authority and legitimacy. Efforts to promote	Donor focus on conflict sensitivity may be weakening as conflict memories recede.	Fiduciary risks are judged to be high when working with national partners, both state and non-state actors, at local and national levels.	1) Grounding strategy in an improved understanding of contextual risks 2) Conflict Sensitive Programming (Basic Operating Guidelines)

Denmark, Germany, USAID, JICA, World Bank, Asian Development Bank, UNDP	social inclusion meet entrenched opposition from elite groups. Continued risk of political instability at the national level and violent disturbances assuming different forms in various parts of Nepal.		Reputational risks include high levels of corruption and human rights violations in Nepal. These challenges increase risk aversion among development agencies. Security problems have declined in Nepal, but remain a threat.	3) Using specialised services for risk management (Risk Management Office) 4) Use of Country Systems (Nepal Peace Trust Fund)

2. Evidence on how providers of development assistance act on risk

Referring to the first of the three questions stated in the overview chapter, this section summarises evidence on how development agencies act in response to various categories of risk. The section assesses broad evidence of the extent to which donors have used the different risk management approaches detailed in Section 1.4 (Table 1) in relation to contextual, programmatic and institutional risk. It concludes with an assessment of how these broad responses to risk have affected the impact of aid programmes.

2.1 Contextual risk

Donors' expenditure in fragile and conflict affected states indicates their willingness to engage in situations of high contextual risk with 38% of ODA devoted to these countries.[14] In all the case study countries, contextual risks have remained high over this period. This indicates that providers of development assistance are not seeking to avoid the contextual risks of supporting fragile and conflict affected states (or that risk avoidance has lessened over time). Development agencies have instead consciously chosen to invest greater resources in countries prone to contextual risk. This reflects a combination of development, humanitarian and foreign policy objectives discussed in Section 4.

Figure 2 - ODA flows to case study countries 2004-2011 (USD millions; net disbursements ODA)
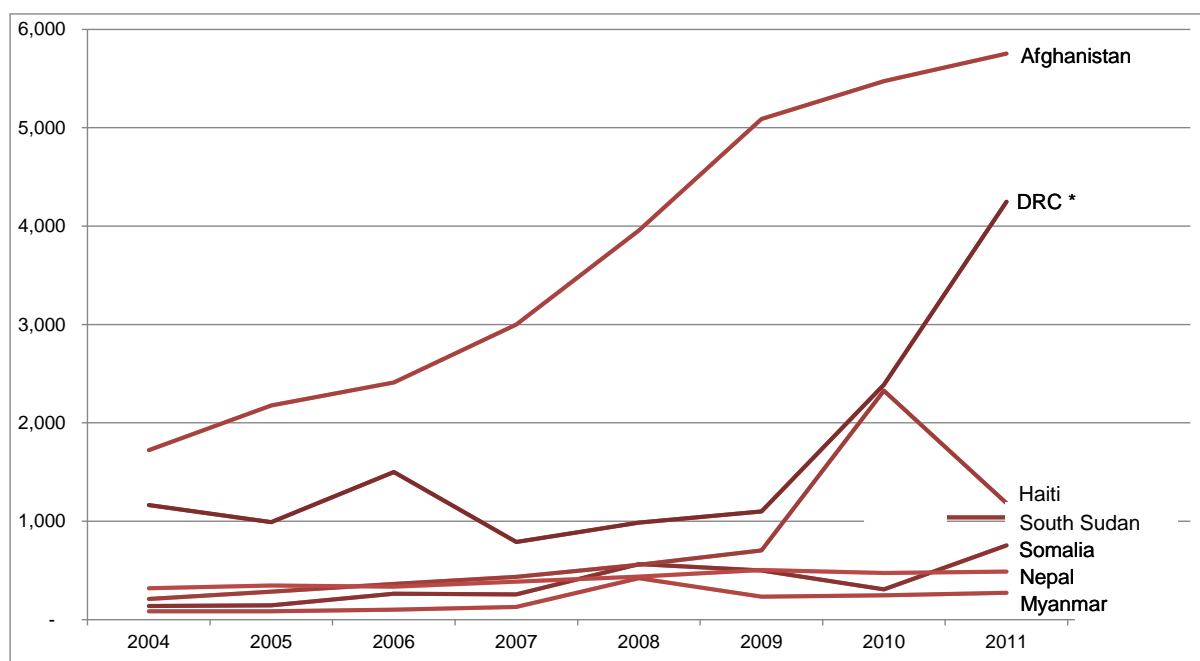
OECD (2012), Statistics on resource flows to developing countries, Table 2.

* Note that the figure relating to the DRC for 2011 includes debt relief. Without debt relief net ODA to DRC in 2011 was USD 2.29 billion.

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[14] OECD (2014), Fragile States 2014: Domestic Revenue Mobilisation in Fragile States, http://www.oecd.org/dac/incaf/FSR-2014.pdf.

Table 1 shows that development agencies have engaged in various strategies to *mitigate* contextual risks. There has been a focus on initiatives aimed at reducing contextual risk in the long-term by promoting statebuilding and peacebuilding (evident to varying extents in all countries), supporting disaster risk management (most evident is Haiti and Somalia), and encouraging economic reforms that increase resilience to macroeconomic shocks (evident for example in proposed New Deal commitments in South Sudan).

In devising strategies to mitigate contextual risk, providers of development assistance have needed to ponder a variety of guidance on appropriate strategies to reduce conflict and fragility. This includes the statebuilding literature that emphasises the need to restore core state functions,[15] the 'good enough governance' literature that focuses on issues of prioritisation, sequencing and achievable next steps,[16] and the post 2011 World Development Report focus on 'best fit' solutions tailored to local context. Approaches are also grounded in perceptions of the failings of previous work in fragile states, and recognition of the need to avoid overloading programmes and setting unrealistic statebuilding goals. In spite of this experience, there is still considerable uncertainty about the efficacy of alternative strategies for statebuilding and peacebuilding, especially in situations where power is exercised through informal institutions, and where elite incentives are not aligned with long-term development goals.

As discussed further in Section 2.2, donor strategies to reduce contextual risk require interventions that carry high programmatic and institutional (mainly fiduciary) risk. Donors' focus on programmatic and institutional risk has varied between countries, according to the need for addressing contextual risk. Development agencies have often preferred lower risk programming in fragile and conflict affected states leading to a strong focus on humanitarian programmes and direct service provision (often provided by NGOs rather than government service providers).

Contextual risk has also been mitigated by selecting and designing programmes in ways that are less likely to be thrown off course by adverse contextual risk outcomes. This in part explains the preference towards direct service delivery and humanitarian support. Such programmes are less likely to be affected by changes in the political environment, especially where they are delivered by non-state actors. However, they often lack transformative impact in terms of building national systems and institutions.

Within this general depiction of approaches to managing contextual risk, there is **much variation between countries**. There are some examples of providers of development assistance adopting a focused approach to statebuilding and peacebuilding with the aim of reducing contextual risk in the long-term. This is most evident in countries with a higher risk of state failure where development agencies have prioritised the need to ensure the basic functions of government and have financed civil service salaries. This has been undertaken in Afghanistan and Somalia. State security expenditures have also been financed in Afghanistan and Somalia through non-ODA channels. In South Sudan and Afghanistan, this approach was accompanied by a strong focus on building formal state institutions, including the large-scale provision of technical assistance embedded within ministries. While these approaches aim to

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[15] OECD (2011), Supporting Statebuilding in Situations of Conflict and Fragility: Policy Guidance, DAC Guidelines and Reference Series, http://www.oecd-ilibrary.org/development/supporting-statebuilding-in-situations-of-conflict-and-fragility_9789264074989-en.

[16] Grindle, M. (2011), "Governance Reform, The New Analytics of Next Steps", *Governance: An International Journal of Policy, Administration and Institutions*, 24(3).

reduce contextual risk factors in the long-term, they are also highly exposed to near term contextual risk outcomes, for example a political or security crisis. Development agencies funding such operations need to demonstrate *acceptance of contextual risk*, as well as tolerance of the high programmatic and fiduciary risks that are also involved.

In several cases the existence of high contextual risks appears to have **dissuaded providers of development assistance** from direct support to state or other endogenous institutions. The DRC case study documents a trend towards reduced support to institution building projects in government, and an increasing focus on direct service delivery. This appears to reflect development agencies' lack of confidence in government reform commitments, and concerns around the conduct of the 2011 elections. In Myanmar, political reforms have encouraged greater donor engagement in the country, but direct support to state institutions has so far been limited given continued concerns over the political change process (see also Section 3.2).

In several cases (DRC, Somalia, Afghanistan, Haiti and Nepal) donor governments and the UN have supported **concerted efforts to establish stable governance through elections or other means**. Donors have also offered technical assistance to ministries and at times funded government salaries. In Nepal, for example, donors have taken risks in promoting more inclusive governance, addressing discrimination and empowering disadvantaged groups (see Sections 5.1 and 5.2). However, in some cases (DRC for example), providers of development assistance have engaged less widely in supporting accountability, inclusiveness, state-society bargaining and a more stable political settlement.

Donor programmes in the case study countries have generally **followed relatively conventional approaches to statebuilding** focussed on strengthening formal institutions. There has been a tendency to focus on more immediate stabilisation goals and restoring basic state functions. While this is often an overriding priority, there are risks in following this approach, especially where power is exercised through informal institutions (e.g. networks of patronage), where states lack legitimacy, where elites do not share statebuilding and peacebuilding goals, and where human rights are violated. This highlights the complexity of the statebuilding and peacebuilding agenda, and the need to balance objectives of restoring state authority against concerns about public accountability, inclusiveness, human rights, gender, justice and democratic governance. Striking the right balance is very difficult and requires deep contextual understanding and sensitivity to the complexity of the statebuilding and peacebuilding agenda.

All of the case study countries provide **examples of targeted conflict reduction and stabilisation programmes** aimed at directly reducing conflict risks. Most commonly these are individual programmes or components of programmes, but there are also some large-scale multi-donor initiatives, such as the proposed revamped International Security and Stabilisation Support Strategy (I4S) in eastern DRC. However, some weaknesses in the management of conflict risks are also evident in most case study countries. In most cases, conflict risks were addressed through separate programmes rather than through a peacebuilding strategy mainstreamed across the country programme as a whole.

There are also questions regarding the geographical and sector focus of donor programmes. As interviews suggest, in South Sudan[17] and Nepal[18] for example, the bulk of donor funding has

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[17] With the exception of humanitarian aid, there has been a tendency by development agencies to focus on investment in the more accessible and less conflict prone parts of the country in the Equatoria provinces.

not been focussed on the most conflict prone parts of the countries at the time of research, and in DRC some interviewees suggested that donors should be more engaged in critical sectors for conflict reduction, in particular land and natural resources management. Some of these examples indicate the tensions that development agencies often experience between considerations over where it is best to work from a growth and poverty reduction perspective, and where resources need to be invested for conflict reduction. There are risks inherent in unequal aid distribution where this generates perceptions of regional and ethnic disadvantage.[19]

2.2 Programmatic risk

Programmatic risk varies greatly according to the types of programmes that providers of development assistance decide to fund. Some programming choices are relatively low-risk in the sense that they are likely to achieve objectives and unlikely to do harm, while other programming choices are inherently risky. The case studies provide evidence on the level of programmatic risk embodied in development agencies' programming choices.

There is experience from several case study countries where donors have **tended to avoid funding interventions with high programmatic risk**. This was evident in DRC, South Sudan, Myanmar and Haiti, where there has been a preference for funding direct service provision and humanitarian assistance, usually delivered by non-state actors outside of government systems. These programmes have generally sought to meet immediate social development objectives, and have given limited attention to promoting systemic change, policy and institutional reform required for lasting improvements in service delivery and government performance. Addressing these areas requires providers of development assistance to take on significant programmatic risks because donor support to reform and systems building can easily be undermined by weak political commitment and weak capacity within government. In DRC there appears to be a rather limited (and probably declining) focus on strengthening government functions and capacity. In Myanmar, programming outside the sphere of humanitarian support and international NGO service provision has so far been limited because opportunities to work directly with government have until recently been extremely constrained.

These examples indicate a common tendency by development agencies to avoid programmatic risk. However, there are **many exceptions where development agencies have accepted higher programmatic risk**. In Afghanistan providers of development assistance have been heavily engaged in supporting the core functions of government through large-scale institution building programmes and payment of salaries. These programmes have had both positive and negative results; they indicated problems such as fiscal sustainability, civil service overstaffing and underperformance, highlighting the at times high programmatic risks of ambitious statebuilding programmes. In Somalia, where aid has so far mainly been directed at humanitarian relief, some donors are providing assistance to the new government as part of wider international backing and recognition. This includes the payment of salary costs and support for core government functions. In DRC there are some examples of higher risk

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[18] Foreign aid has tended to concentrate on central and highland parts of Nepal, partly in response to higher poverty levels in those areas but also reflecting how the lowland region that has experienced acute conflict tensions in recent years was often marginalised from donor as well as government decision making.

[19] There may also be a concern that focusing more aid on conflict prone areas rather than the peaceful ones can be perceived as rewarding violence, creating perverse incentives and possibly fuelling tensions in areas which are relatively peaceful.

programming choices. For instance, DFID has funded police reform, Belgian Technical Cooperation is engaged with institutional development programmes for the Ministries of Rural Development, Agriculture and Education (see Section 4.6), and several providers of development assistance are preparing to support public financial reform through a pooled fund. In Haiti, post-earthquake humanitarian support is giving way to an increasing emphasis on institution building needs, as exemplified by Canada's support to police and customs and tax reform.

The case study experience revealed some **cases of risk sharing and risk transfer in relation to programmatic risk**. Multi-donor funding arrangements have often been used in cases of high programmatic risk. Examples are institutional strengthening programmes in Afghanistan (funded under the Afghanistan Reconstruction Trust Fund) and Somalia (Special Financing Facility), as well as PFM reform programmes in DRC and Somalia. In such cases risks are spread between donors, who would share losses if programmes failed to achieve objectives. The management of these programmes is often entrusted to multilateral agencies, which may be in a stronger position to bear and manage programmatic risk (see Section 4). Such arrangements enable bilateral providers of development assistance to support programmes with higher programmatic risks, and to transfer risk management responsibilities to the multilateral partner. Bilateral agencies obtain a degree of cover from multilateral funding, although risks are not fully transferred, and the bilateral donor remains ultimately responsible for ensuring that its resources deliver development results.

2.3 Institutional risk

Fiduciary risk. Case study experience indicates a strong tendency by development agencies to *avoid fiduciary risk*. Bilateral agencies subject to high level of domestic public and parliamentary scrutiny are particularly concerned about such risks, which in some cases threaten their ability to continue operating in a particular country. One donor in DRC described corruption risk as an 'existential risk'.

Avoidance of fiduciary risk **clearly influences choices on aid modalities**. In DRC, South Sudan and Haiti providers of development assistance (bilateral agencies in particular) work mainly through international NGOs and specialised UN agencies. However, in Afghanistan and Nepal the use of country systems is significantly greater, albeit subject to significant donor controls. In Somalia there is also increasing willingness to devise ways to fund government operations (including army and civil service salaries). Other studies also support the finding that development agencies' aversion to fiduciary risk has held back their use of country systems. One recent study suggests that "donors tend to give more weight to risk factors than to the potential benefits of using country systems."[20]

Providers of development assistance also face **fiduciary risk when they work with NGOs and other non-governmental implementing partners**, UN agencies and trust fund managers. These risks can most easily be managed where development agencies are in close contact with their implementing partners. However, development agencies face significant challenges when they must manage such relationships remotely, and where aid delivery involves a long chain of intermediaries. Amongst the case study countries, these challenges are most evident in Somalia, where security concerns limit donors' country presence and require providers of

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[20] OECD (2011), *Using Country Public Financial Management Systems: Practitioner's Guide*, http://www.oecd.org/dac/effectiveness/49066168.pdf.

development assistance to use remote management systems. Until recently many development agencies adhered rigidly to a zero-tolerance approach to corruption, which has been criticised by NGOs, as a form of risk transfer or risk dumping rather than risk management on the part of development agencies. The Somalia case study documents an instance of an NGO being required to return donor funds following a report of corruption that the NGO itself brought to light. Such experiences tend to discourage open and willing disclosure of incidents where programmes have encountered corruption. Recognising this problem, providers of development assistance are developing improved approaches to fiduciary risk management in Somalia that involve greater risk sharing, as illustrated by the UN Risk Management Unit discussed in Section 4.9.

Reputational and legal risks. Reputational risks closely mirror fiduciary risk. In cases where funds have been lost or have been diverted, development agencies may face reputational and political damage in their home country. This is most apparent where domestic media take a particular interest in donor performance and cases of misuse of funds, a trend that has become more apparent in OECD countries affected by budget austerity. Development agencies can become particularly averse to fiduciary risk under this reputational pressure.

Providers of development assistance face **particular reputational and legal concerns when operating in territories with sanctioned terrorist groups**. This is a particular issue in Somalia where donors stopped funding programmes in Al-Shabab held areas across southern and central Somalia for fear of reputational damage and legal repercussions in the USA and Europe. It has been suggested that the resulting inaction on the part of humanitarian actors, along with Al-Shabab's denial of access to many humanitarian actors, worsened the effects of the 2010/2011 famine. [21] Learning lessons from this experience, many donors have since shifted their position to enable continued humanitarian access to vulnerable populations while working jointly with implementing partners on managing risks in a more flexible manner.[22]

Providers of development assistance are particularly concerned about **avoiding reputational risk in their home country**. The case studies indicate that there is typically less concern about their reputation in the beneficiary country. However, development agencies' reputation in Nepal has been challenged following a backlash from established elites, who have complained that development agencies risk destabilising the country by promoting more affirmative approaches to social inclusion and low-caste rights. Recognising the need to mitigate the risk of further reputational damage, development agencies have somewhat modified their approaches by continuing to promote an inclusion agenda, but in a more sensitive and low profile manner. Local sensitivities also prompted USAID to waive its normal approaches to publicity and branding in Somalia. In Haiti the reputation of the international community has been tested by local frustrations about the slow pace of reconstruction, and public anger about cholera infection (likely brought to the country by UN peacekeepers).

Security risks. There are enormous variations in security conditions between and within the countries reviewed for this report. Consequently, approaches used to manage security risks vary greatly. The case studies identified several examples where security problems have limited

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[21] For additional information, please refer to Hammond, L. and Vaughan-Lee, H. (April 2012), Humanitarian space in Somalia: a scarce commodity, HPG Working Paper, ODI, http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/7646.pdf.

[22] Humanitarian space in Somalia: a scarce commodity, op cit.

access to the field on a temporary or longer-term basis (for example, parts of North Kivu province in eastern DRC, Jonglei State in South Sudan in 2013 and large parts of Somalia).

In general, donor agencies are **averse to exposing their own staff to insecurity**. Strict security protocols often limit ability to travel. This applies particularly to Somalia and to parts of DRC. For example, USAID staff have not been allowed to visit North Kivu province in DRC for the past 12 months at the time of drafting this report. Providers of development assistance are able to continue working in these areas through implementing partners, who are typically more accepting of security risks. Implementing partners are able to continue operating by mitigating security risks through a variety of practices including building community acceptance, maintaining high mobility, withdrawing temporarily during security crises, sharing information on security conditions and incidents, and applying different security protocols to local and international staff. In broad terms, implementing partners appear to manage local security risks effectively, and are able continue working in insecure zones. However, they certainly face a significant cost in terms of deaths and injuries to staff, and disruptions to their ability to access project areas.

These practices have led to a **debate** on the extent to which **development agencies have *transferred or dumped security risks* on their implementing partners**, and whether in turn international NGOs have transferred security risks to local NGOs, who operate at the front line in insecure zones. While the burden of security risks falls heavily on implementing partners and local staff in the case study countries, it is unclear whether this amounts to unfair risk dumping.[23] More likely this simply reflects the varying acceptance of security risk by different partners, and their ability to work safely in the field.[24] Interviews with implementing partners in the case study countries indicated that they generally do not perceive a problem of risk transfer (they accept security risks as part of their development or humanitarian mission), but they are concerned that development agencies need to recognise more fully the risks faced by implementing partners, and should afford them sufficient flexibility in programme delivery to keep their staff safe.

2.4 Consequences of risk responses for the impact of aid programmes

The case studies provide some indications on how donor responses to different categories of risk are affecting the impact of aid. Some general findings emerge, which point to a common tendency for providers of development assistance to avoid:

- Fiduciary risk (and related reputational risk) which has made donors reluctant to channel funds through country systems where there is a significant danger of funds being lost through corruption and embezzlement.
- Programmatic risk which has tended to result in relatively safe programming choices (direct service delivery and humanitarian support) that limit the extent to which development

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[23] Wille, C. and Fast, L. (2013), Operating in Insecurity, Shifting patterns of violence against humanitarian aid providers and their staff (1996-2010), *Insecurity Insight*, http://www.insecurityinsight.org/files/Report_13_1_Operating_in_Insecurity.pdf. This paper argues that the increased number of attacks against aid workers mainly reflects the increase in humanitarian programmes in insecure zones rather than a transfer of security risks from one party to another.

[24] Some NGOs reported that their local staff felt safer than other local residents because they had better access to security information, mobility and communications.

agencies engage in supporting systems building, institutional strengthening and policy reform.

The avoidance of fiduciary and programmatic risk tends to **limit donors' support for higher risk activities** that are necessary to support statebuilding, peacebuilding and economic reform that in turn help to reduce contextual risk over the long-term.

A large body of work (e.g. OECD's Peacebuilding and Statebuilding Guidance) indicate that these higher risk areas can help reduce contextual risk over the long-term and offer substantial benefits. However, the evidence from the case studies suggests that providers of development assistance often avoid investing in these areas as a result of their risk management practices (and aversion to programmatic and fiduciary risk). This is likely to reduce the impact of aid over the longer-term.

Some examples from the case studies suggest that higher risk interventions aimed at supporting statebuilding and peacebuilding have the **potential to deliver significant development impact**. For example, the payment of salaries to government workers in Somalia could deliver significant benefits in terms of stabilisation and assuring basic state functions which will be essential for future development. There may be limitations to institution building programmes in Afghanistan, although in broad terms there is a strong case that they have helped to strengthen the capacity and resilience of government institutions.

The case studies also highlight several ways in which **donor risk management practices may undermine aid impact**. Development agencies' reluctance to channel funds through country systems as a result of fear of corruption or misuse is understandable, but risks doing harm over the longer term by undermining government institutions. When development agencies establish parallel systems for aid delivery they often draw human resources and skills out of government systems, heighten problems of institutional fragmentation, weaken systems of public accountability, and make it harder for government to implement coherent policies and a unified budget.

Donor responses to security risks also have consequences that affect the impact of aid programmes. Limitations on donor travel to the field make it difficult to monitor the performance and financial systems of implementing partners, and hinder development agencies' analysis of contextual risks and shifting local political and social dynamics. In these conditions it is more difficult to manage fiduciary, programmatic and contextual risks, and aid impact is likely to be reduced. As discussed in Section 4.9, some of these issues can be partly addressed through measures to enable 'remote working' (as has occurred in Somalia).

3. Explanations of donor responses to risk

The previous section identified a variety of donor responses to different categories of risk. This section analyses the variety of factors that affect donor responses to risk. These relate in particular to global policy trends, the political economy of donor organisations and development agencies' operational practices. These drivers tend to push donor approaches to risk management in different directions resulting in the significant variations observed between providers of development assistance and country contexts.

3.1 Global policy trends and the New Deal

Increased donor engagement in the case study countries can be viewed as **part of a global policy trend** leading to increased focus on the needs of fragile and conflict states. This reflects the changing policies of individual agencies, the policy work of global fora such as OECD-DAC, the organisation of fragile and conflict affected states under the G7+ grouping, and international commitments to the New Deal backed by high profile international meetings such as those covering South Sudan (April 2013) and Somalia (September 2013). There is a widespread recognition that state fragility and collapse carries unacceptable humanitarian, development and international security costs. Increasingly, the risks of inaction are being viewed as exceeding the risks of engaging in fragile and conflict affected states. This broad shift in understanding is an underlying driver of increased donor engagement in fragile and conflict affected states, and increased acceptance of the high contextual, programmatic and institutional risks of operating in these countries.

3.2 The political economy of donor organisations

Donor responses to risk are shaped by the incentives facing individual staff and the organisation as a whole. Some of these incentives arise from external pressures acting on the organisation, while others relate to internal management pressures, career incentives, and the organisation's own risk culture.

The case studies and evidence from other literature suggests that donors' attitude to risk is **influenced by broader foreign policy and international security concerns**. Development agencies appear to be more willing to fund interventions with higher programmatic risk in countries that are viewed as strategically important. These include: Afghanistan, which has been subject to long-term NATO support;[25] Somalia, which is the focus of international efforts to contain terrorism and piracy; and in 2013 South Sudan, which has received western backing in its secession from Sudan. In these countries providers of development assistance appear more willing to engage in challenging and high-risk statebuilding activities, to work through country systems, and to set aside concerns about fiduciary risk. Following political reforms, there is also

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[25] In Afghanistan, there has been increasing alignment between development programming and broader security and military strategy. The 2009 McChrystal Strategy for NATO's International Security Assistance Force (ISAF) emphasised the need for greater focus on "responsive and accountable governance" as an essential element of stabilisation and counter-insurgency. As a result, both development and military actors have moved towards a greater focus on building state legitimacy and capacity. This has encouraged development agencies to work through country systems and to emphasise Afghan leadership. There is an increasing focus on statebuilding, including governance initiatives at local level in conflict affected zones.

intense international interest in Myanmar. However, development agencies have only increased aid at a modest pace and have limited their engagement with government.[26]

Contextual factors within aid receiving countries can also affect risk tolerance. Development agencies appear to be more willing to make riskier programmatic choices when there is an immediate challenge (for example an upcoming election) or a risk of state authority breaking down. For example, in South Sudan, fiscal austerity following the oil shutdown prompted providers of development assistance to look for ways to finance the salaries of health and education workers who might otherwise leave their posts if salaries were unpaid. It is also likely that a recent or ongoing humanitarian emergency may affect development agencies' tolerance of certain types of risk. Donors are willing to finance humanitarian programmes in situations of very high contextual and programmatic risk because of their life saving imperative. However, fiduciary controls over humanitarian providers remain very strict. In eastern DRC and South Sudan development programming has grown out of large-scale humanitarian support drawing on many of the same service providers and donor networks. This may have enabled providers of development assistance to start longer-term development programming in areas that might otherwise be considered too unstable. In Haiti, however, the massive international response to the 2010 earthquake has not yet resulted in greater tolerance of the risks of using country systems. Instead, the massive inflow of funds for relief and reconstruction was mainly channelled through NGOs, UN agencies and contractors. This may have been harmful to government capacity because the earthquake response was largely planned by external actors, and many government staff left to join relief and reconstruction agencies.[27]

In all of the case studies, **development agencies appeared to be heavily influenced by political and reputational pressures** in their home countries. Strong domestic scrutiny of aid programmes through the media, parliament and public voice appear to be one of the main reasons why development agencies are particularly wary about fiduciary risks and working with country systems.

Several donor interviewees also suggested that risk management practices are influenced by the **increasing emphasis on the delivery of measurable results and value for money**. This makes it more difficult for providers of development assistance to support programmes with high programmatic risks (e.g. institution building programmes) where results are not assured, may not materialise over the duration of the programme, and are inherently difficult to measure. The emphasis on value for money has tended to encourage lower risk programmes involved in direct service provision. Where programmatic risks are lower, results can be achieved more quickly and benefits are more easily measurable. The relative weakness of the evidence base on the long-term impacts of statebuilding and peacebuilding programmes makes it difficult to present a strong results and value for money justification for such programmes.

Pressure on development agencies to achieve disbursement targets can also affect risk management decisions. The urgency of meeting spending targets might encourage development agencies to set aside risk safeguards. However, it is also possible that spending pressure results in a tendency to stick with familiar programming models and disbursement

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[26] External pressures, including the influence of the Burmese diaspora, and concerns about ethnic conflict are part of the explanation for this wariness.

[27] OECD (2011), *Rapport 2011 sur l'engagement international dans les états fragiles: République d'Haïti,* http://www.oecd.org/fr/cad/incaf/48697932.pdf.

channels making it more difficult for providers of development assistance to devote staff time to more experimental and high-risk initiatives.

Incentives do vary between donor organisations. Several staff of multilateral organisations interviewed for this study commented that they are more able to take on fiduciary and programmatic risk because they are less directly accountable to taxpayers. There are also differences between bilateral agencies depending on the extent to which they are subject to domestic public scrutiny, and their historical and political ties to the beneficiary country.[28]

3.3 Donor choices of instruments and mechanisms

Risk management is affected by several aspects of donors' operational practices and practices which determine the choice of instruments and mechanisms they use to manage development programmes.

Aid instruments. Most aid instruments are subject to long programming cycles, lengthy preparation lead times, and project management and monitoring frameworks that limit the flexibility to adapt to changing conditions. This creates particular challenges in fragile and conflict affected states where modular, incremental and adaptive approaches are often more suitable than large, long-duration and inflexible programmes.

Where providers of development assistance cannot adjust their approach rapidly to changing conditions, there is a risk that portfolios can become misaligned with contextual risks. In DRC the EU's 10th National Indicative Programme under the 10th European Development Fund was programmed in 2008 at a time when optimism following the first Presidential election spurred engagement in an ambitious institution building agenda. Disappointing results and a loss of donor confidence in government's reform commitments have caused the EU to rethink its approach. However, the lengthy funding cycle under EDF procedures did not allow new programmes to be established until late 2013.

These constraints vary by instrument, and there are often opportunities within programmes to respond flexibly to changing conditions. Humanitarian programmes that are funded over a one to two year cycle also enable greater flexibility, and can be blended with longer-term development initiatives. In eastern DRC, DFID has shown flexibility in enabling the Tuungane programme to switch between developmental and humanitarian activities in response to local conflict dynamics (see Section 4.4).

Several providers of development assistance have been experimenting with specially designed, fast disbursing instruments that are intended to enable a flexible response to changing contextual risks. Section 4.4 features several examples, including the EU Instrument for Stability and the US Transition Initiatives for Stabilisation in Somalia. While offering more flexibility, such short-term initiatives may struggle to address underlying challenges that can only be addressed over longer periods.

Coordination mechanisms. A key issue experienced in several case study countries is the variability of donor coordination. Effective donor coordination can help development agencies to manage risks by strengthening their collective voice and influence over government, facilitating

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[28] For example, Belgium's long experience of development programming in the Democratic Republic of Congo may explain its willingness to work with government in support of institutional strengthening in contrast to the approach of some other bilateral development agencies. DFATD's focus on institutional strengthening programmes in Haiti also reflects its long country experience and sector expertise.

the sharing of information on risks, and enabling the pooling of resources and expertise for risk management. Weak donor coordination on the other hand is very likely to increase risks faced by individual donors. In the absence of a common approach, development agencies lack collective influence, and donor programmes are likely to work at cross purposes – thereby increasing programmatic risk. The case study evidence found that the quality of donor coordination varied between countries. In DRC, many providers of development assistance admitted that donor coordination had been weak, but expressed optimism in the creation of a new donor coordination group. Afghanistan provided an example of much stronger coordination around a highly developed pooled funding mechanism (the Afghanistan Reconstruction Trust Fund, see Section 4.5). There is evidence of increased fragmentation in some case study countries, which has been driven by the increased number of development agencies and volume of their assistance. In South Sudan an aid inventory in 2013 counted 419 planned projects for 2012/2013 compared to 331 in 2011. Furthermore, the average project size fell from USD 2.8 million in 2011 to USD 2.2 million in 2012/2013.[29]

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[29] Republic of South Sudan, Ministry of Finance and Economic Planning (2013), Donor Book, http://www.jdt-juba.org/wp-content/uploads/RSS-Donor-Book-2012-13-FINAL.pdf.

4. Risk management practices

The case studies revealed numerous examples of specific practices, tools and instruments used by donors to manage risks. This section outlines these practices under ten headings and assesses their strengths and weaknesses. Each of these practices is relevant to the management of contextual, programmatic and institutional risk, as indicated in Table 3 below.

Table 3 - Risk management practices and their relevance to different categories of risk

Risk management practice	Relevance of each practice to managing categories of risk		
	Contextual risk	**Programmatic risk**	**Institutional risk**
1) Improving understanding of contextual risks and building a strong country and regional knowledge base.	**Risk assessment.** Better understanding of contextual risk factors and probability and severity of contextual risk outcomes. **Risk mitigation**. Informing the design of statebuilding, peacebuilding and other transformative programmes aimed at reducing contextual risk.	**Risk assessment**. Understanding how contextual risk outcomes may adversely affect programme performance (i.e. link between contextual and programmatic risk). **Risk mitigation.** Adjusting programme design to make them less vulnerable to interruption in the case of contextual risk outcomes.	**Risk assessment.** Understanding how contextual risk factors fuel conflict and how this affects security risks facing donor and programme staff.
2) Mainstreaming conflict sensitive programming	**Risk mitigation**. Finding ways to design and implement programmes in ways to help to reduce socio-economic and political tensions, and so contribute to peacebuilding.	**Risk mitigation**. Inclusion of safeguards in programme design to avoid doing harm.	**Risk mitigation.** Efforts to reduce social tensions amongst programme beneficiaries may reduce reputational risks to donor organisations and security risks to aid workers.
3) Finding synergies between development, humanitarian and peacekeeping work	**Risk mitigation**. More effective peacekeeping and focus on longer-term development objectives can reduce conflict risks.	**Risk mitigation.** Presence of peacekeepers reduces the risk of losing access to insecure zones. Combining the expertise of security and development professionals reduces the risk of the failure of SSR and DDR programmes.	**Risk mitigation**. Presence of peacekeepers can reduce security risks for aid workers (but many humanitarian organisations employ strict rules limiting cooperation with peacekeepers).
4) Using fast disbursing and flexible instruments in combination with longer-term development programming	**Risk mitigation**. Enables more rapid response to changing contextual risk factors and outcomes.	**Risk mitigation**. Greater ability to adjust the country portfolio to address programmatic risks linked to changing context.	May lead to increased fiduciary risks if due diligence checks are hurried.

5)	Using pooled funds to share risks	**Risk assessment**. Development agencies can pool expertise for better understanding of contextual risks. **Risk mitigation**. Development agencies can respond in a more coordinated manner to contextual risk outcomes.	**Risk mitigation**. Reduces risks of multiple donor projects working at cross purposes. Strengthens donor leverage over government. **Risk sharing.** Programmatic risks of pooled funds are shared between contributing providers of development assistance.	**Risk mitigation**. Enables donors to combine resources in support of more effective fiduciary controls. **Risk sharing**. Potential fiduciary losses shared between development agencies.
6)	Adopting an incremental approach to using country systems	**Risk mitigation**. May contribute to statebuilding by strengthening critical PFM systems.	**Risk mitigation**. Avoids risk of doing harm by undermining government institutions through the establishment of parallel systems for aid delivery.	**Risk mitigation**. Maintaining adequate financial controls can enable providers of development assistance to mitigate fiduciary risks while progressively increasing their use of country systems.
7)	Building confidence between development agencies and government by using transition compacts and mutual accountability frameworks under the New Deal	**Risk mitigation**. Aims to strengthen government commitment to delivering on statebuilding and peacebuilding goals.	**Risk mitigation.** May strengthen government commitment to create conducive conditions for programmes to deliver on objectives. Strengthens donor commitment to improving coordination and using country systems (see 5 and 6).	**Risk mitigation**. May strengthen acceptance of donor presence thereby reducing reputational risk. Mutual accountability frameworks may include mechanisms to mitigate fiduciary risks of using country systems.
8)	Using third parties to monitor corruption and fiduciary risks, and security conditions	Third-party risk management is usually restricted to management of institutional risks.	Third-party risk management usually restricted to management of institutional risks.	**Risk mitigation**. More effective and professional management of fiduciary risks. More professional security advice.
9)	Developing robust remote management systems where access is limited.	**Risk mitigation**. Avoids the need to stop funding areas experiencing high security risks.	**Risk mitigation**. Enables donors to maintain some control over programmatic risks in spite of the difficulty of monitoring and evaluation from a remote position.	**Risk mitigation**. Removes security risks to providers of development assistance. **Risk mitigation**. Enables development agencies to maintain some control over fiduciary risks in spite of the difficulty of direct oversight.
10)	Applying more portfolio based approaches to risk management	Enables more balanced approaches to assessing and managing different categories of risk, taking account of the links between these categories and ensuring risk diversification.		

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4.1 Improving understanding of contextual risks and building a strong country and regional knowledge base

Thorough contextual analysis is essential for effective risk management. As indicated in Table 3, contextual analysis can help to improve understanding of the contextual risks and their likely effects on aid programmes. This can assist risk management in four ways:

(1) by enabling development agencies to make informed judgements on whether a country programme is viable in the face of contextual risks,

(2) by improving understanding of how programmes may be affected by contextual risks,

(3) by identifying means to adapt programme design to reduce the impact of contextual risk outcomes, and

(4) by identifying opportunities for programmes to promote changes that can reduce contextual risk factors in the long-term.

The case studies revealed illustrative examples of contextual analyses that have been used to assess and manage contextual risks. These include conflict assessments in DRC and Nepal, and the DFID *Understanding Afghanistan* study. However, many interviewees commented that analysis of country context and contextual risks was inadequate, and development agencies' understanding was insufficient. Development agencies often lack understanding of cross-border and regional processes, which are often extremely relevant, for example in explaining conflict in eastern DRC. Lack of country and regional knowledge appears to be a particular problem where donors lack a track record in the country, are subject to frequent staff rotation, do not have local language skills, and are limited in their exposure to country realities. Donor staff often have a tacit understanding of contextual risks, but this is not backed by systematic knowledge gathering, documentation and analysis. These problems can be addressed by following a more systematic approach to building and maintaining a country knowledge base over the long-term, undertaking structured political economy analysis, and linking this evidence to risk management and programming functions. The following describe examples of such processes encountered in the country case studies.

Joint government-donor analyses. The South Sudan case study, conducted in early 2013, revealed several examples of contextual analysis. Questions were raised about the inclusiveness of the process in South Sudan, and the tension between ensuring broad participation and state-society interaction around the fragility assessment, and maintaining momentum in implementing the New Deal. It was also clear that the fragility assessment did not fully meet donors' needs as a risk assessment tool, and would need to be supplemented with other evidence sources, including political economy and conflict analysis, in order to inform risk management decisions. In contrast to the South Sudan experience, progress in drafting a fragility assessment in DRC has proceeded more slowly, demonstrating the difficulty of ensuring government leadership of the process and the complexity of managing joint assessment processes.

Other examples of joint contextual analysis were encountered in Myanmar and Nepal. The Peace and Development Needs Assessment in Myanmar has offered an opportunity to work with the government on identifying key challenges. Development agencies have found that this initiative has enabled them to establish better relationships with government counterparts and to develop common principles of working without having to limit their engagement to an agenda entirely defined by the government. In Nepal, a multi-donor evaluation of peacebuilding programmes is being undertaken. Both processes have at times required careful wording and selective use of information in order to manage relationships and

reputational risks. Such constraints point to the need for both in-house and separately commissioned analytical work in order to provide a full assessment of contextual risks, and to understand country specific complexities and risks associated with statebuilding and peacebuilding programmes.

Development agencies' own analyses. There are many examples of contextual analysis led by donors, including cases of joint donor assessment.

In Nepal, many high quality political economy and conflict assessments have been conducted. A strategic conflict assessment carried out by DFID in 2002 suggested that development agencies were inadvertently channelling aid in ways that deepened social exclusion, thereby contributing to risks of continued conflict. This analysis led to a major reorientation of programmes to work with government more selectively, to support a more affirmative approach to promoting the rights of low-caste and disadvantaged groups, and to focus more on micro-level community development. Following the end of the civil war, political economy analysis focused on new sources of regional conflict, the political economy of growth, and the role of trade unions. Taken together, these political economy studies have helped DFID think through how they could most effectively support an emerging political settlement, economic development and statebuilding without exacerbating conflict risks.

Development agencies' analyses of Nepal's development and peacebuilding challenges tend to follow an unusually politically and socially grounded line, recognising the root causes of conflict in injustice and inequality, as well as weak rule of law and poor security. Many development agencies directly draw links between peacebuilding, political representation, and access to development. This enables them to 'mainstream' peacebuilding into their poverty reduction and economic growth interventions. For example, the World Bank promotes 'connectivity' in its recent strategies, linking peace promotion with access to services and transport infrastructure.

In Haiti, there are concerns that donors' understanding of the country context built up over the long-term was not adequately transferred or used during the massive influx of humanitarian support following the 2010 earthquake. Humanitarian agencies arriving after the earthquake were not in a position to draw valuable lessons about local political economy processes that would have helped to ensure that their assistance was better targeted and used.[30]

Similar issues arise in Myanmar where donor experience and contextual knowledge is more recent. Development agencies face difficult challenges in judging how to respond to the opportunities of national political transition, while also dealing with the risks of increasing conflict. Myanmar is affected by a string of long-lasting, low-intensity border conflicts with ethnic minorities, which each require specific responses. For development agencies, this requires strong localised knowledge of contexts and institutions, as well as recognition that minority leaders and the wider population in many conflict-affected areas do not regard the government as legitimate. Research in Myanmar indicated that donors need to work flexibly, gradually building engagement and deepening their contextual knowledge in order to engage usefully. Aid agencies that have achieved effective work at the ground level in Myanmar or supported positive policy change have long track records of working in the country. They have

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[30] This led to poor decision making, for example in the resettlement process and rubble clearance, which was slowed by limited understanding of links between politics and control of land. See Katz, J. (2013), The big truck that went by: How the world came to save Haiti and left behind a disaster.

gradually established a knowledge base and institutional relationships over time. Examples include some UN agencies, which have been operating for at least a decade in the country.

Several of the case studies highlighted the challenge of translating good contextual analysis into programming. In part this reflects institutional incentives and blockages. It also reflects continued uncertainty about how development agencies can most effectively work to reduce conflict and fragility. Development agencies have needed to weigh up a variety of competing guidance on working in fragile and conflict affected states, and are each influenced by their varied past experience. In practice, the approaches used by donors to address state fragility vary greatly among case study countries (see Section 2.1). More evidence is needed on which approaches to statebuilding are more effective in different contexts, and how each can best contribute to reducing contextual risk.

4.2 Mainstreaming conflict sensitive programming

In all the case study countries, development agencies emphasised the importance of conflict sensitive programming as a means to manage risk and avoid doing harm. In principle, conflict sensitive programming provides a means to mitigate contextual and programmatic risks. It should help development agencies to design and implement programmes that reduce socio-economic and political tensions, and to include safeguards in programme design to avoid doing harm. These principles may also help donors to mitigate reputational, fiduciary and security risks. Aid workers may be less likely to be attacked or their work undermined where they are seen to be improving local livelihoods and incorporating the concerns of potential spoilers.

Conflict sensitive programming practices were found to be well developed in Nepal, but less evident elsewhere. In Nepal, development agencies have established a range of tools for conflict sensitive programming:

- The World Bank and the Asian Development Bank applied peace 'filters' to their new projects (see Box 2). These have since been merged with broader governance assessment tools and the standard social and indigenous safeguards employed across their projects globally. ADB also conducted a fragility analysis for its country programme review.
- JICA conducts quarterly peacebuilding and needs and impact assessments. UNDP works to promote conflict sensitivity in its programme design. The UN has developed a detailed checklist of steps to ensure conflict sensitivity within programmes under its Nepal Peace Fund.[31]
- Donor agencies including the Swiss Government and UNDP promote staff diversity in order to improve their programmes, considering gender, ethnicity, geographical background, religion and caste in recruitment. Donor and government social statistics are commonly disaggregated along these variables.
- Swiss Development Cooperation (SDC) developed a fund flow analysis following feedback from partners and colleagues. The tool monitors the flow of funds towards targeted receivers and beneficiaries, using the information for project monitoring and steering. The aim is to ensure that funds do not unintentionally flow towards better-connected groups to the detriment of the poorest and disadvantaged.

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[31] UN Peace Fund for Nepal (November 2012), *Strategy to Mainstream Conflict Sensitive Approaches*.

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Box 2 - The Nepal Peace Filter

The experience of the World Bank in Nepal demonstrates some of the challenges encountered when aiming to mainstream conflict sensitive programming. The World Bank developed a tool referred to as the Peace Filter in 2010 designed to ensure that new projects were conflict sensitive. This took the form of a three-stage process of information gathering (including fieldwork in some cases), analysis, and identification of conflict implications. The filter was designed as a process rather than a checklist.

However, some staff reported that they found little added value in the process given their existing levels of knowledge. The process proved time consuming and conflicted with concerns over low disbursement rates in Nepal. This, combined with the World Bank's global drive to streamline procedures, created pressures to accelerate project preparation and to avoid complicating relationships with the Nepalese government. These led to a decision to merge the Peace Filter with the World Bank's wider governance assessment tools, an approach that could enable more strategic conflict analysis, but may also lead to a dilution of the initial aims of the Peace Filter.

The lessons from Nepal appear to be similar to those found over decades of experience attempting to mainstream gender equality into aid programming. Tools, such as checklists and filters, may add value, but will only work when supported by institutional culture and values. Other agencies, including SDC and the UN Peace Fund stress the importance of adopting more structural measures to promote conflict sensitivity, such as staff diversity policies, the use of disaggregated statistics, and prioritising conflict as a high level policy issue.

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The Basic Operating Guidelines (BOGs) in Nepal provide a further example of a conflict-sensitive approach that achieved considerable success (see Box 3). The BOGs were introduced in Nepal in 2003 when the armed conflict was limiting operational space for development organisations. The BOGs were developed as a way of ensuring access and staff security by communicating operating principles to all local actors in a clear and comprehensible way. In addition to mitigating security risks, the promotion of the BOGs has provided a reference point for conflict sensitive programming. They are supported by a BOGs office that provides a forum for the exchange of opinion, peer reviews, enhanced context analysis and rapid reaction to conflict incidents. These services are highly valued, but do not replace the need for dedicated staff within individual agencies to manage security risks and promote conflict sensitive programming.

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Box 3 - The Basic Operating Guidelines in Nepal

- Apply strict security principles and Do No Harm criteria

- Maintain added-value and best practices of endeavours and efforts

- Demonstrate tangible results that justify the presence of development agencies

- Adjust methods of working to minimise exposure and risk, e.g. prevent unnecessary mobility

- Maintain impartial communication contacts and work through local communities and local Non-Governmental Organisations (NGOs)

- Ensure that the positive effects of agencies' presence are highly visible and that agencies are accountable to all stakeholders.

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4.3 Finding synergies between development, humanitarian and peacekeeping work

In South Sudan and DRC a recurring theme emphasised by interviewees was the need to strengthen synergies between development/humanitarian programmes and international security/peacekeeping operations. More effective peacekeeping can mitigate several risks faced by donor agencies:

(1) contextual risks where peacekeepers successfully prevent or reduce conflict,
(2) programmatic risks where the presence of peacekeepers helps to maintain access to beneficiary populations and so reduce the risk of programme interruption, and
(3) institutional risks where peacekeeping helps to improve the security of aid workers.

A number of examples of effective linkages between peacekeeping and development missions were noted from the case study countries (see Box 4 on recent progress in DRC). However, many shortcomings remain. These relate generally to perceptions of the poor performance of peacekeeping missions and their weak coordination with development missions. For example, in principle MONUSCO in DRC is an integrated UN mission. However, in practice, evidence of integration on the ground is somewhat limited, and opportunities are being missed to use the UN mission in support of humanitarian and development objectives. The challenge is to convert the rhetoric surrounding integrated missions into reality on the ground.

There are many practical steps that can be taken to strengthen the integration of UN missions and their coordination with the programmes of donor agencies. There is a particular need for more concerted working in relation to programmes in support of security sector reform (SSR) and disarmament, demobilisation and reintegration (DDR). These are usually led by the UN mission and play a critical role in statebuilding and peacebuilding. However, they can perform poorly because they are exposed to high contextual, programmatic and institutional risks. These risks could be better managed by drawing on the expertise of development professionals specifically in relation to conflict sensitivity, managing reform processes and promoting alternative livelihoods for ex-combatants. However, the opportunities of collaborative working are generally not realised, and a disconnect remains between the demilitarisation and the development agendas. An interesting exception was noted in South Sudan where Denmark is funding a position in UNMISS in the office of the Deputy Special Representative of the Secretary General to work on harmonising the military, political, humanitarian and political agendas. Two issues calling for a joint development and security sector response include pensions for former combatants and supporting demilitarisation more broadly through integrated justice and security sector support.

There is also scope for greater coordination in the sharing of security information. The UN missions provide general security briefings to development agencies and NGOs, but detailed information is usually not shared. South Sudan presented an interesting case where the UN mission provides some logistical support to aid organisations. For example, the mission organises escorted convoys and County Support Bases, which provide local centres for peacekeeping and aid operations. While some humanitarian organisations strictly separate themselves from peacekeepers in order to maintain neutrality, it appears that many aid organisations in South Sudan do actively use UN logistical support and appreciate the security benefits. However, shortcomings in this support were noted, including stretched UN capacity, the slow roll out of the County Support Bases and occasional cases where UN staff have denied aid workers access to safe havens.

Box 4 - More joint development, diplomatic and peacekeeping initiatives in eastern DRC

The recent security crisis in North Kivu has spurred more concerted action to address conflict risks through a combination of development, diplomatic and military means. Development agencies have recognised the need to revamp their assistance to stabilisation in eastern DRC and have established a Stabilisation Task Force under the Donor Coordination Group. Jointly with the UN mission (MONUSCO), the Task Force is revising the International Security and Stabilisation Support Strategy (I4S).

As highlighted in interviews with country staff of development agencies, on the diplomatic front, external partners are reported to have engaged Rwanda and Uganda over their alleged support to M23.[32] Some argue that this intervention has calmed the conflict and may have contributed to the surrender of Bosco Ntaganda to the International Criminal Court in March 2013. Some countries have also applied direct sanctions against M23 members, although, as mentioned in section 2.3, this has complicated aid delivery.

Negotiations led by the African Union resulted in the signing on 24 March 2013 of a new Peace, Security and Cooperation Framework for the DRC and the Region, which sets out mutual commitments of DRC, its neighbours and the international community.

The UN Security Council Resolution of 28 March 2013 has provided MONUSCO with a renewed and more robust mandate. Unprecedented in UN peacekeeping, this includes the creation of a 2,500 strong Intervention Brigade with a mandate enabling it to engage armed groups continuing violence and abuse of human rights "in a robust, highly mobile and versatile manner".[33] This could shift conflict dynamics and risks in eastern DRC, but much will depend on the Intervention Brigade's rules of engagement, capability, contextual understanding, and the level of support by national and provincial authorities, as well as local communities. The Intervention Brigade's ability to perform a peace enforcement and deterrent role has yet to be proven. There are also substantial risks that unsuccessful missions, human rights abuses or collateral damage could alienate local communities and discredit international engagement in DRC more widely.

The Security Council resolution also includes a commitment to renewed engagement in security sector reform and support to a revised and revamped I4S.

4.4 Using fast disbursing and flexible instruments in combination with longer-term development programming

Several development agencies have developed specific instruments to enable rapid response to changing conflict conditions outside normal programming cycles. These include the EU Instrument for Stability, USAID's Office of Transition Initiatives and the Netherlands Stability Fund. Such instruments create useful flexibility and allow donors to play a more proactive role in responding to changing contextual risks.

The EU Instrument for Stability has recently been used in DRC and South Sudan to fund short-term projects (12-24 months) relating to identified urgent priorities. In DRC these have included housing for military families, completion of the introduction of biometric ID cards for

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[32] Pflanz, M. and Blair, D. (2013, 31 October) "DR Congo: M23 rebels close to defeat after US and Britain urge Rwanda to stay out", The Telegraph,
http://www.telegraph.co.uk/news/worldnews/africaandindianocean/democraticrepublicofcongo/10417909/DR-Congo-M23-rebels-close-to-defeat-after-US-and-Britain-urge-Rwanda-to-stay-out.html.

[33] UN Security Council resolution 2098 (28 March 2013), *The situation in Democratic Republic of the Congo,* S/RES/2098 (2013), http://www.un.org/en/ga/search/view_doc.asp?symbol=S/RES/2098(2013).

the police, support to military justice and an International Alert community reconciliation project.

The creation of the EU Instrument for Stability and its high level political backing appears to have created space for more responsive and high-risk initiatives. It fills a gap that cannot be met using normal EDF programming. A recent evaluation found that the existence of the fund has catalysed much greater engagement by EU Delegations in conflict prevention and peacebuilding work.[34] However, the evaluation also noted limitations of the instrument, including lack of expertise within Delegations on conflict issues. The rapid preparation process may lead to hurried and inappropriate funding choices. It is also apparent that on its own the Instrument for Stability cannot address longer-term causes of conflict and peacebuilding needs, and must be provided in combination and coordination with longer-term development programmes.

Successful risk management, therefore, depends on the ability to combine long-term programming grounded in an understanding of contextual risks with the flexibility to respond to particular opportunities, threats and events. One suitable model that meets these requirements is USAID's Transition Initiatives for Stabilisation in Somalia (see Box 5). UNICEF also combines humanitarian and development mandates, and is able to shift its programming flexibly according to changing local contexts. Flexibility can also be built into the design of long-term development programmes. A prime example of this is the DFID funded Tuungane Programme in eastern DRC implemented by the International Rescue Committee. This initiative has been able to respond to the M23 rebellion in North Kivu by shifting from developmental to humanitarian programming. It has succeeded in maintaining access to zones at the centre of the conflict, including Rutshuru and Masisi, where other agencies have pulled out. The ability to shift between development and humanitarian activities was built into the programme design from the outset, and the donor was able to respond rapidly and positively to requests by the programme to change its activities. A critical success factor appears to have been the close working relationship between the donor and implementing partner. Flexibility appears to be better served by collaborative working relationships based on information sharing and joint approaches to managing problems, rather than more arms-length and solely contractual relationships.

Box 5 - USAID Transition Initiatives for Stabilisation (TIS) in Somalia

One example of a rapid-impact, responsive and results-driven programme promoting peace and stability is USAID's Transition Initiatives for Stabilization (TIS) in Somalia. The programme, which has a budget of around USD 87 million over five years, forges collaborative partnerships and creates a space for interaction between government institutions, the private sector and civil society. Activities are chosen by community representatives in collaboration with local governments. They currently include the construction of government facilities, the provision of fishing equipment, trauma healing workshops, facilities to support peace committees and other measures associated with 'social cohesion'. Effort is made to increase domestic ownership of the programme, removing foreign branding and encouraging government outreach.

The TIS place strong emphasis on the process of engagement, as well as its results. Preparatory work includes scenario planning that addresses the variation of conditions across Somalia, and analyses the potential drivers of change towards a more peaceful environment. Project development occurs through several participatory steps that involve local leadership and the wider community before tenders are issued. Contracting is undertaken openly in order to encourage shared scrutiny and accountability.

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[34] ADE (2011), *Thematic Evaluation of European Commission Support to Conflict Prevention and Peacebuilding 2001-2010*. Vol. 1-3. Brussels: Evaluation for the European Commission.

4.5 Using pooled funds to share risk

Numerous examples of multi-donor pooled funds were encountered during the case study research (see Table 4). The structure of these funds varies. Some are entirely donor financed and managed, while others included significant government involvement, financing and use of country systems.

Table 4 - Pooled funds operating in the case study countries

Country	Pooled funds	Level of government involvement and use of country systems
Afghanistan	Afghanistan Reconstruction Trust Fund	Ministry of Finance co-chairs the Steering Committee. ARTF funds are provided on budget to finance government's recurrent and development spending subject to donor supervision.
DRC	Stabilisation and Recovery Funding Facility in Eastern DRC Common Humanitarian Fund New pooled funds in preparation (e.g. PFMA)	Government required to co-finance STAREC programme. Consultation only.
Haiti	Haiti Reconstruction Fund	Administered by the World Bank and governed by a steering committee consisting of government and donor representatives.
Myanmar	Livelihoods and Food Security Trust Fund Three Millennium Development Goals Fund Multi-Donor Education Phase II Fund Myanmar Peace Support Initiative	Limited government involvement. Programme implementation mainly by international NGOs
Nepal	Nepal Peace Trust Fund UN Peace Fund for Nepal	Mainly government led. Two thirds of funding provided by government.
Somalia	Proposed multi-donor Public Financial Management Strengthening Initiative	In support of government's PFM reforms.
South Sudan	Multi-Donor Trust Fund (2005-2012) Capacity Building Trust Fund South Sudan Recovery Fund Common Humanitarian Fund	Required Government of South Sudan to manage procurement. Government provides strategic direction and requests projects. Fund management by Joint donor team. Government sets strategic direction and requests projects. Consultation only.

The literature on the use of pooled funds in fragile and conflict affected states indicates that performance has been mixed. In some cases the use of pooled funds has improved donor coordination, lowered transactions costs and enabled development agencies to share risks. However, in other cases performance has fallen below expectations with slow disbursements being a key problem.[35] This research also found large variations in the performance of pooled funds in the case study countries. Several pool funds were cited, however, as examples of valuable instruments for risk management (see Box 6 on the Afghanistan Reconstruction Trust Fund and Box 7 on the Capacity Building Trust Fund in South Sudan). Interviewees identified several important mechanisms by which pooled funds enable development agencies to share fiduciary and programmatic risks. The potential advantages of pooled funding include:

- **Transferring risk management functions to specialised management agents** (usually a multilateral agency and/or private contractor) better positioned to monitor and control fiduciary risks. The contributing donors share the costs of programme management and are able to achieve economies of scale.

- **Putting in place an effective division of labour** between lead development agencies and silent partners. Different donors can perform distinct roles. Multilateral agencies are often put in the lead administrative position because of their perceived non-political stance, their better access to government and expertise in fund management.

- **Emboldening development agencies to fund higher risk programmes.** Development agencies appear to gain confidence when working with others on joint activities. It may also be easier to justify higher risk programmes to domestic audiences (and bear potential losses) when this is presented as part of an international effort.

- Enabling donors to **combine their technical and diplomatic resources** to ensure that problems encountered during the operations of the fund can be readily addressed and remedial actions taken.

- **Ensuring greater collective donor influence in policy dialogue with government.** When working through pooled funds, development agencies are more easily able to articulate a common view and will be in a stronger position to influence government on issues pertinent to contextual risk. A joint approach can also avoid the political risk of donors becoming aligned with different factions in government.

In spite of these advantages, poorly conceived or implemented pooled funds can increase risks for development agencies and partner governments. The Multi-Donor Trust Fund in South Sudan has been widely criticised for unsuitable management procedures that led to considerable implementation delays and damage to donor reputation. A critical problem appears to have been the understaffing of the World Bank administered technical secretariat. It has been suggested that donors contributing to the fund also bear responsibility for demanding difficult financial controls, and simply transferring responsibilities to the World Bank without ensuring that suitable arrangements were in place.[36] The government was required to

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[35] DFID (2013), *Pooled Funding to Support Service Delivery Lessons of Experience from Fragile and Conflict-Affected States.*

[36] *Aid Risks in Fragile and Transitional Contexts: Improving Donor Behaviour*, op cit., see Box 2 on the MDTF in South Sudan.

manage procurement using World Bank procedures, which proved to be unrealistic given its lack of capacity and experience. In addition, the government was initially required to provide large-scale counterpart funds, which grossly overestimated the government's financing capacity. These factors seriously slowed down disbursements from the fund.[37] In practice, the fund did not succeed in helping to share risks and risk management responsibilities. The processes for managing fiduciary risks resulted in very slow disbursements that held back the mobilisation of donor resources.

Another general concern with pooled funds is that the focus on managing fiduciary risk can crowd out attention to broader questions of addressing programmatic and contextual risk. In the case of the MDTF in South Sudan, donors expressed frustration in 2012 that the challenges of ensuring the basic functioning of the trust fund and integrity of financial controls meant that development agencies lost perspective on the big picture questions of how the fund was intended to address statebuilding and development needs. Similar concerns are raised in Somalia.

Government involvement in pooled funds creates risks where the government is expected to provide counterpart funding. The Stabilisation and Recovery Funding Facility in Eastern DRC (SRFF), for example, failed to attract much donor support. According to country-based staff of development agencies, the SRFF is now considered to some degree moribund mainly because the government has not met its financial commitments to support stabilisation under the STAREC programme.[38] However, the Nepal Peace Trust Fund, which is funded two thirds by government, has proven to be a successful vehicle for financing post conflict programmes and strengthening the political process around peacebuilding. A key success factor has been the lead taken by the Government of Nepal throughout the peace process. Development agencies were willing to play a facilitative role, over time providing additional technical support to build confidence in the government's financial procedures. Where donors and the government did not agree on a shared approach (for example over reintegration payments for ex-combatants), the government was able to proceed without assistance from the donors supporting the NPTF.

In most cases, donors expressed satisfaction with the performance of pooled funds, although many had experienced start-up problems. Some of the key success factors identified by pooled fund donors included:

- Articulating a clear strategy for the purpose of the fund and its contribution to development, peacebuilding and statebuilding.

- Putting in place a functioning governance structure with a committed steering group representing both the government and development agencies.

- Ensuring a sense of government ownership of the fund. At a minimum, government needs to feel it has a voice in determining funding priorities. Transferring management and financial responsibilities to the government should not be attempted too quickly, but it is desirable to develop a medium term strategy for greater use of country

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[37] In the early period of MDTF operations (November 2007 to June 2009) the fund did not disburse any money. In May 2009 the MDTF held unspent donor contributions of USD 270 million. OECD (2010), *Transition Financing: Building a Better Response*, http://www.oecd-ilibrary.org/development/transition-financing_9789264083981-en.

[38] According to interviews conducted by the report's authors with country-based staff.

systems (see Section 4.6). Requirements for government counterpart funding need to be carefully matched with the government's financing capacity.

- Providing sufficient resources for fund management, fiduciary risk monitoring and technical assistance.

- Considering inclusion of financial incentives linked to reform progress, as is being currently applied to the Afghanistan Reconstruction Trust Fund (see Box 6).

The pooled funds that have these conditions in place have proven to be an effective risk management instrument. Development agencies are gaining valuable experience on what works in different contexts that should help to avoid some of the failures of the past. The increasing use of pooled funds is helpful from a risk management perspective, but development agencies will need to move further in this direction. As discussed in Section 3.3, aid fragmentation is getting worse in some countries (e.g. South Sudan in 2013). Opportunities have also been missed to develop pooled funds in several countries, including DRC, where few pooled funds are currently operating.

Box 6 – The Afghanistan Reconstruction Trust Fund (ARTF)

The Afghanistan Reconstruction Trust Fund (ARTF) was set up in May 2002 to provide a coordinated financing mechanism for the Government's recurrent budget and priority reconstruction needs. Over the past 10 years, 33 different donors have used the ARTF to channel USD 6.2 billion in support of the 22 Afghan national priorities (figures January 2013). The latest financing strategy (2012-2014) foresees an important increase in contributions from USD 1.8 billion spent during the last three year period (2009-2011) to around USD 3 billion for the next three year period. Donors have also pledged to increase the share of aid spent through the ARTF Incentive Programme to 10% by 2014 and 20% by 2024.

The ARTF provides both recurrent and investment funding. The "recurrent cost window" reimburses the government for a certain portion of eligible, non-security related operating expenditure. The "investment window" provides grant financing for national development programmes. The trust fund operates through a single account managed by the World Bank. ARTF funds are accounted for as part of the Government of Afghanistan's budget, and managed according to the Ministry of Finance's accounting and cash management arrangements in the Ministry of Finance. The World Bank applies additional financial controls relating to receipts, cash management, disbursement and procurement, and the verification of transactions.

The ARTF has a three-tier governance framework (steering committee, management committee and administration), as well as two working groups. The role of the Afghan government has increased over time. Initially, ARTF management was entirely donor driven, but the Ministry of Finance was admitted as an observer to the management committee in 2005. Since 2012 the Afghan Ministry of Finance has been a full member (and co-chair) of the steering committee.

The ARTF was set up rapidly following the Bonn Agreement as an instrument to finance salaries at a time when resources were urgently needed to finance the operating costs of the interim government. The ARTF was established as relatively short-term framework, but has since evolved and been extended. The ARTF has been favourably reviewed in several external evaluations. Key success factors appear to have been the donors' intense political interest in supporting stabilisation, the lead taken by government in identifying priorities, and the appropriate use of country systems in line with government capacity and supported by development agencies' own controls and fiduciary safeguards.[39]

The number of donors using the trust fund has increased over the years. It is intended to increase the

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[39] *Transition Financing: Building a Better Response*, op cit.

share of funding channelled through the incentive programme, and to link disbursements to progress in implementing the Tokyo Mutual Accountability Framework. Under the incentive programme there will be a decline in recurrent cost financing, but this will be offset by increased investment financing linked to progress in the domestic revenue collection and public finance reforms.

At the time the ARTF was set up, the major focus of risk management was to control fiduciary and corruption risks. The World Bank applied a dual strategy of providing technical and emergency assistance to the government to establish basic PFM systems, and supervising the use of the funds directly using Bank staff and a monitoring agent. The ARTF has thus made use of country systems, but has also been subject to external controls. For the period 2012-2014 2,220 supervisory agent site visits are planned. Development agencies have expressed confidence in these arrangements.

However, the ARTF has not eliminated fiduciary risk. Financial scandals outside the ARTF have also had knock-on effects. The 2010 Kabul Bank scandal led to a crisis in public confidence in the banking system and suspension of IMF loans. Other donors responded to the suspension of the IMF programme by withholding aid, including through the ARTF.

4.6 Adopting an incremental approach to using country systems

In most of the case studies (especially DRC, Haiti, South Sudan, Somalia and Myanmar) development agencies make limited use of country systems to deliver aid. Development agencies are wary of the fiduciary and reputational risks of working with country systems, which are often not well established, function poorly and may be corrupted. These concerns are particularly great in countries whose governments lack broad legitimacy, and fail to uphold human rights.

The present position of development agencies is understandable; however, the avoidance of country systems might create risks of doing harm by undermining government institutions through the establishment of parallel systems for aid delivery. Government representatives interviewed for this study were critical of donors' reluctance to use country systems, and feel a sense of frustration that development agencies are not putting aid effectiveness and New Deal commitments into action.

There is broad consensus amongst the donor community that a transition towards greater use of country systems is a desirable long-term goal, but there is a lack of a common and coherent view on how to manage such a transition and the risks it entails.[40] Development agencies often wrongly assume that using country systems entails the rapid adoption of general budget support; whilst the use of country systems is not limited to a particular aid modality. In practice many intermediate and lower risk options exist to work through country systems. Change is most likely to occur through small and achievable steps that ensure incremental increases in the use of country systems while maintaining safeguards that allow development agencies to control fiduciary and reputational risk. Innovation is already occurring at this level, but often in the form of separate donor initiatives rather than a coordinated approach. Several examples of interesting practice were recorded during the case study research. Some of these involve preparatory measures to strengthen country systems and build confidence, while others provide means to increase the use of country systems and to transfer responsibilities to government while maintaining adequate fiduciary controls.

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[40] *Using Country Public Financial Management Systems: Practitioner's Guide*, op cit.

Preparatory measures to strengthen country systems

- Embedded technical assistance

In South Sudan prior to the conflict, donors were particularly active in placing foreign technical assistance within ministries. By 2013, the IGAD Capacity Development/Twinning project had placed 199 civil servants from Ethiopia, Uganda and Kenya within central government ministries. Most UNDP staff were also embedded within government. In DRC, the Belgian Technical Cooperation (BTC) established joint management support units (*unités conjoints d'appui à la gestion)* to support institutional strengthening. These were provided with technical assistance and financial support through programmes that are nationally directed, but subject to joint donor-government financial controls. The South Sudan example highlighted risks in the provision of technical assistance, including the difficulty to integrate it sufficiently into national administration, the potential to create parallel structures, and to undermine capacity.

- Strengthening public financial management

Improved public financial management (PFM), particularly in the area of budget controls, accounting systems, procurement procedures, payroll management and audit functions, is considered to be a prerequisite for development agencies to use country systems. Donors are supporting major PFM reform initiatives in DRC, South Sudan and Somalia. In Somalia this relates to the urgency of finding ways to finance civil servant salaries in the new government. In South Sudan support from the Capacity Building Trust Fund had enabled the government to strengthen payroll management systems, which had given development agencies the confidence to discuss financing the salaries of health and education workers through New Deal programmes. In DRC development agencies have begun to support and finance PFM reform, which will be critical to enabling the use of country systems. A new multi-donor trust fund will focus on strengthening budget execution, accounting functions and audit processes, as well as provincial level PFM.

Incremental arrangements for using country systems

- UNDP Letters of Agreement

UNDP is experimenting with letters of agreement that are a hybrid of its *direct implementation* and *national implementation* modalities. Under this arrangement, recipients of UNDP funds are first subject to a financial management capacity assessment. They then receive a Letter of Agreement that specifies how the funds should be spent. Expenditure is later audited through UNDP systems. It is expected that confidence will grow in channelling funds through ministries that have successfully managed a sequence of Letters of Agreement. UNDP expects that the use of Letters of Agreement will be a transitional stage enabling a move towards national implementation modalities over a five year horizon.

- UNDP Harmonised Approach to Cash Transfers (HACT)

In DRC, UNDP is testing an implementation modality referred to as the Harmonised Approach to Cash Transfers (see Box 7). This enables donor funds to be advanced to national entities subject to previous accreditation, spot checks during project

implementation and ex-post auditing. The approach aims to build confidence in the use of accredited partners and to manage fiduciary risk. The system is already being used by other UN agencies. Ultimately it could become a mechanism available to all development agencies to ensure collective due diligence and limit fiduciary risk.

Box 7 – UNDP's Harmonised Approach to Cash Transfers (HACT)

The Harmonised Approach to Cash Transfers (HACT) is a common operational framework for disbursing funds to implementing partners (NGOs and government partners). The approach underpins the alignment of development aid with national priorities through the strengthening of capacities for management and accountability, but is not a tool for conditionality. The HACT strives to seek both a reduction in transaction costs with partners, and to adopt a fiduciary risk management approach rather than simply avoiding risk.

In the DRC, a high-risk fragile state, four UN agencies started implementing the HACT in the DRC in 2011. UNDP, UNICEF, UNFPA, and WFP opted to implement this approach for the management of their governmental and NGO implementing partners.

The HACT relies on two fundamental assessments ('macro assessment' and 'micro assessment') conducted with implementing partners during programme preparation, to determine levels of risk and capacity gaps of implementing partners. The HACT then employs assurance activities, such as audits and spot checks during implementation, introducing a new harmonised format for implementing partners to request and report on how funds have been utilised.

The macro assessment covers both development and financial objectives. With regards to the former, it helps UN agencies and government to identify strengths and weaknesses in the public financial management system that are flagged for follow-up assistance. On the latter, it helps the UN to understand more fully the financial environment within which it is operating. The seven-page macro assessment is completed through a review of existing key documentation, such as the World Bank's PEFA and other public expenditure and audit reviews.

The micro assessment supports two similar objectives. With regards to capacity development, it reviews the strengths and weaknesses of an implementing partner's financial management system, and includes recommendations to strengthen less robust areas. This information should then be included in the overall capacity development plan of implementing partners. On financial management, it helps the UN agencies identify the most appropriate assurance methods and most suitable procedures for the purposes of transferring funds. In the DRC from 2008-2012 over 250 micro assessments were conducted.

Latest figures indicate that the use of HACT is gaining traction in DRC. In 2011 total UNDP expenditures were USD 199 million, of which USD 66 million was expended via the HACT. In 2012 UNICEF expended USD 183 million, of which USD 136 million passed through the HACT, and much of this was spent through the health and education ministries.

The adoption of HACT has helped shift the partnership with the UN from a system of verification and control of expenditures to one of facilitating results-orientation and reduced paperwork with the partner. Striving for both results effectiveness and cost efficiencies, the HACT approach for the period 2010-2012 was estimated by UNDP to have led to a reduction of transaction and operating costs in the order of 50%-60%, allowing for a greater portion funds to be shifted in favour of clients and beneficiaries.

Text provided by UNDP DRC

- Intermediate arrangements towards budget support

The case studies provide numerous examples of donors putting in place intermediate arrangements that provide elements of budget support while maintaining donor's own fiduciary controls. The Afghanistan Reconstruction Trust Fund (Box 6) is an important example in this respect. There has also been progress in Haiti where a number of donors (Spain and EU) are already providing limited budget support, and an IMF led working group is exploring how budget support mechanisms could be scaled up. In DRC, the European Union has experimented with a form of budget support where it has reimbursed the DRC government against audited salary payments for teachers. This was provided in 2010-2011 as a means to ease budget and balance of payments constraints at a time when public finances and external accounts were strained by the global food and financial crisis. In South Sudan, the European Union is planning to finance the salaries of health and education workers on an advance basis subject to later audit. The DRC and South Sudan examples cannot be regarded as budget support because donor contributions are tightly earmarked. However, they do provide a means for development agencies to fund selected expenditures within the government's budget. Fungibility concerns aside, the audit arrangements provide an assurance that donor funds have been channelled towards the intended purposes.

4.7 Building confidence between development agencies and government by using transition compacts and mutual accountability frameworks under the New Deal

From a risk management perspective there are important benefits to the use of transition compacts and mutual accountability frameworks. They can help mitigate contextual and programmatic risks by strengthening government commitment to deliver on statebuilding and peacebuilding goals, as well as other reforms that create more conducive conditions for donor programmes to deliver on objectives. At the same time they require development agencies to improve coordination and increase the use country systems, which have important implications for risk management as discussed in Sections 5.5 and 5.6.

The case study research revealed mixed progress in developing transition compacts in the case study countries that are New Deal pilot countries. Greatest progress has been made in Afghanistan where the Tokyo Mutual Accountability Framework sets out mutual commitments of the Afghan government and donor community. On the government side these include commitments to conduct free and fair elections, strengthen the rule of law, enact economic reforms, increase revenue collection and strengthen locally accountable budget execution. Development agencies have committed to align their aid more firmly in support of national priorities, and to increase the share of aid spent through the Afghanistan Reconstruction Trust Fund (ARTF) to 10% by 2014 and to 20% by 2024.

Somalia is a context in which active discussions have taken place on collaboration for risk management, including with government through the mechanism of a New Deal compact. Somalia, with its partners, agreed to a compact under the New Deal in September 2013. Somalia is also a good example in which the New Deal represents the main framework to determine its relationships with the international community. The compact included an agreement to follow a less risk-averse approach to deliver more effective development assistance. Joint risk management can contribute to ensuring that the USD 2.4 billion pledged

by donors reach their intended purpose, and to increase trust on the part of development agencies to use country systems. The joint financing mechanism Somalia Development and Reconstruction Facility (SDRF) has a noteworthy role in the concrete delivery of these objectives. The SDRF provides an opportunity to foster risk management particularly with regards to fiduciary risk, which in turn is crucial to facilitate use of country systems. For Somaliland, the National Planning Commission (NPC) was designated to focus on risk management as part of its mandate to prioritise development planning and providing strategic guidance under the Somaliland Special Arrangement. This agreement envisions a leading role for the NPC in developing joint risk management strategies with partners, as highlighted in interviews with country-based staff of development agencies.[41]

In DRC, progress in implementing the New Deal has been slower and has not yet advanced to the stage of preparing a transition compact. Government awareness and ownership of the process appears to be limited to the Ministry of Planning. Development agencies express support for the principles of the New Deal, but consider that their engagement will depend on stronger government leadership.[42]

While recognising that New Deal processes will proceed at different speeds in different places, there appears to be scope to increase the use of transition compacts and mutual accountability frameworks as a tool to increase aid effectiveness and strengthen risk management. However, the approach needs to be grounded in local political realities and recognise that development agencies and governments are subject to complex and differing incentives. Transition compacts will work best where development agencies and government can identify common interests in managing risks. These may include, for example, measures to stabilise the economy and increase resilience to shocks, support for disaster risk management, donor payment of government salaries to protect basic state functions and other measures to build state capacity including the use of country systems. Common interests will be less apparent in situations where government is a conflict actor, and where short-term political imperatives undermine government's commitment to delivering on development goals. However, well designed transition compacts should help to maximise opportunities to build on common interests. These can be best identified using political economy analysis and joint donor-government processes for assessing risks and identifying responses, for example Fragility Assessments.

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[41] *V. Somaliland Special Arrangement*, in: The Federal Republic of Somalia, The Somali Compact, http://www.pbsbdialogue.org/The%20Somali%20Compact.pdf.

[42] As revealed in interviews conducted by the report's authors with in-country staff of development agencies.

4.8 Using third parties to monitor corruption, fiduciary and security risks

Specialised risk management units can help pool resources in addressing security, fiduciary and other risks encountered during operational work. Two examples from Nepal and Somalia are covered here (see Table 5 for a comparison of main features):

Table 5 – Comparison of risk management offices in Nepal and Somalia

	Nepal Risk Management Office	Somalia Risk Management Unit
Main risks addressed	Security risks to personnel; risks that tensions, violence or threats affect project implementation	Reputational risks related to fiduciary loss. Associated risk of poor coordination
Main purpose	Managing security risks and enabling conflict sensitive local level implementation (from 2003)	Establishing minimum standards of due diligence and identifying problematic or risky implementing partners and contractors (from 2011)
Key agencies	GIZ and DFID – sharing resources across two bilateral agencies	UN Country Team for Somalia
Location	Main office Kathmandu, field staff within existing aid offices outside capital	Main office Nairobi, field teams in Somalia
Operating practice	• Responds to demands from GIZ, DFID and partners • Regular briefings, security and conflict monitoring. • Contributes to wider common donor approaches.	• Responds to demand from UN agencies and donors. • Maintains database of partners / contractors. • Follows ISO 31,000 on risk management. • Supports improved risk management by UN country team
Change over time	As conflict has receded, RMO has moved a focus on conflict sensitive programming. RMO opened field offices in response to demand.	Gathered momentum over time as database established, field teams in place.
Capacity	Small, low-cost team. Reviews warn that further expansion may over-stretch capacity.	Small, low-cost team. Already fully stretched.

In Nepal, the GIZ - DFID Risk Management Office (RMO) was established in 2003 during the period of conflict when staff security was a major concern. Initially the office adopted a security-based approach. Over time the RMO has broadened its approach in support of 'Safe and Effective Development', a more holistic perspective that includes steps to limit extortion, maintain neutrality and build local support for project activities.

The RMO has always operated by providing advisory support in response to demand rather than by laying down regulations. Following a 2008 review the RMO has switched to focusing more specifically on training and support functions.

Evaluations conclude that the RMO has worked well. It receives positive reports from field workers and management, and has adapted over time to changing circumstances. Its proactive, politically aware approach differentiates it from narrower, security-minded risk management. Its relatively informal structure, strong knowledge base (both international and national staff), and reasonable running costs make it a suitable model to adapt for other countries. The RMO also conducts situational analyses of security and associated political problems, working closely with other bodies, including UN offices, bilateral development agencies and the Carter Center. It conducts these tasks and maintains its field presence at a relatively low cost of roughly EUR 400,000 annually.

While the Risk Management Office has served DFID and GIZ well, it is questionable that a single office could usefully service a greater number of development agencies. The different administrative systems and requirements of DFID and GIZ created a burden that could have become unmanageable with a greater number of partners. In addition, there are limits to the scope of risk management functions that can be transferred to an external office.

In Somalia, the UN Risk Management Unit (RMU) was formally established in October 2011. It consists of a small team based in Nairobi and travelling across Somalia frequently, along with a field team in Somalia that can conduct reviews and assessments in response to demand.[43] The idea of a shared RMU emerged from concerns that limited access to Somalia, and the need to operate remotely was leading to corruption and inefficiency on the part of contractors. The RMU was therefore established with the primary purpose of managing fiduciary risk and monitoring implementing partners.

The RMU maintains an information database of projects and contractors, recording problems that have arisen and sharing them across UN agencies. The database contains details of 1,200 partners involving contracts worth over USD 450 million. Where problems have occurred, this information enables agencies to ensure that mistakes are not repeated. Rather than simply black-listing local bodies, the RMU aims along with its partners to address the problems and improve performance. It encourages UN agencies to work proactively with ground level implementers when difficulties arise.

Emphasis is placed on risk management training for partners including UN agencies, international NGOs and implementing NGOs to encourage good risk management practice. The RMU adds a coordinating layer to risk management that enhances rather than replaces the in-house operations of aid agencies.

The RMU conducts investigations on request, following up suspected cases of malpractice. It works at different levels of the typical implementation chain in Somalia: UN agencies, INGOs, local NGOs and contractors, and beneficiaries.

In June 2012, the RMU was recognised as a best practice example in the Monitoring Group Report for Somalia. It has also extended its expertise to the UN country teams in Mali, Afghanistan, DRC and Egypt.

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[43] Thanks in particular for information provided by Matthew Leslie, Head of Risk Management Unit, UN in Somalia.

4.9 Developing robust remote management systems where access is limited

Donor access and direct programme monitoring is at times limited as a result of the security situation. For example in Somalia, development agencies have had to adapt to lack of access by developing systems of remote management. This has stimulated the development of a range of innovative monitoring measures. Examples mentioned by the Common Humanitarian Fund of UN OCHA include:

- **Use of satellite imagery** to verify construction.

- **Encouraging direct feedback** from beneficiaries or intermediaries through SMS text messages and social media. This can be used to verify that humanitarian aid has reached beneficiaries, identify where supplies and services have not been received in the aid delivery chain, and to provide a feedback mechanism as an accountability and performance measuring tool.[44]

- **Regular use of third-party monitoring.** The challenge with third-party monitoring is to identify reliable and independent firms willing to undertake regular visits to beneficiary groups in insecure areas at reasonable cost. Even with strong systems for third-party monitoring in place, options for management to respond to identified problems are often limited.

- **Using audit companies** and other bodies to appraise institutional capacity and then taking action to address identified weaknesses with implementing partners.

- **Sharing information.** In addition to the UN's Risk Management Unit, an informal monitoring and evaluation working group allows for exchanges of information and experience.

The challenges of remote management are spurring interesting innovations that could usefully be applied elsewhere. Yet, remote management is a second best approach to aid delivery and is clearly associated with higher risks. Problems have occurred in Somalia and elsewhere, with funds going astray, staff of implementing agencies targeted by militants, access denied to project areas, and poor programme performance. For example, one donor representative commented that no matter how good satellite imagery had become, it was still impossible to tell whether the water channels dug under an irrigation project were actually being used without a site visit. Weak monitoring and evaluation, as well as little concern over the unintended impact of aid provision on local political dynamics, typifies remote aid provision in Somalia over several decades. However, these risks can often be managed through methods including those described above. When operating remotely or otherwise, good risk management practice involves engaging partner agencies in solving problems that arise rather than simply transferring risk and potential blame.

4.10 Applying portfolio-based approaches to risk management

Development agencies usually manage risks within the framework of individual programmes. However, experience from the case studies suggests that there would be significant benefits to a portfolio wide approach to risk management. This would enable donors to take a broad

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[44] For an example of an SMS feedback programme in Somalia, refer to the Danish Refugee Council SMS Feedback System (http://somcdrd.org/hif/).

view of different categories of risk across the portfolio, and the appropriate balance between high-risk investments with potentially transformative impacts, and low-risk investments delivering immediate service delivery gains. This would in some ways resemble portfolio risk management in the financial sector where analysts target an expected return on investment across a basket of investments with different risk and return characteristics.[45]

In principle, a portfolio approach to risk management would enable providers of development assistance to answer the following questions, which have emerged as being critical issues in the case study countries:

1) Is there a suitable balance between high and low programmatic risk interventions across the portfolio?

2) Is there a suitable mix between long-term programmes and short-term, more responsive instruments?

3) Does the portfolio provide a sufficient balance between low-risk service delivery and higher risk systems building and institutional development programmes?

4) Have opportunities to promote statebuilding, peacebuilding and other forms of transformational change been missed because of aversion to programmatic and institutional risk?

5) What specific risk management mechanisms are being used, how can they be strengthened, and what is missing from the range of tools and approaches for risk management applied to the country portfolio?

The case study research indicated limited use of formal tools for portfolio-wide risk management. One example is Canada's Country Risk Profile and Risk Registers that are close to the model described here (see Box 1). There is evidence that development agencies often do informally consider the balance on risks across their portfolio, but this is not formally stated in the country strategy. For example, DFID DRC reported that the majority of its portfolio had been set aside for lower risk service delivery programmes. However, space had been retained for higher risk programmes aimed at institutional strengthening and policy reform. For example, DFID DRC is funding large-scale bednet distribution, while at the same time making more strategic investments in strengthening national malaria prevention systems. Similarly, the DFID funded WASH programme follows a low-risk, tried-and-tested approach to water and sanitation. The programme is being extended into higher risk and experimental activities in urban areas. It appears that these decisions were driven by individual sector advisers rather than an explicit analysis of portfolio level risks.

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[45] Although there are interesting parallels between risk management methods used by donors and the financial sector, it is important to stress that donors are looking at a broader and less predictable set of risks. Donor risk management can be expected to be a less precise art than portfolio management in the financial sector for two main reasons: (1) the wide range of overlapping risks faced by donors creates uncertainty, and (2) the results of donor programmes cannot easily be measured in monetary terms (especially for long-term statebuilding and peacebuilding) making it difficult to carry out a risk/reward calculation.

5. Recommendations for providers of development assistance

Because of the diversity of country conditions and donor responses to risk, different recommendations will apply in different contexts. Approaches to risk management need to be guided by a complete assessment of the country context, and informed discussion of the appropriate level of risk across the country portfolio. In many cases development agencies will need to be bolder in supporting statebuilding and peacebuilding work, and will need to accept the higher programmatic and institutional risks this entails. In other cases they may already be taking on sufficient (or possibly excessive) risk. Effective risk management requires providers of development assistance to identify these situations, strike the appropriate balance between risks and rewards, and develop strategies for addressing different categories of risk, including the links between them.

The case studies have highlighted numerous practices that can help development agencies to manage risks more effectively. There will often be scope to transfer good practice from one setting to another, and for providers of development assistance in one country to reflect on practices used elsewhere. However, it is important to be aware that practices that work well in one context may not be transferrable to other situations. For example, in many cases it will be appropriate to increase the use of country systems, but this may carry unacceptable risks in very weak institutional environments and where government legitimacy is highly contested. This requires development agencies to avoid universal notions of 'good practice', and to identify and adapt risk management practices so as to provide a 'good fit' based on a detailed understanding of local context.

While recognising the need for context specific approaches to risk management, this study points to a number of recommendations that are widely applicable:

1. **Strengthen the analysis of contextual risks**. Improved understanding of country context can help development agencies better understand contextual risks, and the opportunities to mitigate these through statebuilding and peacebuilding work. Contextual understanding can also help development agencies avoid the pitfalls of inappropriate approaches to statebuilding and peacebuilding and avoid the risks of doing harm. To increase their understanding of contextual risk, development agencies need to invest more in research and analytical work using tools, such as political economy analysis, conflict assessment and scenario analysis. It is equally important for providers of development assistance to encourage the acquisition and transfer of country and regional knowledge, for example by avoiding rapid staff turnover, ensuring long country presence, upgrading language skills and providing field exposure.

2. **Pilot joint risk assessment methods.** Joint risk assessments provide an opportunity to improve understanding of contextual risks, avoid analytical duplication, and identify common interests in risk management that may be shared between development partners as in fragility assessments required under the New Deal. However, there is limited experience in managing these processes, and in responding to situations where different parties have different interests and priorities. Further donor practice and pilot testing in this area is warranted to determine a

shared understanding and common approaches on how to carry out joint risk assessments and ensure adequate follow-up and monitoring. It is recommended to proceed initially with joint risk assessment on a selective basis where common interests between partners are more likely to be found. Joint risk assessment should be seen as a useful complement, but not a substitute for donors' own analysis.

3. **Require stronger coordination and joint working between development, humanitarian and UN peacekeeping missions**. Shortcomings in coordination between peacekeeping, development and humanitarian programmes undermine the collective impact of international assistance and the ability of international agencies to manage risks effectively. Where such problems arise, it will be useful to conduct reviews of coordination between development, humanitarian and peacekeeping actors at country level. The specific areas for review will vary by country, but are likely to include joint working on mitigating contextual risks (including joint actions on security sector reform, disarmament, demobilisation and reintegration) and joint approaches to managing security risks (e.g. sharing information on security risks, policies regarding sharing of services provided by peacekeepers, including transport and logistics, escorting and safe havens).

4. **Adapt aid instruments to ensure greater programming flexibility.** Programming flexibility is essential in fragile and conflict affected states, both to respond to changing contextual risks and to enable experimentation and lesson learning. Recent experience in the use of flexible programming instruments needs to be continued and adopted by other development agencies. However, short-term flexible instruments will need to be used within the framework of a longer-term strategy to avoid the risk of piecemeal and ad hoc programming. Flexibility is also required within programmes to enable year-on-year adjustments in the face of changing contextual risks.

5. **Make greater use of pooled funds to share risk.** Pooled funds offer a powerful means for providers of development assistance to manage risk collectively and more effectively. However, opportunities to develop pooled funds are not always being taken, and in some cases the fragmentation of donor programmes is increasing. There is a growing body of experience on what it takes for pooled funds to operate successfully and to enable the optimal sharing of risk (see Section 4.5). Key risks to avoid include cumbersome and slow procedures, focussing excessively on fiduciary risk and failing to develop a coherent vision and strategy for the fund. The pooled fund model is appropriate in many aid settings. However, the extent of government involvement in the managing and financing pooled funds should vary according to local capacity and donor confidence in country systems.

6. **Develop country level, multi-donor frameworks for the progressive increase in the use of country systems.** There are numerous models available for progressively increasing the use of country systems while maintaining suitable fiduciary safeguards. Wider and more coordinated adoption of these models will depend on providers of development assistance engaging in joint analysis at country level on the obstacles and opportunities for using country systems, and devising a common approach for enabling transition to the adoption of country systems. Further

support to strengthening local procurement systems and developing effective risk management systems will be essential, including through focus on this area within multi-donor trust funds. Transition compacts and mutual accountability frameworks required under the New Deal can help build confidence between partners on increasing the use of country systems. Follow-up work to capture and disseminate lessons learned should be undertaken.

7. **Consider wider adoption of third-party risk management where this brings access to specialist expertise.** The experience of risk management units in Nepal and Somalia, as well as the services of management agents for pooled funds, demonstrates the value transferring certain risk management functions to professional service providers (in particular the management of fiduciary and security risks). This model could be applied to other aid environments. However, this should not detract from donors' ultimate responsibility for risk management, and the need to ensure coherence between the management of contextual, programmatic and institutional risk.

8. **Develop more robust remote management systems where access is limited.** In practice there will continue to be many situations where development agencies cannot access the field because of security concerns. In these situations providers of development assistance will need to fall back on remote management systems. Experience from Somalia suggests that the risks of remote management can be satisfactorily managed, and that systems can be strengthened using innovative ICT practices and third-party monitoring. Remote management requires a particular focus on fiduciary risks, but also developing a level of trust with implementing and monitoring partners. Further research and experimentation on remote management systems is warranted.

9. **Develop tools for portfolio-based risk management.** Portfolio approaches to risk management discussed in Section 4.10 could help development agencies to think broadly about risk categories and to manage the trade-offs between them so as to ensure a better balance of risks and rewards across the country portfolio. There are some existing tools available (for example, Canadian DFATD's country profile), which could provide a basis for more systematic management of risks across donor portfolios and instruments.

10. **Adopt good practice for risk sharing with implementing partners**. Successful aid delivery depends on an appropriate sharing of risk between development agencies and implementing partners. This is more likely to occur where providers of development assistance are in close contact with implementing partners rather than in situations of arms-length, formal, solely contractual relations. Rigid, zero-tolerance approaches to corruption can prove counterproductive and may cause implementing partners to conceal fiduciary risk. Development agencies generally need to be more sensitive to the fiduciary and security risks faced by implementing partners and ready to respond flexibly to their operational needs.

11. **Provide evidence of the results of different approaches to supporting fragile and conflict affected states.** A critical problem that contributes to donor

preferences for short-term, low-risk programming is the difficulty of measuring and demonstrating the results of long-term programmes to support statebuilding, peacebuilding and other forms of transformational change. More systematic impact monitoring (including longer-term and more indirect impacts) of such programmes would help to strengthen the evidence of results and could shift risk/reward calculations in favour of higher risk programming.

12. **Communicate more effectively with audiences in donor countries**. Political and reputational risks in donor countries could be mitigated through better communication of the realities and risks of aid delivery, and challenges and rewards of statebuilding and peacebuilding work. This requires development agencies to move beyond simplified aid narratives that emphasise quick results and service delivery, and to develop ways of communicating risk better to donor accountability bodies (be they legislatures, supreme audit institutions, civil society, etc.). This would require the development of communication tools that help to explain the importance of risk mitigation and the lessons learned.

Annex: Research methodology

The country case studies were selected following an initial screening of 16 fragile and conflict affected states against indicators covering country context, aid relations, risk management practices and practical research considerations. The screening exercise was used to develop a mapping of the risks and risk management practices in each country. The final selection of case study countries was made by the INCAF Steering Group for this report. The selection process aimed at ensuring a balanced coverage of different types of risk management problem and donor response across the Copenhagen Circles. New Deal pilot countries were purposefully included in the country selection.

The INCAF Steering Group selected four countries for full case studies: Democratic Republic of Congo (DRC), South Sudan, Somalia and Nepal. Additional examples of risk management practices were drawn from Myanmar, Afghanistan and Haiti, which were researched through literature, remote interviews, and in the case of Myanmar a brief country visit. Each case study focussed on three or four key risk management themes identified in Table 2. These were selected from the previously completed mapping of risk management problems and practices. The selection aims to provide a broad spread of illustrative examples covering all parts of the Copenhagen Circles.

The research process sought to obtain evidence on the three main research questions stated in the introduction: (1) how do providers of development assistance act on risk, (2) why do they act in this way, and (3) what particular risk management practices have proven to be effective? The Copenhagen circles were used as a guiding framework to structure the research and analysis, to focus on specific categories of risk and risk management problem, and to analyse connections between risk categories. Another consideration reflected in the research design was to capture the aid delivery chain linking development agencies and their implementing partners. This is important in order to understand how risks are managed at each level, how risks and transferred and shared, and to analyse the consequences for aid delivery and impact. Interviews were held with implementing partners (UN agencies, government counterparts, international and local NGOs) to cover this dimension.

The four full case studies were researched through the following steps:

- Initial scoping exercise based on a literature review
- Distribution of a project summary and indicative questionnaire to key informants prior to the country visit.
- A one week visit to the capital city of the case study country (Somalia development agencies were interviewed in Nairobi).
- For each case study 15-20 interviews were conducted in country with bilateral and multilateral agencies (see Table 2), implementing partners (NGOs, UN agencies and private companies), as well as some government representatives where access was possible. Donor interviewees were selected to ensure a good spread between donor organisations, although in practice sampling was affected by availability of donor staff. Implementing partners were selected on the basis of recommendations from their funding organisations.
- A multi-donor workshop was held in Nairobi for development agencies engaged in Somalia.

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- Follow-up questions and interviews by telephone and email to selected informants to provide a more detailed assessment of interesting risk management practices identified in country.
- Circulation of the draft case study report to the INCAF Steering Group, external peer reviewers and key informants in country.
- Finalisation of case study.

The research design enabled a rapid appraisal of selected risk management issues in the case study countries. The research revealed numerous examples of promising risk management practices, which are featured in Section 4 of this report. Evidence on the effectiveness of these practices has been provided where available (for example from evaluation reports), but in some cases such evidence is limited and will need to be backed by further research.