RISK MANAGEMENT & THE GRANTMAKING LIFECYCLE

How to manage what you can't control

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Risk management and the grantmaking lifecycle

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SmartyGrants: Driving best practice in grantmaking

Risk management and the grantmaking lifecycle

Introduction

From catastrophic bushfires to the ongoing health and economic impact of the COVID-19 pandemic, grantmakers in recent years have faced an array of threats that have disrupted well-crafted funding programs.

Grantmakers with established risk management frameworks and practices have weathered those storms better, and will be better placed for the inevitable ones to come.

Those grantmakers will always have the capacity to be more responsive and agile in the face of unpredictable events in every area of their portfolio: program management, finance, workplace health and safety, human resources, the political environment, media management and much more.

SmartyGrants has produced this white paper to help grantmakers to manage risk, avoid trouble, embrace opportunity and make the most of their grant programs.

The benefits of managing risk well include:

- Improved efficiency
- Improved effectiveness of grants programs and hence increased impact
- Better meeting of compliance obligations

Grantmakers who manage risk effectively are able to reduce the administrative burden on their organisations and on grantseekers by avoiding excessive interventions, leaving their programs free to flourish.

Implementing and maintaining a well-formed risk management program will pay dividends in terms of your time, your effort and your impact.

This white paper explores risk management in the context of each step of the grantmaking lifecycle as outlined in the SmartyGrants Grantmaking Toolkit, the definitive guide to building best practice into your grants processes and programs. In applying it to your organisation, you should also consider your existing risk management frameworks.

This paper forms part of the SmartyGrants suite of information, guidance and resources at smartygrants.com.au (free) and at help.smartygrants.com.au (SmartyGrants users only).

What is risk?

The [International Risk Management Standard (ISO3100:2018)] defines risk as "the effect of uncertainty on objectives". Other common definitions refer to a risk as an uncertain or unpredictable incident or issue, brought about by internal or external factors, that would affect a grantmaker's ability to achieve goals or objectives if it were to occur.

Why should you manage risk?

Effective risk management is integral to best-practice grantmaking. When integrated into policies and procedures, it contributes to good decision-making. For grantmakers, the benefits of managing risk include:

Improved efficiency: the principle of proportionality

Grants programs aren't all the same. They vary in size, complexity, the vulnerability of their beneficiaries, their public profile and their political sensitivities. Likewise, no two grant recipients are alike – they have different levels of experience, expertise and capability.

A one-size-fits-all approach to grants management is inefficient or risky or both, whereas a proportional approach maximises efficiency and minimises risk.

For example, let's say you're offering grants of $1 million and grants of $1000. If you require all applicants to fill out exactly the same application form, with the same level of detail, you're either making things far too burdensome for the small-grant applicants (that's inefficient), or you're not getting all the information you need to conduct due diligence before you hand out $1 million grants (that's risky).

The principle of proportionality is an excellent risk management strategy. It enables grantmakers to make risk-informed decisions so that that risks are neither overmanaged nor undermanaged, allowing scarce resources (e.g. the time available to grantmakers and grantseekers) to be efficiently and effectively used.

The principle of proportionality allows grantmakers to tailor controls for their programs and grants based on the level of assessed risk. (For an explanation of control types, see 'What are controls?' on page 15.) For example, by reducing monitoring and streamlining reporting requirements for lower-risk grants, grantmakers can free up time and resources for themselves and their grantees, allowing them to get on with the important work of creating change in the world. Grantmakers are then free to spend more time monitoring and supporting the smaller number of higher-risk grants.

Improved effectiveness and increased impact

Life is unpredictable, but effective risk management enables grantmakers to identify risks that could prevent a grant, program or grantmaking organisation from achieving the desired outcomes. Analysing these risks allows grantmakers to understand them and to put in place strategies (known as controls) to reduce their likelihood and consequences.

However, eliminating or avoiding all risk is a risk in itself. The cost of *not* pursuing an opportunity or taking an action because it is risky might turn out to be higher than the cost of the risk. Risk management helps grantmakers to make considered decisions and can encourage and facilitate innovation by giving them confidence to pursue new opportunities.

Meeting your compliance obligations

Grantmakers have an obligation to be responsible stewards of grant funds, ensuring they are used efficiently, effectively and for their intended purpose.

Risk management is a critical component of a grantmaker's overall governance framework. Without good risk management processes, those accountable (e.g. boards, secretaries, senior management) are unable to effectively discharge their duty to make quality risk-informed decisions.

Government grantmakers in particular are often required by legislation to incorporate risk management into their processes. At a commonwealth level, effective risk management processes are mandated by the Public Governance, Performance and Accountability Act 2013 and the Commonwealth Grants Rules and Guidelines 2017.

Driving continuous improvement

Like the grant management lifecycle, the risk management process is iterative. Monitoring and review should be embedded into all stages of the risk management process. Regular reviews of the internal environment, the external environment, and the effectiveness of current controls and treatment plans should provide assurance that risk assessments are current and accurate.

The benefits of a continuously improving risk management process flow through to improvements to the efficiency and effectiveness of grants programs.

The risk management process

The ISO31000/2018 International Risk Management Standard outlines a best-practice framework, principles and a process for undertaking risk management. For grantmakers seeking a more formalised approach to risk management, it's a great place to start.

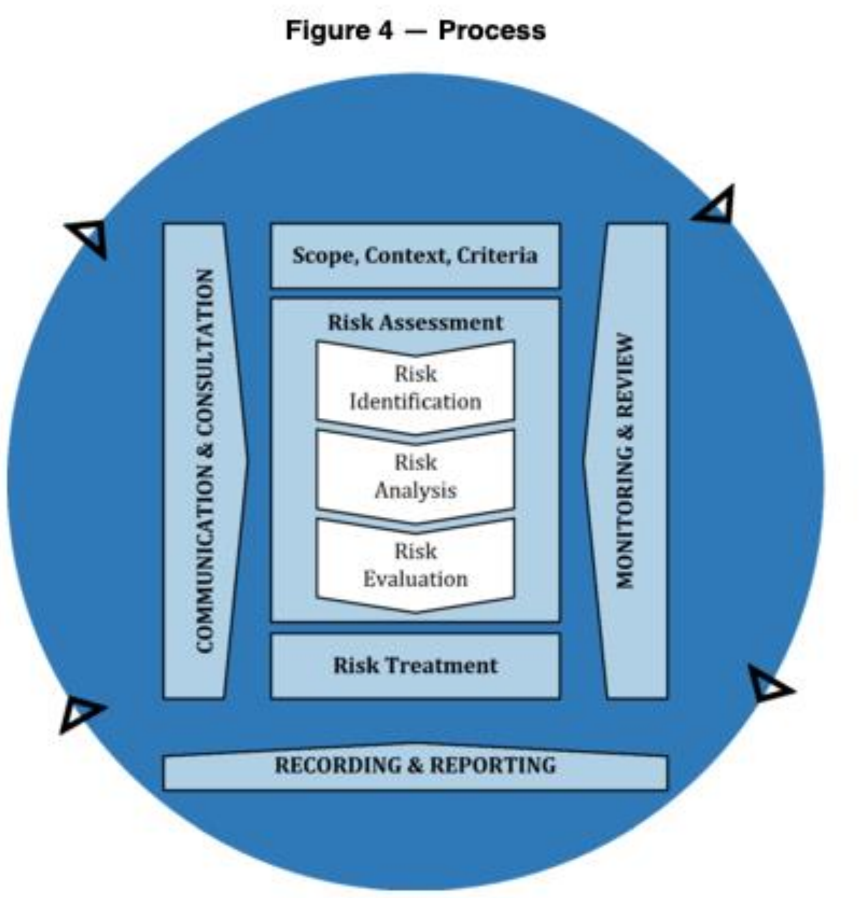


Figure 1. (above) The risk management process as outlined in the ISO31000/2018

The risk management process (pictured here) should be incorporated into the structure, policies and procedures of grantmaking organisations. Risk management as outlined in this process can be undertaken at the enterprise (whole of organisation), program or individual grant level.

The process involves establishing:

- scope (e.g. program or grant level risk management)
- context (internal and external environment)
- criteria (e.g. categories of grantmaker consequence or impact; risk matrix composition; likelihood and consequence definitions).

Identifying and analysing risks allows grantmakers to understand their causes and to make informed assessments of their likelihood and consequences, taking into account existing controls and their effectiveness.

Evaluating risks involves comparing the assessed level of controlled risk against the grantmaker's target level of risk for each impact category and deciding what, if any, further risk treatments are required.

Communication and consultation with stakeholders run throughout the whole process, as do monitoring and review.

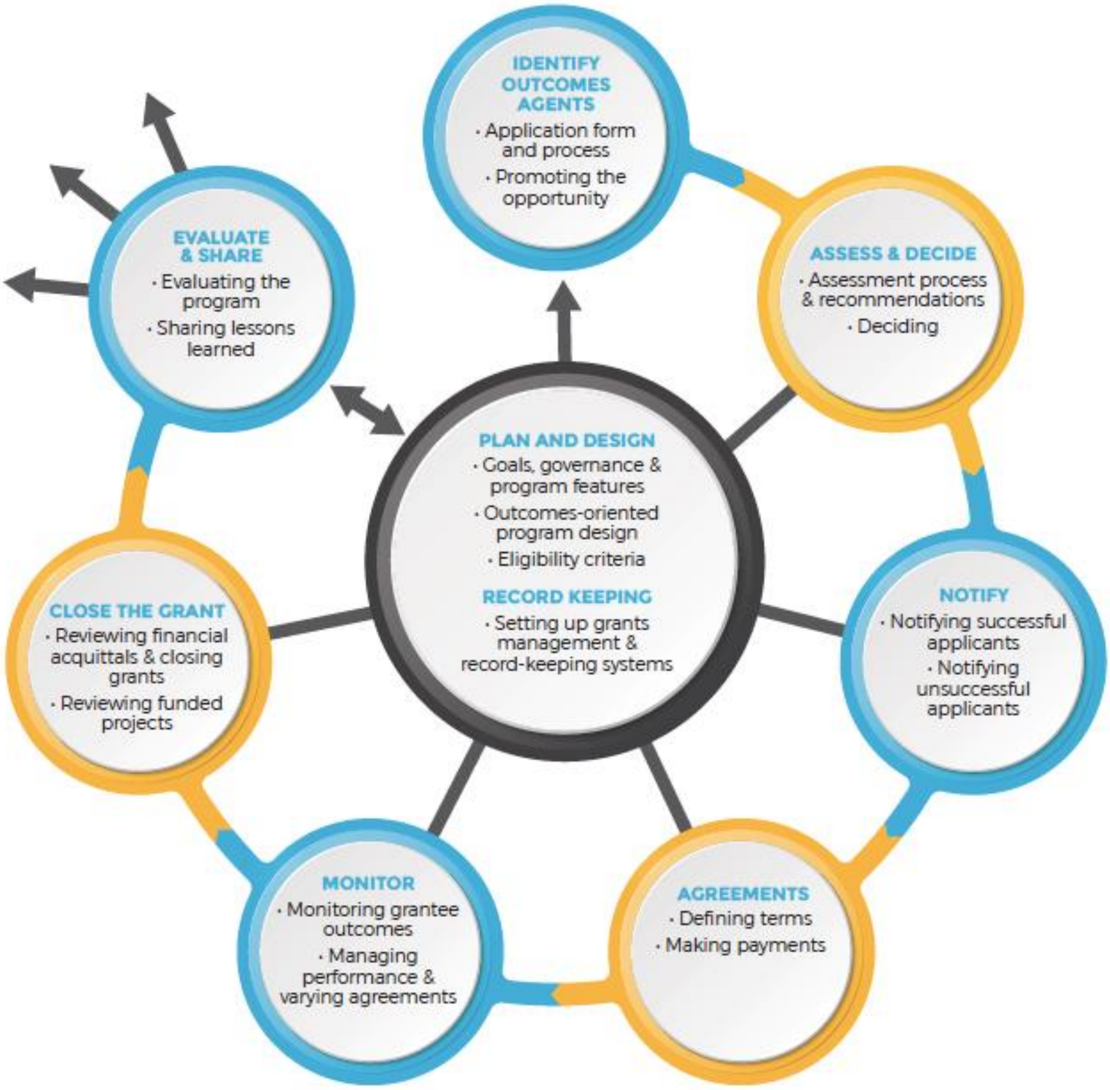
The whole risk management process is also underpinned by recording and reporting, which documents the process (so it can be widely disseminated and doesn't live only in one person's head), provides information to inform decision making, records those decisions, facilitates review and continuous improvement, and assists with stakeholder communication.

Risk management and the grants lifecycle

Whether intuitively, or through more formal risk management processes, grantmakers are (or should be) making risk-informed decisions at every stage of the grantmaking lifecycle.

What follows is a discussion of some possible risks, controls and decisions faced by grantmakers at each stage. The risks and controls listed are examples only and are by no means exhaustive.

Grantmakers are encouraged to undertake their own risk management process, identifying and managing risks that are applicable to their organisations, programs and grantees.



The SmartyGrants grantmaking lifecycle

1. Plan and design

This is the foundation of your grants program, and consideration of risk is paramount at this point. A program-level risk assessment early in the process allows grantmakers to identify key risks and ensure that necessary controls are built into program design.

Here are some tips for identifying program risks:

- Think about how previous iterations of the program went. Consider the findings and lessons learned from previous program evaluations.
- Engagement with stakeholders is critical to identifying and managing risks. Stakeholder engagement allows grantmakers to understand diverse perspectives (e.g. those of grantees, prospective grantees, peak bodies and internal grantmaking staff), and can help identify risks that would otherwise go unnoticed.
- If your program is new, consider talking to other grantmakers working in the same field. Although every contract and grant program is different, there will be risks common to grantmakers of similar type and sector.

Eligibility and assessment criteria are your opportunity to specify exactly what qualities, skills and experience you require from potential applicants. Most of your eligibility and assessment criteria will flow from the outcome goals of your program, but they are also an opportunity to mitigate risk in the program. For example, programs often require that applicants are incorporated entities and that they have a minimum amount of public liability insurance coverage.

The controls you decide to implement in relation to eligibility and assessment criteria must be proportional to the assessed level of risk. Make the criteria too strict and you may unnecessarily exclude or discourage applicants; make them too loose and you may expose yourself to unnecessary risk. It's important to get the balance right.

For example, a disaster relief grant program needs to balance the need to get money out the door quickly against the possibility of fraud, and reputational risks. If the eligibility requirements are too tight, they will impede the flow of aid to those most in need, but if they are too loose, they may lead to fraud and reputational risks, which have negative consequences for beneficiaries and the grantmaker.

Record keeping

It is no coincidence that record keeping underpins both the grantmaking lifecycle and the risk management processes. Effective grants management and effective risk management are both dependant on good record-keeping systems and practice.

Quality record keeping and reporting systems contribute to good governance. They are repositories of corporate knowledge, taking critical information out of grant officers' heads, organising it logically and making it easily accessible to those who need it. Record keeping and reporting facilitates risk-informed decision making and ensures accountability, by recording decisions and their rationale. Keeping records of stakeholder communications and engagement is part of the process.

When designing your records management systems, policy and practice, consider how you will manage risks related to privacy, confidentiality and data security.

Some common controls to mitigate these risks include privacy and records management training, confidentiality agreements for staff, IT access controls, system audits, and IT policies and procedures.

2. Identify outcomes agents

Application forms gather information from grant applicants to inform decisions about who is best suited to deliver your desired outcomes. Your eligibility and assessment criteria, your reporting requirements and your risk assessment will guide the questions you put on your form.

Having the right questions on application forms allows grantmakers to make risk-informed decisions about who to fund, the level of risk, and what, if any, controls are required.

Questions for grant recipients that can inform an assessment of risk include questions about governance arrangements, financial viability, their track record with regard to compliance, financial management, and previous delivery of outcomes.

Again, it's important to get the balance right here, asking for just the information you need, but no more. Every unnecessary question you ask imposes an additional burden on grant applicants and makes assessing applications more difficult.

For example, you are highly unlikely to require financial viability information from grantees if your program is giving small, one-off grants for community festivals.

The help sheet '[Identifying outcomes agents: How to target grantseekers to reach your goals]' discusses considerations for grantmakers during this stage of the grantmaking lifecycle, with a focus on maximising eligible, high-quality grants applications.

3. Assess and decide

As grants scandals so often demonstrate, the assessment and decision-making stage of the grantmaking process is fraught with risk. As much as possible, grantmakers need to identify and manage these risks to ensure that their processes are beyond reproach.

When designing your assessment and decision processes, consider how you might manage risks related to conflict of interest, confidentiality, data security, and the quality and consistency of assessments and funding decisions.

Common controls to mitigate these risks include assessor training (including probity training), engagement of probity advisors, assessor guidelines (including policies and procedures), conflict of interest and confidentiality declarations, assessment moderation processes, internal quality assessment processes, internal audits and external audits.

4. Notify

Notifying applicants of the outcome of grant rounds carries a degree of risk, particularly with regard to unsuccessful applicants.

When designing policies and processes for notifying applicants, consider how you will manage privacy, confidentiality, and the potential for unsuccessful applicants to challenge the results.

Common controls include form letters with specific feedback for applicants, and the provision of designated contact officers trained in providing feedback. Ensuring that assessment and decision-making processes (including any appeals process) are well documented, communicated and adhered to will also help mitigate risks at this stage.

5. Agreements

Defining terms

A grantmaker's approach to grant agreements and contracts should be proportional to the assessed level of risk.

Some grantmakers issue a standard agreement to all successful grantees with little negotiation, while others undertake individualised negotiations and generate bespoke agreements. A best-of-both-worlds approach is to develop a few different templates and tailor them as required to suit individual grants. For example, you might use a streamlined template for smaller, lower-risk grants, and a more detailed template for larger, higher-risk grants.

The Commonwealth Department of Finance has adopted this approach and developed a series of risk-based contract templates. A letter of agreement is used for simple, low-risk grants; a 'simple agreement' for more complex yet still low-risk grants; and a 'standard grant agreement' for medium- to high-risk grants. It has also developed a 'clause bank' which contains additional clauses that can be employed as needed to mitigate specific risks.

Making payments

Grantmakers should design a payments policy that is consistent with the objectives of their program. Depending on the assessed level of risk, payment policy decisions can either streamline processes and reduce administrative burden, or they can mitigate risks related to fraud or serious non-compliance.

Take into consideration your payment schedule as well as your payments approval process. For example, you might design a policy where grants assessed as lower risk are paid in larger instalments, in advance, and at larger intervals (e.g. annually), while grants assessed as higher risk are paid in arrears, in smaller amounts, and at more frequent intervals.

Payments for grants assessed as lower risk may be set to 'auto-release' by default, while those assessed as higher risk might have to be manually released subject to satisfactory performance or the achievement of specific milestones.

Consider how you will manage the risk of fraud, both internally and externally. Common controls related to payments include (but are not limited to) requesting evidence that nominated bank accounts are held in the name of the applicant; carefully considered financial delegations and approval processes; and provision for internal and external audits.

You will also need to ensure business continuity – i.e. that grantees can continue to be paid in unforeseen circumstances, such as an IT system failure.

6. Monitor

Decisions on monitoring, like most other grantmaker decisions, are contingent on the level of assessed risk. Lower-risk grant recipients will require less monitoring, while less experienced or higher-risk recipients may require more intensive support.

However, things change, and neither risk assessments nor monitoring strategies should be ‘set and forget’. Risk assessments should be regularly reviewed at risk-based intervals, and as new issues arise or critical information comes to hand. Risk assessments should feed into monitoring strategies, and the results of monitoring into risk assessments. For example, a grantee may be assessed as low risk initially, but changes to their governance arrangements might prompt a change in their risk rating and hence increased monitoring while remedial actions are implemented and evaluated. Once these issues have been resolved, the risk rating and monitoring approach would again be revisited and adjusted accordingly.

The most effective monitoring is based on an open, trusting relationship between the grantmaker and the grantee. A collaborative relationship in which grantees feel safe to raise issues and grantmakers work constructively with them to devise solutions allows for early identification of issues and better outcomes.

Varying agreements

Contract variations are a powerful tool grantmakers can use to control all types of risk. Variations are often undertaken as part of a collaborative effort with grantees to address emerging risks. A 2020 SmartyGrants survey of grantmakers found that 75% of respondents had initiated or approved some sort of contract variation as a result of the COVID-19 pandemic. These variations included changing the focus of funded projects, enabling projects to run online, and making other changes to allow projects to continue to operate safely. All these variations allowed risks to be mitigated and outcomes to be safeguarded.

Variations can also be used to mitigate more serious fraud or non-compliance risks. For example, increased reporting and changes to payment schedules can be implemented to limit financial exposure.

7 and 8. Close the grant, and evaluate and share

Reviewing financial acquittals and closing grants

Financial acquittals drive accountability and are an important control designed to mitigate against financial and other types of risk. Decisions about the frequency and requirements of financial acquittals should be based on the level of assessed risk. For example, if you are working with large, complex grants, or with inexperienced grantees who are assessed as higher risk, you may choose to acquit funds more regularly or require more rigorous documentary evidence (e.g. audited financial statements). Conversely, if you are working with small, simple grants or very experienced, capable grantees with strong financial governance, you may choose to acquit just once at the end of the grant and opt for a less burdensome process such as a simple financial declaration.

Reviewing funded projects

Both the risk management process and the SmartyGrants grantmaking lifecycle are iterative and involve continuous improvement.

Project evaluation is an opportunity to reflect on what worked well, what didn't work so well, and what can be learned from the project. Like monitoring, it works best when grantmakers have an open, trusting and collaborative relationship with grantees, and they feel safe to raise problems and concerns, as well as achievements.

Findings from project reviews can be fed into grantee-level risk assessments. For example, assessments of grantee capability can be used to inform future grant round assessments and refine controls and supports required for future grants awarded to the grantee.

Evaluating the program

Program evaluations typically examine the success of your whole grants program, the extent to which it achieved its desired outcomes, and the means by which those outcomes were achieved (policies, processes and systems).

When risk management is embedded into program design, then policies and procedures, program evaluation and risk management are inextricably linked. In reviewing the 'how' of your program, an evaluation will necessarily also review the effectiveness of your risk management practices, the quality of your risk-informed decisions, and their contribution to the effectiveness and efficiency of your program.

Risk management data from your program (e.g. incident reports, risk registers, complaints, and treatment plans) can be used in conjunction with other program evaluation data (e.g. grantmaker data, engagement with stakeholders) to allow a holistic evaluation of your program – including your risk management – and underpin any necessary improvements to risk management and program design.

With monitoring and review embedded in each step of the risk management process, grantmakers don't have to wait until the end of their program to start evaluating whether their systems are working effectively and their program is on track to achieve its desired objectives. Collecting the right data, managing records well and maintaining good reporting systems will give grantmakers access to an accurate picture of how things are going at any point in time over the course of the program and allow improvements to be made in real time.

What are controls?

Controls are any measures or actions that have been implemented with intention of reducing risk. Any assessment of risk should take into account the effectiveness of existing controls.

When deciding on controls, grantmakers should consider the multiple causes and consequences of the risk, as separate controls may be required for each identified cause and consequence. Grantmakers should also ensure that their chosen controls are proportional to the assessed level of risk.

In risk management, controls are commonly grouped into three main categories:

1. Preventative controls are used for risks that are within the grantmaker's control. They seek to reduce the likelihood of a risk event occurring. Examples of preventative controls include policies and procedures (e.g. assessor guidelines and codes of conduct), staff and grantee training, multifactor authentications on IT systems, and a requirement for grant applicants to provide evidence of their bank account details on their grant applications.
2. Detective controls are those that are used to detect risk events after they have occurred. Examples include internal quality assurance processes and internal and external audit programs that assess grant officer or grantee compliance with policies and procedures. Detective controls help grantmakers to understand the effectiveness of their existing preventative controls, and provide assurance that incidents are not going unnoticed.
3. Corrective controls are intended to reduce the consequence of a risk that is out of the control of the grantmaker, or in the event that preventative controls fail, and the risk is realised. Examples of corrective controls include contingency plans (business continuity plans), insurance policies and cloud-based data backups.

Risk treatment strategies

According to the International Risk Management Standard (ISO 31000), the purpose of risk treatment is to 'select and implement options to address risk'. A grantmaker's choice of treatment strategies will depend on the assessed level of risk, and the grantmaker's individual risk appetite and risk tolerance.

ISO 31000 outlines a full list of risk treatment options, which are often grouped into the following five categories:

1. Avoid the risk

If the risk is unacceptable, grantmakers may choose to avoid the actions, activities or programs that cause the risk. For example, a grantmaker may choose not to fund an applicant who has been deemed to be an unacceptably high risk or choose not to proceed with a community festival grants program because of the public health risks associated with the COVID-19 pandemic. Risk-averse grantmakers should note that risk avoidance isn't always a viable option, and that avoiding risk carries its own risks, discussed later.

2. Reduce or mitigate the risk

Mitigation treatments seek to reduce the likelihood of the risk event occurring, or reduce the consequences of that risk if it is realised (or both). Risk mitigation should be cost-effective (e.g. there is no point spending $50,000 on mitigating a financial risk if it will only reduce the potential consequence by $20,000). It should also have well defined timelines, an owner who is accountable for its implementation, and good accompanying documentation. The overall aim of risk mitigation is to reduce the residual risk to a level that is acceptable to the organisation.

3. Share the risk

Another treatment strategy is to share the risk with others. Collaborating with other grantmakers is an approach that entails sharing operational, political or financial risks. The SmartyGrants article 'Funding collaboratives' discusses some of the benefits and challenges of this approach.

4. Transfer the risk

The most commonly cited example of risk transfer is insurance. By purchasing an insurance policy, you are transferring the financial risk of an event to the insurance company.

5. Accept the risk

Accepting the risk results in doing nothing. Grantmakers might choose to accept the risk if it is within their risk tolerance level, can't be effectively mitigated, or can't be avoided.

Be aware of the risks of managing risks

Treatment strategies carry their own risks which also need to be considered and managed appropriately. For example, avoiding a risk by refusing to fund a controversial applicant, or choosing not to proceed with a grants program, could expose the grantmaker to public scrutiny and reputational risk.

Risk mitigation treatment strategies can inadvertently create worse problems than they are trying to solve. For example, imposing strict key performance indicator compliance measures might ensure the volume of outputs, but come at the cost of a reduction in the quality of outcomes. Avoid knee-jerk reactions to incidents and examine the effectiveness of your existing controls before rushing in to add additional treatments.

Sharing risks (e.g. through collaboration with other grantmakers) carries its own risks. Alignment of strategic objectives, shared decision making, and managing relationships are all factors that could contribute to risk. Ensuring that strategic objectives are aligned, decision making is shared, and relationships are well managed helps to mitigate the risks associated with sharing risks.

More Information

- The SmartyGrants Grantmaking Toolkit, 2020
- The International Risk Management Standard (ISO3100:2018)
- The Public Governance, Performance and Accountability Act 2013
- SmartyGrants Helpsheet: Identifying outcomes agents: How to target grantseekers to reach your goals, 2020
- The Commonwealth Department of Finance risk-based contract templates
- SmartyGrants COVID-19 Grantmaking Survey 2020
- Funding Colaboratives, SmartyGrants article, 2020