Organisation for Economic Co-operation and Development

DCD(2023)48

Unclassified **English text only**

13 November 2023

DEVELOPMENT CO-OPERATION DIRECTORATE

Risk management and locally led development: Understanding how to better manage risks for sustainable impact

This Perspectives note provides key lessons for risk management in locally led and owned development co-operation. It is part of a broader peer learning exercise on locally led development within the Development Assistance Committee [DCD/DAC(2023)5]. This note examines necessary reforms to risk management from three perspectives. The first focuses on organisational systems for risk management to ensure they enable rather than impede partnering with local actors. The second perspective explores adjustments to due diligence and risk management in partnerships. The third deals with creating an enabling environment by sensitising domestic oversight bodies.

Related case studies of member practices can be found on the OECD platform Development Co-operation TIPs · Tools Insights Practices.

Contacts:
Renwick Irvine, Renwick.Irvine@oecd.org
Joëlline Benefice, Joelline.Benefice@oecd.org
Santhosh Persaud, Santhosh.Persaud@oecd.org

JT03531573

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Perspectives paper on locally led development

Risk management and locally led development

Understanding how to better manage risks for sustainable impact

This *Perspectives note* provides key lessons for risk management in locally led and owned development co-operation. It is part of a broader peer learning exercise on locally led development within the Development Assistance Committee [DCD/DAC(2023)5]. This note examines necessary reforms to risk management from three perspectives. The first focuses on organisational systems for risk management to ensure they enable rather than impede partnering with local actors. The second perspective explores adjustments to due diligence and risk management in partnerships. The third deals with creating an enabling environment by sensitising domestic oversight bodies.

Related case studies of member practices can be found on the OECD platform Development Co-operation TIPs · Tools Insights Practices.

1. Introduction

Despite long-standing recognition of their role and importance, local[1] actors are still not in the driving seat of development co-operation efforts. Members of the OECD Development Assistance Committee (DAC) have long recognised the importance of local actors for achieving and sustaining development progress in partner countries. The Busan Partnership Agreement (OECD, 2011[1]) is one example expressing such recognition. This ranges from national and subnational governments and public institutions to civil society, the private sector and local communities. However, approaches to financing and partnerships have not yet enabled a shift of power to local actors (Cruz, 2023[2]); monitoring by the Global Partnership for Effective Development Co-operation showed that the use of country systems has not substantially increased (GPEDC, 2019[3]); and partners agreed that, after almost 20 years of work on aid effectiveness, "[r]eliance on country ownership and local leadership has become an even more important priority" (GPEDC, 2022[4]). Facing increasing pressure to overcome traditional donor-recipient relations, many DAC members are now reinforcing their efforts under the "locally led development" banner. In essence, this means that local stakeholders should have agency for development co-operation: in framing; design; delivery, including control over resources; and accountability (OECD, 2023[5]).

To enable locally led development, DAC members must critically examine their own systems, processes and approaches to partnerships. In early 2023, the DAC, therefore, launched a peer learning exercise to identify how DAC members can overcome barriers and seize opportunities for locally led development co-operation. As part of this peer learning exercise, this perspective note assesses the linkages between risk management and locally led development. It draws on a desk review, semi-structured interviews with risk and development policy experts in 12 DAC member systems, and virtual peer learning exchanges with the participation of 17 DAC member experts in July 2023.

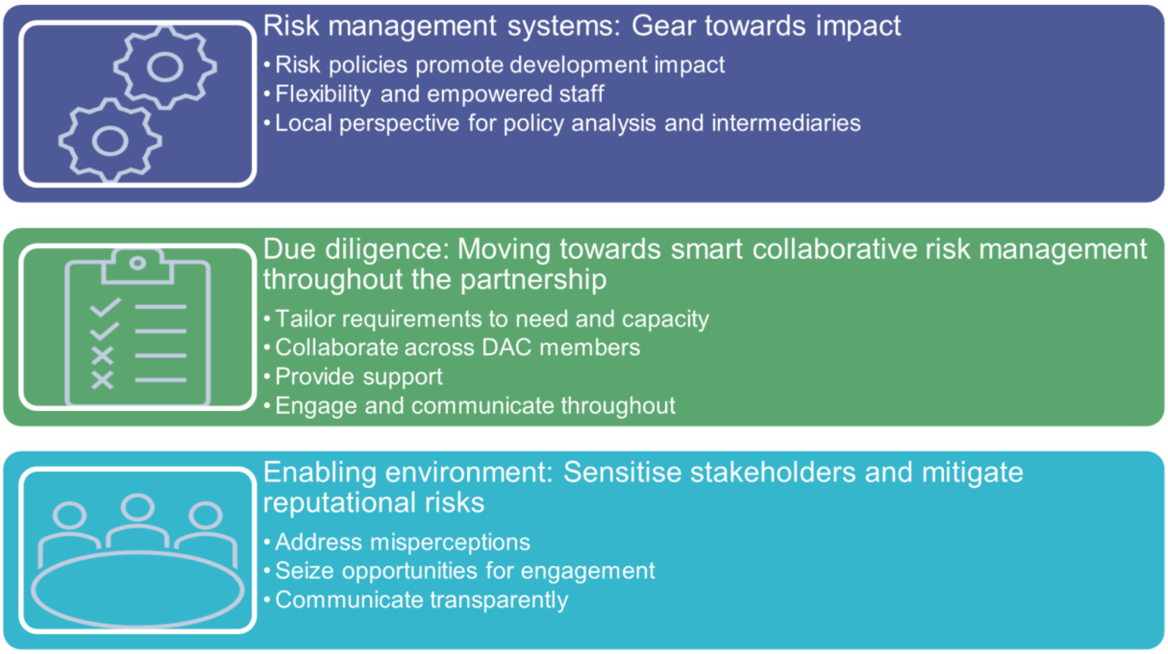
Risk management, or more precisely, the current practice of risk management, is a key impediment to locally led development co-operation. This might be surprising since the "purpose of risk management is the creation and protection of value. It improves performance, encourages innovation and supports the achievement of objectives" (ISO, 2018[6]). By identifying and effectively responding to risks, risk management should, therefore, support the achievement of development impact. However, in practice, the focus in development co-operation frequently lies in minimising select risks, particularly fiduciary and reputational risks. This affects the effectiveness of development co-operation, in particular ownership, and ultimately comes at the expense of enabling impact.

Local actors highlight the consequences of bias in risk management. They criticise "how funding to local actors in the Global South is used by the Global North as an instrument of control and power" and "how funding modalities often reflect a lack of trust in local actors" (Peace Direct, 2023[7]). In particular, they stress that side-lining local actors actually increases risks for the effectiveness and sustainability of development co-operation (Ali, 2023[8]). As an underlying factor, local actors point to problems of structural racism and colonial attitudes, creating a bias that undermines trust in local actors and readiness to partner with them on an equal footing (Peace Direct, 2023[7]). They are also concerned that risks are not shared fairly but rather passed down the chain, leaving local actors to deal with the costs and consequences of managing security, financial[2] and operational risks (NEAR, 2022[9]). DAC members increasingly recognise these challenges: they discuss underlying racism (International Development Committee, 2022[10]), review their systems (Global Affairs Canada, n.d.[11]) and promote fair risk-sharing (Netherlands Ministry of Foreign Affairs and ICRC, 2022[12]).

This note examines reforms needed to risk management systems from three perspectives (Figure 1). The first focuses on organisational systems for risk management to ensure they enable rather than impede partnering with local actors. The second perspective explores adjustments to due diligence and risk management in partnerships. The third deals with creating an enabling environment by sensitising domestic oversight bodies. This note complements important ongoing work at the level of the DAC, in particular on the GPEDC monitoring,[3] enabling civil society,[4] anti-corruption and illicit financial flows,[5] engagement in politically constrained environments,[6] and local procurement.

This note is directed towards DAC members, but findings equally apply to other organisations, including across delivery chains. Multilateral organisations, international and DAC country civil society and implementation companies work directly with local partners. They all can use the findings from this perspective note to adjust their risk management systems, improve their approach to due diligence and engage with their stakeholders. In many instances, there is a delivery chain, from DAC member to intermediary partners to local partners, sometimes with multiple intermediaries. Every institution within this delivery chain has risk management systems that can enable or impede locally led development. Blockages at one level will hinder progress at another. Dialogue on locally led development-enabling risk management across delivery chains is therefore critical.

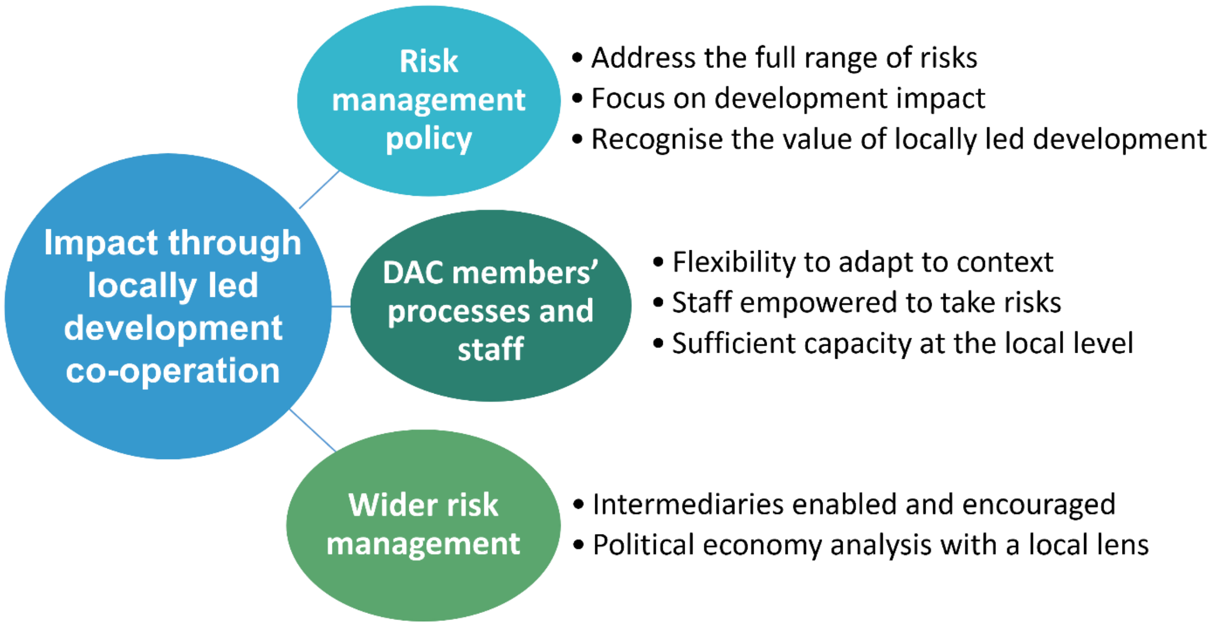
Figure 1. Adjusting risk management systems to enable locally led development co-operation



2. Gearing risk management systems towards the impact of locally led development

All aspects of a risk management system require adjustments to enable locally led development. The function of risk management systems is to identify a range of risks, assess their likelihood and consequences, decide on responses to these risks, implement mitigating measures, and monitor and adapt to risks as they evolve (OECD, 2021[13]). Key elements are risk management policies, institutional responsibilities and capacities, and processes. This section identifies opportunities to integrate locally led development in each of these (see Figure 2 for an overview). Given their importance, the subsequent section explores due diligence processes in more detail.

Figure 2. Integrating locally led development across the risk management system



Note: DAC: Development Assistance Committee.

Risk management policies need to enable locally led development

A broader scope of risk management allows assessing the advantages and challenges of locally led development. For most DAC members, risk management policies and systems were designed for and have evolved to meet legal obligations and international standards, for example, to combat fraud, corruption, money laundering and financing of terrorism (Barbelet et al., 2021[14]). However, many DAC members rightly take a broader view, considering a range of risks, such as operational, security and reputational risks. This wider perspective is highly relevant in the context of locally led development when considering which partner is best placed to implement an intervention. Local actors' role and contextualised expertise can significantly lower some operational risks, which might offset concerns around their capacity to maintain audited accounts and prepare donor reporting. At the same time, they may face different sets of security risks than international actors.

Risk management policies need to focus on impact, not risk avoidance. Even where DAC members take a broad approach to risk, systems are often skewed towards financial and fiduciary risks. It is in these areas that regulation and control systems are most detailed, often with a view to avoiding risks or reducing them to a minimum. A misunderstood "zero tolerance for corruption" principle has been a key example of this approach. While some DAC members are shifting towards more proportionate responses to risks (and cases) of corruption (OECD, 2022[15]), there remains room for improvement. Risk appetite statements can provide a powerful steer to focus instead on opportunities and impact. The United States Agency for International Development's (USAID) risk appetite statement makes this explicit: "USAID prioritizes as an 'opportunity' the ability to strengthen locally-led development for long-term sustainability, while acknowledging the 'threat' that this approach to development could come at the expense of short-term performance" (USAID, 2022[16]). The statement specifically allows for higher risk appetite for fiduciary risks when local partners carry out the implementation. It can be helpful to make it explicit that a comprehensive approach to risk management and risk appetite applies to fragile contexts, as they often present more significant risks, be they security, operational, financial or reputational risks.

Flexibility and support help staff manage risks within their context

Systems need to allow for sufficient flexibility to adapt to context and keep responses dynamic, notably through portfolio approaches. In the United Kingdom, the risk appetite statement provides an indication of the level of risk the Foreign, Commonwealth & Development Office (FCDO) is willing to accept on average at the corporate level. Recognising the very diverse risk contexts between countries and individual programmes, decisions on risks should be taken close to the delivery level, and FCDO programme managers can document that their operation requires a higher risk. Some DAC members also consider risks not only for individual projects but also at the programme and corporate levels (Austrian Development Agency, 2019[17]). This approach allows a useful portfolio perspective, where some partnerships may present a high risk for a high reward, and others present less exposure.

Staff need guidance and support to be empowered risk managers. Members reported that staff (especially less experienced staff) frequently do not use the room for risk taking that risk policies provide. An important reason for this is fear of repercussions at a project or personal level should risks materialise. Again, this drives implementation choices for the "safer" option of non-local partners. Clear risk policies, leadership's commitment to risk appetite, transparency and learning from failures[7] are important signals to staff that risk is a shared responsibility. The FCDO's Better Delivery Unit provides dedicated training and backstopping on managing risk and understanding and using existing flexibility within the system. Combined with results systems that focus on outcomes and impact, alongside sufficiently long partnership agreements to achieve these results and which incorporate learning, these empower staff to manage risks with impact as their primary consideration.

Prompts for staff could strengthen the consideration of local actors in project initiation. Considerations for operational risks and sustainability often come into play only once an implementing partner has already been identified. This can result in local partners being screened out or not considered in the initial stage of projects (from a fiduciary risk perspective). To avoid this imbalance, DAC members could specifically include a prompt for staff to assess the added value of local partners (or, conversely, the risks of their exclusion) into project design requirements before a decision for an implementing partner is taken. In a similar thrust, many DAC members require their national or international civil society partners to demonstrate their collaboration with local civil society organisations (CSOs) (OECD, 2020[18]), such as Belgium (OECD, 2020[19]), Germany, the Netherlands (OECD, 2023[20]) and New Zealand (OECD, 2023[21]).

DAC member country offices need sufficient capacity to enable risk management with a local perspective. As locally led development approaches drive more context specificity and increased support to more local partners, demands on country offices are increasing and capacity constraints are a key concern (Cruz, 2023[2]). When risks materialise, this usually also requires very substantial engagement from local programme staff. High staff turnover at the country level can also affect relationships with partners and understanding of the local risk context. To address resource constraints, some members are seeking to maintain a significant presence in partner countries and rely more on local staff.

Broader risk management processes need to integrate a local perspective

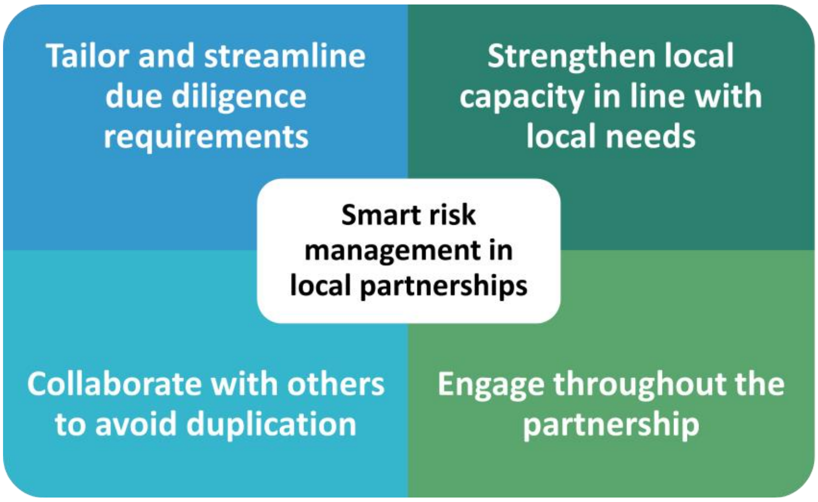
DAC members also need to promote better risk management in their engagement with intermediary partners. DAC member approaches to risk management significantly affect to what extent intermediary partners can (or are willing to) integrate principles of locally led development. When providing core and programmatic funding, DAC members can encourage their partners to have clear approaches to locally led development and adjust their risk management accordingly. For instance, Ireland now expects its civil society partners to develop a strategy for locally led development. In project financing, DAC members must ensure that they allow, or instruct, partners to manage risks with locally led development in mind (following the principles set out in this perspective brief); and any flexibility they provide is passed down to local partners. For example, New Zealand expects permission for higher overhead costs to benefit local partners[8] (OECD, 2023[22]). In blending, this implies more lending in local currency to avoid shifting currency risks to partners (Fink, Lankes and Sacchetto, 2023[23]). In humanitarian assistance, work on risk sharing has stressed the importance of dialogue across delivery chains, as perceptions of risk fundamentally differ (Netherlands Ministry of Foreign Affairs and ICRC, 2022[12]).

Context-specific analyses are needed to inform local partnerships and engagement strategies. Political economy and context analyses often inform DAC members' engagement and partnership choices in a given context. Conducting them in consultation and collaboration with local partners can help ensure that opportunities for engaging with local actors are identified. This can also help identify how DAC members can strengthen partner country's capacities to address systemic risks (Development Cooperation Forum, 2021[24]). At the same time, there is broad recognition that DAC member presence and operations will inevitably change the balance of power in local actor ecosystems depending on with whom they choose to work and how. More deliberate consideration of how local ecosystems operate and evolve is prompting critical reflection on when and how it is appropriate to enter or exit partnerships and ramifications for local ecosystems should the situation or focus of DAC members evolve.

3. Due diligence: Moving towards smart collaborative risk management throughout the partnership

Due diligence is at the heart of tensions between risk management and locally led development. Due diligence describes the process through which DAC members assess partners, and, notably, their capacity to manage funds and risks and deliver on a programme's objectives [see guidance from Australia (DFAT, 2021[25])]. They apply across the range of partnerships with public institutions, CSOs and private sector actors. Due diligence assessments frequently respond to legal requirements for the accountability of DAC member administrations, which are not allowed to extend financial resources without an assessment of the recipient. The process should enable dialogue between partners on objectives, risks and collaboration: only dialogue will ensure that all relevant risks are identified. Due diligence also establishes a hierarchy of power between a donor, who defines rules and objectives, and a recipient, who needs to fulfil requirements. While DAC members confirm that due diligence of local partners usually does not affect the "if" of a partnership, it significantly shapes the "how". This section identifies opportunities for due diligence that better balance partnership and accountability (for an overview, see Figure 3).

Figure 3. From heavy *ex ante* due diligence to proportionate and risk-based approaches



Due diligence assessments can be tailored and streamlined to reduce bureaucracy

Due diligence assessments need to be proportionate to the capacity of the partner and the nature of the partnership. A shift towards more risk-based management approaches is useful; it allows focusing on those risks that are the most likely to happen and/or most detrimental to development objectives. Local actors such as national or subnational government, state-owned enterprises, national or community-based CSOs, companies, academia, etc., have highly different roles, mandates, structures and capacities. Large-scale and sensitive operations might require more robust checks, while programmes specifically seeking to engage with new partners might want to simplify access. Cumbersome regulations and the need to meet complex donor requirements can constitute key barriers for local organisations. Due diligence processes should, therefore, be differentiated to better target assessment requirements to actual needs and avoid overwhelming partners. Australia makes proportionality a dedicated principle of its due diligence (DFAT, 2021[25]). Switzerland applies "less strict audit requirements to organisations it considers as 'trusted partners', and where risks are deemed lower, due to previous partner assessments or to the nature of the partnership, etc." (OECD, 2022[15]).

DAC members can explore simplification within their own systems. As a simple step, DAC members can verify whether they have already received the information and better share information across their government institutions. Another aspect is the ease of documenting relevant requirements, for instance, submission in local languages. DAC members can also increase flexibility in the tools and processes considered to meet requirements, e.g. allowing oral or video reporting. In some instances, standardised third-party certification tools (or mutual recognition) might also be an effective way of minimising the burden on local actors. USAID's new partnership initiative has specifically lowered requirements for local organisations (USAID, n.d.[26]), while Hungary deliberately starts with small amounts, increasing them over time (OECD, 2022[27]). Canada is currently reviewing its due diligence requirements to reduce the administrative burden for partner as part of a wider reform initiative (Global Affairs Canada, n.d.[11]).

Collaboration among DAC members and other providers could greatly simplify due diligence for local partners who work with multiple donors

An important element would be harmonising due diligence requirements so that partners can directly submit the same information rather than repackaging it for different forms. DAC members could also consider recognising (parts of) other DAC members' assessments, where local partners have agreed to the information being shared, given data sensitivity. Already a decade ago, DAC members under the leadership of Sweden had started a Code of Practice Initiative, an effort to harmonise due diligence requirements for their domestic CSOs – an effort that deserves wider traction (Sida, 2019[28]; OECD, 2020[18]). CSOs, in particular in the area of humanitarian assistance, are again driving efforts for harmonised and shared due diligence, such as the Charter for Change Due Diligence Passporting Tool (Humentum, n.d.[29]). Finally, there are already good examples of joint assessments, namely the Public Expenditure and Financial Accountability network[9] and the Multilateral Organisation Performance Assessment Network (MOPAN).[10] The joint financing of programmes has, of course, similar benefits, since it means that all donors accept the procedures of the lead implementer.

Risk mitigation can strengthen local capacities that align with local needs

Strengthening local actors' capacities is a key risk mitigation measure to enable locally led development. When a due diligence assessment identifies challenges, interviewed DAC members frequently choose mitigation measures rather than avoiding the risk of entering the partnership. This is good practice. Rather than relying on additional external controls, the design of these risk mitigation measures can strengthen local actors' capacities. For example, this can involve financial support or higher overheads for reform measures or additional staff, training and support, and backstopping mechanisms. Many DAC members highlighted in interviews the significant efforts of embassies and country offices to accompany local partners to ensure that due diligence requirements are met. Recognising this in embassy planning and objectives can help ensure this is not considered a task "on top of" other tasks. Other DAC members use implementing partners throughout the delivery chain to support local actors, and these intermediaries can also be based in developing countries. The Netherlands is a good example. It supports Leading from the South, a feminist global South-led consortium (OECD, 2022[30]). Paying for results rather than reimbursing costs can allow combining risk mitigation with trust in delivery capacity, as in USAID's New Partnership Initiative (USAID, n.d.[26]).

Capacity strengthening needs to meet actual partner needs based on dialogue. Dialogue and agreement between the donor and local partner on risk mitigation measures allows identifying mitigation measures that respond to the interests of both sides. For instance, the FCDO agrees upon an action plan with its partners. This allows starting the collaboration while sequencing measures throughout the partnership. An essential guiding question should be which capacity related to managing risks would be necessary or helpful for the local partner to play its role, and which aspects would primarily serve to fulfil donor requirements. For the latter, solutions should not impose an additional burden on local partners, be it strengthening capacity they do not need or requiring time and staff capacity. DAC members could, therefore, consider covering costs for compliance support separately and do so in collaboration with others.

It is also important to explore how the local risk management system can be strengthened: What value is given to local risk standards, what role do local actors have in identifying and assessing risk, and what role do they have in risk mitigation? Interesting models in this regard are mentoring between local organisations and support through national CSO platforms (Cruz, 2023[2]). For example, the Local Coalition Accelerator[11] acts as a local intermediary that supports local communities in Bangladesh, Nigeria and Uganda and enables them to access international funding. As good practice, DAC members also invest in local accountability mechanisms, such as audit bodies or civil society watchdogs, and promote whistle-blowing by local populations.

Engaging throughout the partnership is more effective than heavy upfront assessments

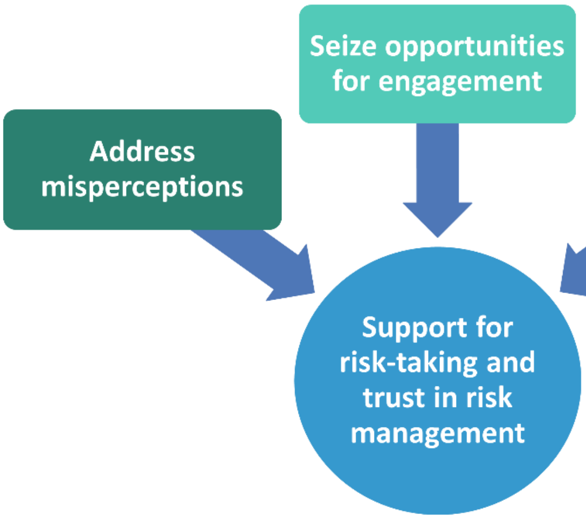
Risk management needs to focus on the risks that matter throughout the partnership. While still considered challenging, many DAC members would like to shift towards such risk-based approaches, allowing them to focus resources where risks are higher (OECD, 2022[15]). In contrast, putting too much weight on *ex ante* controls increases the burden on partners while reducing the capacity for jointly managing risks throughout the partnership. An evaluation for Sweden underlined the importance of engaging in monitoring and mitigation (Sida, 2020[31]). When New Zealand provides budget support, embassies play a key role in engaging with national authorities also when concerns arise (OECD, 2023[21]). Luxembourg has closely collaborated with Senegalese authorities over several years to design “budgetised support” in a way that uses country systems while responding to risk concerns (Government of Senegal and LuxDev, 2019[32]). Due diligence processes should, therefore, be understood as the starting point for regular dialogue on risk management. This allows monitoring if risk mitigation is effective, discussing changing and emerging risks in time, and agreeing on responses to risks that materialise.

Weighing the potential knock-on effects of overly punitive responses is important to ensure responses allow for accountability, development and local participation. Donors are increasingly concerned with adequately aligning their responses to confirmed cases of corruption with the need to maintain and strengthen local partners’ capacity when fraud is uncovered. Suspending funding, or even ending the co-operation with a partner, can have significant negative consequences for local organisations, especially where they are highly dependent on external resources, meaning that staff need to be let go and programmes aborted. Responses to risks that materialise, therefore, need to be considered carefully. In interviews, respondents echoed the experience of Finland’s Ministry of Foreign Affairs (Ministry of Foreign Affairs of Finland, n.d.[33]): suspected cases of fraud are frequently the result of poor management and accounting rather than ill-intent. Often, incidents concern individuals rather than entire organisations. It is, therefore, advisable to distinguish between the response to the actual offence and the wider programming (OECD, 2022[15]). To encourage the reporting of fraud while acknowledging the limited financial buffer of local organisations, some DAC members allow the use of recovered funds within the project. In addition, they can further support partners in tackling vulnerabilities, accompanied by the use of third-party monitoring and learning and adaptive management processes.

4. Sensitising domestic stakeholders and mitigating reputational risks

Domestic stakeholders are highly relevant for DAC member approaches to risk management. Playing an important accountability role, domestic stakeholders such as parliaments and the media in DAC member countries often focus their attention on risks of corruption and mismanagement. This puts local partners at a disadvantage, as they are perceived as less well-equipped to ensure and document the correct use of funds (Metcalfe-Hough et al., 2021[34]). In some DAC countries, domestic stakeholders and the broader public question, in particular, partnerships with partner governments (Couper and Mandala, 2022[35]), even more so where human rights protection, civic space and governance are particularly poor. These factors can impede locally led development at multiple levels. Concerned particularly with reputational risks, DAC members might choose not to partner with local stakeholders, although they would be well placed, and instead prefer international or domestic actors. They might decide against partnerships with governments, even where those would be highly relevant. And they might opt for humanitarian assistance (considered more palatable), although development approaches would be more sustainable. It should be stressed that DAC members respond very differently to reputational risks, illustrated by the wide range of engagement with a central government in one and the same country. This section identifies how development co-operation administrations can overcome domestic concerns around the risks of locally led development (see Figure 4 for an overview).

Figure 4. Engaging with domestic stakeholders to overcome concerns around risks of locally led development



Co-operation actors need to address misperceptions about the risks of locally led development

DAC governments need to communicate the risks and opportunities of locally led development as part of their broader dialogue on risk management. This enables domestic stakeholders to appreciate that development co-operation necessarily implies risk taking. It can strengthen the understanding that international partners are not immune to fiduciary and safeguarding risks and that disregarding local actors presents risks for effectiveness and sustainability. In the same vein, it avoids feeding perceptions that partnerships with local actors present much higher risks. In its 2022 development policy, the Dutch government stresses that taking risks is necessary to achieve results and, through examples, makes it clear that risks are not specific to local partners (Netherlands Ministry of Foreign Affairs, 2022[36]). It also allows DAC members to highlight that they act jointly, on the basis of joint commitments (including for locally led development), and in joint programmes with other DAC members, sharing both operational and reputational risks.

DAC members could build on a widely accepted logic of risk taking in private sector development to foster risk appetite in partnerships with other local actors. There is a broad understanding that risk taking is necessary in blended finance: if all projects were financially viable at the outset, there would not be any financial and development additionality. Partnerships with local intermediaries are frequent because of their financial role in local markets and accessing, in particular, small and medium-sized enterprises. DAC members and their local intermediaries accept that some loans will not be paid back, some businesses will fail and some guarantees need to be triggered. This includes accepting that moral hazard (such as fraud) can occur, with solid measures in place to reduce its likelihood, sanction fraud and recover any losses. They do so because their overall portfolio of investments will provide positive results. DAC members can use this parallel to make the case for the full range of their co-operation partnerships: ODA is a long-term investment for which external resources are needed; engaging with local actors is imperative to achieve impact; failure in some partnerships is to be expected, but the full ODA portfolio delivers development impact.

Co-operation actors can seize opportunities for engaging with accountability stakeholders

DAC governments can engage early on with accountability stakeholders to secure their support for the rationale and approach to risk management. Developing new co-operation policies, preparing a new programming cycle, and drafting risk policies and risk appetite statements present excellent opportunities to hold such dialogues. A significant advantage lies in being able to discuss incidents against the overall approach. This increases the chance that an incident such as a case of corruption does not put the overall approach into question but rather serves to explain how risk management systems are deployed and which lessons can be drawn. For example, in its development policy, the Netherlands clearly committed to taking risks and staying engaged in fragile contexts. On this basis, the government was able to clearly set out its gradual response to challenges in its partnership (OECD, 2023[37]).

DAC co-operation administrations can engage with their control environment to strengthen the understanding of development contexts. Internal and external audit and control bodies play a valuable role in verifying the respect for legal standards in the spending of development funding. Sometimes the application of these standards raises significant challenges in practice. Engaging with control bodies, development institutions such as the United Kingdom's FCDO and Global Affairs Canada set out where challenges lie and explore how standards can best be applied to enable development while preventing violations of rules or even criminal activity. Many DAC members, including Ireland, have dedicated rules for development co-operation grants compared to other public procurement, recognising that some risk mitigation measures in procurement require adjustments.

Anti-money laundering and countering the financing of terrorism (AML/CFT) is a key area for engagement between development co-operation and oversight stakeholders. Standards can weigh heavily on organisations, especially in fragile states, both in terms of providing information upfront and in upholding standards.[12] This challenge is also recognised in the *DAC Recommendation on Enabling Civil Society in Development Co-operation and Humanitarian Assistance* [OECD/LEGAL/5021]. The Financial Action Task Force (FATF) is undertaking work to mitigate the unintended consequences of these standards on not-profit organisations (NPO), especially where the FATF's standards are, unintentionally, and in some cases, intentionally, applied to constrain the work of these organisations (FATF, 2021[38]). Following a stock-take, FATF is currently reviewing Recommendation 8 of its standards to address its misapplication and misinterpretation that could lead countries to apply disproportionate measures on NPOs. Specifically related to official development assistance, in 2022, the United Nations Security Council decided that asset freeze measures under United Nations sanctions should not apply to humanitarian assistance (United Nations Security Council, 2022[39]). When engaging with oversight bodies, development administrations can stress the importance of implementing Recommendation 8 in line with the risk-based approach to preserve the integrity of the NPOs, without unduly disrupting or discouraging their legitimate activities. In turn, this should support NPOs' ability to operate and pursue their missions effectively and access resources and financial services, including development funding.

Transparent communication builds trust in risk management

Through transparency on incidents, DAC governments can build trust and maintain regular dialogue on risk management. To avoid reputational risks arising from a perception of inaction, it is better to regularly inform the public and stakeholders on risks that have materialised.[13] By quickly establishing what has happened and the response taken (building on good documentation of their risk management), governments can demonstrate their ability to effectively handle incidents. This allows domestic stakeholders to understand the scale and nature of an incident and the response taken. As with institutional accountability stakeholders, regular engagement with the media can also help build their understanding of risk management in development co-operation. As good practice, Denmark's Ministry of Foreign Affairs publishes regular reports on incidents of corruption and the response taken, providing the public and parliamentarians with a reliable overview and maintaining trust in the government's capacity to manage risks (Ministry of Foreign Affairs of Denmark, n.d.[40]).

5. Outlook

This note has highlighted a broad range of avenues for DAC members to ensure that their risk management enables rather than impedes locally led development. Many of these practices are not technically difficult to implement, and a broad range of DAC member good practices exists that others can draw upon. DAC members could explore in particular:

1. a risk policy that focuses on impact and acknowledges the value of locally led development
2. guidance and support to empower co-operation staff to take risks for greater impact
3. dialogue with intermediary partners on risk management to promote locally led development
4. drawing on local actors' expertise when it comes to identifying and managing risks
5. a review of due diligence requirements to support risk-based approaches
6. agreement with the range of local partners on strengthening capacities in line with their needs
7. regular and transparent communication on risk management and incidents.

There is also ample space for DAC members to collaborate to effectively reduce the burden of due diligence requirements. Even if DAC members simplify and adjust their individual requirements, the fact remains that all pursue the same objective and require very similar information. Identical assessment requirements, sharing information, mutual recognition and joint assessments are all opportunities for reducing bureaucracy, benefiting both local partners and DAC members.

However, recommendations for better risk management in development co-operation have long been discussed, without substantial progress. In 2012, the OECD's Conflict and Fragility Network analysed risk management in fragile and transitional contexts (OECD, 2012[41]) and recommended to "establish a culture which encourages appropriate risk taking" and collaborate with other DAC members. In 2010, the OECD-hosted Task Force on Public Financial Management suggested moving "towards a balanced assessment of risks and benefits" for greater use of country systems (Task Force on Public Financial Management, 2010[42]) and later "urge[d] donor institutions to also communicate with their parliaments and accountability institutions and in particular around definitions of risks and expected benefits as well as developmental risks of not using country PFM" (Task Force on Public Financial Management, 2011[43]). While this note has shown emerging good practice, it is also clear that progress is too slow.

Many measures will require political will and a readiness to actually shift the power. Even if technically straightforward, their introduction will challenge DAC members to convince domestic stakeholders of smarter approaches to risk management, and to face their own institutional biases. Risk management will be a litmus test for whether or not DAC members are ready to walk the talk on locally led development.

Accountability will be essential to ensure words translate into action. DAC members need to set a clear trajectory for the adjustments they plan to their risk management and the objectives they seek to achieve. Tracking progress, including through the current GPEDC monitoring round, will allow partners in developing countries and stakeholders at home to push for greater action where needed. Joint initiatives such as on harmonised due diligence assessments would also create peer pressure, ensuring that all participants take action. Without accountability for greater action, DAC member approaches to risk management might well remain the barrier to locally led development they still are today.

References

Ali, D. (2023), "In my view: Funding more proximately is not risky, but not doing so is", in *Development Co-operation Report 2023: Debating the Aid System*, OECD Publishing, Paris, https://doi.org/10.1787/5467daf3-en. [8]

Austrian Development Agency (2019), *Risk Management: Strategy of the Austrian Development Agency*, Austrian Development Agency, Vienna, https://www.entwicklung.at/fileadmin/user_upload/Dokumente/Risikomanagement/EN_Strategy_Risik_management_FINAL.pdf. [17]

Barbelet, V. et al. (2021), *Interrogating the Evidence Base on Humanitarian Localisation: A Literature Study*, HPG Literature Review, Overseas Development Institute, London, https://odi.org/en/publications/interrogating-the-evidence-base-on-humanitarian-localisation-a-literature-study (accessed on 6 September 2023). [14]

Couper, R. and T. Mandala (2022), "Governments are crucial to locally led development", web page, https://dai-global-developments.com/articles/governments-are-crucial-to-locally-led-development (accessed on 6 September 2023). [35]

Cruz, A. (2023), "In focus: Voice and agency of civil society in the Global South", in *Development Co-operation Report 2023: Debating the Aid System*, OECD Publishing, Paris, https://doi.org/10.1787/698bcf06-en. [2]

Development Cooperation Forum (2021), *Risk-Informed Development Cooperation and its Implications for Official Development Assistance (ODA) Use and Allocation: Lessons for the Decade of Action to Deliver the SDGs*, United Nations Department of Economic and Social Affairs, New York, NY, https://financing.desa.un.org/sites/default/files/2023-03/ODA%20Study%20-%20Finalized%20Version%20%281%29.pdf. [24]

DFAT (2021), *Due Diligence Framework*, Department of Foreign Affairs and Trade, Australian Government, https://www.dfat.gov.au/about-us/publications/due-diligence-framework. [25]

FATF (2021), *Mitigating the Unintended Consequences of the FATF Standards*, Financial Action Task Force, Paris, https://www.fatf-gafi.org/en/publications/Financialinclusionandnpoissues/Unintended-consequences-project.html (accessed on 1 October 2023). [38]

Fink, C., H. Lankes and C. Sacchetto (2023), *Mitigating Foreign Exchange Risk in Local Currency Lending in Fragile States*, International Growth Centre, London School of Economics and Political Science, London, https://www.theigc.org/publications/mitigating-foreign-exchange-risk-local-currency-lending-fragile-states. [23]

Global Affairs Canada (n.d.), "Grants and Contributions Transformation Initiative", web page, https://www.international.gc.ca/world-monde/funding-financement/grants-contributions-subventions-contributions.aspx?lang=eng (accessed on 1 October 2023). [11]

Government of Senegal and LuxDev (2019), *Note de capitalisation: Efficacité de l'aide: Une autre voie est possible*, Government of Senegal and LuxDev, https://luxdev.lu/files/documents/Note_4_execnat_vF2.pdf. [32]

GPEDC (2022), *2022 Effective Development Co-operation Summit Declaration*, Global Partnership for Effective Development Co-operation, https://www.effectivecooperation.org/hlm3. [4]

GPEDC (2019), *Making Development Co-operation More Effective: How Partner Countries Are Promoting Effective Partnerships*, Global Partnership for Effective Development Co-operation, https://www.undp.org/publications/making-development-co-operation-more-effective-how-partner-countries-are-promoting-effective-partnerships. [3]

Humentum (n.d.), "Charter for Change Due Diligence Passporting Tool", web page, https://humentum.org/charter-for-change-due-diligence-passporting-tool (accessed on 10 October 2023). [29]

IASC (2022), *IASC Guidance on the Provision of Overheads to Local and National Partners*, Inter-Agency Standing Committee, https://interagencystandingcommittee.org/humanitarian-financing/iasc-guidance-provision-overheads-local-and-national-partners. [46]

International Development Committee (2022), *Racism in the Aid Sector*, House of Commons, London, https://publications.parliament.uk/pa/cm5803/cmselect/cmintdev/150/report.html. [10]

ISO (2018), *ISO 31000:2018(en): Risk management – Guidelines*, International Organization for Standardization, https://www.iso.org/obp/ui/en/#iso:std:iso:31000:ed-2:v1:en. [6]

Metcalfe-Hough, V. et al. (2021), *The Grand Bargain At Five Years: An Independent Review*, HPG commissioned report, Overseas Development Institute, London, https://odi.org/en/publications/the-grand-bargain-at-five-years-an-independent-review (accessed on 6 September 2023). [34]

Ministry of Foreign Affairs of Denmark (n.d.), "Anti-corruption", web page, https://um.dk/en/danida/anti-corruption. [40]

Ministry of Foreign Affairs of Finland (n.d.), "The risks of misuse of development cooperation funds are monitored closely", web page, https://um.fi/misuse-is-addressed (accessed on 1 October 2023). [33]

NEAR (2022), "Local leadership in Northwest Syria fund and implement their own winter relief campaign", https://www.near.ngo/voices/give-them-warmth-local-leadership-in-northwest-syrua. [9]

Netherlands Ministry of Foreign Affairs (2022), *Policy Document for Foreign Trade and Development Cooperation: Do What We Do Best*, Netherlands Ministry of Foreign Affairs, The Hague, https://www.government.nl/documents/policy-notes/2022/10/10/policy-document-for-foreign-trade-and-development-cooperation-do-what-we-do-best. [36]

Netherlands Ministry of Foreign Affairs and ICRC (2022), *Risk Sharing In Practice: Success Stories, Enablers, and Barriers to Risk Sharing in the Humanitarian Sector*, Netherlands Ministry of Foreign Affairs and International Committee of the Red Cross, https://reliefweb.int/report/world/risk-sharing-practice-success-stories-enablers-and-barriers-risk-sharing-humanitarian-sector-june-2022. [12]

OECD (2023), *Briefing Note: Initial Findings of the Programme of Work on IFFs, De-risking and Financial Exclusion*, OECD, Paris. [44]

OECD (2023), *Development Co-operation Peer Reviews: New Zealand 2023*, OECD Publishing, Paris, https://doi.org/10.1787/10883ac5-en. [21]

OECD (2023), *Framing DAC member approaches to enabling locally led development*, OECD, https://one.oecd.org/document/DCD(2023)47/en/pdf. [5]

OECD (2023), *Funding Civil Society in Partner Countries: Toolkit for Implementing the DAC Recommendation on Enabling Civil Society in Development Co-operation and Humanitarian Assistance*, OECD Publishing, Paris, https://doi.org/10.1787/9ea40a9c-en. [47]

OECD (2023), *Informal Consultation on Development Co-operation in Autocratising Contexts with GovNet Members*, OECD, Paris. [45]

OECD (2023), *OECD Development Co-operation Peer Reviews: Netherlands 2023*, OECD Publishing, Paris, https://doi.org/10.1787/67b0a326-en. [20]

OECD (2023), "Partnering for impact: How New Zealand co-designed new civil society funding mechanisms", *Development Co-operation TIPS: Tools Insights Practices*, OECD, Paris, https://www.oecd.org/development-cooperation-learning/practices/partnering-for-impact-how-new-zealand-co-designed-new-civil-society-funding-mechanisms-b776a631. [22]

OECD (2023), "Staying engaged under pressure: The Netherlands' support to the justice, law and order sector in Uganda", *Development Co-operation TIPS: Tools Insights Practices*, OECD, Paris, https://www.oecd.org/development-cooperation-learning/practices/staying-engaged-under-pressure-the-netherlands-support-to-the-justice-law-and-order-sector-in-uganda-b75b8b93. [37]

OECD (2022), "Hungary engages with local faith-based organisations in fragile contexts", *Development Co-operation TIPS: Tools Insights Practices*, OECD, Paris, https://www.oecd.org/development-cooperation-learning/practices/hungary-engages-with-local-faith-based-organisations-in-fragile-contexts-2d11cfe2. [27]

OECD (2022), *Report on the Implementation of the OECD Recommendation for Development Co-operation Actors on Managing the Risk of Corruption*, OECD, Paris, https://one.oecd.org/document/C(2022)175/en/pdf. [15]

OECD (2022), "The Netherlands partner with local women's rights organisations and feminist movements for gender transformative change", *Development Co-operation TIPS: Tools Insights Practices*, OECD, Paris, https://www.oecd.org/development-cooperation-learning/practices/the-netherlands-partner-with-local-women-s-rights-organisations-and-feminist-movements-for-gender-transformative-change-81754f1c. [30]

OECD (2021), "Development Co-operation TIPs fundamental: Risk management", web page, https://www.oecd.org/development-cooperation-learning?_ga=2.42110821.1783174906.1697038032-1631167217.1693994259#fundamentals. [13]

OECD (2020), *Development Assistance Committee Members and Civil Society*, OECD Publishing, Paris, https://doi.org/10.1787/51eb6df1-en. [18]

OECD (2020), *OECD Development Co-operation Peer Reviews: Belgium 2020*, OECD Publishing, Paris, https://doi.org/10.1787/026f1aad-en. [19]

OECD (2012), *Managing Risks in Fragile and Transitional Contexts: The Price of Success?*, OECD Publishing, Paris, https://doi.org/10.1787/9789264118744-en. [41]

OECD (2011), *Busan Partnership for Effective Development Co-operation: Fourth High Level Forum on Aid Effectiveness Busan, Republic of Korea, 29 November - 1 December 2011*, OECD Publishing,, Paris, https://doi.org/10.1787/54de7baa-en. [1]

Peace Direct (2023), *Transforming Partnerships in International Cooperation: A Practical Resource for Civil Society, Donors, INGOs and Intermediaries*, Peace Direct, https://www.peacedirect.org/transforming-partnerships. [7]

Sida (2020), *Evaluation of Sida's Risk Management of Contributions*, Swedish International Development Cooperation Agency, Sundbyberg, https://www.sida.se/en/publications/evaluation-of-sidas-risk-management-of-contributions. [31]

Sida (2019), *Guiding Principles for Sida's Engagement With and Support to Civil Society*, Swedish International Development Cooperation Agency, Sundbyberg, https://www.sida.se/en/for-partners/civil-society-organisations. [28]

Task Force on Public Financial Management (2011), *Manila Consensus on Public Financial Management: Partnering to Strengthen Public Financial Management for Effective States*, OECD, Paris, https://www.oecd.org/dac/effectiveness/48780763.pdf. [43]

Task Force on Public Financial Management (2010), "What are the benefits of using country systems", *Policy Brief 2: Oversight Institutions*, OECD, Paris, https://www.oecd.org/dac/effectiveness/48780917.pdf. [42]

United Nations Security Council (2022), *Resolution S/RES/2664(2022)*, United Nations Security Council, https://undocs.org/Home/Mobile?FinalSymbol=S%2FRES%2F2664(2022). [39]

USAID (2022), *USAID Risk Appetite Statement: A Mandatory Reference for ADS Chapter 596*, United States Agency for International Development, https://www.usaid.gov/sites/default/agency-policy/596mad.pdf. [16]

USAID (n.d.), "New Partnerships Initiative", web page, https://www.usaid.gov/npi (accessed on 1 October 2023). [26]

Notes

[1] Local is understood as being based in a developing country as opposed to international actors or actors based in DAC member countries.

[2] For corruption risks, an OECD report found "a stark imbalance in risk-sharing as between respondents and partners, where most donors transfer the lion's share of responsibility for corruption risk management to their partners, often with little to no risk management support, despite considerable imbalances in their resources and capabilities" (OECD, 2022[15]).

[3] The fourth round of the GPEDC Global Partnership Monitoring will generate evidence on important aspects related to risk and locally led development. This includes on the use of various country systems – with the opportunity to provide complementary information on risk-related reasons for not doing so – and on some issues related to the quality of support to CSOs. A dedicated adaptation for fragile contexts inquires into risk analysis. In addition, the new Kampala Principles Assessment, an integral part of the monitoring exercise, looks at due diligence processes for private sector engagement.

[4] In follow-up to the *DAC Recommendation on Enabling Civil Society in Development Co-operation and Humanitarian Assistance* [OECD/LEGAL/5021], the OECD developed a "Toolkit on Funding Civil Society in Partner Countries", which offers practical guidance on the main funding choices for providers to locally support and strengthen local leadership and ownership, and foster a strong, independent, diverse civil society (OECD, 2023[47]).

[5] Notably, work on the OECD *Recommendation of the Council for Development Co-operation Actors on Managing the Risk of Corruption* [OECD-LEGAL-0431] and the programme of work on illicit financial flows, derisking and financial exclusion (OECD, 2023[44]).

[6] In joint work of the DAC International Network on Conflict and Fragility and the DAC Network on Governance; see, for instance, OECD (2023[45]).

[7] An example is a fail fest organised by the Netherlands' Ministry of Foreign Affairs (OECD, 2023[20]).

[8] Specifically for humanitarian assistance; see also dedicated guidance by the IASC (2022[46]).

[9] https://www.pefa.org.

[10] https://www.mopanonline.org.

[11] https://thesharetrust.org/local-coalition-accelerator.

[12] It should also be noted there can be indirect effects where local actors cannot access funding because local financial markets are affected by derisking.

[13] The OECD Rec*ommendation of the Council for Development Co-operation Actors on Managing the Risk of Corruption* [OECD-LEGAL-0431] contains a specific point on fostering accountability and transparency.