



### STANDARD

Procurement should identify risk factors associated with each procurement, analyze the probability of the risk occurring and consider the potential impacts (*See Element 1.1*). Risk management plans should then be developed, based on the decision to avoid, assume, or transfer the identified risks.

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#### Definition

**Risk management** is a process including the identification and analysis of risk; and the decision to either accept or mitigate the exposure to such risk when compared to the potential impact on the achievement of the organization's objectives.

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#### Element 1.1: Identifying Where Risk is Located

Various risks exist for procurement. These risks can be external and internal, as well as strategic and operational. It is important to identify where these risks are located. The following are areas to be considered:

##### Strategic Risk<sup>1</sup>

Defined as risks that need to be considered in relation to medium and long-term goals and objectives of the organization. They include:

- *Political*: risks associated with a failure to deliver policy for the entity that is served, or to meet the local administration's policy commitments (e.g. a failure to integrate sustainability considerations into acquisition decisions), and the impact of social unrest, changes in government, and the potential for political turmoil at home or abroad.
- *Economic*: risks affecting the organization's ability to meet its financial commitments (e.g. failing to consider the consequences of proposed major investment decisions prior to an acquisition; effects of inflation, recession, and foreign exchange rates).
- *Social*: risks relating to the effects that changes in demographic, residential or socio-economic trends will have on the organization's ability to deliver appropriate services (e.g. failure to procure sufficient elderly care provision for an aging population).
- *Technological*: risks associated with the organization's capacity to deal with the pace/scale of technological change or its ability to use technology to address changing demands (e.g. a failure to procure the appropriate software to allow for the efficient financial management of the authority; failure to manage and protect the security of the data).
- *Legislative/Regulatory*: risks associated with current or potential changes in law (e.g. a failure to address a legal directive).
- *Competitive*: risks affecting the cost, quality, or competitiveness of a service (e.g. the failure to address a failing service through improvement, market testing, or outsourcing).
- *Customer/citizen*: risks associated with the failure to meet the current or changing needs and expectations of customers and citizens (e.g. the demand to improve the availability of public transport).



## Public Procurement Practice

### RISK MANAGEMENT *(cont.)*

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#### Operational risk<sup>2</sup>

These are risks that managers and staff will encounter in their work. They may be:

- *Professional*: risks associated with the practice of procurement (e.g. failure to develop and implement robust procurement processes).
- *Financial*: risks associated with a failure to secure a most economically advantageous outcome to an acquisition (e.g. the failure to apply lifetime costing techniques in a tender evaluation or the failure to apply appropriate financial appraisal techniques prior to contract award leading to supplier failure).
- *Legal*: risks related to possible breach of legislation (e.g. failing to advertise a contract under required directives; failure to include specific contract terms leading to contract failure).
- *Physical*: risks related to fire, security, accident prevention, and health and safety (e.g. failing to procure properly labelled cleaning materials).
- *Contractual*: risks associated with the failure of contractors to deliver services or products to the agreed cost and specification (e.g. delivery by contractors of substandard or out of date food products; failure to meet specified outcomes).
- *Technological*: risks relating to a reliance on operational equipment (e.g. exclusive reliance on an eProcurement system to deliver critical supply acquisition).
- *Environmental*: risks relating to pollution, noise or the energy efficiency of on-going operations (e.g. reliance on unsustainable sources of commodities).

#### Element 1.2: Types of Risk Factors

The decision regarding which risk factors to focus on will vary by organizational goals and objectives. However, it is recommended that at a minimum procurement should consider the following risk factors:<sup>3</sup>

- Escalating costs of fuel, energy, and raw materials
- General lack of internal risk management capability on the part of the supplier<sup>4</sup>
- Exchange rate fluctuations
- Financial instability of suppliers leading to supplier failure
- Conflicts in supply chain caused by cost cutting and survival activities
- The amount of emphasis on cost cutting over quality improvement
- Supplier failure to deliver on contracted obligations
- Sole sourcing arrangements
- Changes in environment or legislation that affect the supply base
- Product with no available alternatives
- Changes that result in obsolete technology and/ or products, or new unproven technology or products

#### Element 1.3: Methods and Tools to Identify Risk

Techniques and tools that may be used to identify supply chain risks include:

- Brainstorming sessions to identify risks
- Establishment of cross-functional teams
- Risk Registers<sup>5</sup>
- Total Risk Profiling
- SWOT Analysis
- Balance sheet analysis
- Site observation
- Close collaborative working with suppliers<sup>6</sup>



### Element 1.4: Understanding Risk<sup>7</sup>

Analysis should be performed throughout the procurement cycle to understand the probability of risk, the severity of the risk, and the actions necessary to mitigate such risk.

- **Stage 1 (Identification of Need for Procurement)** – Once the need to procure is established the procurement professional should think about the main areas of risk involved in the specific procurement.
- **Stage 2 (Creation of Procurement Strategy)** – This stage occurs prior to the specification stage, and requires the procurement professional to determine whether or not to carry out a formal risk analysis. During this stage it may be determined whether or not to use a risk register to allocate and manage the mitigation of the procurement risks.
- **Stage 3 (Preparing for the Quotation or Procurement)** – If it is determined that a formal risk analysis is necessary during Stage 2, the Lead Procurement Professional, in collaboration with those drafting the specifications, should produce a Procurement Risk Register that identifies risks. The Risk Register will be the document that identifies the risks and the chosen risk management approach, as well as any related contract provisions. A simple template for the Risk Register should be provided by the procurement department.
- **Stage 4 (Issue Request and or Solicitation)** – The choice of contract type, e.g. fixed price or cost/labor hours, performance-based vs. design, is sometimes discussed as one of the fundamental decisions to manage procurement risk during this stage. In appropriate cases, requirements may include a request that offerors address risk management in their proposals, e.g. what do they consider the most significant risks to the project; what risk management model do they use; what specific actions, transfers, reductions, avoidance, sharing, or acceptance of risk do they recommend for each risk.
- **Stage 5 (Evaluation Period)** – Consider including risk as part of the criteria for evaluation, (e.g. understanding of the requirements, soundness of approach, and overall risk of unsuccessful project performance).
- **Stage 6 (Award & Implementation of Contract)** – Prior to the award of contract, the Lead Procurement Professional should revisit the Procurement Risk Register, in collaboration with the prospective supplier, and check that risk has been appropriately allocated (e.g. avoided, transferred, assumed) and that it is appropriate to award the contract on this basis.
- **Stage 7 (Management of the Contract)** – Risk monitoring is considered the last element of effective risk management. Contract management arrangements should be sufficiently flexible to allow for the review of the risk register and revision of the mitigation plans at appropriate intervals, including exercise of appropriate contract remedies.
- **Stage 8 (Review and Consider options for future)** – This stage should always include an assessment of how well risk was managed and comment on the future allocation of risk in any forthcoming contract.

### Element 1.5: The Risk Management Plan – Allocation and Mitigation<sup>8</sup>

Procurement should focus on the balance between the severity of the risk and its mitigation. Mitigation seeks to put measures in place to lessen the severity of an unplanned event should that event occur. Mitigation should flow to those risks that have the potential for the most severe impact and greatest probability.

Identification of risks, consideration of their probability, and impacts should lead to a risk management plan that allocates the identified risks appropriately. This may be done by:

- **Sharing the risk** – appropriate contract provisions can grant entitlement to equitable adjustment in schedule and/or price for identified events, e.g. force majeure clauses, excusable delay for default, suspension of work, differing site conditions in construction, changes, clauses, and terminations for convenience.
- **Monitoring the risk** – reporting/notice and dispute elevation provisions as monitoring methods to forecast events that increase risk may also be considered. In appropriate cases, the contractor may be required to have a quality management system that includes periodic reporting requirements and progress meetings between the contractor and agency.

# Public Procurement Practice

## RISK MANAGEMENT *(cont.)*



PRINCIPLES AND  
PRACTICES OF  
PUBLIC PROCUREMENT

- **Transferring risk** – Risks may be transferred via a number of strategies. These strategies include, but are not limited to:
  - **Insurance** – care must be taken to ensure that all types of applicable insurance to be provided by the supplier are identified (comprehensive, general liability, automobile liability, error and omission, and travel-per-occasion) for the term or post contract.
  - **Bid Deposit, Bond, and Security** – should be requested in high risk, high value, and highly sensitive requisitions. The amount of Bid Deposits should be reasonable and based on the risk and nature of the acquisition in terms of its technical aspects or sensitivity. A Bid Bond (surety bond, irrevocable letter of credit, a bank note or draft, a certified or cashier's check, money order, bearer bond, or an insurance certificate from a registered bonding company) acts as surety and when submitted should be retained by the public entity until the evaluation process has been completed and contact award has been determined.
  - **Performance and Payment Bond** – the performance bond should indemnify or protect the public entity for a certain percentage of the value of a contract in the event of default on the part of the supplier, or the supplier in performance of the work covered under the contract; the payment bond should serve as a guarantee that all suppliers and sub-suppliers are paid for labour and materials furnished to the prime supplier for use on the project and work described in the solicitation document, and agreement. Clear and concise explanation of the bond should be included in the Special Conditions section of the contract.

### Background

In any procurement there are a variety of risk factors that arise from external and internal sources that must be assessed. A precondition to overall risk management is the risk assessment. Risk assessment involves analyzing the probability, the impact, and the effect of every known risk on the achievement of established objectives, as well as the corrective action to take should that risk occur. The risk assessment is therefore a prerequisite for determining how the risks should be managed and mitigated. Mitigation seeks to put measures<sup>9</sup> in place to lessen the severity of a risk event, should that event occur.<sup>10</sup>

The formality of the overall risk management plan is a continuum based on the size or nature of the procurement. Planning can extend from simple consideration or incorporation of risk registers as a part of the procurement planning agenda, to inclusion of risks in more formal acquisition plans, to comprehensive risk management plans on enterprise-wide projects where their complexity and scope warrants it.

To realize the maximum benefit of risk management, the management and communication of risks needs to be an integral part of existing procurement and organizational functions.

1 Adapted from Carmarthenshire County Council. (n.d.). Carmarthenshire county council Wales: Discussion paper on procurement risk and the integration of procurement risk into the procurement cycle. Retrieved from [www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc](http://www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc)

2 Ibid.

3 Squire, B. & Chu, Y. Supply Chains at Risk. EPSRC 2010

4 On critical or complex procurements the purchasing entity may need to do a complete risk analysis at the supplier level and provide an initial level of support or education

5 A Procurement Risk Register, in its most basic form, is a list of the risks associated with a specific procurement and a response to those risks. Responsibility for acting on the risk is assigned to a specific person to manage. The "list" is applicable only to the particular procurement and the principle is to identify risk and allocate this to the party best suited to manage, mitigate or eliminate it. The Register is a live document throughout the project and should be seen as fluid, responding to developing circumstances as appropriate." Carmarthenshire County Council. (n.d.). Carmarthenshire county council Wales: Discussion paper on procurement risk and the integration of procurement risk into the procurement cycle. Retrieved from [www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc](http://www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc)

6 Ensuring that key suppliers have Business Continuity Plans, and that they are regularly reviewed can be used as a tool to mitigate risk.

7 Op. cit.

8 Pettijohn, C. and Babich, K.. (2008). Sourcing in the public sector. Herndon, VA: NIGP.

9 Projects and procurements should be continuously monitored in order to assess the effectiveness of mitigation measures and whether they need to be adjusted.

10 Carmarthenshire County Council. (n.d.). Carmarthenshire county council Wales: Discussion paper on procurement risk and the integration of procurement risk into the procurement cycle. Retrieved from [www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc](http://www.tenderwise.com/docs/MitigatingProcurementRisk091205.doc)