



## The basics of corruption risk management

A framework for decision making and  
integration into the project cycles

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U4 is a web-based resource centre for development practitioners who wish to effectively address corruption challenges in their work.

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## Abstract

Aid agencies need better systems to identify, assess, and mitigate corruption risks. Risk assessments should consider two main dimensions of an act of corruption: probability and expected impact. Cost-effectiveness considerations determine whether corruption risks should be treated, and how. Aid agencies cannot focus on own fiduciary and reputational risk, but must make investment decisions based on the magnitude of risk that different types of corruption pose for development objectives. The aim is not to eliminate corruption but to optimise development results. Agencies need information on the severity of corruption risks and the effectiveness of counter-measures throughout the project cycle in order to properly analyse and manage risks. To help agencies move beyond front-end risk assessment, the paper shows how different risk mitigation tools can be applied across the project cycle.

## Acknowledgements

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# 1. Introduction

This paper examines corruption risk management in a development aid context and explains how these risks can be identified, assessed, and mitigated across the project cycle. It provides a framework that can be used to build the strongest risk management framework possible, or, alternatively, a lighter model. It suggests considerations that should inform the decision to invest in corruption risk management and presents a menu of different corruption risk management tools.

“Corruption” and “risk” seem like naturally associated concepts. However, the disciplines of risk management and anti-corruption are farther apart than one might think. There is a noticeable scarcity of risk management literature that specifically treats corruption risks.<sup>1</sup> *World Development Report 2014*, for example, provided useful information on development risks in general but not on corruption risks in particular (World Bank 2013). Risk management is not aimed at eliminating or avoiding risks, but instead takes a calculated approach to recognising and managing key risks effectively.

In development aid, corruption risks are often treated differently than other risks because there is a moral dimension to corruption and great reputational risks involved for the organisation. A minor fraud case in a project implemented by an aid agency may pose a significant reputational risk for the agency itself, but the loss may be insignificant for the average citizen in a developing country where grand corruption makes headlines routinely. In other words, perceptions of and tolerance for corruption risk can differ depending on perspectives. The aid community does not currently have a systematic way to decide on the right level of investment in risk mitigation for different types and magnitudes of corruption in different settings. But more nuanced views are emerging on the costs of corruption to individuals and their surroundings, on why corruption control matters, and on what works and why in curbing corruption (Rocha Menocal et al. 2015).

Measurement and diagnostic tools have improved, and zero-tolerance policies are increasingly becoming more operational and pragmatic (Sequeira 2012; De Simone and Taxell 2014). As a result, decision makers increasingly realise that it is folly to expect that all types of corruption can be eliminated in any context, let alone in poorly governed countries. Still, it remains hard to communicate the nuances effectively to audiences in aid-providing countries (Marquette 2014). Communication is a key part of effective risk management, as different audiences have different levels of tolerance for corruption. Aid agencies have problems squaring the zero-tolerance slogan, popular with domestic audiences, with realities on the ground, where hard choices have to be made in terms of which corruption risks should be prioritised.

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1 Risk management has been an integral part of engineering and finance studies for three decades (Loosemore et al. 2006). It is also well developed within the environmental sciences, where it is known as environmental impact assessment (Glasson, Therivel, and Chadwick 2005). The concept has recently become popular within business disciplines and is slowly gaining attention within development aid. Scholars who developed the concept of the “risk society,” including Ulrich Beck (1992) argue that societies can no longer be preoccupied only with naturally occurring risks, such as natural disasters, but must also assess risk factors produced by science and technology and by human behaviour. Societies are only slowly learning how to deal with these new sources of risk, such as HIV-AIDS, avian influenza, terrorism, and financial crisis. See also Hood and Jones (1996).

Section 2 of the paper presents a basic conceptual framework for corruption risk management, applicable across sectors and disciplines, and explains why corruption risk management could offer a radical new approach to anti-corruption efforts. Section 3 suggests ways to identify different levels and types of corruption risks and explains how to use the conceptual distinctions between risk identification, assessment, and mitigation to improve overall risk management. Section 4 identifies the stages where it is appropriate to apply corruption risk management tools in a typical project cycle, identifying the key corruption risks and most useful risk management tools for each stage.

This paper attempts to bring a realistic and pragmatic perspective to corruption prevention in development aid programming, one that integrates new anti-corruption tools and policies in a coherent framework. It illustrates how existing tools to assess and curb corruption can be used most optimally and how to identify blind spots in aid agencies' approaches to corruption risks. It bridges the phases of project appraisal, design, implementation, and evaluation, which are often kept separate, and shows why an effective response to corruption needs an integrated approach. The paper is intended for development practitioners, especially those involved in development aid programming who are tasked with safeguarding aid funds.

## 2. What is corruption risk management and why do aid agencies need it?

Aid agencies have internal systems to mitigate the costs of corruption in their development assistance, but these are currently at a rudimentary stage. They tend to focus on internal fiduciary risks and are front-loaded. Most analysis is based on country-level assessments (Hart 2015). Risk management is an integral part of most project management toolkits. There are, however, some bad practices, or misunderstandings, in how corruption risks have traditionally been addressed. Current approaches tend to emphasise risk identification and pay less attention to risk assessment. This is often because risk assessment methodologies are missing or data are lacking. It follows from this that risk mitigation measures are often chosen without much relevant information: they may therefore be more like “controls” (applying the same measures against risks regardless of level of severity) than like actual risk management measures. The distinction between risk identification, assessment, and mitigation is explained below.

Corruption risk management has become a popular phrase, but it is often used as a substitute for “corruption control” or “anti-corruption” without any substantive differentiation. However, there is a real potential for the anti-corruption field to learn from the risk management field. If this happens, our approach to the identification, assessment, and mitigation of corruption threats would change.

Defining risk is not easy. *World Development Report 2014*, entitled *Risk and Opportunity: Managing Risk for Development*, defines risk as “the possibility of loss.” The report offers four key messages relevant to an effective corruption risk management approach:

- Risk taking is necessary. The risk of inaction may well be the worst option of all.
- A shift from unplanned, ad hoc responses towards pro-active, systematic, and integrated risk management is essential.
- Identifying risk is not enough: trade-offs and obstacles to risk management must be addressed.
- Risk management requires shared action. (World Bank 2013, 4, 11)

Decision makers who view corruption as a risk in line with other risks to development will be more concerned with identifying the types of corruption most harmful to development in a given context, and less concerned with changing overall perceptions of corruption at the national level. They will focus on the cost-benefit ratios of suggested reforms rather than only on their immediate effects (Johnsøn 2014).

An effective risk management regime, then, does not strive to eliminate risks but rather seeks to determine a tolerable level of risk for a given activity. As shown in the model in the next section, risks are only treated if the level of risk crosses the threshold established. Not all risk mitigation

measures need to be applied, only those that are necessary to bring down the risk to an acceptable level.<sup>2</sup> The cost of treatment is compared to the expected benefit of risk reduction.

Perceptions of risks can be just as damaging as actual experience if they perpetuate unconstructive behaviours, lower social trust, or discourage investment in productive activity. Risk management therefore is not purely a technical, inward-looking exercise. Risks have to be considered in their full social and cultural complexity, and communication is an important part of risk management. Risk mitigation measures should be made visible as part of the communication strategy.

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2 Kolstad (2008) identifies two main perspectives on corruption: a consequentialist logic that regards corruption as wrong because it brings bad consequences, and a moralistic, duty-based perspective that emphasises that corruption is wrong in and of itself. Both perspectives are useful, but for different purposes. Aid policies can be based on both a consequentialist and a moralistic argument. Risk management approaches cannot be based on a moralistic argument, however. A consequentialist approach to risk management would be a useful complement to the existing moral and criminal view of corruption. Such an approach would be more concerned with evidence and value for money than with principles of fairness and justice, and more focused on prevention than on sanctions.

### 3. A corruption risk management model

This section presents U4's corruption risk management model. Before turning to the steps in the model, it is helpful to consider how risk management entails interlinked but conceptually independent processes of risk identification, assessment, and mitigation. Any basic risk management process has a minimum of three stages:

- Risk identification: Identifying types of risk (bribery, nepotism, absenteeism, etc.) in a given process or system, based on a generic risk model.
- Risk assessment: Estimating the magnitude of each type of risk (probability x impact).
- Risk mitigation: Putting measures in place to minimise risk, monitoring those measures to ensure that they have their desired effect, and redesigning them if they do not.

The problem with most governance and corruption diagnostic tools available for development practitioners is that they rarely move beyond risk identification (we ascertain that a type of corruption risk exists) to the next stage, risk assessment (we estimate the probability of the event occurring and the impact this will have on programme objectives). For example, Public Expenditure and Financial Accountability (PEFA) reports and Fiduciary Risk Assessments (FRAs) identify weaknesses in public financial management systems.<sup>3</sup> This is risk identification, not risk assessment. FRAs do not translate identified weaknesses into specific types of corruption risk, nor do they provide an assessment of the level (probability x impact) of risk, except by making the indirect assumption that weak systems are more risky in general than strong systems.

Some existing tools can both identify and assess corruption risks, and they may also include a monitoring function that can have preventive or mitigation effects. Examples are Public Expenditure Tracking Surveys (PETS), different types of community monitoring (scorecards, social audits, etc.), and different types of evaluations and audits.

No existing tools can deliver ready-made corruption risk assessments. Existing tools can only provide partial information, on which the final risk assessment will have to be based. For example, an FRA can provide a qualitative indication of the likelihood of procurement fraud. However, probability can better be assessed if data can be found on the frequency of procurement fraud in the past. The impact of procurement fraud will depend on the size of the programme, but it is best estimated based on past cases. For truly programme-specific risk assessment, the most vital information will often be raw data from government records or aid agencies' own records of the frequency and impact of corruption cases. Because reliable estimates depend on past data, corruption risk management is a resource-intensive endeavour. Tools need to be combined to allow for triangulation of information. Moreover, systems should assess which corruption risks occur most frequently in which contexts/circumstances. Such risk profiling improves decision making, but it requires a good database.

The Inter-American Development Bank (IDB) and the World Bank have taken steps to develop a genuine corruption risk management approach by using their investigative units to collect,

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3 Dorotinsky and Pradhan (2007) provide an overview. DFID's (2011) "How to Note" on managing fiduciary risk is also useful. The PEFA Secretariat also provides methodological information on their website ([www.pefa.org](http://www.pefa.org)).

collate, and analyse data on occurrences of corruption and feeding that data back into the system for future risk identification and assessment. The IDB's Office of Institutional Integrity (OII) is conducting Integrity Risk Reviews (IRRs) to gather data on corruption cases to inform future risk identification, assessment, and mitigation. IRRs use both quantitative and qualitative data from OII investigations, such as the most frequently recurring types of corruption and fraud in a country's portfolio, to assess risk and feed the information back into the project cycle by training country office staff and helping them design mitigation measures. The World Bank's Integrity Vice Presidency performs a function similar to that of its IDB counterpart. It publishes redacted investigation and forensic audit reports to provide staff members with an opportunity to familiarise themselves with past cases of corruption.<sup>4</sup>

A standard project management approach would (a) identify risks, (b) assess their severity using some kind of scale, for example high-medium-low, and (c) recommend mitigation measures. The risk management approach developed by U4 builds on these standard components but incorporates insights from the broader risk management literature. This four-step model, shown in Figure 1, expands on the risk assessment phase by defining risk thresholds and a more systematic assessment, and insists that risk mitigation measures should be chosen based on a simple cost-benefit analysis.

The model in Figure 1 assumes that risk identification, assessment, and mitigation are interconnected but separate activities; that criteria for tolerable levels of risk need to be formulated; that risk assessments should consider both the probability of the risk occurring and the impact the risk is expected to have on development outcomes; that a cost-effectiveness approach is preferable to a control-based approach, because the aim is not to eliminate risk but to increase gains; and that risk mitigation strategies need to flow from risk assessments, based on the notion of acceptable risk and on cost-benefit considerations.<sup>5</sup>

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4 More information on IRRs is available on the IDB website (<http://www.iadb.org/en/topics/transparency/integrity-at-the-idb-group/corruption-prevention-tools-at-the-idb,2706.html>). The World Bank's redacted investigation and forensic audit reports are available at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/ORGUNITS/EXTDOI/0,,contentMDK:22641983~menuPK:2452528~pagePK:64168445~piPK:64168309~theSitePK:588921,00.html>.

5 Risk tolerance needs to be defined a priori. For example, Belgian law places the responsible minister in charge of defining levels of risk tolerance

**Figure 1. Four-step corruption risk management model**

Sources: This model draws on the risk management approach recommended by the International Organization for Standardization (ISO) in its 31000 framework, the Deming quality circle, and the model developed by Leitch (2008).

## Step 1: Identify corruption risks and determine risk tolerance

Aid agencies care about corruption risks for many reasons. There are risks to development overall, direct fiduciary risks, and more indirect reputational risks. Corruption poses a *development risk* when resources are diverted from public services, leading to lost public revenue, poor-quality infrastructure, wasted resources spent on underperforming public institutions or employees, an unattractive investment environment, erosion of public trust in government, and fuelling of conflict. Corruption also poses a direct *fiduciary risk* to aid agencies. These agencies have a responsibility to ensure that development funds are spent efficiently and effectively, without misuse. In 2011, examining the anti-corruption approaches of the Department for International Development (DFID), the UK Independent Commission for Aid Impact emphasised that DFID's fiduciary responsibility also extends to its implementation partners, such as United Nations agencies, contractors, and non-governmental organisations (NGOs) (ICAI 2011). Finally, corruption can pose a *reputational risk* for aid agencies. Misuse and waste of development funds damages the reputation of aid providers, and perhaps more importantly, may delegitimise and undermine public support for the entire enterprise of development assistance, both domestically and in partner countries.

There is no clear demarcation between development risks, fiduciary risks, and reputational risks. An analysis focused purely on fiduciary risks is only partial. Reputational risks are often intangible but will nevertheless be a key concern for decision makers. Still, the risks that different types of corruption pose for development outcomes must be the central analytical point of departure.

Risks can be assessed in relation to countries, sectors, institutions, programmes, projects, individuals, and internal levels of operations. Even if a country is rife with corruption, it might not affect a specific programme; nonetheless, country-level risk is often a crude indicator of programme-level risk. Of course, if the focus is on programme-level risk then data gathering should target this level when one attempts to estimate probability and impact. Assessing programme-level risk by using only country-level data sources is not advisable, though it is still practiced.

Four aspects of a programme can affect corruption risks: budget size and structure, the capability of partners, corruption levels in relevant sectors and institutions, and the service delivery mechanisms. The bigger the budget, the bigger the potential risk. Complicated budget structures are also more vulnerable to corruption. When implementation is done through partner organisations, such as NGOs, the capacity of each organisation to handle funds directly affects the level of risk (Trivunovic, Johnsen, and Mathisen 2011). Finally, the way in which an intervention delivers services can affect corruption risks. For example, a complex design involving multiple

partners, subcontractors, and disbursement channels provides more entry points for corruption. Operations in insecure areas where monitoring is difficult are also high-risk.

Corruption risks constitute a broad risk category, just as corruption is a broad concept encompassing many different behaviours. The definition of corruption as “the abuse of entrusted power for private gain” is not always easy to operationalise and may not be shared by local counterparts. For example, patronage and “quiet corruption”—the failure of public officials to do their jobs and deliver public services—are rarely defined in national legislation and may not be regarded as corruption by citizens (World Bank 2010). If the broad concept of corruption is unpacked, then one can identify the concrete corruption risks that need to be mitigated. Absenteeism, for example, may be a more precise term than quiet corruption, and it points more clearly to the problematic behaviour that needs to be addressed.

Aid agencies tend to focus on financial fraud and bribery, often using these concepts as synonyms for corruption. Fraud and bribery cases, however, may not always present the most risk to aid operations. All relevant types of corruption should be identified and their potential risk assessed, even if some types are easier to measure than others. Effective risk management requires a good vocabulary of risks and, ideally, a complete list of possible risks that can be encountered (called a risk model). Corruption risks may include any of the following:

- **Bribery:** The act of dishonestly persuading someone to act in one’s favour by a payment or other inducement. Inducements can take the form of gifts, loans, fees, rewards, or other advantages (taxes, services, donations, etc.).
- **Embezzlement/misappropriation:** Stealing or misdirecting funds or assets placed in one’s trust or under one’s control.
- **Fraud:** The act of intentionally and dishonestly deceiving someone in order to gain an unfair or illegal advantage (financial, political, or other).
- **Abuse of power/influence:** Using entrusted powers to, for example, divert benefits to a different area or target group, circumvent systems for personal gain, pervert judicial processes, or use the delivery of goods/services as an opportunity to exploit local communities.
- **Patronage, nepotism, and clientelism:** Patronage, in government, refers to the practice of appointing people directly based on personal or party considerations. Nepotism is a narrow type of patronage, where offices or benefits are granted to close friends or relatives rather than on the basis of merit. Clientelism was originally conceived as the exchange of votes for political support, but it has come to refer to long-term patron-client relationships in which various types of favours are exchanged. Clientelism may not be illegal in itself.
- **Rent-seeking:** The socially costly pursuit of rents, for example, the high returns that might be gained from monopoly control of a particular commodity or service. This is not necessarily an act of corruption, but it may be.
- **Conflict of interest:** A conflict between the public duty and private interests of a public official. It arises when the public official’s private interests have the potential to improperly influence his or her performance of official duties and responsibilities.
- **Absenteeism:** Habitual failure to appear for work or other regular duty without justifiable cause for this absence, such as sickness.

In summary, corruption risks exist at the level of countries, sectors, institutions, programmes, projects, individuals, and internal levels of operations. Effective risk management by an aid agency will draw on information at all levels. The broad concept of corruption should be unpacked into specific types of corrupt behaviour.

Finally, each organisation needs to choose its level of tolerance for each of these corruption risks. This can seem at odds with a dogmatic understanding of aid agencies' zero-tolerance principle, whereby all forms of corruption in development aid are (unrealistically) considered preventable and all acts of corruption are sanctioned the same way. However, a nuanced operationalisation of the zero-tolerance principle, such as that followed by DFID, just means that all known cases of corruption must be addressed, using a differentiated approach to these cases. The level of risk tolerance, understood as the threshold at which one should start to mitigate corruption risks, will be determined by a blend of political considerations and assessments of the relative harm that different types and levels of corruption may cause. It is therefore important to state the tolerance levels up front, but also to acknowledge that they will change over time.

## Step 2: Assess the level of risk

Effective risk management requires good analysis of the likelihood that a risk will occur, and of how damaging this occurrence will be. We want to move from a situation where we are aware of risks but uncertain of how they will affect us to a situation where we estimate with some confidence the effects of risks on programming and outcomes. It is useful to consider a risk as an event whose exact likelihood and outcome are uncertain but nonetheless can be estimated. The magnitude of a risk depends ultimately depends on (a) the *probability* of the event occurring, and (b) the *expected impact* of the event.

In the financial sector, for example, risk models can be fed huge quantities of financial and economic data, but there is a scarcity of data in most areas of development aid. A move from uncertainty to a calculated risk approach will depend on the feasibility of quantifying a certain type of corruption risk (e.g., bribery is probably easier to quantify than nepotism) and on the resources available. If bribery is thought to be an important risk that threatens achievement of a programme's overall development objective, then one can make strong estimates of the probability and impact of this risk. For example, if there is concern that informal payments in a health sector programme may divert resources from service delivery to personal gain, then the probability and impact of this risk can be measured by running a poll among service users. Public Expenditure Tracking Surveys can identify the amount of leakage (waste + corruption) in a financial flow – for example, the discrepancy between a disbursement from the Ministry of Finance and the amount actually spent by a local school – but they are expensive to implement. Qualitative data can reduce uncertainty and help make risk assessments more systematic. Vulnerability to corruption assessments, and other types of value chain analyses, provide useful information on the likelihood and potential impact of corruption for different institutions/processes, even if they are not always quantifiable.

Some country- and sector-level data are already available in, for example, Transparency International's Global Corruption Barometer and similar regional barometers. This is a useful starting point, but it does not provide the type of granular information that facility-level surveys would offer. If the decision maker has a solid estimate of the level of risk at facility level, it becomes possible to make sound, differentiated choices on risk management measures that are cost-effective.

Probability does not have to be estimated using advanced statistical models; simple frequency is enough. But reliable data have to be found to make estimations. Examples of tools that can provide such data are provided in the following sections, with stylised examples of quantitative and qualitative estimations shown in Box 1. Probability should not be confused with imminence: probability does not reflect the likely timing of the event, only the chance of it occurring. For prioritisation of risk management tools and their deployment, imminence may be an important factor to consider, but it does not directly play a part in the model.

Risk assessments can be done quantitatively or qualitatively. The key is to take a uniform, systematic approach to risk assessment.

### **Box 1. Quantitative and qualitative risk assessments**

#### ***Quantitative estimates***

A probability is the chance that an event will happen. It can be represented in percentage terms. For example, if the manager of a large health programme says there is a 5 per cent probability that internal fraud will happen on a project, it means that based on past data, experience, and/or opinion, he or she believes that five of every 100 comparable projects have experienced internal fraud.

Impact is the important second part of the risk equation. It is not enough to estimate the probability that an operation will be subject to internal fraud: we also need to know the scale of the fraud. If, on average, the loss from internal fraud has been US\$1,000 in each past case, then we can assign a value to the impact.

Probability of event x impact = risk

$$0.05 \times \$1,000 = \$50$$

Now consider a different type of corruption risk for the same health programme: embezzlement or fraud by implementing agents (government, multilaterals, or NGOs). The health programme budget is US\$100 million. Past data show that 65 per cent of similar health programmes experienced major corruption problems. In the programmes affected, up to 40 per cent of funds for health care do not reach the intended beneficiaries, and estimates are that up to 15 per cent of this leakage is directly related to corruption. This makes the negative impact of corruption US\$15 million on average per programme. The risk is calculated as follows:

$$0.65 \times \$15\text{m} = \$9.75\text{m}$$

These calculations are intentionally simplified to illustrate the basic logic behind a calculated risk assessment. The analysis shows that most efforts should be put into risk management of implementing agents.

**Qualitative estimates**

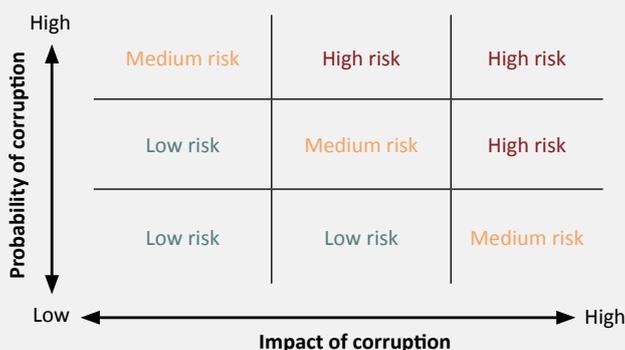
If credible, relevant quantitative data do not exist on specific corruption risks, then a qualitative assessment can be made. This can be done, for example, by assigning a risk value of high, medium, or low, or by using a traffic light system of red, yellow, and green. Normally, project management approaches assign one value to a risk (for example, “low” or “green”). However, for a systematic assessment process, it is still useful to distinguish between probability and impact, even when only qualitative estimates are possible.

*Probability:* The assessment should answer the question: how likely is it that the corruption risk will affect the programme? When statistical probability cannot be estimated, it is still important to ensure that qualitative assessments are underpinned by as much evidence as possible. This can often be done by drawing from various governance and corruption diagnostic reports from, for example, the World Bank and Transparency International, combined with expert judgments.

*Impact:* The next step is to assess what the impact of the corruption event will be if it takes place. It is often necessary to be specific when defining the corruption risks in order to be able to determine their impact. Bribery, for example, can cover both petty informal payments and large payments intended to rig procurement processes, but the latter is likely to have a greater impact than the former. The assessment should answer the question: if a given type of corruption occurs, what will be the likely consequence for the programmes? To make such a prediction, we need a clear definition of risks, a so-called risk model. The table below provides an example of a risk model that can be used for qualitative assessments.

Corruption risk	Probability	Impact	Final risk assessment
Procurement fraud	Low	High	Medium
Informal payments	Medium	Low	Low

The final risk assessment, shown in the last column, would depend on what weight is placed on probability versus impact. This assessment is based on the matrix below, but this can be adapted to be more or less risk averse. The main point is that it provides a uniform, systematic approach to risk analysis even for qualitative assessments.



### Step 3: Compare actual risk with tolerable risk, decide whether mitigation is required

It is not until the third step that one decides whether or not a specific type of corruption should be actively mitigated. To be clear, this is often not a choice about whether corruption in general should be tackled or not, but about which types of corruption in which sectors should be targeted. Trade-offs are necessary in all development assistance.

For each type of corruption risk – informal payments, procurement fraud, embezzlement by programme staff, and fraud by partner NGOs, for example – predefined “tolerable” risk levels are compared to the actual or estimated levels. It may be that informal payments, for instance, are expected to occur, but very sporadically and involving only small sums, considered a tolerable risk. In that case no specific interventions would be mobilised to tackle that particular type of corruption.

### Step 4: Choose the most cost-effective corruption risk mitigation tools

Once a decision has been made to engage in mitigation, the most cost-effective tools must be found. The basic principle for decision making is to consider the costs of a specific type of corruption on the one hand, and the effectiveness of tools to target that type of corruption on the other hand. It is unrealistic to perform a full cost-effectiveness analysis (CEA) or cost-benefit analysis (CBA) every time, but the principles behind these analyses are useful to keep in mind when making the decision. Johnsen (2014) provides an introduction to CEA and CBA for governance and anti-corruption activities.

A menu of different corruption risk mitigation tools is presented below and in the Annex. The basic point is that none of these tools should be chosen by default. It is not until one has identified the corruption risks, analysed them, and decided whether they should be actively targeted that one looks at which tools may be best for the job. Currently most aid agencies rely by default on regularity/compliance audits and/or due diligence, only rarely selecting other tools to either complement or replace them.

Risk mitigation is not just about which specific tools one uses. The level of risk differs according to programme characteristics and delivery methods, so diversification of programmes is another way to respond to high levels of risk. At the country level, individual donors can diversify across sectors, partners, and aid instruments (including budget support). This is similar to the approach often used with financial investments, where diversification is way to minimise risk, even for a portfolio of high-risk projects. Aid donors can also pool funds and share risks.

Piloting of projects is not just a good learning strategy; it also reduces risk. Big programmes have the benefit of scale, so more can be invested in control mechanisms. But if delivery mechanisms are not diversified, risks may rise as corrupt actors learn how to game the system. It is less risky over time to experiment with different anti-corruption tools than to rely on one or two standard tools, such as audits. Standardised systems tend to displace corruption and graft rather than minimise them. Experimental approaches and continuous, incremental changes to corruption risk management system are disruptive for corruptors.

Budget support presents a specific challenge: there is often little room for stringent control, but there is ample room for displacement of corruption risks outside of monitored systems. To

minimise corruption risks in budget support (and related alternatives like sector-wide assistance), the first step is to realistically assess corruption risks and evaluate how much risk is tolerable while at the same time developing a clear enough agreement about results and monitoring to ensure that the level of risk is not exceeded. Then investments in corruption mitigation should be done in proportion to the risk profile and overall level of funding.

Some sectors and institutions pose greater corruption risks than others. If an aid agency wants to engage in, for example, a highly corruption-prone infrastructure sector, then it would be cost-effective to invest substantially in corruption risk management. Often, effective risk mitigation will require a redesign of a policy or programme to incorporate performance measures, procurement designs, expenditure controls, reporting options, and so on. As aid agencies frequently work through implementing agents, risk mitigation will entail helping these organisations incorporate anti-corruption measures. They may need to simplify their systems and procedures, publish information, standardise work processes, introduce electronic application or financial management systems, and so forth. Spot checks, field visits, and third-party monitoring (evaluations, audits, community monitoring) are also essential risk mitigation tools. Testing and comparing the effectiveness of different tools, and keeping the focus on results, are sound principles in nearly all cases. Effective risk management will not entail one integrated solution but rather a myriad of smaller solutions that address specific risks effectively. Monitoring such a patchwork of solutions requires financial investments, and a business case should show how these costs will be lower than the anticipated gains.

## 4. Corruption risk management and the project cycle

In this section, the principles of the corruption risk management approach outlined above are applied to another model that is integral to most development aid programming: project cycle management (PCM).<sup>6</sup> The aim is to help practitioners understand how tools to analyse and manage corruption risks can be used across the project cycle. There may be many reasons why corruption risk management is not conducted effectively. Project managers may feel overstretched. They may lack sufficient data on corruption risks at programme level, or they may not know how to deal with third-party implementers. Better linkage of corruption risk management methodologies with aid agencies' project cycles can ameliorate some of these problems. In particular, it can help managers avoid front-loading risk management efforts, that is, placing too much emphasis on identification of country- and sector-level risk and not enough on implementing and evaluating the effectiveness of risk mitigation measures.

As shown in Figure 2, risk management is not the responsibility of just one person at one stage, but spans all stages of the project cycle. Different types of corruption risk assessment and risk management tools can be helpful at different stages, and reliance on a single tool is not advisable. The framework is holistic in showing the range of entry points for corruption risk management, but not prescriptive. Not all tools should be chosen in each case. The risk assessment determines which risk mitigation tools should be applied.

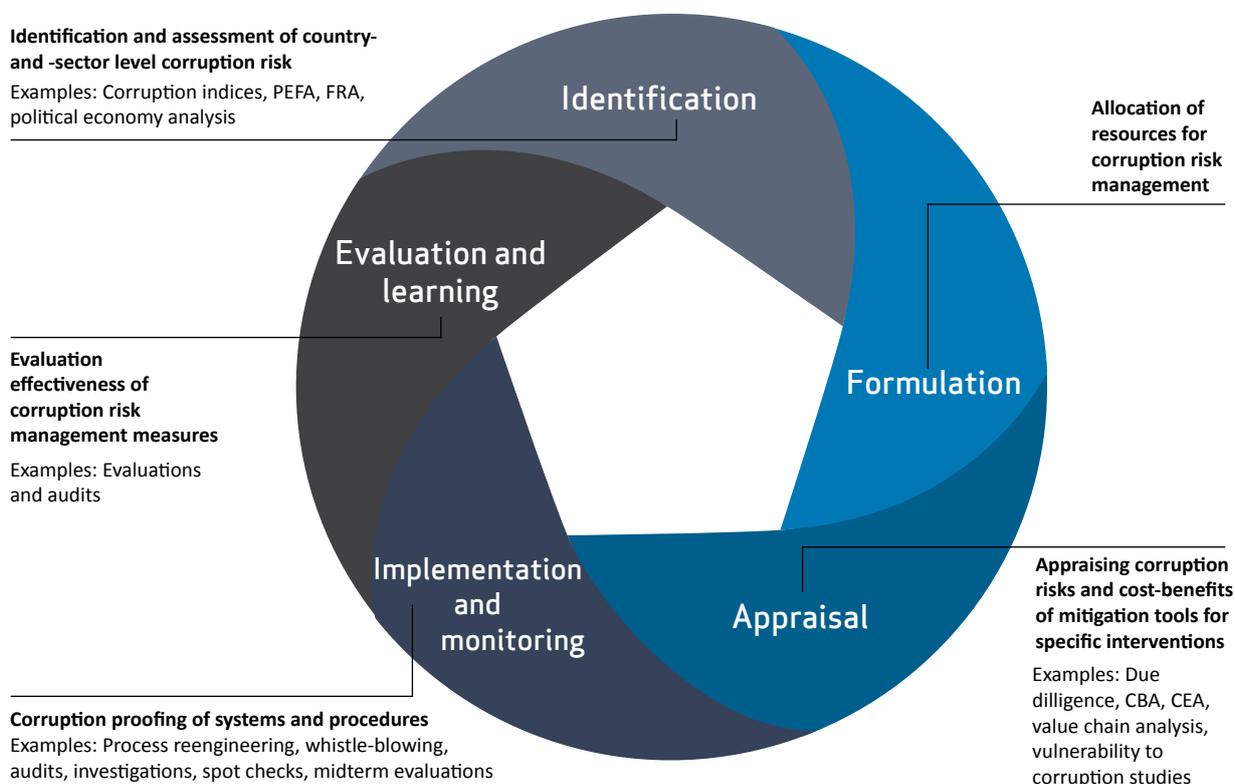
Traditionally, risk matrices are drawn up at the design stage of a programme and used to project possible failures by the end of the project. The figure illustrates that corruption risk management should be a reiterative activity that continues throughout the life cycle of a project. In short, a PCM approach emphasises the interdependency of corruption risk management tools and the collective responsibility of all actors involved at the various stages of the project cycle. This is at the heart of any mainstreaming effort.

The basic features of the project cycle are the same regardless of whether the activities are implemented by the aid agency directly or by an implementing agent, but roles may change. When implementation is delegated to a third party then the agency is no longer responsible for implementation, but it does nevertheless have an oversight role and should insist that corruption risks be managed.

Corruption risks will differ across the phases of the project cycle, and different tools will be useful to identify, assess, and/or mitigate those risks. The next section outlines key corruption risks and the most relevant risk management tools for each stage. The formulation stage is subsumed into its adjacent stages because the relevance of most tools will typically extend across these two stages in the early phases of the project cycle.

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6 Aid agencies have different variants of PCM. This paper uses the methodology developed by the European Commission (2004).

**Figure 2. Corruption risk management across the project cycle**

## 4.1 From identification to formulation

Risk analysis and management begins at the stage where investment decisions are made and programmes formulated. Country- and sector-level corruption diagnostics and risk assessments are used to the extent available to identify the level of risk to proposed policies and programmes.

Two key questions must be asked at this stage: (a) Does corruption pose a significant risk to achieving the desired development outcomes in a country and/or sector? If the answer is yes, we must then determine where, how, why, and to what extent it poses risk. We then move to question (b): Do we continue with our plans, and if we do, what level of resources should be allocated to corruption risk management?

The main tools available at this stage are:

- Country-level measurements and indices (e.g., the World Bank's Worldwide Governance Indicators)
- Assessments of the public financial management system and overall fiduciary risk environment for government funding (PEFA, FRA)

- Political economy analysis (PEA) at the country level

These tools will identify known corruption risks at an aggregate level. It is useful to collate this information in one document. DFID does this in its Anti-Corruption and Counter-Fraud country strategies, and the agency also has an analysis document for a portfolio of major programmes or sector initiatives.

At this stage, a detailed risk analysis is not needed. It is often not possible to design specific risk mitigation measures before the corruption risks are properly assessed at the sectoral or institutional level, but using the tools above allows one to estimate the proportion of resources that should be allocated for corruption risk management activities. High-risk countries and sectors will need a substantial focus on corruption risk management. For example, it makes sense that more resources are devoted to corruption risk management in a high-risk country such as Afghanistan than in, for example, Rwanda, where corruption is less widespread.

## 4.2 From formulation to appraisal

Once the investment decision has been taken, the intervention, often a policy or programme, needs to be designed. It is at this stage that specific corruption risks relevant to the intervention are appraised and an ex ante cost-benefit estimation of different mitigation tools is done. This typically requires a good consultative process and data on specific corruption patterns and dynamics in the relevant sector(s) and institution(s). The tools need to be firmly integrated into the design, not force-fit onto it after the design has already been agreed.

There are three key questions to be asked at this stage: (a) What types of corruption risks affect the programme? (risk identification); (b) How severe are these risks, that is, to what extent do they jeopardise the ability of the programme to achieve its objectives? (risk assessment); and (c) Which measures can best mitigate the identified risks and how should they be integrated into programme design and/or policy priorities? (risk mitigation).

The corruption risks at this stage have to be identified for specific sectors and institutions. Few corruption indices provide this level of disaggregation today (although the different corruption barometers can in some cases), so collection of new data is often necessary.

The main tools available at this stage are:

- Due diligence
- Corruption measurements and indices at sector and institution levels
- Value chain analysis, vulnerability to corruption assessment
- Ex ante cost-benefit or cost-effectiveness analysis
- Political economy analysis at sector and institution levels
- Public expenditure tracking surveys
- Community monitoring, various types
- Quantitative service delivery surveys

These tools mainly identify risk or provide partial data for risk assessment. However, when combined with past data on corruption in programmes, they can enable a decision maker to

construct reasonable estimates of the probability of different types of corruption occurring and the likely impact.

### 4.3 Implementation and monitoring

In the transition from design to implementation it is easy to assume that risk analysis is complete and the risk mitigation phase begins, but this is not the case. Risk analysis is a continuous effort. However, it is true that risk mitigation is in the forefront at this stage, when corruption proofing of systems and procedures becomes key. Importantly, one should monitor the effectiveness of the risk mitigation measures during the implementation phase.

There are four key questions at this stage: (a) Have corruption risks changed over time? (b) How well are project funds protected against corruption? (c) Are corruption risk mitigation measures working, and would other measures work better? (d) Are corruption risk management measures a good return on investment? At this stage, one still monitors corruption risks generally in the relevant sector to understand whether risk profiles change over time, but the main focus is on corruption risks in own systems and those of implementing partners.

The main tools available at this stage are:

- Internal corruption risk management/quality assurance systems (risk matrices), with periodic reporting on corruption risks and risk mitigation results
- Internal reporting and whistle-blowing mechanisms and external grievance and reporting mechanisms
- Audits, various types
- Investigations
- Real-time/formative/midterm evaluations, spot checks
- Ex post cost-benefit or cost-effectiveness analysis
- Public expenditure tracking surveys and quantitative service delivery surveys
- Community monitoring, various types

These tools document the actual incidence of corruption in programmes. In this way they provide essential data to inform future risk analysis (including the development, over time, of comprehensive risk models) and improve current risk mitigation measures. Experience shows that clear mechanisms for reporting corruption, along with evaluations, are important tools for detection of malfeasance. They are also important for preventive purposes insofar as they act as a deterrent.

### 4.4 Evaluation and learning

The final stage of the PCM approach is to evaluate the effectiveness of the corruption risk management initiatives, including both risk analysis and risk mitigation tools.

Three key questions must be asked at this final stage: (a) Did the programme detect the relevant types of corruption risks, and did they change over time? (b) Which risk assessment tools were

(most) useful? (c) How successful was the programme in minimising corruption, graft, and leakage of funds during implementation? In general, we want to know what worked and what didn't so we can create a feedback loop to the next phase of the programme or a similar programme. The analysis at this stage should be concerned with all types of corruption risks: those at the country and sector levels, as well as those specific to the implementing partner and to the aid agency's own systems.

These questions could be added to planned evaluations of projects and programmes. The evidence will be stronger if a plan for evaluation of corruption risk management tools is part of the design process. A comparison of the efficacies of different tools across projects requires good planning.

The main tools available at this stage are:

- Evaluations, various types, including ex post cost-benefit and cost-effectiveness evaluations
- Audits, various types, including performance and forensic audits

Certain types of audits, such as forensic audits, can document the actual incidence of corruption in programmes, informing future risk analysis. Evaluations and cost-benefit or cost-effectiveness analysis can assess the effectiveness of risk mitigation efforts, providing useful learning for future programming.

## 5. Conclusion

Aid agencies need better systems for corruption risk management. Both the agencies themselves and aid-receiving nations would benefit. Systems to control corruption risks should be integrated into other operations systems, and they should be flexible to suit different contexts and corruption patterns. A setup to manage corruption risks is only as good as its data. Organisations without useful risk data typically over-prioritise compliance and controls. When few resources are invested in corruption risk analysis, it means that risk mitigation tools are not chosen based on a solid diagnosis of the problem and may therefore be less effective.

A corruption risk management approach would promote better assessment of the costs of corruption and smarter choices of remedies to prevent corruption, because corruption is seen a constant – although varying – risk inherent to aid operations, not as an external evil that should be controlled at all costs. Instead of fighting corruption, a smart approach seeks to minimise its negative effects. Risks are assessed along two dimensions: probability and expected impact. Cost-benefit considerations determine which corruption risks should be treated, how they should be treated, and how much should be invested in treatments.

To manage risk effectively, one needs information on risk levels and the effectiveness of counter-measures throughout the project cycle. However, it remains a challenge for aid agencies to move beyond front-end risk assessment. Too much emphasis is placed on identification of country- and sector-level risks and not enough on, for example, evaluating the effectiveness of risk mitigation measures.

U4's corruption risk management model presents universal principles, but the design of an organisation's specific system will be highly context-specific. The model is not prescriptive, but offers a roadmap for decision making. Agencies should take systematic but differentiated approaches. That means following the basic principles but choosing only the tools that will be most effective in a given context.

From a policy perspective, contexts with high levels of corruption should receive more investments in corruption risk mitigation. The specific quantity of investments depends on the costs of corruption to society, the expected efficacy of risk mitigation measures, and the tolerance for corruption risks set by policymakers. Moreover, a corruption risk management perspective makes clear why aid agencies need to move beyond a concern about fiduciary risk and internal safeguarding of funds to a broader view that considers the impact of corruption on overall development objectives. Corruption is a crime, and immoral, and it should not be tolerated. However, it would, paradoxically, lead to more investments in anti-corruption if corruption were treated as just another risk to development. This perspective would emphasise that curbing corruption is not just the right thing to do, but also the smart thing to do.

## Annex I. Overview of phases, steps, levels of analysis, and relevant tools

Figure 1 showed a basic framework for how corruption risk management fit into the project cycle. The table below shows how (a) the project cycles stages, (b) key corruption risk management steps, (c) associated risk management phases, (d) level of analysis, and (e) the relevant tools all relate to each other. We also produced a Prezi presentation that expands on Figure 1, which can be accessed here: <http://low.ly/PZfyb>.

Project cycle stage	Key corruption risk management steps/functions	Associated risk management phases	Main level(s) of analysis	Relevant tools/sources
Problem definition and investment decision	<ul style="list-style-type: none"> <li>Identify broad patterns of corruption in country</li> <li>Identify general threats to development outcomes caused by corruption</li> </ul>	Risk identification Risk assessment (country and sector levels, not detailed)	Country level	<ul style="list-style-type: none"> <li>Country-level anti-corruption strategies</li> <li>Programme portfolio risk analysis</li> <li>Country measurements and indices, country level</li> <li>Assessments of the public financial management system and overall fiduciary risk environment (PEFA, FRA)</li> <li>Political economy analysis, country level</li> </ul>
Programme formulation and programme appraisal	<ul style="list-style-type: none"> <li>Identify specific corruption risks directly relevant to the programme</li> <li>Disaggregate corruption risks by systems, processes, institutions, and populations directly involved in the programme</li> <li>Assess scale/severity of identified corruption risks</li> <li>Identify possible mitigation measures</li> <li>Evaluate relative cost and benefit of mitigation measures and prioritise mitigations accordingly</li> <li>Design selected mitigation measures into programme</li> <li>Clarify and document accepted levels of (residual) risk</li> </ul>	Risk identification Risk assessment (all levels, detailed) Design of risk mitigation measures	Country level (or sector level) Programme level	<ul style="list-style-type: none"> <li>Business cases and tools for assessing corruption risk</li> <li>Due diligence</li> <li>Country measurements and indices, sector and institution levels</li> <li>Value chain analysis, vulnerability to corruption assessment</li> <li>Monitoring and evaluation</li> <li>Cost-benefit or cost-effectiveness analysis</li> <li>Political economy analysis, sector and institution levels</li> <li>Public expenditure tracking surveys</li> <li>Community monitoring, various types</li> <li>Quantitative service delivery surveys</li> </ul> Combine with past data on corruption occurrences and impact (or qualitative assessments of this) to do rigorous risk assessment.

Project cycle stage	Key corruption risk management steps/functions	Associated risk management phases	Main level(s) of analysis	Relevant tools/sources
Implementation and monitoring	<ul style="list-style-type: none"> <li>Check whether results are being achieved and track resource use against outputs to identify potential problems</li> <li>Conduct audits or other exercises to monitor use of funds</li> <li>Consistently communicate ethical standards, required practices, and options for reporting problems</li> <li>Evaluate progress on specific corruption mitigation measures in the programme</li> <li>Assess the cost of mitigation measures against the impact</li> <li>Monitor corruption risk profile to assess whether key factors have changed</li> <li>If necessary, revise mitigation measures</li> </ul>	Risk mitigation applied  Risk (re)assessment	Programme level  Implementing partners  Internal systems  Country level for monitoring and re-evaluating overall risk profile	<ul style="list-style-type: none"> <li>Internal corruption risk management/quality assurance systems</li> <li>Internal reporting and whistle-blowing mechanisms, external grievance and reporting mechanisms, code of conduct</li> <li>Audits, various types</li> <li>Investigations</li> <li>Real-time/formative/midterm evaluations, spot checks</li> <li>Cost-benefit or effectiveness analysis</li> <li>Public expenditure tracking surveys</li> <li>Community monitoring, various types</li> <li>Quantitative service delivery surveys</li> <li>Periodic reporting on corruption risks and risk mitigation results</li> </ul>
Evaluation and learning	<ul style="list-style-type: none"> <li>Revisit programme design to assess accuracy/appropriateness of risk identification and assessment and selection of mitigation approaches</li> <li>Summarise experience in terms of protecting programme funds, achieving results and value for money, and advancing anti-corruption goals in the country (if this was a programme objective)</li> <li>Document failures and successes</li> <li>Document, to the extent possible, information on frequency and scale of various corruption problems to inform future risk assessment</li> </ul>	Risk identification  Risk assessment (mainly for future projects)	Programme level  Internal systems	<ul style="list-style-type: none"> <li>Evaluations (potentially drawing on cost-benefit or cost-effectiveness analysis, public expenditure tracking surveys, scorecards, or quantitative service delivery surveys)</li> <li>Audits</li> </ul>

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Aid agencies need better systems to identify, assess, and mitigate corruption risks. Risk assessments should consider two main dimensions of an act of corruption: probability and expected impact. Cost-effectiveness considerations determine whether corruption risks should be treated, and how. Aid agencies cannot focus on own fiduciary and reputational risk, but must make investment decisions based on the magnitude of risk that different types of corruption pose for development objectives. The aim is not to eliminate corruption but to optimise development results. Agencies need information on the severity of corruption risks and the effectiveness of counter-measures throughout the project cycle in order to properly analyse and manage risks. To help agencies move beyond front-end risk assessment, the paper shows how different risk mitigation tools can be applied across the project cycle.