

**LIABILITY RISK MANAGEMENT  
PROCESS**

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## LIABILITY RISK MANAGEMENT PROCESS

### 1. INTRODUCTION

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- 1.1.1. The purpose of this paper is to set out a process for use by Defence and industry when conducting that part of the Risk assessment for Defence procurement that is used in determining the allocation of Liability between contractual parties. The allocation of Liability between the parties must be considered and a Risk assessment undertaken for these purposes at various stages of the Defence procurement process as set out in section 3 of this paper, in particular:
- a. prior to procurement;
  - b. where a tender process is necessary for a procurement, as part of the evaluation of a tenderer's proposal;
  - c. during negotiation of the contract; and
  - d. at the time of any contract change proposal.
- 1.1.2. For definitions of the capitalised terms used throughout this paper please refer to the Glossary contained in Schedule 6.
- 1.1.3. The development of the DMO Acquisition and Sustainment Risk Guide is noted. A liability risk assessment in accordance with this methodology is part of the broader Project risk assessment process outlined in that Guide.

### 2. STEPS IN THE RISK MANAGEMENT PROCESS

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- 2.1.1. In undertaking a Risk assessment in the context of allocating Liability the steps of the Risk-management process that is generally employed within Defence, which has been adapted from AS/NZS 4360:2004, should be followed. These steps are detailed in the below diagram:

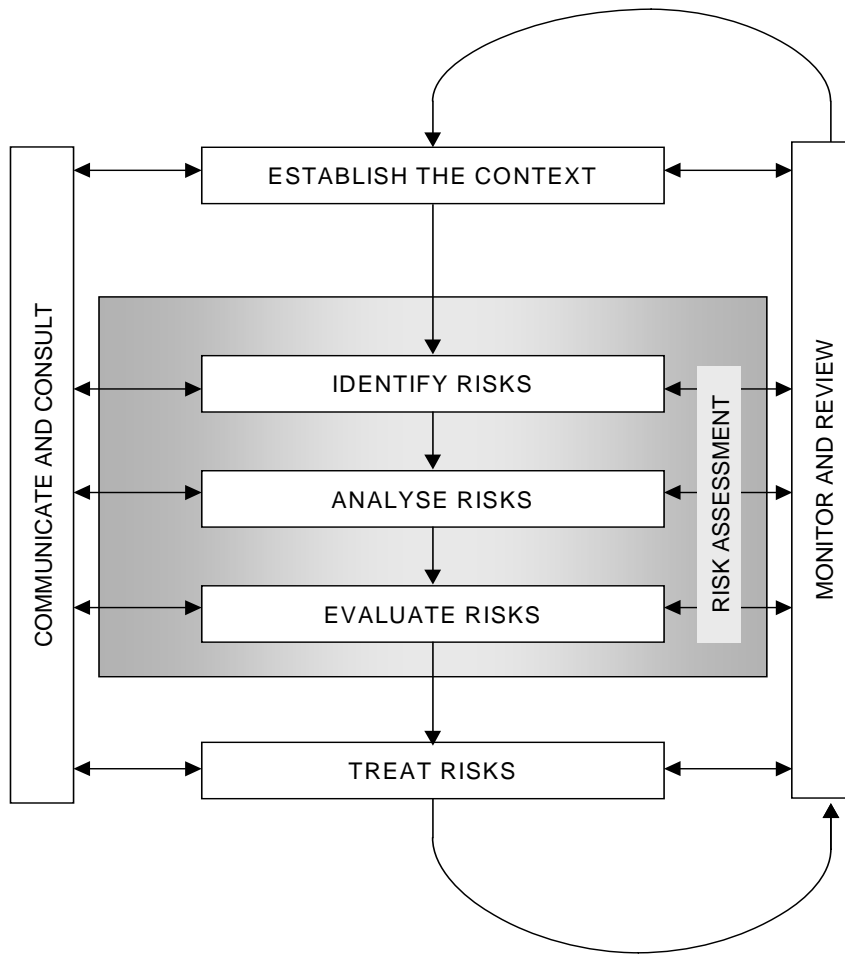


Figure 2.1 RISK MANAGEMENT PROCESS - OVERVIEW FROM AS/NZS 4360:2004

2.1.2. For the purposes of demonstrating the application of the process set out in this paper an example scenario is set out below. This example scenario is used throughout this paper to provide practical guidance as to how the process set out in this paper should be used.

**Example Scenario:**

Defence is under an imperative to replace or modify its current weapons systems to be more environmentally friendly. The flagship project for this initiative is the Engine Replacement Project (ERP). The aim of the project is to source an engine suite suitable for use in existing Defence trucks, aircraft and ships and to develop a new eco-friendly tank.

The Defence project team undertakes the Risk assessment process prior to undertaking the procurement in accordance with this paper.

## **2.2. Communicate and consult**

- 2.2.1. Effective internal and external communication with stakeholders is important to ensure that those responsible for implementing Risk management, and the stakeholders, understand the basis on which decisions are made and why particular actions are required. In terms of a Risk assessment in the context of allocating Liability in relation to a Defence procurement possible stakeholders include:
- a. potential and actual tenderers;
  - b. contractor entities, including subcontractors;
  - c. the Department of Finance and Deregulation (in the context of Commonwealth policy and legislative considerations such as under the *Financial Management and Accountability Act 1997*); and
  - d. internal branches and individuals (including those in the direct chain of command) of Defence.
- 2.2.2. The stakeholders for a Risk assessment should be documented in the Liability Risk Assessment Document (refer to Schedule 4). The Liability Risk Assessment document has also been extrapolated from Schedule 4 and established as a standalone template for use by stakeholders.
- 2.2.3. Communication and consultation in relation to allocating Liability is important in terms of assessing tenders, negotiating the final terms of a contract, determining the allocation of Risk between the parties and ensuring that allocated Risks are appropriately treated.

## **2.3. Establish context**

- 2.3.1. Establishing the context involves the identification of the external, internal and Risk management context for a Defence procurement.
- 2.3.2. Establishing the context for a procurement involves the following four steps:
- a. set/review procurement objectives;
  - b. scan and analyse the procurement environment;
  - c. develop Risk analysis criteria for the procurement; and
  - d. develop Risk evaluation criteria for the procurement.
- 2.3.3. The context established in accordance with this section 2.3 should be documented in the Liability Risk Assessment Document.

**Step 1 – Set/review procurement objectives**

- 2.3.4. This step involves an assessment of the internal context of the procurement such as the goals and objectives of the procurement. This may be able to be drawn from the acquisition strategy for the project.

**Example Scenario:**

In the example scenario set out in paragraph 2.1.2 the goals and objective of the procurement is:

- a. to source an engine suite suitable for use in existing Defence trucks, aircraft and ships; and
- b. the development of a new eco-friendly tank.

It is determined that in order to achieve these goals and objectives suppliers must meet the following parameters:

*Engines*

- a. particular size and weight constraints for replacement engines dictated by existing engine bays in existing trucks, aircraft and ships;
- b. particular design constraints to ensure that OH&S requirements can be met for maintenance personnel;
- c. carbon emission constraints;
- d. fuel/energy source to be renewable;
- e. performance parameters such as speed, noise levels, life cycle costs, meant time between failures etc;

*Supplier*

- f. must be capable of being licensed to use relevant intellectual property or have appropriate subcontracting strategies regarding intellectual property in existing trucks, aircraft and ships needed for engine modification;
- g. must be the prime contractor for the development of the eco-friendly tank;
- h. must be willing to license intellectual property in engines and disclose relevant technical data to relevant manufacturers for existing trucks aircraft and ships to allow ongoing maintenance and other development/modifications;
- i. must have proven design with existing supply chain;
- j. schedule must be able to fit in with the existing refurbishment

schedule for ships and existing engine overhaul schedule for trucks. For aircraft and development of the eco-friendly tank, the supplier can specify the schedule; and

- k. all work in fitting engines to existing assets must be performed on Defence premises with skills transfer to Defence personnel.

The fuel source for the engine is not specified.

**Step 2 – Scan and analyse the procurement environment**

- 2.3.5. Defining the procurement environment will assist in identifying elements that are Sources of Risk, or even Risks themselves. This involves an assessment of the external environment for the procurement and defines the relationship between the procurement and the external environment.
- 2.3.6. An environmental scan of the relevant industry sector capability to which the procurement relates should be undertaken.
- 2.3.7. Where it is determined that a tender process for a procurement is necessary considerations that should be undertaken as part of the environmental scan for that procurement include:
  - a. the number of likely tenderers;
  - b. the capacity and size of tenderers and whether there are any SMEs;
  - c. the identification of potential issues and Risks, including:
    - i. track record of potential tenderers; and
    - ii. nature of the procurement; and
  - d. any obstacles to participation, such as:
    - i. availability of insurance; and
    - ii. difficulty in managing/accepting Risk allocation
- 2.3.8. As part of completing an environmental scan Risk Sources for the procurement should be identified. Risk Sources are those areas or things from which a Risk could arise. Some Risk Sources will be under the control of Defence and others will be outside of Defence's control. Both types need to be considered when identifying Risks.

**Example Scenario:**

A tender process is necessary for the procurement set out in the example scenario in paragraph 2.1.2.

The Defence project team has done some market research based on the goals

and objectives of the procurement and has determined that there are only two companies world wide who are likely to be able to take on the project. The estimated cost of the procurement is \$100m.

Risk Sources include:

- a. the financial viability of the companies;
- b. the lack of technical expertise in the companies in performing the work, leading to defects in supplies;
- c. the solution for the project being unproven;
- d. the capacity of the companies to do the project, given competing projects, lack of engineering staff, poor management skills;
- e. unsafe work practices;
- f. failure to secure intellectual property rights in supplies;
- g. failure to secure confidential information; and
- h. failure to check GFM before supply by Defence.

**Step 3 – Develop Risk analysis criteria for the procurement**

2.3.9. Analysis criteria provide the basis against which Risk is to be evaluated. They provide the basis for determining the Likelihood and Consequences of identified Risks and then to combine these measures to gain an overall Risk Level for each Risk.

2.3.10. It can be helpful for Risk analysis to Categorise Risks. This helps to group related Risks, which is advantageous when determining Risk treatments. The Categories that are likely to be common for most contracts are set out in the table below:

<b>Table 1 - Categories of Risk</b>	
<b>Category</b>	<b>Description</b>
<b>Safety</b>	The Risk could cause injury or death to persons.
<b>Performance</b>	The Risk could effect the performance of the supplies to which the procurement relates.
<b>Supportability</b>	The Risk could effect whether the supplies are supportable.
<b>Schedule</b>	The Risk could cause a delay the in schedule for delivery

	of the supplies to which the procurement relates.
<b>Cost</b>	The Risk could cause the total actual contract costs, taking into account liabilities incurred by the Commonwealth, to exceed currently approved cost.

2.3.11. There may be some variation to these Categories for specific procurements. In addition, it is possible that a Risk may relate to one or more Categories.

2.3.12. The Standard Defence Risk Management Matrix provides for qualitative analysis in the form of a five-by-five matrix. This gives five measures of Likelihood, ranging from rare to almost certain; and five measures of Consequence from insignificant to severe. This results in four Risk Levels of Low, Medium, High and Extreme. The following paragraphs describe the measures of likelihood and consequence that are needed to use the Standard Defence Risk Management Matrix.

2.3.13. The table below provides the standard Defence definitions for assigning Likelihood Ratings. This table is to be used for qualitative analysis of the Likelihood of Risk for all procurements.

<b>Table 2 - Likelihood Ratings</b>	
<b>Rating</b>	<b>Description</b>
<b><i>Almost certain</i></b>	Expected to occur in most circumstances.
<b><i>Likely</i></b>	Will probably occur in most circumstances.
<b><i>Possible</i></b>	Could occur at some time.
<b><i>Unlikely</i></b>	Not expected to occur.
<b><i>Rare</i></b>	Will probably occur in exceptional circumstances only.

2.3.14. The qualitative descriptions in Table 2 may also be supplemented by semi-quantitative descriptions appropriate to specific types of Risks. However, these semi-quantitative descriptions must be appended or mapped to the descriptions in Table 2.

2.3.15. Defence holds certain quantitative Likelihood-related information that may assist in assessing the Likelihood of Risks. For example such information includes information on:

- a. system and sub-system failure rates and mean time between failures;
- b. frequency and severity of accidents and incidents;
- c. duration of systems down time;
- d. equipment obsolescence rates; and
- e. system technology refresh cycles.

2.3.16. This kind of information can be introduced and adapted to the standard qualitative Likelihood Ratings. This semi-quantitative approach to assessment of Likelihood adds objectivity to the qualitative process. Where the information exists, semi-quantitative scales of Likelihood can be used to assist in Risk assessment. An example of three semi-quantitative scales of Likelihood is provided in the below table:

<b>Table 3 - Examples of Three Semi-Quantitative Likelihood Scales</b>			
<b>Rating</b>	<b>General Scale of Probability</b>	<b>System Failure Rate Scale</b>	<b>Accident/Incident Scale</b>
<b><i>Almost certain</i></b>	> 80 % probability	System fails once every hour.	Accident expected to occur frequently in life of the system.
<b><i>Likely</i></b>	40 - 80 % probability	System fails once every 10 hours.	Accident may occur frequently in life of the system.
<b><i>Possible</i></b>	20 - 40 % probability	System fails once every 100 hours.	Accident may occur once a year in life of the system.
<b><i>Unlikely</i></b>	10 - 20 % probability	System fails once every 1 000 hours.	Accident may occur once in life of the system.
<b><i>Rare</i></b>	< 10 % probability	System fails once every 10 000 hours.	Accident not expected in life of the system.

2.3.17. The table below provides Defence with definitions for assigning qualitative Consequence Ratings in relation to Risk assessments when allocating Liability.

<b>Table 4 - Consequence Ratings for Risks when allocating Liability</b>	
<b>Rating</b>	<b>Description</b>
<b>Severe</b>	Would have a huge effect in relation to the Category of Risk to which the Risk relates, huge financial loss.
<b>Major</b>	Would have a major effect in relation to the Category of Risk to which the Risk relates, major financial loss.
<b>Moderate</b>	Would have a moderate effect in relation to the Category of Risk to which the Risk relates, high financial loss.
<b>Minor</b>	Would have a minor effect in relation to the Category of Risk to which the Risk relates, medium financial loss.
<b>Insignificant</b>	Would have an insignificant or low effect in relation to the Category of Risk to which the Risk relates, low financial loss.

2.3.18. The definitions can be refined according to the Category of Risk as is shown in the example in Table 5 below. Refining the definition of financial loss by reference to actual amounts for the specific Project being assessed will be of most assistance.

<b>Table 5 - Assessment of Consequence Ratings against Categories</b>					
<b>Consequence</b>	<b>Safety</b>	<b>Performance</b>	<b>Supportability</b>	<b>Schedule</b>	<b>Cost</b>
<b>Severe</b>	Would cause loss of life.	Would cause the supplies to be functionally unfit for their intended purpose (i.e. unable to perform core missions or essential tasks).	Would cause the supplies to be unsupported under normal peacetime operations due to deficiencies in one or more fundamental inputs to capability. There are no known	Would cause the specified in-service date to be missed by more than 12 months. Would cause the date for full operational capability to be missed by two or more years.	Would cause the total actual contract costs, taking into account liabilities incurred by the Commonwealth, to exceed currently approved cost provisions by > 10%.



<b>Table 5 - Assessment of Consequence Ratings against Categories</b>					
<b>Consequence</b>	<b>Safety</b>	<b>Performance</b>	<b>Supportability</b>	<b>Schedule</b>	<b>Cost</b>
<b><i>Insignificant</i></b>	Would cause minor injuries that are able to be treated at the site with no long-term effects.	Would cause the supplies to be functionally fit for all desired missions or tasks, but there may be some qualification to the level to which it would perform non-critical elements of the mission or task. Few such qualifications would exist.	Would cause the supplies to be supportable in medium or high-tempo operations or for extended periods of time; however, there would be a few qualifications on the level of performance although the qualifications would not be significant.	Would cause some non-critical elements of the contract to not achieve full operational capability within a reasonable period following the specified in service date. Would cause the date for full operational capability to be missed by up to three months.	Would cause contract contingency funds to be used but total actual contract costs would not exceed currently programmed or approved cost provisions.

2.3.19. There may be more than one Category to which a Risk relates, in which case there may be more than one Consequence Rating for each Risk, based on an assessment of Consequence in relation to each Category, as noted in paragraph 2.3.11. The different Consequence Ratings against the Category or Categories to which the Risk relates should be separately described in the Risk assessment in the Procurement Risk Log discussed in section 2.9.

2.3.20. Consequence and Likelihood may be estimated using statistical analysis and calculations. Where no reliable or relevant past data is available, subjective estimates may be made which reflect an individual's or group's degree of belief that a particular event or outcome will occur. Sources of information that may be used when analysing Consequences and Likelihood may include:

- a. past records;
- b. practice and relevant experience;
- c. relevant published literature;
- d. market research;
- e. the results of public consultation;
- f. experiments and prototypes;
- g. economic, engineering or other models; and
- h. specialist and expert judgements.

2.3.21. Techniques for analysing Consequences and Likelihood include:

- a. structured interviews with experts in the area of interest;

- b. use of multi-disciplinary groups of experts;
- c. individual evaluations using questionnaires; and
- d. use of models and simulations.

2.3.22. The table below provides the Standard Defence Risk Management Matrix, which is the mechanism for combining the Likelihood Rating and Consequence Ratings to determine the Risk Level for each Risk. Where there are different Consequence Ratings, in terms of the Category or Categories to which the Risk relates, for the purposes of determining the Risk Level for a Risk the highest level of Consequence in terms of the Category or Categories to which the Risk relates should be selected.

<b>Table 6 - Standard Defence Risk Management Matrix</b>					
<b>Likelihood</b>	<b>Consequence</b>				
	<b>Insignificant</b>	<b>Minor</b>	<b>Moderate</b>	<b>Major</b>	<b>Severe</b>
<b>Almost Certain</b>	Medium	Medium	High	High	Extreme
<b>Likely</b>	Medium	Medium	Medium	High	Extreme
<b>Possible</b>	Low	Medium	Medium	High	High
<b>Unlikely</b>	Low	Low	Medium	Medium	High
<b>Rare</b>	Low	Low	Low	Medium	Medium

**Step 4 – Develop Risk evaluation criteria for the procurement**

2.3.23. Evaluation criteria provide the basis for determining whether Risks are acceptable or need to be treated. The outcome of the Risk-evaluation process is a prioritised list of Risks that require treatment. The evaluation criteria are to incorporate relevant legislative, statutory and policy requirements (e.g. OH&S legislation).

2.3.24. Some examples of evaluation criteria that dictate treatment include:

- a. serious injury (or greater) to personnel could occur;
- b. a breach of government legislation (e.g. environmental) could occur;
- c. the date the system is required to be in-service may not be achieved within tolerances;
- d. some qualification to the performance of the equipment could occur;

- e. the reputation of Defence could be affected; or
- f. the funding approved for the procurement could be exceeded.

2.3.25. Consideration may be given to accepting Risks where:

- a. no treatment strategies are available;
- b. the cost of treatment makes it unattractive to treat the Risk; or
- c. the expected effect can be tolerated.

However, if Risk cannot be accepted in these circumstances, consideration may need to be given to whether the procurement should proceed in its current guise or whether the Risk in question should be avoided by not undertaking the procurement.

**2.4. Identify Risks**

2.4.1. Risk identification seeks to identify the Risks to be managed.

2.4.2. Risk identification essentially answers the following two questions:

- a. What can happen?
- b. How can it happen?

2.4.3. Risks that may be relevant in the context of allocating Liability, depending on the circumstances of the procurement, are set out below. These are descriptions of events that could occur during performance of the contract for the procurement and for which Liability should be allocated to one of the parties or shared between the parties. By understanding the proposed allocation of Liability for these events under competing proposals, the relative value for money being offered in respect of each proposed Risk regime put forward by tenderers will be able to be assessed. Some Risks listed below will probably apply to most contracts, although consideration should be given as to whether there are any special circumstances that may arise under the particular contract:

<b>Risks</b>
The contractor fails to complete the contract, i.e. the contractor goes into liquidation.
The contractor completes but the supplies provided under the contract do not work or do not provide the capability contracted for.
The contractor completes but not on time.
The contractor injures or kills people in the course of performing the contract.
The contractor damages Commonwealth or third party property (tangible or intangible).
The contractor causes a third party to suffer economic loss in the course of performing the contract.

Defects in supplies (after acceptance) result in people being injured or killed or damage to property.
Defects in supplies cause the Commonwealth extra expense or loss of productivity.
A third party claims against the Commonwealth for infringement of intellectual property rights as a result of the Commonwealth's use of the supplies.
A third party claims against the Commonwealth for breach of confidentiality arising out of the Commonwealth's use of information supplied under the contract.
The contractor claims against the Commonwealth for breach of warranty in relation to mandated GFM.

- 2.4.4. There are many methods available to assist with Risk identification, which may be conducted either singly or in combination, including:
- a. using focussing tools, such as the generic Risk Sources listed in paragraph 2.4.3;
  - b. brainstorming, which should include key stakeholders and technical specialists;
  - c. evaluating other procurements, particularly related or similar procurements;
  - d. consulting with specialists (e.g. for safety, security and environmental Risks);
  - e. use of specific Risk-analysis and related techniques, such as LCC analysis, fault tree analysis, Failure Mode Effects and Criticality Analysis (FMECA), and the Monte Carlo approach defined under the Improved Project Scheduling and Status Reporting (IPSSR) initiative;
  - f. scenario planning; and
  - g. benchmarking.
- 2.4.5. The approach used will depend on the nature of the procurement. A Risk identification worksheet which may be used in the identification of Risks is contained at Schedule 1.
- 2.4.6. Having identified the Risks, it is necessary to consider the Source of each Risk (if not self-evident from the statement of the Risk), and the Impact of the Risk, to ensure that the full scope of the event is understood and that the Risks can be analysed effectively in the subsequent steps of the Risk-management process. In assessing the Impact of the Risk the potential exposure to the Commonwealth in terms of cost should be estimated, and if possible a potential dollar amount should be determined. Analysing the Source of each Risk is also important on the basis that several Sources can give rise to the same Risk. Making an assessment of this assists in ensuring that Risks are not double-counted.

**Example Scenario:**

A Risk identification worksheet is completed in relation to the example scenario as follows:

REF e.g. 1	Risk (What?)	Sources (How?)	Impacts (Why a Risk)
1	The contractor fails to complete the contract, e.g. the contractor goes into liquidation.	Financial viability of the company.	Completion of the contract. Cost impact of finding alternative supplier to complete and keeping existing equipment operating for longer. This cost is estimated to be \$50m including re-tendering costs, project office costs and costs of maintaining existing equipment.
2	The contractor completes but the supplies provided under the contract do not work or do not provide the capability contracted for.	Lack of expertise in the company. Unproven solution.	Performance of the supplies. Schedule might be affected if issues impact acceptance (see liquidated damages).
3	The contractor completes but not on time.	Capacity issues given competing projects, lack of engineering staff, poor management skills.	Fitting in with schedule for ship refurbishment and truck engine overhaul. Cost impact of having to fit engines outside existing refurbishment/overhaul schedule is \$20m. Cost of keeping existing equipment operating for longer. Estimated at \$45m.
4	The contractor injures or kills people in the course of performing the contract.	Unsafe work practices. Lack of technical expertise in performing the work, leading to defects in supplies.	Potential claims against the Commonwealth by third parties.
5	The contractor damages Commonwealth or third party property (tangible or intangible).	Unsafe work practices. Lack of technical expertise in performing the work, leading to defects in supplies.	Potential claims against the Commonwealth by third parties. Commonwealth expense to replace damaged Commonwealth property. In some circumstances proportionate liability regime will protect Commonwealth from loss from third party claims.
6	The contractor causes a third party to suffer economic loss in the course of performing the	Unsafe work practices. Lack of technical expertise in performing the	Potential claims against the Commonwealth by third parties. In some circumstances

		contract.	work, leading to defects in supplies.	proportionate liability regime will protect Commonwealth from loss from third party claims.
7		Defects in supplies cause the Commonwealth extra expense or loss of productivity.	Lack of technical expertise in performing the work, leading to defects in supplies.	Expense to the Commonwealth. Performance of supplies. Given the nature of the assets being fitted with engines, loss could be \$10m for loss of ship, \$30,000 for loss of truck, \$100,000 for loss of tank. Doubtful that loss would affect operations so negligible productivity loss.
8		A third party claims against the Commonwealth for infringement of intellectual property rights as a result of the Commonwealth's use of the supplies.	Failure to secure IP rights.	Commonwealth loss as a result of a third party claim. Most likely loss would be to maintenance schedule and future upgrades. Estimated loss \$10m including damages, cost of defending claim, securing alternate rights.
9		A third party claims against the Commonwealth for breach of confidentiality arising out of the Commonwealth's use of information supplied under the contract.	Failure to secure confidential information.	Commonwealth loss as a result of a third party claim. Given nature of likely information estimated loss \$10m.
10		The contractor claims against the Commonwealth for breach of warranty in relation to mandated government furnished material.	Failure to adequately check GFM before supply.	Commonwealth liability to contractor for GFM. Schedule impact because potential excusable delay claim.

2.4.7. An assessment should also be made of the Categories to which the identified Risks relate as discussed in paragraphs 2.3.10 and 2.3.11.

<b>Example Scenario:</b>	
An assessment is made that the Risks identified relate to the following Categories:	
<b>Risk</b>	<b>Category</b>
The contractor fails to complete the contract e.g. the contractor goes into liquidation.	Schedule
The contractor completes but the supplies provided	Performance

	under the contract do not work or do not provide the capability contracted for.	
	The contractor completes but not on time.	Schedule
	The contractor injures or kills people in the course of performing the contract.	Cost/Safety
	The contractor damages Commonwealth or third party property (tangible or intangible).	Cost
	The contractor causes a third party to suffer economic loss in the course of performing the contract.	Cost
	Defects in supplies cause the Commonwealth extra expense or loss of productivity.	Cost
	A third party claims against the Commonwealth for infringement of intellectual property rights as a result of the Commonwealth's use of the supplies.	Cost
	A third party claims against the Commonwealth for breach of confidentiality arising out of the Commonwealth's use of information supplied under the contract.	Cost
	The contractor claims against the Commonwealth for breach of warranty in relation to mandated government furnished material.	Cost

2.4.8. All identified Risks, their Source, their Impact and Category or Categories should be documented in the Procurement Risk Log discussed in section 2.9. Sufficient information must be captured to enable these Risks to be appropriately analysed, treated, communicated and monitored.

2.4.9. In addition the process, procedures and tools used to identify Risks, all identified Risks, their Source, their Impact and Category or Categories should also be documented in the Liability Risk Assessment Document.

**2.5. Analyse Risks**

2.5.1. Each of the Risks identified needs to be analysed to determine the Likelihood of the Risk occurring and the Consequences should the Risk occur. The Likelihood and Consequences should be assessed in the context of Controls in place in relation to the Risks. The procedures used for analysing Risks and the outcome of the Risk analysis should be documented in the Liability Risk Assessment Document.

2.5.2. Accordingly, Risk analysis involves the following steps:

- a. evaluate Controls;
- b. estimate Likelihood;
- c. estimate Consequences; and

- d. determine Risk Level.

**Step 1 – Evaluate Controls**

2.5.3. An assessment of the Controls that are in place for each Risk identified should be made. In particular the following question should be assessed in relation to each Risk - If the Risk occurs, what can or should the Commonwealth do about it (under the contract or at common law etc)? The assessment of this question should refer to any remedies the Commonwealth has available/or should have available to it if the Risk crystallises, either under the contract or at common law etc. Reference should also be made to any of the specific clauses of the contract that relate to the Risk, for example:

- a. is there a right for the Commonwealth to terminate if a particular Risk occurs?;
- b. is there any grace period before the Commonwealth may claim damages if the Risk occurs?;
- c. how does the contracted payment regime affect the likely loss suffered by the Commonwealth at the time the Risk is likely to occur?;
- d. what is the effect of any acceptance testing provisions on the Risk?;
- e. what insurances are required to be in place under the contract and will the Commonwealth have access to the full extent of that insurance?; and
- f. is the contractor required to have any financial undertakings or guarantees under the contract?

2.5.4. It should also be considered:

- i. if the Risk is not dealt with in the contract, how the Commonwealth envisages that the Liability for the Risk will be allocated, i.e. according to the common law?
- ii. is the contractor required to have insurance in respect of the Risk?

2.5.5. All identified Controls should be documented in the Procurement Risk Log discussed in section 2.9.

**Step 2 – Estimate Likelihood**

2.5.6. Using the Likelihood Ratings, an estimate of the Likelihood of each Risk occurring should be undertaken and documented in the Procurement Risk Log discussed in section 2.9.

2.5.7. Information to support this estimation will, in the main, come from the details of the Sources of the Risk documented during the Risk-identification stage. For more detailed analysis, historical data (if available) can be used to estimate the probability of the Risk occurring, although care should be taken to ensure that

the historical data is valid in relation to the particular procurement. Other information sources and techniques for analysing Likelihood are described in paragraphs 2.3.20 and 2.3.21. The Controls assessed in relation to Risk may also effect the Likelihood of each Risk occurring.

2.5.8. In the context a Risk assessment undertaken to allocate Liability consideration as to the Likelihood of a Risk occurring should be determined according to the nature of the supplies and services, the payment regime, the acceptance procedures, how closely the performance of the services is managed, and how specialised or difficult the services being provided are.

2.5.9. By way of example, some of the considerations that could be taken into account in the context of some of the more common Risks for the purposes of assessing Likelihood are:

<b>Risks</b>	<b>Source of Controls</b>
The contractor fails to complete the contract, i.e. the contractor goes into liquidation.	The financial viability of the contractor and its subcontractors.
The contractor completes but the supplies provided under the contract do not work or do not provide the capability contracted for.	Whether the supplies being delivered are proven products. The degree of difficulty in providing the supplies.
The contractor completes but not on time.	How far advanced plans for the supplies are? How much development work, if any, has to be done before supplies can be provided? Is the proposed schedule realistic when objectively assessed?
The contractor injures or kills people in the course of performing the contract.	Will the contractor be on Commonwealth premises such that the Commonwealth may be sued for their actions?
The contractor damages Commonwealth or third party property (tangible or intangible).	Will the contractor be in a position to harm property belonging to the Commonwealth or third parties?
The contractor causes a third party to suffer economic loss in the course of performing the contract.	Will the contractor be in a position to harm the business interests of third parties, and if so are they likely to be able to sue the Commonwealth?
Defects in supplies (after acceptance) result in people being injured or killed or damage to property.	Whether the supplies being provided are of a type or nature that a defect may cause such results? Whether any testing mechanisms required by the contract would reduce the probability of defects escaping detection

	prior to acceptance?
Defects in supplies cause the Commonwealth extra expense or loss of productivity.	Whether the supplies being provided are of the type or nature that a defect may cause such results and if so, the extent the defects may affect the Commonwealth?  Whether any testing mechanisms required by the contract would reduce the probability of defects escaping detection prior to acceptance?
A third party claims against the Commonwealth for infringement of intellectual property rights as a result of the Commonwealth's use of the supplies.	Whether the supplies are a proven product?  Who any third party would be and any existing arrangements between the third party and the Commonwealth or the contractor with regard to intellectual property rights
A third party claims against the Commonwealth for breach of confidentiality arising out of the Commonwealth's use of information supplied under the contract.	The nature and likely source of information (whether or not identified as confidential) provided to the Commonwealth under the contract.  The identity of any third party that may have an interest in such information and the existence of arrangements between the Commonwealth and that third party.
The contractor claims against the Commonwealth for breach of warranty in relation to mandated GFM.	The source of the GFM and the arrangements governing the original supply of the GFM to the Commonwealth.

**Step 3 – Estimate Consequences**

- 2.5.10. Using the Consequence Ratings, the level of potential Consequence for each Risk against the Category or Categories to which the Risk relates and in relation to cost should be assessed and documented in the Procurement Risk Log discussed in section 2.9. There may be a different Consequence Rating for a Risk in terms of its assessment against the Category or Categories to which the Risk relates and in relation to cost. Where this is the case several different Consequence Ratings should be detailed in the Procurement Risk Log.
- 2.5.11. In the context of a proposed limitation of Liability the following question should be asked in terms of Consequence - how would the limitation of Liability affect what the Commonwealth can do if the Risk occurs? Consideration should be given to issues such as:
- a. if the contract does not deal with the Risk explicitly and it is intended that common law principles are to apply instead, whether that position would be affected by the proposed limitation of Liability?; and

- b. if the contractor is required to have insurance, does the Commonwealth have access to the full extent of that insurance, or does the limitation of Liability affect it? (That is, the Commonwealth may only recover under the contractor's insurance to the extent that the contractor is liable.) For example, if the same limitations apply that are listed above, a contractor may be required to have a public liability insurance policy of \$10 million, but the Commonwealth's ability to recover would be limited to the contract price and the Commonwealth may not be able to recover for consequential or incidental losses.

2.5.12. Implications should be considered in the context of the Controls having been applied rather than on a worst case basis.

***Step 4 – Determine Risk Level***

2.5.13. Using the Standard Defence Risk Management Matrix (refer to Table 6 at paragraph 2.3.22), the Likelihood and Consequence estimates should be plotted for each Risk to determine the overall Risk Level for each Risk. The assessed Risk Level for each Risk should be documented in the Procurement Risk Log discussed in section 2.9.

2.5.14. In situations where there are several Consequence estimates for a Risk for the purposes of determining the overall Risk Level for that Risk the highest level of Consequence across the different estimates should be selected as discussed in paragraph 2.3.22.

2.5.15. Risk Levels are used to gain an indication of the importance of each Risk relative to the other Risks, which provides one of the inputs to the next step in the Risk-assessment process (i.e. Risk evaluation).

**Example Scenario:**

A Project Risk Log has been completed in relation to the example scenario in paragraph 2.1.2 and is set out in Schedule 3.

**2.6. Evaluate Risks**

2.6.1. The purpose of the evaluation of Risks is to make decisions, based on the outcomes of Risk analysis, about which Risks need treatment and treatment priorities and how Risks should be allocated.

2.6.2. Each identified Risk needs to be evaluated to determine which Risks are unacceptable. The previously-developed evaluation criteria (as discussed in paragraphs 2.3.23 to 2.3.25) should be used to assist in determining the acceptability of a Risk. Those Risks that are not acceptable are then prioritised to further assist and direct management effort.

- 2.6.3. In general, if a Risk is not going to be treated, it is deemed to be accepted (i.e. resources and effort will not be directed at actively managing the Risk). Some Risks might have to be accepted because no treatment exists or because the treatment is not cost- or time-effective. Risks that are evaluated as acceptable are still important and must be retained in the Procurement Risk Log. Ongoing monitoring and review of these Risks must be conducted to detect any change in their status.
- 2.6.4. Prioritising Risks will assist to plan what Risks will be treated first. In the simplest cases, this can be achieved by listing the Risks in order of Risk Level from Extreme through to Low, with multiple Risks at one level being considered as equal. If further prioritisation is required, the Likelihood and Consequences of each Risk can be reviewed, with the most likely Risks with the largest effects being considered for treatment first. Of note, the relative priorities between the Categories of Risk can assist with prioritising the Risks.
- 2.6.5. Another alternative is the application of a method called Borda voting. This approach can be applied to a complex array of Risks where priorities are not obvious. The Borda method ranks Risks from most-to-least critical on the basis of the Consequence Ratings and Likelihood Ratings. The Risks are then ordered (ranked) according to these counts.
- 2.6.6. Risks should also be considered cumulatively. Special care should be given to compound Risks or the presence of multiple Risks that are closely coupled. Having said that, care should also be taken not to double count Risks where there are a number of Consequences with the same Source.
- 2.6.7. The reasons for deciding to treat or not to treat a Risk are to be documented to provide evidence that a logical process was followed should the decision need to be justified at some time in the future. Details of evaluations should be documented in the Liability Risk Assessment Document.

## **2.7. Treat Risks**

- 2.7.1. The outcome of the Risk-evaluation step in any Risk assessment will be a prioritised list of Risks that require treatment.
- 2.7.2. Risk treatment involves identifying the range of options for treating Risks, assessing those options and the preparation and implementation of treatment plans.
- 2.7.3. Selecting treatments for Risks involves five main steps, as follows:
- a. identify the Risk treatment options;
  - b. estimate treatment effect on Likelihood and Consequences;
  - c. estimate the residual Risk exposure;

- d. appraise cost-effectiveness; and
- e. select preferred Risk treatment option(s).

2.7.4. Details of Risk treatment should be documented in the Liability Risk Assessment Document.

***Step 1a – Identify Risk Treatment Options***

2.7.5. Risk-treatment options fall into the following groups:

- a. Avoid the Risk. This strategy involves either deciding not to proceed with an activity (or the procurement), or choosing an alternative activity with a more acceptable level of Risk.
- b. Change the Likelihood of the Risk. Treatment strategies can be employed to reduce the probability of negative effects.
- c. Change the Consequence of the Risk. Treatment strategies can be employed to reduce the size of losses.
- d. Transfer the Risk. This strategy involves transferring a Risk, in full or in part, to another party. Mechanisms include the use of contracts and insurance. The most common form of Risk transfer is to take out insurance. Generally there is some financial cost or benefit associated with sharing part of the Risk with another entity, such as the premium paid for insurance. Note that when a Risk is transferred, a new Risk is acquired in return – that the entity to which the Risk has been transferred may not manage the Risk effectively.
- e. Retain the Risk. In cases where it is decided not to perform any Risk-treatment activities, the Risk will be retained. Sometimes the cost of treating a Risk may be similar to the cost of the Risk eventuating and, therefore, no treatment action will be taken.

2.7.6. Several treatment options can be, and may need to be, employed to reduce the level of any Risk. Each treatment option should be assessed until either the preferred treatment option or a set of treatment options is identified that reduces the Risk Level to an acceptable level. Furthermore, a Risk treatment may treat more than one Risk.

2.7.7. In identifying Risk-treatment options, the feasibility of the option must be gauged. For example, Risk-treatment options that involve significant increases in staff or changes to a contract that would be unacceptable to the contractor are unlikely to be feasible.

2.7.8. In making a decision as to the Risk treatment options for a procurement the following principles must be applied:

<p><b>Principle 1</b></p>	<p>The allocation of Liability between the parties to a contract must comply with applicable Commonwealth legislation and policy, including without limitation:</p> <ul style="list-style-type: none"> <li>a. section 44 of the <i>Financial Management and Accountability Act 1997</i>;</li> <li>b. regulations 7 to 13 of the <i>Financial Management and Accountability Regulations 1997</i>;</li> <li>c. Financial Management Guidance No. 1, <i>Commonwealth Procurement Guidelines</i>, December 2008;</li> <li>d. Finance Circular No, 2003/02, <i>Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort</i>, September 2003;</li> <li>e. Financial Management Guidance No. 6, <i>Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort</i>, September 2003;</li> <li>f. Finance Circular 2006/03, <i>Limited Liability in Information and Communications and Technology Contracts</i>, August 2006; and</li> <li>g. Finance Circular 2007/10, <i>FMA Regulation 10</i>, June 2007.</li> </ul>
<p><b>Principle 1A</b></p>	<p>It is acknowledged that there are a number of commercial factors to be taken into account by industry when considering the terms on which goods and services will be supplied.</p>
<p><b>Principle 2</b></p>	<p>The allocation of Liability between the parties to a contract must comply with the principle that Risks should be borne by the party best placed to manage them, i.e. prevent or lessen the possibility of the event occurring or mitigate the consequences should it occur.</p>
<p><b>Principle 3</b></p>	<p>The Commonwealth must not consider a proposal from industry to limit Liability without first reviewing a comprehensive Risk assessment undertaken by the contractor in the form set out in this paper.</p>
<p><b>Principle 4</b></p>	<p>Subject to Principle 8, each party must manage the Risk and</p>

	take responsibility for injury to or death of its employees.
<b>Principle 5</b>	The Commonwealth should not agree to a limitation on the contractor's Liability to the Commonwealth for claims by third parties in respect of personal injury and death, that arise as a consequence of an unlawful or negligent act or omission or breach of contract by the contractor, its officers, employees, agents or subcontractors.
<b>Principle 6</b>	The Commonwealth should not agree to a limitation on the contractor's Liability to the Commonwealth for claims by third parties in respect of property damage, that arise as a consequence of an unlawful or negligent act or omission or breach of contract by the contractor, its officers, employees, agents or subcontractors.
<b>Principle 7</b>	The Commonwealth should not agree to a limitation on the contractor's Liability to the Commonwealth for claims by third parties in respect of: <ul style="list-style-type: none"> <li>a. intellectual property infringement, where the intellectual property in question was supplied to the Commonwealth by the contractor and the Commonwealth is not in breach of the conditions of that supply;</li> <li>b. breach of confidentiality, where the claim arises as a result of the contractor's conduct; or</li> <li>c. breach of privacy obligations, where the claim arises as a result of the contractor's conduct.</li> </ul>
<b>Principle 8</b>	Each party must manage the Risk of and take responsibility for its unlawful or negligent acts or omissions and those of its officers, employees, agents or subcontractors.
<b>Principle 9</b>	The contractor should manage the Risk of and take responsibility for loss of, or damage to, supplies at any time that the supplies are in the contractor's care, custody or control except where loss or damage results from the impact of war, terrorism, insurrection, ionising radiation or radioactivity, government confiscation or nationalisation.
<b>Principle 10</b>	Provided the contractor takes appropriate steps to care for, preserve and protect Commonwealth property (excluding supplies provided by the contractor under the contract) in its case, custody or control, the Commonwealth and the

	<p>contractor may agree to limit the contractor's Liability for loss of, or damage to, Commonwealth property (whether or not in the contractor's care, custody or control) on a basis that represents overall value for money to the Commonwealth. Any such agreed limitation may distinguish between Commonwealth property administered within the Defence portfolio and other Commonwealth property where there is a Risk of loss of or damage to other Commonwealth property as a result of contractor activities.</p>
<b>Principle 11</b>	<p>If an exclusion of Liability is included in the contract it must be stated in clear terms and set out specific types of loss or damage to be excluded. Generic descriptions such as "all consequential loss" must not be included. Any agreed exclusion must not limit the contractor's Liability to the Commonwealth in respect of third party claims, including third party claims for pure economic loss.</p>
<b>Principle 11A</b>	<p>The Commonwealth must not agree generic contractual statements that its remedies will be limited to those expressed in the contract. The Commonwealth may agree to limit its remedy for a specific type of loss or damage to a particular contractual remedy where such a limit represents overall value for money to the Commonwealth. For example, if liquidated damages are specified in the contract for a particular period of delay, the Commonwealth generally agrees to the liquidated damages being the sole remedy for the delay.</p>
<b>Principle 12</b>	<p>Provided appropriate warranty and latent defect provisions are in place in the contract to remedy a particular defect in supplies, and provided that the contractor's Liability in respect of third party claims is not affected, the Commonwealth and the contractor may agree a financial cap on the contractor's Liability to the Commonwealth for damage suffered as a consequence of defects in supplies on a basis that represents overall value for money to the Commonwealth.</p>
<b>Principle 13</b>	<p>Where liquidated damages for delay in delivery have been included in the contract, the Commonwealth and the contractor may agree a financial cap on the payment of such liquidated damages provided that:</p> <ol style="list-style-type: none"> <li>a. there is a right for the Commonwealth to terminate the contract for default should the cap be reached; and</li> </ol>

	<p>b. either the cap is sufficient to appropriately compensate the Commonwealth for its loss in the event of termination or there is a right to claim damages at common law on termination.</p>
<b>Principle 14</b>	<p>Consideration of a Liability regime based on the above principles should also take into account the availability of insurance in the industry sector being contracted, recognising that:</p> <p>a. some insurance is not available or relevant to certain industry sectors; and</p> <p>b. some specific insurances should be considered mandatory for contracting in certain industry sectors e.g. hangar-keepers' liability insurance.</p>
<b>Principle 15</b>	<p>The Liability of a contractor must not be limited in respect of the fraud or dishonesty of the contractor, its officers, employees, agents, or subcontractors.</p>
<b>Principle 16</b>	<p>If the Commonwealth is required to provide a warranty or indemnity (for example a warranty in respect of Commonwealth mandated Government Furnished Material) the Commonwealth may seek a financial cap on its contingent Liability under the warranty or indemnity.</p>
<b>Principle 17</b>	<p>The Commonwealth and the contractor may agree to an overarching aggregate financial cap on those areas of the contractor's Liability that have been limited in accordance with these principles, provided that the value of the aggregate financial cap is sufficient, taking into account the effect of the Commonwealth's potential exposure to Liability, in excess of the aggregate cap, on the transaction's overall value for money to the Commonwealth.</p>

**Step 2 – Estimate treatment effect on Likelihood or Consequences**

2.7.9. Treatment options can affect the Likelihood or the Consequences (or both) associated with a Risk, which will have an effect on the Risk Level for the Risk. The effect of each treatment option on the Risk Level must be assessed to determine the likely effect of the option, both positive and negative. The analysis underpinning the estimated effect on the Likelihood and Consequences should be documented in the Liability Risk Assessment Document.

**Step 3 – Estimate residual Risk exposure**

- 2.7.10. Risk treatments rarely eliminate Risks totally, and there is usually some level of residual Risk exposure. This residual exposure also exists for Risks that have been accepted where no treatment is planned.

**Step 4 – Appraise cost-effectiveness**

- 2.7.11. Selecting the most appropriate option(s) involves balancing the costs of implementing each option against the benefits derived from it. Each treatment option must be costed and compared against the Risk exposure. In general the cost of managing Risks should be commensurate with the benefits obtained. A treatment option would not be cost-effective if it were to be more expensive to implement than the cost of the realised Risk if left untreated. If the Consequences of a Risk, however, are judged too significant or onerous to contemplate, then Risk treatments may be required even if treatment cost is high.
- 2.7.12. As for any cost-effectiveness analysis, the 'cost' of a Risk may not be able to be quantified in dollar terms. In these situations, the analysis will necessarily be more subjective. It is important to consider all direct and indirect costs and benefits, whether tangible or intangible, and measured in financial or other terms. All of the factors addressed in the analysis, including any weightings applied to subjective factors, are to be documented in the Liability Risk Assessment Document.
- 2.7.13. The cost-effectiveness analysis must identify any new Risks introduced by the Risk treatment and factor these new Risks into the cost-effectiveness analysis. An assessment of the Likelihood and Consequences of these new Risks must also be made to ensure that the totality of the situation is addressed.
- 2.7.14. The cost-effectiveness analysis must also incorporate any other already-identified Risks that will be affected by the Risk treatment because this can be a factor in determining the preferred Risk-treatment option(s).

**Step 5 – Select preferred Risk treatment option(s)**

- 2.7.15. Based on the assessment of cost-effectiveness the Risk-treatment options should be selected.
- 2.7.16. If it is determined that the procurement is a Complex or Strategic procurement, the following Risk treatments should be determined, on the basis of the Risk assessment for the contract for the procurement:
- a. the wording of the Liability clauses in the contract;
  - b. whether liquidated damages will be sought;
  - c. what the preferred payment structure should be;

- d. whether financial securities should be sought;
- e. what insurance requirements should there be and who should be responsible for obtaining such insurance; and
- f. what warranties should be sought.

**2.8. Monitor and review**

- 2.8.1. Risks and the effectiveness of treatment measures need to be monitored to ensure changing circumstances do not alter priorities. Section 3 sets out various stages for a procurement during which Risk needs to be assessed and reviewed.
- 2.8.2. For each of the stages for a procurement in section 3 the following actions need to be undertaken:
  - a. the Risks identified need to be reviewed to ensure that they are still current;
  - b. to the extent that the Risks identified are still current the assessment of their Likelihood and Consequences must be reviewed to ensure that they are still current;
  - c. to the extent that Risks are no longer applicable they may be retired;
  - d. any new Risks should be identified and evaluated according to the methodology outlined in sections 2.4, 2.5, 2.6 and 2.7; and
  - e. Risk treatments should be evaluated to ensure that they have been implemented and are effective.

**2.9. Document**

- 2.9.1. The Risk management process for Risks should be documented, including assumptions, methods, data sources and results. This enables the basis on which decisions have been made to be understood.
- 2.9.2. There are two key documents that need to be established and maintained to capture a Risk assessment, which are the:
  - a. Procurement Risk Log; and
  - b. Liability Risk Assessment Document.
- 2.9.3. The Procurement Risk Log is intended to set out the identified Risks and the Risk analysis.
- 2.9.4. The Liability Risk Assessment Document is intended to set out the full Risk assessment undertaken, including all procedures used and considerations taken into account in that Risk assessment. The Liability Risk Assessment Document should cross-refer to appropriate supporting documentation, where applicable.

- 2.9.5. In addition to these key documents, records need to be kept of the considerations and decisions relating to the management of Risks.

## **SUMMARY**

In undertaking a Risk assessment in the context of allocating Liability the following process needs to be undertaken:

### **Communicate and consult**

Effective internal and external communication with stakeholders in the procurement should be undertaken to ensure that those responsible for implementing Risk management or are stakeholders in any resultant contract understand the basis on which decisions are made and why particular actions are required.

### **Establish context**

Establishing the context is essential in being able to accurately assess the Risk context in allocating Liability. It involves:

- a. setting/reviewing procurement objectives;
- b. scanning and analysing the procurement environment;
- c. developing Risk analysis criteria for the procurement - certain Risk analysis criteria has been established in this document for use for this purpose, including the Likelihood Ratings, Consequence Ratings and the Standard Defence Risk Management Matrix; and
- d. develop Risk evaluation criteria for the procurement.

### **Identify Risks**

Risks must then be identified for assessment using a systematic process by asking: what can happen?; and how it can happen?

The Source and Impact of each Risk must then be identified so that the full scope of each Risk is understood and to ensure that Risks are not double-counted, given that several Sources can give rise to the same Risk.

### **Analyse Risks**

Each of the Risks identified needs to be analysed to determine the Likelihood of the Risk occurring and the Consequences should the Risk occur.

The Likelihood and Consequences should be assessed in the context of Controls in place in relation to the Risks.

These assessments should then be used to determine the overall Risk Level for each Risk to gain an indication of the importance of each Risk relative to the other Risks.

### **Evaluate Risks**

After analysing the Risks each Risk needs to then be evaluated to determine which Risks are unacceptable and need treatment, what the treatment priorities are and how responsibility for the Risks should be allocated.

### **Treat Risks**

The outcome of the Risk-evaluation step in any Risk assessment will be a prioritised list of Risks that require treatment. Treating Risks involves:

- a. identifying the Risk treatment options;
- b. estimate treatment effect on Likelihood and Consequences;
- c. estimate the residual Risk exposure;
- d. appraise cost-effectiveness; and
- e. select preferred Risk treatment option(s).

Treatments include Liability clauses in a contract, liquidated damages, payments structures, financial securities, warranties and insurance.

### **Monitor and review**

During the various stages of the Defence procurement process set out in section 3 Risks and the effectiveness of treatment measures need to be assessed and reviewed to ensure they are still current, that the assessment of their Likelihood and Consequences are still current, that new Risks are identified and that Risk treatments are implemented and are effective.

### **Document**

The Risk management process is required to be documented to ensure that Risk decisions are understood. The two key documents that need to be established and maintained to capture a Risk assessment, are the:

- a. Procurement Risk Log - which sets out the identified Risks and Risk analysis; and
- b. Liability Risk Assessment Document - which sets out the full

Risk assessment undertaken.

In addition to these key documents, records need to be kept of the considerations and decisions relating to the management of Risks.

For further information in relation to the Risk management process refer to AS/NZS 4360:2004.

### **3. STAGES IN A LIABILITY RISK ASSESSMENT**

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3.1.1. The allocation of Risk and resulting Liability obligations must be assessed at various stages in relation to a procurement as follows:

- a. prior to procurement;
- b. where a tender process is necessary for a procurement, as part of the evaluation of a tenderer's proposal;
- c. during negotiation of the contract; and
- d. at the time of any contract change proposal.

#### **3.2. Stage 1 - Prior to procurement**

3.2.1. Prior to undertaking a procurement, a Risk assessment should be undertaken to establish the 'Liability baseline' for the resultant contract.

3.2.2. This assessment also determines what information should be sought from proposed contractors (tenderers, where a tender process is necessary) in relation to Liability.

3.2.3. This assessment should also be used to determine what type of procurement should be undertaken, i.e. Simple, Complex or Strategic. A Simple procurement is a procurement type where the overall level of Risk and complexity is assessed as Low after a Risk assessment. A Complex procurement is a procurement type where the overall level of Risk and complexity is assessed as Medium to High after a Risk assessment. A strategic procurement is a procurement where the overall level of Risk and complexity is assessed as High to Extreme after a Risk assessment.

3.2.4. The process that should be undertaken in relation to a Risk assessment is that set out in sections 2.4, 2.5, 2.6 and 2.7 to identify Risks, analyse Risks, evaluate Risks and make a decision as to how the Risks should be treated. Following undertaking the Risk assessment, if a tender process is necessary, the RFT together with a draft contract, should be prepared and released to industry. Otherwise the proposed contractor should be approached with the proposed draft contract.

**3.3. Stage 2 - Evaluation of tenderer's proposal**

- 3.3.1. Where a tender process is necessary for a procurement, once tenders have been received in relation to the RFT the tenderer's proposals in relation to Liability and Risk should be evaluated according to the methodology outlined in sections 2.4, 2.5, 2.6 and 2.7.
- 3.3.2. The Risk assessment from Stage 1 should be used in the evaluation to determine the potential exposure for the Commonwealth inherent in each tender.
- 3.3.3. If a tenderer has provided a Risk assessment or cost benefit analysis that identifies additional Risks or provides information that justifies treating Commonwealth identified Risks in a different manner, that information should be taken into account in the evaluation of Risk.

**3.4. Stage 3 - Negotiation**

- 3.4.1. Where a proposed contractor (preferred tenderer(s)) proposes to alter the Liability regime contained in the draft contract, a negotiation Risk assessment should be prepared. In the context of a tender process the negotiation Risk assessment will be based on the evaluation of the preferred tenderer's proposal against the Stage 1 Risk assessment.
- 3.4.2. A negotiation Risk assessment:
  - a. should be prepared taking into account the offer made by the proposed contractor (preferred tenderer(s));
  - b. should be used to prepare a negotiation directive, if applicable; and
  - c. indicates the potential Risk exposure to the Commonwealth offered by the tenderer(s) and how Risk may be mitigated through negotiations.
- 3.4.3. The Risk assessment from Stage 1 (or Stage 2 if there is a tender process) should be updated through negotiations and used to establish the value for money argument needed to obtain contract approval.

**3.5. Stage 4 - Contract change proposals**

- 3.5.1. During the period of the resultant contract any contract change proposals that effect Liability should be assessed by reference the updated Risk assessment from Stage 3.

**SUMMARY**

The allocation of Risk and resulting Liability obligations must be assessed in accordance with sections 2.4, 2.5, 2.6 and 2.7 of this paper at various stages of

the Defence procurement process including:

- a. prior to procurement - to determine the Liability baseline for the resultant contract, what information should be sought, what type of procurement should be undertaken and to assist in the preparation of a draft contract;
- b. where a tender process is necessary for a procurement, as part of the evaluation of a tenderer's proposal - to determine the potential exposure for the Commonwealth inherent in each tender;
- c. during negotiation of the contract - to determine the effect of any alterations to the Liability regime proposed by the contractor or preferred tenderer; and
- d. at the time of any contract change proposal - to determine the effect of the change proposal on the allocation of Liability.

For guidance as to appropriate limitation of liability clauses for different types of procurement refer to the relevant ASDEFCON suite templates and associated ASDEFCON handbooks.

**SCHEDULE 1 RISK IDENTIFICATION WORKSHEET**

Compiled by:		Date:	
REF e.g. 1	Risk (What?)	Sources (How?)	Impacts (Why a Risk)

**SCHEDULE 2 PROCUREMENT RISK LOG**

<b>Risk</b>	<b>Source</b>	<b>Category</b>	<b>Controls</b>	<b>Impact</b>	<b>Likelihood</b>	<b>Consequence</b>	<b>Risk Level</b>
^insert a description of the Risk - refer to paragraph 2.4.3^	^insert a description of the Source of the Risk - refer to paragraph 2.4.6^	^insert the Category of Risk - refer to paragraph 2.3.10^	^insert the Controls for the Risk - refer to paragraphs 2.5.3 to 2.5.5^	^insert a description of what the Risk will Impact on, this will guide what Category the Risk will be - refer to paragraph 2.4.6^	^insert the Likelihood of the Risk - refer to paragraphs 2.5.6 to 2.5.9^	^insert the Consequences of the Risk - refer to paragraphs 2.5.10 to 2.5.12^	^insert the Risk level for the Risk - refer to paragraphs 2.5.13 and 2.5.14^

**SCHEDULE 3 EXAMPLE SCENARIO PROJECT RISK LOG**

Risk	Source	Category	Controls	Impact	Likelihood	Consequence	Risk Level
The contractor fails to complete the contract e.g. the contractor goes into liquidation.	Financial viability of the company	Schedule	Tender allows for evaluation of financial viability. Contract includes clauses that allow Commonwealth to terminate if certain events occur that indicate possible insolvency. Ability to seek damages. Financial security will be obtained to secure performance and progress payments Deed of substitution allows for parent to substituted for contractor	Completion of the contract Cost impact of finding alternative supplier to complete and keeping existing equipment operating for longer. This cost is estimated to be \$50m including re-tendering costs, project office costs and costs of maintaining existing equipment.	Unlikely	Minor	Low
The contractor completes but the supplies provided under the contract do not work or do not provide the capability contracted for.	Lack of expertise in the Company, unproven solution	Performance	Tender will evaluate maturity of the solution. Requirement is for a proven solution with existing supply chain. Contract provides for acceptance testing and warranty period	Performance of the supplies Schedule might be affected if issues impact acceptance (see liquidated damages).	Possible	Moderate	Medium
The contractor completes but not on time.	Capacity issues given competing projects, lack of engineering staff, poor management skills	Schedule	Tender will evaluate proposed management plans and skills, proposed resourcing. Contract specifies liquidated damages of \$5000 per day for delay that decouples ship engine replacement from refurbishment schedule, \$2000 per day for delay that decouples truck engine replacement from overhaul schedule, \$500 per day for other delay and \$1500 per day for delay in eco-tank delivery. Ultimately Contract allows for termination for default if delays are lengthy. Financial security against performance and Deed of substitution to allow parent to be substituted in the event of default.	fitting in with schedule for ship refurbishment and truck engine overhaul. Cost impact of having to fit engines outside existing refurbishment/overhaul schedule is \$20m Cost of keeping existing equipment operating for longer. Estimated at \$45m	Possible	Moderate	Medium
The contractor injures or kills people in the course of performing the contract.	Unsafe work practices. Lack of technical expertise in performing the work, leading to defects in supplies	Cost	Contract contains an indemnity from the contractor in respect of third party personal injury. Contract requires contractor to have insurance. Contractor required to be appropriately licensed and observe OH&S requirements	Potential claims against the Commonwealth by third parties.	Possible	Minor	Medium
The contractor	Unsafe work	Cost	Contract contains an indemnity from the	Potential claims	Possible	Moderate	Medium

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<b>Risk</b>	<b>Source</b>	<b>Category</b>	<b>Controls</b>	<b>Impact</b>	<b>Likelihood</b>	<b>Consequence</b>	<b>Risk Level</b>
damages Commonwealth or third party property (tangible or intangible).	practices. Lack of technical expertise in performing the work, leading to defects in supplies.		contractor in respect of Commonwealth and third party property damage. Contractor has risk of supplies whilst in their possession or control. Specific requirements on Contractor when on Commonwealth premises. Contractor required to have insurance. Scheduling will limit the number of Defence assets being worked on by the Contractor at any one time.	against the Commonwealth by third parties. Commonwealth expense to replace damaged Commonwealth property. In some circumstances proportionate liability regime will protect Commonwealth from loss from third party claims.			
The contractor causes a third party to suffer economic loss in the course of performing the contract.	Unsafe work practices. Lack of technical expertise in performing the work, leading to defects in supplies.	Cost	Contract contains an indemnity in respect of third party claims where eco loss is connected to personal injury, death or property loss. Contract is silent on pure eco loss. Acceptance testing will occur before use of supplies in situations where could do damage. Work will not be performed in commercial areas. Contract requires contractor insurance.	Potential claims against the Commonwealth by third parties. In some circumstances proportionate liability regime will protect Commonwealth from loss from third party claims.	Unlikely in respect to pure eco loss. Eco loss related to personal injury or property damage is possible.	Minor.	Low.
Defects in supplies cause the Commonwealth extra expense or loss of productivity.	Lack of technical expertise in performing the work, leading to defects in supplies.	Cost	Requirement for proven solution. Acceptance testing before introduction of supplies into service Indemnity in respect of loss or damage suffered by the Commonwealth. Warranty provisions	Expense to the Commonwealth Performance of supplies Given the nature of the assets being fitted with engines loss could be \$10m for loss of ship, \$30,000 for loss of truck, \$100,000 for loss of tank. Doubtful that loss would affect operations so negligible productivity loss.	Possible	Moderate	Medium
A third party claims against the Commonwealth for infringement of	Failure to secure IP rights.	Cost	Tender evaluation will consider source of IP rights. Contract contains an indemnity in respect of third party claims for IP infringement.	Commonwealth loss as a result of a third party claim. Most likely loss would	Unlikely	Minor	Low

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<b>Risk</b>	<b>Source</b>	<b>Category</b>	<b>Controls</b>	<b>Impact</b>	<b>Likelihood</b>	<b>Consequence</b>	<b>Risk Level</b>
intellectual property rights as a result of the Commonwealth's use of the supplies.				be to maintenance schedule and future upgrades. Estimated loss \$10m including damages, cost of defending claim, securing alternate rights.			
A third party claims against the Commonwealth for breach of confidentiality arising out of the Commonwealth's use of information supplied under the contract.	Failure to secure confidential information.	Cost	Contract contains an indemnity in respect of third party claims for breach of confidentiality.	Commonwealth loss as a result of a third party claim. Given nature of likely information estimated loss \$10m.	Unlikely	Minor	Low
The contractor claims against the Commonwealth for breach of warranty in relation to mandated government furnished material.	Failure to adequately check GFM before supply.	Cost	Assessment of required GFM to ensure that mandated GFM is limited. indemnity from GFM supplier in respect of adequacy of GFM. Requirement on contractor to inspect GFM before use.	Commonwealth liability to contractor for GFM Schedule impact because potential excusable delay claim.	Possible	Moderate	Medium

**SCHEDULE 4 LIABILITY RISK ASSESSMENT DOCUMENT**

**CONTRACT XYZ**

**LIABILITY RISK ASSESSMENT**

**A. Cover Sheet**

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The **cover sheet** part is to identify the contract number and name, version, security classification and entity responsible for the preparation of the Risk assessment.

**B. Purpose and Scope**

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The **purpose and scope** part is to set out the purpose of the Risk assessment and the scope of the Risk assessment, including the nature of the supplies that are the subject of the contract.

**C. Key Stakeholders**

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The **key stakeholders** part is to identify the stakeholders applicable to the contract, including their areas of interest/concern and their likely influence in terms of Liability. Refer to section 2.2.

**D. Context**

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The **background** part is to set out all the background for the Risk assessment including a description of the procurement to which the Risk assessment relates, including the procurement objectives, and the procurement environment. Refer to section 2.3.

**E. Risk Identification**

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The **Risk identification** part is to set out the matters described in section 2.4, including:

- a. the process, procedures and tools used to identify and capture Risks;
- b. the Risks identified;
- c. the Sources that could initiate each Risk;
- d. a description of the Impact of each Risk; and
- e. the Category or Categories of each Risk (refer to paragraph 2.3.10).

**F. Risk Analysis**

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The **Risk analysis** part is to set out the matters described in section 2.5, including:

- a. the procedures for analysing Risks, including the Risk-analysis criteria, the Likelihood Ratings and Consequence Ratings and any adaptation of them, as well as the Standard Defence Risk Management Matrix for assigning Risk Levels (refer to paragraphs 2.3.12 to 2.3.22); and
- b. the outcome of the analysis, for example by attaching the Procurement Risk Log.

**G. Risk Evaluation**

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The **Risk evaluation** part is to describe the procedures applied for evaluating Risk, including the Risk-evaluation criteria (refer to paragraphs 2.3.23 to 2.3.25), and the outcome of evaluating the Risk against that evaluation criteria (refer to section 2.6).

**H. Risk Treatment**

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The **Risk treatment** part is to describe the Risk treatment options in terms of the Risks and the proposed allocation of those Risks (refer to section 2.7). This is to include:

- a. a description of the Risk treatment options;
- b. an estimate of the effect of the treatment options on Likelihood and Consequences;
- c. an estimate of the residual Risk exposure;
- d. an appraisal of the cost-effectiveness of the treatment options; and
- e. a description of the preferred Risk treatment option.

**I. Summary**

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The **summary** part is to include any recommendations or decisions determined as a result of the Risk assessment.

**SCHEDULE 5 EXAMPLE RISK TREATMENT SECTION**

- A.1.1. The following is an example of Part H of the Liability Risk assessment document using two identified Risks from the example scenario. The first step is to prioritise the identified Risks, that is sort from highest to lowest according to the Risk Level.
- A.1.2. Having prioritised the Risks the five steps for selecting treatments discussed in paragraph 2.7.3 should be followed.

Risk	Source	Category	Treatment	Cost effectiveness	Likelihood	Consequence	Risk Level	Residual Risk Exposure
The contractor completes but the supplies provided under the contract do not work or do not provide the capability contracted for.	Lack of expertise in the Company, unproven solution	Performance	Design tender evaluation criteria to reflect requirement for a mature, proven solution with an existing supply chain. Include acceptance testing and warranty clauses in the draft contract. Include clauses in the draft contract for termination in the event of failure to performance. Require a financial security for performance.	Treatments are commercially standard and should not impact tendered price except in the case of the financial security and that will depend on amount. Commercial practice establishes a norm of financial securities at 10% in this industry. Unlikely to attract premium for financial security at this level.	Possible	Moderate	Medium	Worst case scenario is an exposure of \$5m beyond what could be recovered under the security.
The contractor injures or kills people in the course of performing the contract.	Unsafe work practices. Lack of technical expertise in performing the work, leading to defects in supplies	Cost/Safety	Include in the draft contract an indemnity from the contractor in respect of third party personal injury. Do not allow a limitation on liability in respect of the indemnity. Require the contractor to have insurance for public liability and professional negligence. Require the Contractor to be appropriately licensed and observe OH&S requirements Undertake monitoring of practices and insurance during the contract.	These requirements are commercial standards and should not attract a price premium.	Possible	Minor	Medium	Exposure limited to actions where it cannot be proven that contractor was negligent or cannot recover from the contractor.

**SCHEDULE 6 GLOSSARY****A.1. DEFINITIONS**

A.1.1. In this paper, unless the context implies a contrary intention, a term in bold type in the table below has the meaning shown opposite it.

<b>Category</b>	means the category of Risk to which a Risk relates as set out in paragraph 2.3.10;
<b>Consequence</b>	means the rating of the effect of an Risk occurring using the Consequence Ratings;
<b>Consequence Ratings</b>	means the ratings set out in Table 4 at paragraph 2.3.17;
<b>Control</b>	means a control that is in place for a Risk (refer to paragraphs 2.5.3 to 2.5.5);
<b>Defence</b>	means all organisations within the portfolio of the Department of Defence, including the Defence Materiel Organisation;
<b>Extreme</b>	has the meaning set out in the Standard Defence Risk Management Matrix;
<b>GFM</b>	means government furnished material;
<b>High</b>	has the meaning set out in the Standard Defence Risk Management Matrix;
<b>Impact</b>	means what a Risk will impact on, in other words why the Risk is a Risk;
<b>Liability</b>	means the obligation to pay for, or to pay to rectify, the outcome of an Risk when it occurs;
<b>Liability Risk Assessment Document</b>	means the form set out in Schedule 4;

<b>Likelihood</b>	means the rating of the probability of a Risk occurring using the Likelihood Ratings;
<b>Likelihood Ratings</b>	means the ratings set out in Table 2 at paragraph 2.3.13;
<b>Low</b>	has the meaning set out in the Standard Defence Risk Management Matrix;
<b>Medium</b>	has the meaning set out in the Standard Defence Risk Management Matrix;
<b>Procurement Risk Log</b>	means the form set out in Schedule 2;
<b>Risk</b>	means the possibility of an event occurring;
<b>Risk Level</b>	means the Risk level determined by combining the Consequence Rating and Likelihood Rating of a Risk occurring using the Standard Defence Risk Management Matrix;
<b>SME</b>	means small to medium enterprise;
<b>Source</b>	means factors that could initiate a Risk; and
<b>Standard Defence Risk Management Matrix</b>	means the matrix set out in Table 6 at paragraph 2.3.22.