Colleagues, good afternoon (slide 1)

As the program indicates, my topic centers around the necessary risk value adding that is necessary to secure sound grant performance. The ACT is in caretaker mode, so the views I express today are either my own or those of the Australian Risk Policy Institute. The text of my presentation will be published on the ARPI website in due course.

May I say it is apposite that this conference is so well attended despite tight budgets? There is a lot of money already on the table in relation to the National Disability Insurance Scheme (NDIS) and the National Injury Insurance Scheme (NIIS) and this money will drive a plethora of small engine delivery structures with NGO's and to a lesser extent volunteer groups at the forefront of service delivery. In fact, the Productivity Commission observed in its report:

> A national scheme with national standards and entitlements that would cover people with significant disabilities arising from non-accidents
>
> State-based arrangements for no-fault insurance coverage of all catastrophic accidents — with minimum national standards

And

> The schemes, like all insurers, would aim to minimise long-term costs, so they would have a strong incentive to undertake early intervention where it is cost effective. The scheme would spend dollars to save more dollars and people would not have to wait for basic supports like wheelchairs and personal care

> People would be able to choose their provider or providers. They could choose to have a disability support organisation manage their packages or to act in other ways on their behalf
>
> They would be able to manage their own funds if they wish (within rules)

> The NDIS would encourage and support people into work and/or being more involved in the community. People's short and long-term plans would be reflected in their individual support packages

With new concepts to manage, new types of deliverables to master and very new accountabilities, grant decision making and active risk management will never be more important.

Other speakers have provided an excellent array of assessment and outcome metrics, including good or best practice guides, negotiating tools and contracts.

As vice president of the Australian Risk Policy Institute, I favor a global risk approach to these types of matters, and in some ways we could look at the issues in a very sophisticated way. However, the conveners have asked me to focus on the practical areas of risk. In my view, in order to assess risk, one must first decide where the areas of vulnerability reside.

Consequently, I will focus on some very practical areas of vulnerability in the grants process, particularly at the grass roots level and hopefully provide some useful tips that might work practically. What I want to do also is offer a sneak peek into the NDIS/NIIS risk window, at least what I would observe from documents in the public domain in terms of funding responsibilities, without getting me arrested. I will also, time permitting proffer a couple of salutary lessons with regard to big bang policy efforts with heavy funding and much political capital attached that provide us with important risk, accountability and funding agreement structure opportunities at the threshold of the NDIS.

First, though, it being immediately after lunch, I want to provoke some thought about terminology. Does anyone share my view that post the GFC, the terms "failure of risk and failure of risk management" have been used so often in relation to systemic failure of major institutions and governments, the term has become trivialized (slide 2)? For example, look at how a word of ultimate sanction, has, over the past week been turned into a media and political catchphrase. Suddenly, everyone is an expert in critiquing one of the world's great religions, just as they are in relation to risk management.

Admittedly, all the hard work since AS4360 came into being in 1994 came to naught when a couple of guys convinced the best risk managed insurer in the world that the same real time risk modeling algorithm that protected it from excessive risks insuring collateralized debt obligations (they were invented in 1983) could be shoehorned into risk profiling credit default swaps, and thereby wrecked 40 years of exemplary business and, Combined with other greed stampedes, almost ruined the world economy and may yet do so.

In fact, at the relevant time, Credit ratings agencies' decisions were ostensibly based on risk. Banking and insurance decisions were based on risk. Lenders and investors' decisions were based on risk. Government owned or regulated businesses' decisions were based on risk. They all purported to assess the risks and they all got it wrong. So whatever risk models they used did not work or in a number of well documented cases, risk managers made the correct calls, but were ignored or moved on. Everyone therefore has a right to a view on risk management.

However, since the GFC, new requirements have sprung up to prepare risk plans for the most minor of transactions, even those that don't readily spring off the page as being amenable to being structured in a risk management matrix. Thus, the ISO 31,000 process has, in some cases become simply a tick and flick exercise instead of the important advance it was and is meant to be. It is ironic that risk management has, due to systemic failure to apply it assiduously, become over exposed and over used.

At the broadest level, human beings for the first time have taken hold not only of the world economy and of population dynamics, but most of the planet's systems, so a clear understanding and practical application of the policy drivers behind risk management is imperative.

Meanwhile, the public consciousness has moved in an interesting way. For example, how many people in our social circles are evincing <u>this</u> level of uncertainty: (slide 3)?

Colleagues, acknowledging that in excess of $13 billion are on the table for two brand new laudable but little understood opportunities for NGO service delivery, unless we get the risk picture correct, the public will withdraw support and a golden opportunity will be lost. I say this in the belief that post GFC, expectations attached to ISO 31,000 and other elements of subject dedicated facets of risk management (e.g. Basel III) are too great. To mix literary metaphors, London whales will always get harpooned while ISO 31,000 plods along like the horse in Orwell's Animal Farm without the requisite clearly articulated policy perspective behind it. But that is a speech for another day.

- **Choosing the funding recipients: pre-contractual checks, solvency and probity (slide 4)**

Having hopefully reset your ancient biological clocks (eat then sleep), let me move into the practical areas of my topic. In light of the fact that significant chunks of disability and lifetime care and support services are delivered by NGO's and in view of the imminent rollout of NDIS launch sites, I've taken the liberty of concentrating my topic on NGO grants for service delivery. Having done that, I've added a new risk element that current NGO providers will not, in the main have encountered before: performing under an insurance model. Both NDIS and NIIS will, if the Productivity Commission's views are fully adopted, be managed under the insurance model. In its simplest terms, it means access to either scheme will depend on eligibility, not entitlement; funding will be directed, not broadly based; choice and packaged self-management will be a feature of the funding process, and common minimum standards will apply across Australia. In the case of the NDIS, this is a paradigm shift from traditional approaches to disability funding.

Assuming then, that the grant recipients are NGO's and the principle is the insurance model, the key to risk managing all the issues in my topic can be found in the following rubric: a stable risk platform will most probably produce predictable outcomes (slide 5). This is the core risk construct of compulsory, statutory insurance schemes.

So, when we are at the choice and evaluation phase of the grants process, how can one ascertain what vulnerabilities exist and whether stability might be achieved, then preserved, and objectively evidenced? Let's start by ascertaining the answers to the following questions (slide 6).

1. First, has there been stable overall governance over time.
2. How long has the current board of management served.
3. How long has the NGO's treasurer been in place?
4. Can our performance model and risk picture be mirrored?

Putting aside for the moment all the excellent information and metrics provided by previous speakers, and assuming that an NGO would not bid for work it considered itself incapable of doing, for NGO's, in my view a primary vulnerability attachment point is financial record keeping within the broader category of management continuity and records management.

For instance, while it might not be the public face of an NGO, the office of treasurer has the most work to do in terms of tactical governance, risk and compliance, but it is the office of treasurer that incurs arguably the highest level of management level rotation in and out of an NGO.

Certainly, if payment of a stipend is not involved, the treasurer's position will rotate often. If a stipend is paid, it might rotate less often but consider it a gift from above if a serving treasurer at the date of grant assessment is the same individual when the time comes to assess the effectiveness of the grant at various milestones or at the end of a grant period.

Remember it is not always the case that the office holders bidding for the grant you are allocating are the same who managed a previous grant either from your organization or some other funding source. Consequently the office of treasurer is key because that office is where the funds flow both ways and where the critical records are maintained. It is where the probity story is located. Because in this world, probity has a dollar sign attached to it. The sorts of things that give, say tax alarm signals for profit centered businesses, like barter, countertrade and favors for favors are parts of the glue that keep NGO's functioning in a world with little money.

Thus, heavy rotation of critical office holders presents a serious area of vulnerability in terms of an NGO's stability and business continuity. So that is why I say a primary area of risk is record keeping. The records are going to be the first port of call for any investigation, before, during or after the pendency of a grant.

So, if we extrapolate a little and take a look at the NSW ICAC's approach to grants record keeping, as outlined in the next three slides (7, 8, 9) and as a useful start point, the core of the choice checklist in this regard is predominantly that of qualitative assessment of capacity, performance and stability with respect to the extent and length of the period of grant. An NGO's previous track record cannot always be obtained from canvassing referees it nominates or people you know, even its clients. In fact, it may not reflect current reality. It is the written record that tells the tale of its performance over time. The record provides an insight into receipt and expenditure patterns, outlays, decisions, delegations, even its internal relationships as reflected in its board minutes or related correspondence.

I am a firm believer in observing pattern and practice as a useful tool in evaluating future behavior. At my old Law/Business school in the US, we called it predictive analytics or the gentler, legal rubric "policy oriented jurisprudence." Without blowing my own trumpet, I used it to great effect in litigation. At least in the US, it never failed me.

Quantitatively, there are many options available (I recommend the ANAO publication called "Implementing Better Practice Grants Administration" for instance) but at the practical level the main objective is to look at pattern and practice with respect to how prior grant funds have been spent and the best place to start is with the financial records, followed by its transactional performance, both *inter partes* and externally, as reflected in its business records.

Remember also, while NGO's that are incorporated and churn more than a certain minimum of funds must file audited financials each year, the audit is most likely to be a voluntary affair (slide 10 honorary auditors) so it is critical to be aware of the flow patterns of money, not just who has signed off the balance sheet because what is critical is how the money is spent and when. For example, let's say a periodic payment of $100,000 is made to an NGO every quarter for a certain set of services. What I would want to see is the primary record of the Board's policy decision as to how periodic grants are to be spent, advance commitment sheets outlining the flow of funds once received and quarter by quarter, acquittal records covering the outcomes of those quarterly expenditures, possibly a commentary on the standard of outcome and certainly a detailed, internally generated effectiveness assessment each 6 months. Of course, one would want to see the funds committed, allocated and spent almost as soon as they arrive, quarter by quarter.

Turning back to the issue of performance and risk mirrors, in my view, particularly in connection with the NDIS and NIIS, it is imperative that a major choice point comes with matching expectations. For most, it would be a no-brainer that the NGO's deliverables broadly match the granting Agency's expectations but in relation to these new sources of funding and how they are to be governed and reported (slide 11), I believe it will be a strenuous, iterative process within which NGO's will learn to report consistently, using the same terminology, reflecting the same understanding, across all facets of service delivery in every State and grantors will be on the same learning curve.

That is why I say that risks, deliverables and expectations will need to be mirror images, because both sides will be learning under excruciating, unprecedented scrutiny in real time, even before inevitable external progress audits. A very different circumstance, I think we can agree. Consequently, continuity of office holders will be very important or at the very least, an effective handover mechanism within NGO's to preserve the record. So, in summary, it will not be enough for a grantor agency simply to observe "NGO X always comes through in the end, so we will pick it for this piece of business."

Thus, in order to evaluate an NGO's propensity to spend some of that $13 billion, it will be essential to see how it spent its last $13,000.

If the grantees intend to outsource or partner any of the grant performance obligations, it will be essential for identical parameters to propagate across that process. Now, lest we get hung up on the new paradigm that every facet of grant behavior will need to be risk managed up hill and down dale, hopefully the next segment of my presentation will offer some light.

- Practical accountability measures and legal issues (slide 12)

Let's take another look at slides 7 through 9. I won't bother you with them again on screen, they are in front of you, but let's review them in context. The reason I like the ICAC approach here is because it offers a practical way to account for things done throughout the grant relationship. To be sure, the overall emphasis and context is on preventing corruption but the intended consequence is to establish a declaratory, fully accountable structure which of course minimizes the risk of corruption. Effectively, a closed loop. Post GFC, and in light of current policy developments, I believe the closed loop will provide the best means of dealing with inflationary expectations around the true effectiveness of ISO 31,000 as a practical risk management tool. The closed loop will identify and overcome vulnerabilities that would curtail service delivery. ISO 31,000 may not.

What is the closed loop? Think of it as how American humor works. In my misspent youth, it was known as the army method: first you tell them what you are going to tell them, then you tell them, then you tell them what you told them. Certainly, the input and output characteristics of funding and service delivery are accounted for, but most important, from assessment to conclusion, the accountability framework provides consistent application of principle, so throughout the process (slide 13):

1. Expectations are understood
2. Reporting is consistent
3. Outcomes are known, resulting in

An effective choice point, performance and outcome mirror.

From the legal perspective, the array of policy and outcomes expectations that sparked the decision to offer the grant are all disclosed and contained in the funding agreement. The review points are specified, all known elements of vulnerability are addressed and there is a clear pathway to completion for both sides. Of course, slide 9 proffers the closing of the loop.

I like the methodology used by ICAC because I know it works. As we will see in my last speaking point, various iterations of it have been used as a disaster recovery mechanism for procurements gone wrong. That's what makes it ideal for use in the NDIS/NIIS environment. In my view, it is a really good protection against failure *ab initio* for a high profile, high dollar process that is high on expectation but low on known outcomes.

- How to protect funds and recover unspent funds (Slide 14).

I suggest there is an immutable truth attaching to grants: no matter what mechanisms are used, no matter what degrees of separation are interposed, the reputation risk of the grantor always remains at large and at stake. I suggest in relation to the NDIS and NIIS, there will need to be detailed mechanisms in place for achieving the worthy objective of protecting funds and dealing with unspent funds. For instance, how will the unspent portions of packaged individual fund allocations be accounted for, protected and recovered if required?

For an interesting example, under the catch phrase "follow the money" so loved by movie sleuths, the US Government has established a website within which citizens are able to track stimulus spending down to local level and federal agencies are obliged to report weekly on their expenditures (Slide 15). While there is an air of political imperative attached to what the Americans are doing, I suggest with an eye to past Australian stimulus adventures there will be a renewed emphasis in Australia on accounting for any large sums to be committed on new government programs, that is to say, proactively, virtually in real time, in addition to but not in lieu of Estimates reviews and annual audit.

In the case of the NDIS, the Productivity Commission Report is replete with admonitions about accountability and transparency. I suggest this will flow into grants programs generally as expectations rise in line with whatever accountability framework develops in relation to the NDIS. New standards based on a new paradigm (insurance model) will raise the bar.

In commercial life, one protects funds in various ways: trusts, agencies, loans, countervailing deposits, buffers (such as bank guarantees) and other security methods but these are largely useless in the world of NGO grants, particularly in the case of service delivery. In Australia, you folks probably know more than I do about grant recoveries. Agencies employ various mechanisms (Slides 16 and 17). I do not favor withholding in cases of service delivery assuming all services are supposed to be delivered because withholding a certain percentage connotes the holding back of a profit margin which, in the case of non-profit grantees, is inapplicable and in a worst case may usurp the purpose of the grant.

I do prefer the US rescission and return (slide 17) approach because it means the agreement is dead and via a legal artifice, the funds (or property therein) can be deemed never to have left the aegis of the government. I was lead counsel in a landmark case on this very issue, winning both at trial and subsequently unanimously on appeal so I have a particular fondness for it. Of course, such a mechanism is inapplicable if the funds were committed via the intercession of State or local governments as the funding mechanism and I am unsure if the concept is workable here without statutory change.

Change of purpose is feasible if the grantee is capable of multi-purpose service delivery, but in this regard, particular attention would need to be given to the agreement provisions because unless they are specific on point, that is to say, providing clearly for change of purpose and specify the purpose, there can be complications recovering unspent funds in respect of delays, but generally, too it can become very messy at audit.

- Monitoring performance : importance of milestones and what to look for (slide 18)

Again, we see the relevance of slides 7 through 9. The logic attaching to milestones is inescapable, because if properly administered, these types of agreements are designed to overcome almost any policy obstacle or vulnerability. However, the development of milestones must, of course precede the funding agreement and they must be mutually understood and collaboratively agreed well in advance of any commitment. The ANAO publication I referred to earlier presents a useful primer in terms of understanding this.

In my contention, there is no substitute for the basic approach evidenced in slides 7 through 9 because apart from setting the pathway to performance, it also works well to expose vulnerabilities and most importantly, it shines the light on what cannot be achieved, so expectations are managed effectively from the start and the vision, and values and goals are shared collaboratively (slide 18). Thus, risks become clear and can be addressed well before one gets into the danger zone, say, where they crystallize suddenly at a critical time.

While the nomenclature might be different (grants versus partnership), the concept behind the design of milestones for later implementation is not dissimilar in structure to what ought ideally to be used in public private partnerships, which incidentally would be my preferred funding mechanism with respect to funding <u>for profit</u> entities that might bid to deliver larger component elements of, say an NDIS. Taking an optimal PPP structure (based on an ARPI enhanced OECD precedent) as the model, the whole ambit of the structure, including milestones are established as follows:

1. Prior to any solicitation documents being disseminated, the collaborative arrangement policy proposal is independently evaluated as to structure, optimal and real profitability (or cost, as applicable), appropriate gearing (or flexible funding parameters, as applicable) and an objective formula is established for risk identification and sharing.
2. Objectively quantified performance targets supported by a performance-based contract model, including reporting timelines and benchmarks are finalised at the negotiation phase for later implementation.
3. mutually agreed audit standards supported by an independent auditor chosen by both parties, including reporting timelines and benchmarks is likewise established at the negotiation phase for later implementation;
4. Milestones are of course likewise determined at that stage.

5. Regular reporting on both of those latter elements above, coupled with, say quarterly analysis of the risks to ensure that risk shifts are accounted for is provided for in order that all parties are across the dynamics of the collaborative transaction as it unfolds.

We can see that adapting a collaborative PPP formula is not difficult and scalable down with minor modification for non-profits, delivering the many and varied elements of a much larger whole.

But I digress. If we take as given that in the case of very large scale socially beneficial service delivery projects whether an NDIS or not, public and potential beneficiary expectations may differ in large measure from the project's foundations, even its objectives. Accordingly, adoption of some form of collaborative structure in advance of commitment and the commencement of expenditure is imperative or the whole project may fail for reasons external to its policy underpinnings.

Let me posit two examples, the first, what happens when mutuality is absent. Capital works contracting in NSW nearly always offers fruitful territory for analysis. A couple of years ago, the Association of Consulting Engineers Australia (ACEA) announced their awards for excellence and those awards included a student project award to a student at Sydney University whose project was "the effect of risk quantification on the performance of cost estimates for infrastructure projects in New South Wales." The student's task was to understand why costs were underestimated in some 90% of infrastructure projects.

The ACEA reported there appeared to be over confidence and underestimation of risk quantities in the projects and according to the ACEA, the student's analysis pointed to four major categories of explanation for such errors including technical error, cognitive or psychological bias, economic pressure and political pressure. The student apparently looked at 61 Water and Road infrastructure projects and naturally enough his findings were that the use of quantitative risk modelling usually gave improved cost estimates. He graduated with first class honours.

It is a different type of agreement, but let us not lose sight of the categories of explanation and apply those to the perceived shortcomings of the stimulus effort as demonstrated by audit. We see a clear pattern in my view: technical error, cognitive or psychological bias, economic pressure and political pressure. Take the significant expectations of these new disability and injury federal initiatives, declared to be foundation elements of the Prime Minister's agenda as late as today in NY, and reflect.

As to the second example, NASA, and a well-known case study on the imposition of external policy drivers that upset project delivery and outcomes. One of the reasons that the Challenger took off on the fateful day was due indirectly to President Reagan's policy on numeracy and literacy but also his strenuous efforts to show American dominance in space technology.

The deliverables of that policy objective included putting a teacher in space and a date was chosen as close as possible to the midpoint of the president's second term and his state of the union address. Thus, the project countdown included an external variable that drove the project down its fateful path and after a number of frustrating delays, that day fell during an unseasonably cold spell. The vehicle was not certified to blast off if the temperature was below 40 degrees F and an issue with integrity of the ring seals at low temperatures had been known for 9 years. The previous lowest temperature launch had been undertaken at 53 degree F. However, every school in America was geared for that day, as was the president who was scheduled to give his state of the union address that evening. NASA overrode objections and cleared the launch. 85% of Americans knew what happened within the hour. And there was as yet no internet.

What saved NASA from oblivion was the introduction and implementation, over a ten year period of the types of decision mechanisms chronicled at slides 7 through 9. It took ten years, but it worked. Its latest Mars triumph attests to that. The term sometimes used to describe this approach is “performance based contracting” but its relevance is particularly applicable in relation to grants agreements. The principles are easily stated and are the same as I indicated earlier (slide 19). For example, the formula is used by the US Department of Energy in its enormous university grants programs but it translates rather well in “new system” IT development and implementation agreements.

Colleagues, can I suggest therefore that in the development of NGO service agreements, particularly milestones, the first thing to do is look at the values and goals of prospective participants to the grant agreement, from that one derives context, intentions and objectives which in turn inform the funding agreement and all of the other elements of the grants relationship. Milestones, represented by a series of collaborative, achievable interim goals constitute the natural outflow from that process and the necessary steps one takes to measure them likewise follow.

It is different from strict risk management in that the responsible parties can each take more subtle steps to deal with incremental issues. It also allows allocated responsibilities to be part of the overall benefit dynamic. And better yet, risk elements become clear before the start so the shortcomings of expectation around ISO 31,000 are less of a risk per se.

Finally, what the milestones will be in relation to the multiplicity of grants funding opportunities under the NDIS and NIIS are not yet known, COAG will know before any of us, I suspect.