

THE GOVERNANCE BRIEF

Risk-Based Governance Assessment

An Approach to Assist in Mainstreaming Governance

By Brenda M. Katon¹

Background

A key requirement of the Asian Development Bank's (ADB) Second Governance and Anticorruption Action Plan (GACAP II) is the preparation of governance risk assessments and risk management plans (RA/RMPs) to inform country partnership strategies (CPS), programs, and/or projects in priority sectors. This governance brief provides a concise conceptual introduction to the preparation of these RA/RMPs and presents selected cases that illustrate how RA/RMPs have guided the design of country strategies, sector road maps, and programs and/or projects. The brief concludes with an overview of lessons learned. It is meant primarily for ADB staff and consultants involved in carrying out RA/RMPs.

Before the adoption of GACAP II in 2006, ADB prepared country governance assessments (CGA) using a framework that focused on five governance areas—legal and regulatory frameworks, public administration, public financial management, the judicial system, and civil society. The CGAs were successful in raising awareness about governance issues, increasing opportunities for dialogue, and identifying entry points for technical assistance. However, the assessments tended to

be quite broad in scope, less effective in creating long-term strategic approaches to governance, and lacked the operational focus needed to mainstream governance in sector operations. Moreover, the applied diagnostics did not clearly identify specific governance risks and their impact on development objectives.²

Taking into account these experiences, the approval of GACAP II in July 2006 brought a new dimension to ADB's operations by introducing a risk-based approach to governance assessment. In the context of GACAP II, the term "risk" refers to the risk of reduced development effectiveness, i.e., the risk that the development objectives of developing member countries (DMCs) and ADB will not be met, or will be adversely affected by poor governance, weakly performing institutions, or vulnerability to corruption. Importantly, the preparation of RA/RMPs is approached as a forward-looking, positive exercise, seeking to identify ways to improve the effectiveness of ADB's development interventions in client DMCs.

The operational focus of the RA/RMPs centers on identifying and responding to risks in three thematic priorities that have been identified as critical to development effectiveness and poverty

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² ADB. 2006. *Review of the Implementation of ADB's Governance and Anticorruption Policies*. Manila. www.adb.org/Governance/Review/review-Report-final.pdf

reduction: (i) public financial management (PFM), (ii) procurement, and (iii) combating corruption. In conjunction with wider policy, legal and regulatory, and capacity risks identified through the broader sector diagnostics, the RA/RMPs are meant to inform the preparation of the road map for priority sectors.³ In the majority of cases, the response to identified risks is a capacity development measure, which suggests that the preparation of RA/RMPs is also a useful exercise to focus capacity development interventions. The response to identified risks can equally be a policy reform that will provide the enabling environment for future capacity development measures.

Risk-Based Approach to Governance Assessment

The risk-based approach to governance assessment is distinctive for its systematic process of identifying risks and then prioritizing those risks that require a response. Figure 1 presents four basic types of risks.⁴ Risks that are likely to occur, are relatively serious, and not likely to be mitigated over the life of the CPS are assessed as major risks. The determination of major risks is crucial because limits to ADB's resources, instruments, and influence preclude addressing all identified risks. Once major risks have been identified, risk management measures are formulated, which are

practical actions that ADB can take to reduce the major risks to development effectiveness.

The approach outlined above thus provides an understanding of governance risks that can be used to guide investment decisions. This brings it fully in line with Strategy 2020,⁵ ADB's long-term strategic framework, which puts good governance deeper into the mainstream of its operations by regarding the efficient use of public resources, accountability for economic performance, and effective policy formulation and implementation as essential to achieving development objectives.

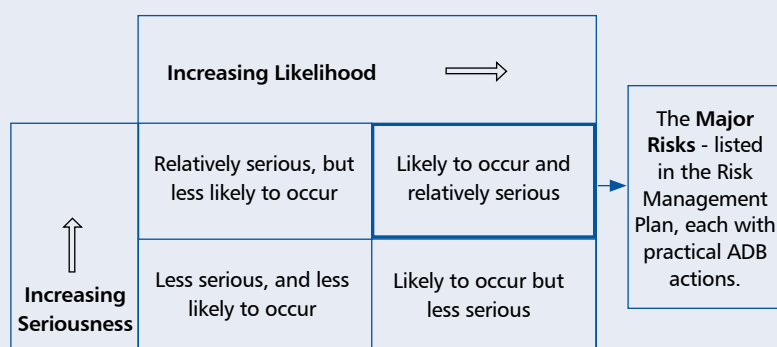
Cascading Governance Risk Assessments

Figure 2 shows the cascading governance risk assessments framework that flows from country to sector, and from sector to program and/or project levels. The country⁶- and sector-level risk assessments are prepared as part of the CPS process. Country systems for PFM, procurement, and anticorruption are analyzed and assessed, and risks to development effectiveness are identified. The functioning of the country systems in priority sectors for ADB operations is then analyzed and assessed, and risks to sector performance are identified. Risk mitigation measures to address the major risks identified at country and sector level are then formulated and included in country and sector risk management plans. The sector RA/RMPs inform the broader-based sector diagnostic for the CPS, which, in turn, informs the sector road maps in the relevant priority sectors. The sector road maps should then guide the preparation of programs and/or projects in the priority sectors. Major risks identified in the RMPs at the country and sector levels are monitored through the country portfolio review missions and the CPS midterm review processes, while program and/or project level RA/RMPs are included in the project administration memorandum and are monitored during program and/or project review missions.

Illustrative Cases

The cases below were drawn from actual examples where (i) concrete RA/RMP links could be traced at multiple levels (country, sector, and program and/or project), and (ii) the thematic priorities of GACAP II were explicitly addressed. They cover DMCs where ADB applied the RA/RMP approach

Figure 1: Types of Risks



ADB = Asian Development Bank.

Source: ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan*. Manila. www.adb.org/Documents/Guidelines/GACAP-II-Guidelines.pdf

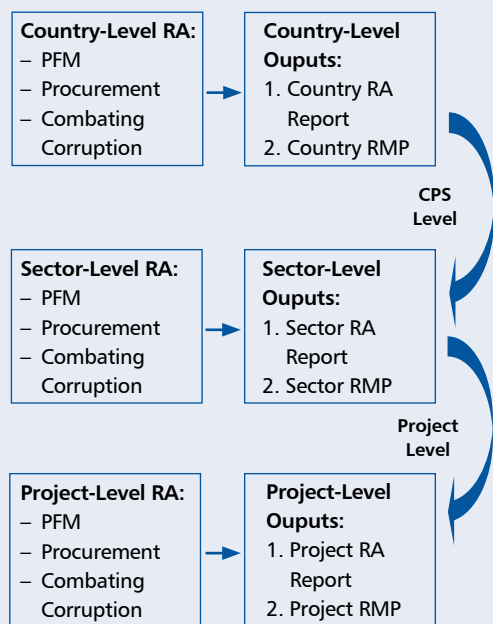
³ Details are found in ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan*. Manila. www.adb.org/Documents/Guidelines/GACAP-II-Guidelines.pdf

⁴ This is a practical, straightforward model. A more nuanced model for identifying types of risks classifies likelihood and seriousness as low, moderate, and high.

⁵ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila. www.adb.org/Documents/Policies/Strategy2020/Strategy2020-print.pdf

⁶ Risk assessments should also be prepared at subnational level where ADB has significant operations.

Figure 2: Cascading Governance Risk Assessments



CPS = country partnership strategy, PFM = public financial management, RA = risk assessment, RMP = risk management plan.

Source: ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan*. Manila. www.adb.org/Documents/Guidelines/GACAP-II-Guidelines.pdf

as part of the CPS preparation, the CPS midterm review, and program and/or project design.⁷ Both the process and the substance of the RA/RMP are highlighted below.

(i) Case 1: Cambodia

RA/RMP Process

Box 1 summarizes how, in 2007, Cambodia piloted the RA/RMP. A tangible result of this exercise was the incorporation of major governance risks into the CPS Midterm Review (2007), and into a grant-financed PFM program for a priority sector (2008). This is a positive demonstration of integrating a risk-based approach to governance into ADB's core operations.

The RA/RMP process in Cambodia brings to light certain key messages. First, clear communication about the purpose of the RA and starting the RA on a positive footing were pivotal. The role of ADB's country director was central in this

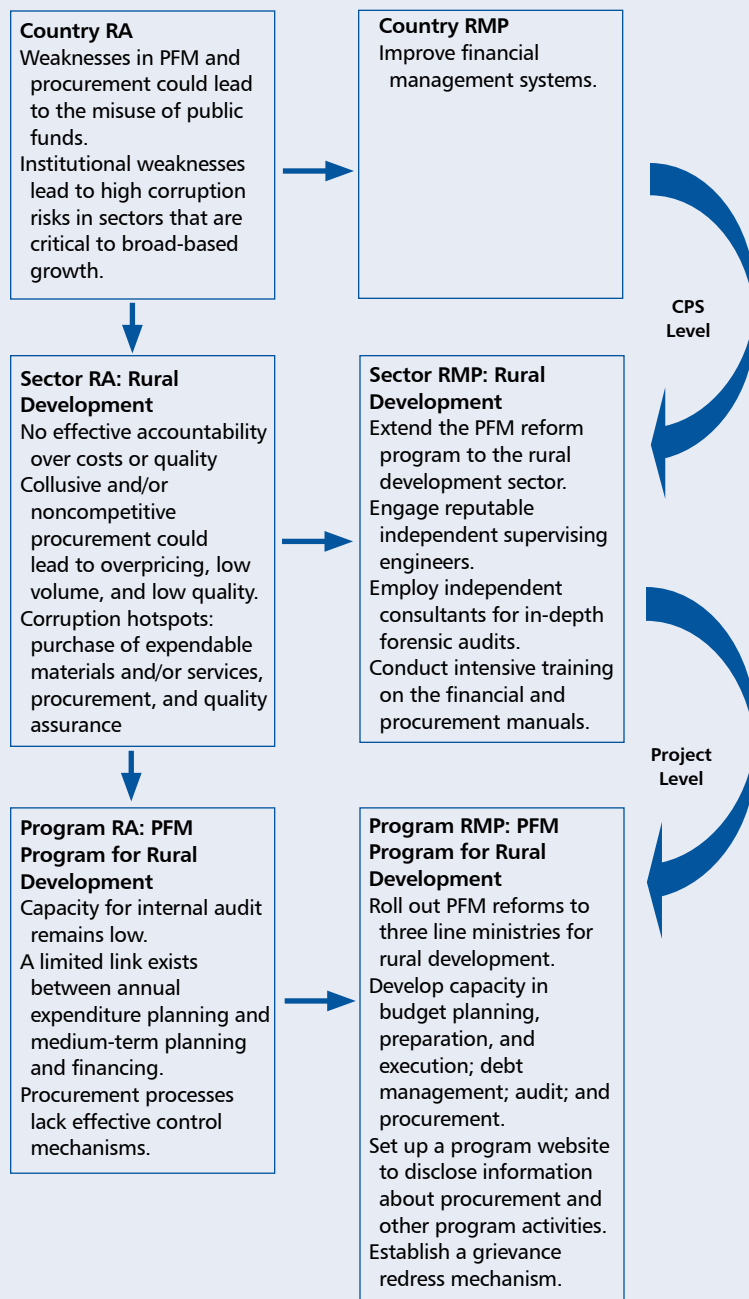
Box 1: Risk Assessment/Risk Management Plan Process in Cambodia

- The risk assessment (RA) was conducted to inform the CPS midterm review. The findings were meant to support the Asian Development Bank's future intensified engagement in a priority sector.
- Given the sensitivities, the initial step was to establish trust and a sound working relationship with the government. The country director met with the minister and his senior officials personally to introduce the purpose of the RA and the consultant responsible for undertaking the RA.
- Before the RA, the compilation of a comprehensive set of relevant documents proved to be time saving, and paved the way for a systematic desk review by the RA consultant of country reports, diagnostic assessments, country portfolio reviews, project reports, audit reports, evaluation studies, and other relevant documents. These documents, along with primary information, helped build the sources of evidence for the RA.
- The government established a liaison team, which greatly facilitated the consultations with various groups of stakeholders. Early mapping of the activities of major development partners in the country was also done. The RA/risk management plan consultant interviewed development partners, project directors, specialists, and other key informants. Confidentiality of the interviews was emphasized. Triangulation of information was done.
- To strengthen the RA, a rapid third party perception study was launched using an e-mailed questionnaire. It incorporated a wide range of perspectives and elicited alternative ideas on priorities and risk mitigations.
- Risks were mapped based on likelihood and seriousness. Actionable measures were incorporated in the proposed risk management plan to address major risks.
- A wrap-up meeting with the minister and a group of senior staff centered on identified risks and options for addressing these risks. The RA findings were generally negative, but interestingly, the officials accepted them, having understood the purpose of the RA at the outset.
- The RA/risk management plan report was shared with the government, the country partnership strategy midterm review team, and with other pertinent departments in the Asian Development Bank.

regard, particularly in introducing the RA as part of a forward-looking approach, rather than a retrospective, investigative exercise. Although current problems were acknowledged, the meeting underscored the need to make future investment projects better. Thus, viewing the RA as a necessary step in a longer-term process of constructive engagement with ADB set a positive tone for the assessment. Second, up front work was vital in obtaining government participation in the RA/RMP and ownership of the findings. Third, ADB used the RA to determine the direction of governance programming at midterm review stage. Operations for the remaining CPS period affirmed support for the expansion of the PFM reform program to three rural development ministries

⁷ Examples were selected from ADB's DMCs in Southeast Asia and East Asia for illustrative purposes. Other regions were not included because the assessed risks were not major and/or the RA/RMP links have not yet cascaded from the country to the project level.

Figure 3: Cascading Governance Risk Assessments—Cambodia



CPS = country partnership strategy, PFM = public financial management, RA = risk assessment, RMP = risk management plan.

Sources

- ADB. 2007a. *Country Strategy and Program Midterm Review: Cambodia 2005–2009*. Manila.
- . 2007b. *Governance Risk Assessment: Cambodia—Ministry of Rural Development*. Consultant's Report under Regional Technical Assistance 6385: Governance and Capacity Building Initiative. Manila.
- . 2007c. *Governance Risk Assessment. Cambodia—Ministry of Water Resources and Meteorology*. Consultant's Report under Regional Technical Assistance 6385: Governance and Capacity Building Initiative. Manila.
- . 2008. *Report and Recommendation of the President on the Proposed Program Cluster, Grant for Subprogram 1, and Grant Assistance Public Financial Management for Rural Development Program (Grant-Financed Program 132/33-Cambodia)*. Manila.

to ensure that resources are used efficiently and effectively. The CPS midterm review, in addition, acknowledged the importance of intensifying governance risk management.

Substance of the Country RA/RMP

Figure 3 sums up key substantive issues in the RA/RMP and illustrates how the governance risk assessments cascaded from country, to sector, and to program levels. The country RA/RMP for Cambodia portrayed a weak PFM system, noncompetitive procurement, weak institutions, a dominance of patronage systems, and high corruption risks. Although many laws had been enacted, the capacity and political will to implement them were not always present. Inadequate resources and authority constrained the activities of the national audit office. Development of internal audit in government institutions remained in its infancy. The implementation of recommended audit response measures was found to be inconsistent, including selective enforcement of sanctions against public officials for corrupt activities. Rent seeking and facilitation fees for public service delivery were found to be common. Consequently, there was a risk that public funds would not be used optimally. The CPS midterm review underscored that weak institutions could lead to a failure to achieve economic diversification, and that institutional weaknesses led to high corruption risks in sectors critical for broad-based growth.

Substance of the Sector RA/RMP

The RA/RMP was done for rural development, a priority sector of ADB in Cambodia. It pointed out governance risks arising from the absence of effective accountability over costs or quality; low quality infrastructure works; and noncompetitive, collusive procurement. Controls over budget allocation, procurement, expenditure control, and the quality of works undertaken were all found to be weak. Collusion among bidders and the bribing of knowledgeable officials for budget information as input into preparation of tenders were part of major assessed risks. Kickbacks were reportedly given to officials for favorable treatment, and were financed through over-invoicing and/or improper certification of supplies, services, or works. Contractors or suppliers tried to cover the costs of corruption by providing substandard materials or workmanship. Moreover, there was no evidence of independent audit and/or evaluation of accounts or quality of service performed or goods delivered. Accounts were cleared through normal accounting procedures rather than through

independent audits. Risks associated with poor quality assurance often resulted from corruption in procurement and purchases of expendable materials. Measures to manage major risks are shown in Figure 3.

Substance of the Program RA/RMP

A subsequent grant-financed PFM program for rural development, approved by ADB in late 2008, indicated that several weaknesses in the line ministries for rural development posed significant governance risks that compromise service delivery to the poor and undermine the investment climate and economic diversification. Core mitigation measures include capacity development support for three areas: (i) financial management framework and accountability, (ii) financial management in rural development ministries, and (iii) external audit. Over the medium term, capacity development support will address budget planning and preparation, budget execution, internal audit, and procurement. Central debt management is being strengthened by refining the legal framework and providing training in using databases. In addition, the audit capacity of the national audit authority is being reinforced, given its central role in improving the quality of financial governance, strengthening institutional oversight, and providing checks and balances in the management of public finances.

(ii) Case 2: Mongolia

RA/RMP Process

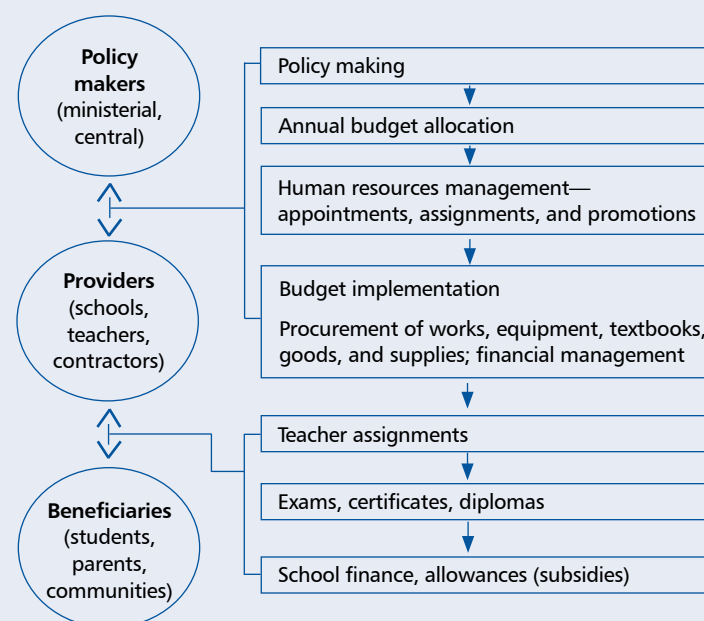
Box 2 illustrates how the RA/RMP process was approached in Mongolia in 2008 to inform the CPS and potential projects in priority sectors. The RA team comprised governance experts from an international nongovernment organization with a credible track record and an in-depth understanding of the situation in Mongolia. This case was distinctive in its conduct of interactive and highly participatory workshops that helped reinforce country ownership of the RA/RMP.

In carrying out the sector RA, the value chain approach was used to lay out the sequence of stages and/or activities that are necessary to deliver a particular output. Figure 4 presents the value chain for the education sector, a priority sector in Mongolia. Along this chain, key vulnerabilities were found in policy making, budget formulation and execution, human resources management, and procurement, among others. Major risks were distilled from key vulnerabilities and were carried forward to the RMP.

Box 2: Risk Assessment/Risk Management Plan Process in Mongolia

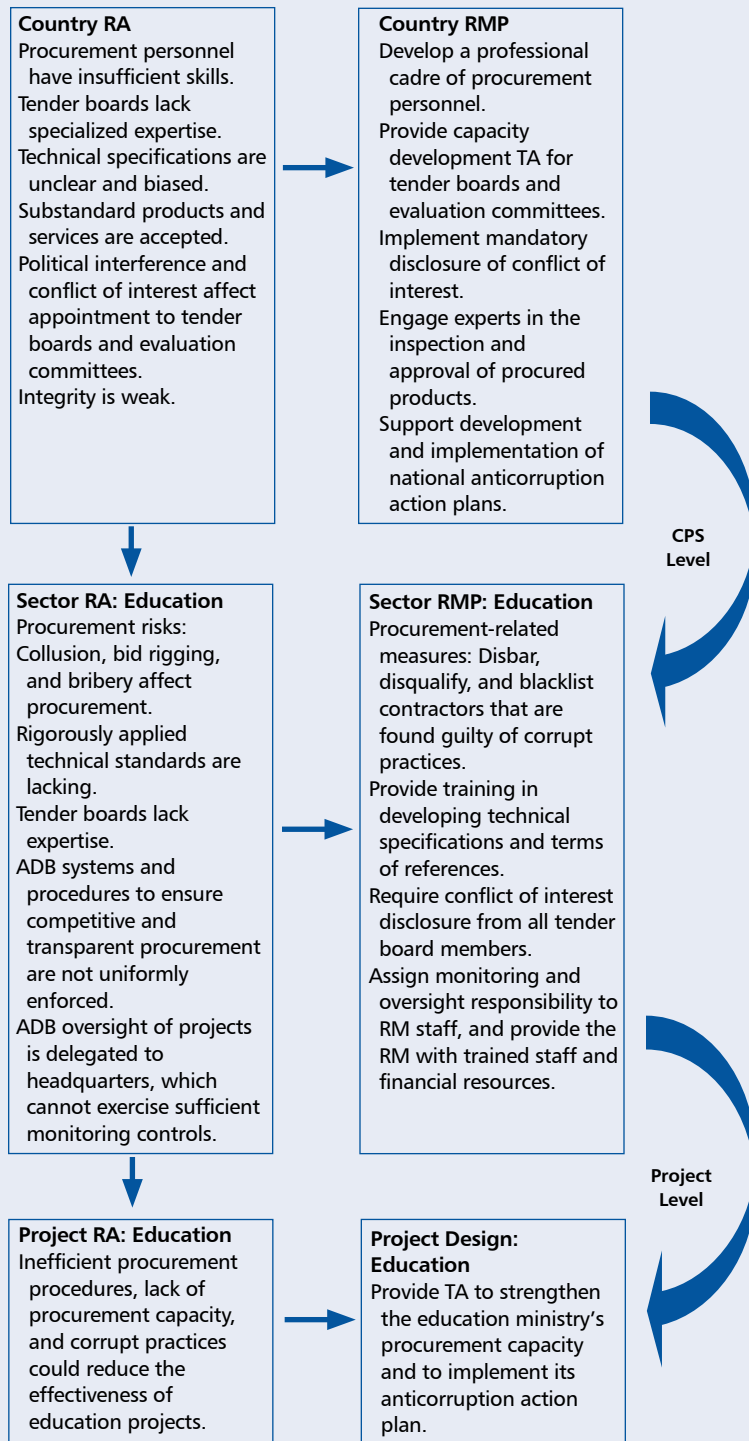
- The risk assessment (RA) was meant to inform the country partnership strategy and potential projects in priority sectors.
- The RA was carried out with full government support during the entire process. An initial briefing was conducted for the anticorruption agency commissioner. The government designated a senior officer as the liaison for the RA team.
- State secretaries of all the ministries and senior ranking line agency officials subsequently participated in a 2-day high-level seminar on governance and combating corruption, which sought to assess corruption risks within ministries and agencies, formulate an anticorruption action plan to reduce the risks, establish systems to monitor implementation of the action plan, and build cooperation with the anticorruption agency. The prime minister and nine ministers attended the closing session. The participants briefed the prime minister on their proposed anticorruption action plan. Participants also responded to a short questionnaire on risks. The seminar results and questionnaire responses comprised one body of evidence for the RA.
- The sources of evidence for the RA/risk management plan comprised both primary and secondary sources. Available secondary sources included past and recent assessments of the country procurement system, investment climate studies, fiscal transparency updates, corruption reports and corruption perception surveys, country portfolio reviews, project reports, evaluation studies, sector reports, and other relevant documents. The RA consultants conducted interviews with key officials in the public, private, and nongovernment sectors as part of collecting primary information.
- Two workshops were organized for two priority sectors. Risks were subsequently mapped based on likelihood and seriousness. Risk management measures were proposed for major risks.
- The workshop participants presented the results to the prime minister, ministers, and agency heads. Wrap-up sessions were instrumental in eliciting comments from developing member country officials and staff on the proposed risk management plan.

Figure 4: Education Sector Value Chain



Source: Adapted from Patrinos, Harry Anthony and Ruth Kagia. 2007. Maximizing the Performance of Education Systems. In *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*, edited by J. Edgardo Campos and Sandjay Pradhan. Washington, DC: World Bank.

Figure 5: Cascading Risk Assessments—Mongolia



ADB = Asian Development Bank, CPS = country partnership strategy, RA = risk assessment, RM = resident mission, RMP = risk management plan, TA = technical assistance.

Sources

ADB. 2008. *Risk Assessments and Risk Management Plans for National Systems and the Education and Urban Infrastructure Sectors in Mongolia*. Consultant's Report under Regional Technical Assistance 6385: Governance and Capacity Building Initiative. Manila.

—. 2009. *Support for the Implementation of the Sector Risk Assessment in the Education Sector: Mongolia*. Subproject Proposal under the Governance Cooperation Fund. Manila.

Distinct messages can be drawn from the RA/RMP process in Mongolia. First, the value chain approach provided a useful point of reference for a consultative process at the sector level. It offered a practical framework for mapping out vulnerabilities along different points of the chain and provided a take-off point for understanding how such vulnerabilities can impair development effectiveness. Second, partnering with a well-established international nongovernment organization gave the process deeper traction and opened doors to a highly participatory RA/RMP. Third, deriving a brief, clear, and prioritized RA was a major challenge, given the broad spectrum of risks identified. Equally challenging was transforming the RA into an actionable RMP. Fourth, the involvement of high-ranking officials (prime minister, anticorruption agency commissioner, ministers, and senior officials of line ministries) helped elevate the importance of the RA/RMP and reinforced the need to improve governance systems in the country.

Substance of the Country RA/RMP

The country RA/RMP for Mongolia indicated that country systems were generally ill-equipped to administer, manage, or implement large-scale investments. Major PFM risks emanated from the government's limited capacity to implement development policies and to ensure that budget formulation, allocation, and execution are consistent with policy priorities. Procurement risks stemmed from noncompliance with the legislative and regulatory frameworks for procurement and from insufficient skills and expertise of procurement personnel, tender boards, and evaluation committees. At present, procurement is not considered a profession in Mongolia. A cadre of trained procurement officials does not exist. The RA found that appointment to tender boards and evaluation committees was subject to political influence and/or interference and conflict of interest. Technical specifications and selection criteria were reportedly unclear, had vague performance criteria, and/or were biased to favor certain bidders. Inspection, supervision, and quality control were found to be weak. Ethics and integrity in the civil service were similarly weak. Implementing agencies had not exercised sufficient rigor to promote integrity, fight corruption, and enforce administrative sanctions. Figure 5 presents some measures to manage major assessed risks.

Substance of the Sector RA/RMP

The education sector RA echoed many of the risks posed by country systems. In addition, weak internal audit practices and the existence of extra-budgetary accounts that could be susceptible to mismanagement and abuse were identified as particular PFM risks to the sector. Specific procurement risks included shortfalls in due diligence, weak capacity and integrity, and inadequate oversight. Corruption risks were assessed as arising from nepotism and conflict of interest in appointment to tender boards and in the recruitment of school principals and teachers. Unqualified teachers were reportedly employed through bribery and fake teaching certificates. These could undermine efforts to improve the quality of education. Opportunities for corruption were also found in the procurement of textbooks, uniforms, and school lunches. Textbooks, in particular, were cited for physical and content deficiencies. The sector RA reported malfeasance in the selection of contractors, the award of contracts, and the acceptance of substandard products and services. Together with the lack of an ethical code, these could undermine sound resource management and responsive service delivery in the education sector.

Substance of the Project RA

A subsequent project for the education ministry, approved in early 2009 under the Governance Cooperation Fund, acknowledged the findings of the sector RA/RMP. It affirmed that risks from procurement, corruption, and weak capacity could undermine effectiveness of education projects. Given this finding, the project design provided for technical assistance to develop the education ministry's procurement capacity, as well as to strengthen and implement the ministry's anticorruption plan.

Lessons Learned and Conclusions

The preceding cases highlighted various types of risks faced by DMCs. Where capacity weaknesses exist side by side with systemic governance weaknesses and adequate reforms are not underway, the potential risks from PFM, procurement, and corruption are likely to be pervasive and complex. An adequate assessment and careful prioritization of risks thus are essential before the preparation of RMPs.

Key lessons that can be drawn from the conduct of RA/RMPs in various DMCs include the following:

RA/RMP Process

- (i) Get senior DMC officials involved from the start, and keep them engaged throughout the process. Introduce the RA/RMP as a positive, forward-looking exercise and as a means to strengthen the partnership between the DMC and ADB. Underscore potential gains from the assessment and establish a sound working relationship. Mobilizing DMC participation helps strengthen country ownership of the RA/RMP and adds depth to the exercise. Building ownership may be enhanced through consultations and workshops. Also, interaction with development partners and civil society organizations on governance risks enables the RA team to obtain a multifaceted understanding of the DMC situation.
- (ii) Sector specialists and governance specialists must work closely in preparing RA/RMPs. The synergy of sector and governance expertise contributes to meaningful results. Much more needs to be done along this line in the future. Learning workshops could help strengthen this synergy.
- (iii) Where consultants are deployed to carry out RAs, it is important for ADB staff responsible to closely supervise and ensure that consultants stay within the agreed terms of reference and framework agreed with the government.
- (iv) Undertake an intensive review of diagnostics conducted by development partners, national, and international nongovernment organizations, think tanks, and other appropriate groups. Complement secondary documents with primary sources of information (interviews with key informants; meetings with development partners, project staff, government officials, and contractors; workshops; site visits; and perception questionnaires). Triangulate insights. Well-informed judgments are imperative. Assessed risks must be based on various sources of evidence.
- (v) Partnership is key. Do not reinvent the wheel. In certain cases, partnering with a credible and capable organization that has done governance work in the DMC facilitated the conduct of RAs. Familiarity with the DMC situation, rapport with senior officials, and capacity to mobilize support from decision makers for the implementation of a risk management plan are valuable.

RA/RMP Substance

- (i) Focus on risks, not issues. This is the value added of a risk-based governance assessment.

Where capacity weaknesses exist side by side with systemic governance weaknesses and adequate reforms are not underway, the potential risks from PFM, procurement, and corruption are likely to be pervasive and complex.



Articulate how governance weaknesses could threaten development effectiveness. For example, risks could be stated as follows: (a) non-alignment of budget priorities with sector plans could make service delivery unresponsive, (b) leakages in fund transfers from the national level to frontline service providers could impair efficient resource uses, (c) lack of external scrutiny of sector agencies could weaken accountability, or (d) the absence of competent procurement professionals undermines sound procurement planning and competitive procurement procedures.

- (ii) Deal with major risks (likely to occur, relatively serious, and not likely to be mitigated over the CPS period). In addressing these risks, bear in mind that risk management measures are context-specific. DMC situations vary. What works in one setting will not necessarily work in another.
- (iii) In proposing risk management measures, consider ADB's potential tools of support (loans, grants, technical assistance, and dialogue), along with close supervision and other control measures. The RMP must be actionable by ADB. To illustrate, such measures could be expressed concretely, as follows: (a) provide a grant and/or loan to implement sectorwide PFM improvements, (b) provide capacity development technical assistance to build a core of procurement professionals in the DMC, or (c) support the establishment of a website for

contract-related information to guard against changing the rules after the procurement process has started.

- (iv) Policy dialogue on the substance of the RMP is vital. It can provide a valuable opportunity to discuss alternative risk management measures, secure agreement on the RMP, and gain support for its implementation.
- (v) In DMCs where language is sensitive, change it (e.g., reducing leakage instead of anticorruption, and systems development instead of governance reform).

In conclusion, a risk-based governance assessment requires an understanding of the potential threats to development effectiveness at various levels and the exercise of sound, well-informed judgment to guide the country strategy, sector road maps, programs and/or projects. The RA should be evidence-based and anchored in reliable and timely information, and the RMP tailored to contextual realities. Risks that impair development effectiveness can result from capacity weaknesses, institutional limitations, and/or corruption. Risk vulnerabilities are often found in areas where discretionary decisions are made, where funds or contracts change hands, or where capacity is weak. A risk-based approach facilitates synergies with capacity development assessments. Finally, effective risk management calls for alertness to changing conditions and adapting the RA/RMP to new and evolving risks.