



ADAPTATION FUND

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Adaptation Fund Board  
Seventeenth Meeting  
Bonn, 14-16 March, 2012

## **PERFORMANCE REVIEW OF THE SECRETARIAT AND TRUSTEE**

# Review of the Interim Arrangements of the Adaptation Fund

5 November 2011

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**ADAPTATION FUND**

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Chairperson,  
Adaptation Fund Board  
C/O Adaptation Fund Board Secretariat  
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5 November 2011

Dear Chairperson and Members of the Adaptation Fund Board,

**Subject: Review of the Interim Arrangements of the Adaptation Fund**

I am pleased to present to you the above-mentioned report for the attention of the Adaptation Fund Board in satisfaction of the Terms of Reference as found in Appendix 1.

In this connection, I wish to thank the prompt cooperation of the Adaptation Fund Secretariat and Trustee staff who afforded me all the required documentation and their time in order for me to complete this review.

Yours sincerely,



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## **I. EXECUTIVE SUMMARY**

### **1.1 Objectives and scope**

As per the terms of reference established by the Conference of the Parties serving as the Meeting of the Parties of the Kyoto Protocol (CMP), the overall objective of this review is to ensure the effectiveness and adequacy of the Adaptation Fund (AF) and its interim institutional arrangements (i.e. Global Environmental Facility (GEF) as the Secretariat and International Bank for Reconstruction & Development (IBRD) as the Trustee), with a view to the CMP adopting an appropriate decision on this matter at its seventh session.

Individual areas, as per the terms of reference, constitute the main headings in the body of the report. The Terms of Reference of this engagement are found under Appendix 1.

### **1.2 Methodology and approach**

The majority of the review was desk-based using information available on the Adaptation Fund & Trustee website, information specifically requested from both the records of the AF Secretariat and the Trustee as well as any reports issued by oversight parties (external and internal auditors). Attendance at the 15<sup>th</sup> meeting of the Adaptation Fund Board was also carried out. Finally, the review concluded with a visit to the Global Environmental Facility's Office in Washington DC and to the IBRD to review documents that were not available by email due to confidentiality.

The methodology followed a formal Work Plan (Refer Appendix III for sample of tests carried out). In general, the Work Plan covered:

1. Existence and adequacy of key policies & procedures;
2. Existence of key controls;
3. Review of the governance and organisational structure of the Adaptation Fund against best practice;
4. Adequacy of the Secretariat's resources.

Throughout the review, a number of compliance tests were carried out on various processes of the Adaptation Fund Board Secretariat specifically to ensure that policies and procedures were in fact being implemented as prescribed.

In respect of the Trustee, we reviewed and placed reliance on the IBRD's Control Framework as it pertains to Trust Funds in addition to the Single Audit of the Adaptation Fund Trust Fund Account in completion of the work in this area. Finally, the review covered Adaptation Fund operations as at 30 June 2011.

### 1.3 Limitations

The findings and recommendations include only those matters which have come to the attention of the reviewer as a result of the review and assessment procedures. They should not be regarded as a statement of all the weaknesses that exist or of all improvements that might be made.

The main limitations on the scope of the review and assessment procedures were as follows:

- The procedures performed do not constitute an external audit examination in accordance with generally accepted international auditing standards.
- The procedures performed do not constitute an internal audit as per the international standards for the Professional Practice of Internal Auditing.
- No technical review has been re-performed on the projects and programmes that have been submitted to the Adaptation Fund for approval.
- Financial figures stated in this report have not been verified to source documentation and records since we have relied on the Single Audit of the Adaptation Fund Trust Account performed by KPMG in 2010 as well as the IBRD Internal Audit Department's report on GEF administrative expenses performed in June 2011.
- The accreditation process was not reviewed.
- The rationale supporting the initial creation of the Adaptation Fund as a discrete body was not reviewed.
- The procedures performed did not include a review of the operations of the Global Environmental Facility's activities.

### 1.4 Executive summary of findings

#### *A-Findings with respect to the Adaptation Fund Board Secretariat*

The review concluded that the Adaptation Fund Board Secretariat (AF Secretariat) has carried out its duties and responsibilities in an effective and efficient manner since its recent inception. Whilst the review noted a number of operational improvements that could be made, the interim arrangements since the beginning of operations have operated well.

Going forward however, and with the size of the operations of the Adaptation Fund growing as a result of an increasing monetized Certified Emission Reduction Certificate (CER) Pool (i.e. Anticipated by the IBRD to reach USD 353 Million by end of December 2012), it may be timely to consider, notwithstanding that the interim arrangements have served the Adaption Fund well in the formative early years, whether a more formal organisational approach is more appropriate. This would be

in line with a maturing organisation acquiring critical mass and thus requiring a more independent structure to operate without undue reliance on other parties.

In this connection, the growth of the Adaptation Fund's operations due to increased funding and the increase in the number and the experience of accredited national and multilateral implementing entities, may well place pressures on the current arrangements from a governance, control and operational independence point of view. Whilst the Adaptation Fund Secretariat has been headed up by GEF senior management, which has served to support the fledgling Adaptation Fund from inception to operationalisation, such arrangements may become incompatible with the latter's maturity. Since each organisation has different operational objectives, funding sources, corporate profiles and legal personality, conflicts in the manner by which the Adaptation Fund is strategically positioned are more likely to arise.

The review's recommendations for the forthcoming period are as follows:

*Current Operational Improvement Recommendations*

1. The Adaptation Fund Board should review the current staffing level of the AF Secretariat given the now active project pipeline, the importance of dedicated AF staff for all technical reviews and co-reviews of projects and programmes and the eventual need for on-site project and programme monitoring.
2. The AF Secretariat should take on an oversight role over the operations of the Trustee's activities for sake of increased control. By way of examples, the Secretariat should ensure that the CERs available to the Adaptation Fund in its *Share of Proceeds* Account held with the Clean Development Mechanism is complete, accurate and received in a timely manner. In the same manner, it should reconcile the amount of CERs sold by the IBRD with those remaining in the *Share of Proceeds* Account. This oversight complements the work of the IBRD and is considered standard practice for financial institutions to ensure the appropriate management of their funds when outsourced to a third party.
3. The AF Secretariat should invoke an additional control over project disbursements to ensure that each disbursement application is supported by the requisite tender evaluation reporting as per the National Implementing Entity's/Multilateral Implementing Entity's approved Procurement Policies (i.e. those previously accredited by the Accreditation Panel). This would ensure all costs are verifiable against concrete supplies of goods and services that have been/will be contracted for in compliance with best procurement practice. Such a control would ensure that the previously accredited procurement policies are operating effectively and would therefore safeguard the Adaptation Fund from potential reputational risk if they were not.



### *Future Operational Improvement Recommendations*

Going forward, the Adaptation Fund's operational expansion may necessitate a new approach to the current interim arrangements. A new approach however should best serve the Adaptation Fund and be conducive to good governance, management control and strategic planning. Points to consider are as follows:

1. The role of the GEF Secretariat and the role of the dedicated Adaptation Fund Secretariat, which is only now becoming mature in geographic scope and operational size, may not correspond or dovetail entirely potentially leading, in acute cases, to conflict as opposed to being complementary. As such, consideration for allowing the Adaptation Fund Secretariat an independent role with managerial capacity should be considered. At the moment, management of the Adaptation Fund Secretariat rests with GEF senior management as opposed to any dedicated Adaptation Fund staff. In accordance with good governance, only dedicated full time staff of an organisation should be tasked with managing it.
2. Further to the point above, the lack of an independent executive management for the Adaptation Fund has caused the Adaptation Fund's Board of Directors to become the executive body of the organisation and embody the role of executive management. Whilst this may have been the initial interim objective, such a role is incompatible with the directors' existing full time country-specific ministerial duties and with their responsibilities as Board members of the Adaptation Fund. As the Adaptation Fund's operations expand, the requirement for a dedicated Adaptation Fund managerial capacity within the dedicated Adaptation Fund Secretariat is critical to provide effective and focused uninterrupted leadership to a growing and innovative organisation.
3. The Adaptation Fund Secretariat should have the requisite number of staff and to be sufficiently independent over the conduct of its operations and not be unduly reliant on non-dedicated staff.

### ***B-Overall conclusion with respect to the Adaptation Fund Secretariat***

To summarise, the current interim arrangements of the Adaptation Fund Secretariat has served it well since its inception. The current *SWOT Analysis* is as follows:

#### *Strengths*

1. Availability of a motivated core team;
2. Developed technical skills within the core team;

3. Operational procedures for project and programme reviews as well as national & multilateral implementing entity accreditation operating efficiently and effectively;
4. Administrative tasks for Board meetings being carried out effectively;
5. Assistance from GEF staff where required and use of its institutional memory.

#### *Weaknesses*

1. Lack of a formal Adaptation Fund-specific management structure within the Secretariat leading to the absence of effective leadership (ex-Board) required to support the strategic positioning and control of the Adaptation Fund;
2. Undue reliance on chargeable and non-dedicated Adaptation Fund staff (i.e. GEF staff) to undertake Adaptation Fund-specific technical co-reviews of projects and programmes leading to lack of full accountability;
3. Lack of sufficient number of own staff to undertake co-reviews if GEF staff members are not available or otherwise committed to GEF tasks;
4. Lack of jurisdiction over other elements of the Adaptation Fund's operations such as CER stock control and Trustee investment management conformance with Board of Directors' investment risk appetite.

#### *Opportunities*

1. Ability to become an independent, pioneering and leading organisation focused on adaptation projects;
2. Unutilised legal capacity conferred on it which would support point 1 above.

#### *Threats*

1. Growth in operational pipeline and workload not accompanied with growth in resources;
2. Growth of operations within another entity may not lead to synergy but potentially to competition over resources and overlap leading to Adaptation Fund's own objectives not being met fully.

The foregoing leads the review to note that the current interim arrangements of the secretariat, going forward, may require a new approach to bring about organisational independence, management control, transparency and accountability in its operations. Using the analogy of a baby that has grown to full term, it is now time for its natural next phase, that of its full birth. Continuing the analogy, the nurturing environment of the GEF has allowed the Adaptation Fund to develop and mature. However, any delay in its logical transition *may* now be counterproductive. Such a change however, would still retain the services of the Trustee (Refer section IV).

Should this independent route be considered, there are two main options for the Adaption Fund as follows:

*Independent Secretariat-Option 1*

Take the opportunity of the legal capacity available to it and consider whether an independent and fully resourced secretariat may better serve the objectives of the organisation (akin to the Multilateral Fund model).

The benefits of the above would be as follows:

- Enhanced independence in the manner by which its operations are managed and implemented.
- Enhanced control over its own operations and therefore full accountability for its performance.
- Allows closer links to the United Nations Framework Convention for Climate Change (UNFCCC) and potentially use of its support services (Human Resources etc).
- Benefits from the immunities and privileges conferred to it by the German Government.

*Independent Secretariat-Option 2*

In this scenario, the Adaptation Fund Secretariat could adopt a GEF-like model by having the existing dedicated AF Secretariat remain within the IBRD's organisational and physical structure but as a stand-alone body. In adopting this option, the AF Board of Directors would need to ensure that the Secretariat possesses the requisite managerial authority and additional staff depth for this independent organisational structure.

All accounting and other administrative services currently being received, via the GEF, would be delivered directly by the IBRD to the newly created independent Adaptation Fund Secretariat in this alternative arrangement.

The benefits of the above would be as follows:

- Enhanced independence in the manner by which its operations are managed and implemented.
- Enhanced control over its own operations and therefore full accountability for its performance.
- Avoids logistical geographical move and re-location.

Both of these options however, would entail additional costs to fully staff the missing functions and house the requisite structure. It is recommended that the AF Secretariat provide the Adaptation Fund Board with a budget for either of these two options by way of additional information to fully consider the proposals made here.

### *C-Findings with respect to the Adaptation Fund Trustee*

The review concludes that the IBRD has carried out its work as Trustee in an effective and efficient manner across all its duties and responsibilities since its inception. Going forward, the review notes no pressing issues that would require altering the existing interim arrangements. However, a number of operational improvements and issues are noted as follows:

1. It is recommended that, at the next AF Board of Directors meeting, the IBRD should confirm the Board's investment risk appetite in respect of its investment of the Adaptation Fund's liquid assets. To date, we could not ascertain whether the current strategic asset allocation of the Adaptation Fund's liquid assets had been formally advised to the Board and agreed. This process should be carried out annually or semi-annually and agreement of the investment strategy for each forthcoming period approved formally.
2. The review has recommended improvements to the current limited investment management reporting of the Trustee, specifically to contain more information as to the credit risk and profile of the Adaptation Fund's liquid assets under management (Counterparty names, instrument type, tenors etc). At present, it is therefore unclear with which counterparties are Adaptation Fund investments held with.
3. The review noted that there was a lack of clarity with respect to the liability for any credit losses incurred on Adaptation Fund funds under IBRD management. This is particularly relevant considering the fact that Adaptation Fund funds are *commingled with other trust fund assets maintained by the IBRD*, with the result that, within a pool of USD25 billion, it will be difficult, if not impossible, to identify where the Adaptation Funds are. This matter should be resolved to avoid any unnecessary legal dispute should the event occur. As such, the Adaptation Fund Board should seek clarification from, or agreement with, the IBRD on this matter.

## II. BACKGROUND

### 2.1 Introduction

At the third session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), which was held in Bali, Indonesia from 3-14 December 2007, the Parties in decision 1/CMP.3 decided to establish the Adaptation Fund Board (AFB) as the operating entity to supervise and manage the Adaptation Fund, under the authority and guidance of the CMP. The AFB is fully accountable to the CMP, which decides on the overall policies of the Adaptation Fund.

Upon invitation from the Parties, the Global Environment Facility (GEF) provides secretariat services to the AFB and the World Bank (IBRD) serves as trustee of the Adaptation Fund on an interim basis with a review due of these interim institutional arrangements in 2011.

At CMP 4, Parties expressed their appreciation to the AFB for having carried out the functions of its work plan, in accordance with decisions 5/CMP.2 and 1/CMP.3, and urged it to continue to do so with a view to fully operationalising the Adaptation Fund. The CMP encouraged the AFB to keep its rules of procedure under review and, if necessary, make recommendations concerning any amendments aimed at enabling the AFB to function in an efficient, cost-effective and transparent manner.

At CMP 5, Parties endorsed the decision of the AFB to accept the offer of Germany to confer legal capacity on the AFB and invited Germany to make the necessary arrangements.

At CMP 6, Parties expressed appreciation to the Government of Germany for conferring legal capacity on the AFB and requested the Adaptation Fund Board to undertake independent performance reviews of the interim secretariat and the interim trustee servicing the Adaptation Fund.

This document represents the results of the subject review as requested.

## 2.2 Operational context of the review

Since inception, the Adaptation Fund has reviewed over 30 projects submitted since its call for projects dated April 2010 (or 49 if re-submissions are considered). It has, since this period, approved and/or disbursed on 10 projects and programmes across the following countries:

Table 1: Approved and disbursed projects to June 2011 (USD)

Project Country	Approval Date	Amount Committed	Amount Disbursed
Honduras	Sep 2010	5,620,300	987,702
Senegal	Sep 2010	8,619,000	2,924,000
Pakistan	Dec 2010	3,906,000	1,697,324
Nicaragua	Dec 2010	5,500,950	2,263,870
Solomon Islands	Mar 2011	5,533,500	925,827
Eritrea	Mar 2011	6,520,850	889,329
Ecuador	Mar 2011	7,449,468	2,647,029
Turkmenistan	Jun 2011	2,929,500	N/A
Maldives	Jun 2011	8,989,225	N/A
Mongolia	Jun 2011	5,500,000	N/A

### *Cash flow statement*

In addition, the capital contributions and donations to the Fund have totalled USD 230 Million spread over the following timeline. The *net* cash flow available to the Adaptation Fund after costs/expenses on a cumulative annual basis is as follows:

Table 2: Cumulative income, costs, funds received & disbursements-June 2011(USD)

Category	August 2008	August 2009	July 2010	June 2011
Cumulative income from liquid asset investments	0	90,000	440,000	980,000
Less cumulative total AF Costs	(112,026)	(3,310,000)	(9,540,000)	(9,160,000)
<b>Net Income/Loss</b>	(112,026)	(3,220,000)	(9,100,000)	(8,180,000)
Donations	1,538,706	156	57,070,000	85,820,000
CER Monetization	0	18,700,000	112,470,000	163,120,000
Projects & Programmes	0	0	0	(12,370,000)
<b>Net Cash Position</b>	1,426,680	15,480,156	160,440,000	228,390,000

*Operational costs*

In addition, the actual expenditure of the fund has been as follows:

Table 3: Income and expenditure to June 2011 (USD)

<b>Trustee Costs</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>
CER Monetization	471,000	645,000	673,467
Financial Management	138,000	288,000	152,186
Investment Management	600	20,000	70,252
Programme Management	211,000		
Accounting & Reporting	147,000	55,000	55,220
Legal Services	251,000	67,100	44,243
External Audit			42,479
Travel	117,000		
Relationship Management			
<b>Total</b>	<b>1,335,600</b>	<b>1,075,100</b>	<b>1,037,847</b>
<b>AF Secretariat Costs</b>			
Staff-Secretariat	763,531	140,058	636,101
GEF staff	378,590	255,657	198,978
Travel-Other	670,097	478,205	603,334
Travel-Secretariat adj	(16,495 )		137,432
Consultants	91,138	147,057	390,140
General Operating Costs		84,856	165,130
Media workshop	315,110		
Costs of Meetings		426,370	390,185
Contractual Services	62,101		
<b>Total</b>	<b>2,264,072</b>	<b>1,532,203</b>	<b>2,521,300</b>
<b>Grand Total</b>	<b>3,599,672</b>	<b>2,607,303</b>	<b>3,559,147</b>

### 2.3 Background of the Adaptation Fund Secretariat

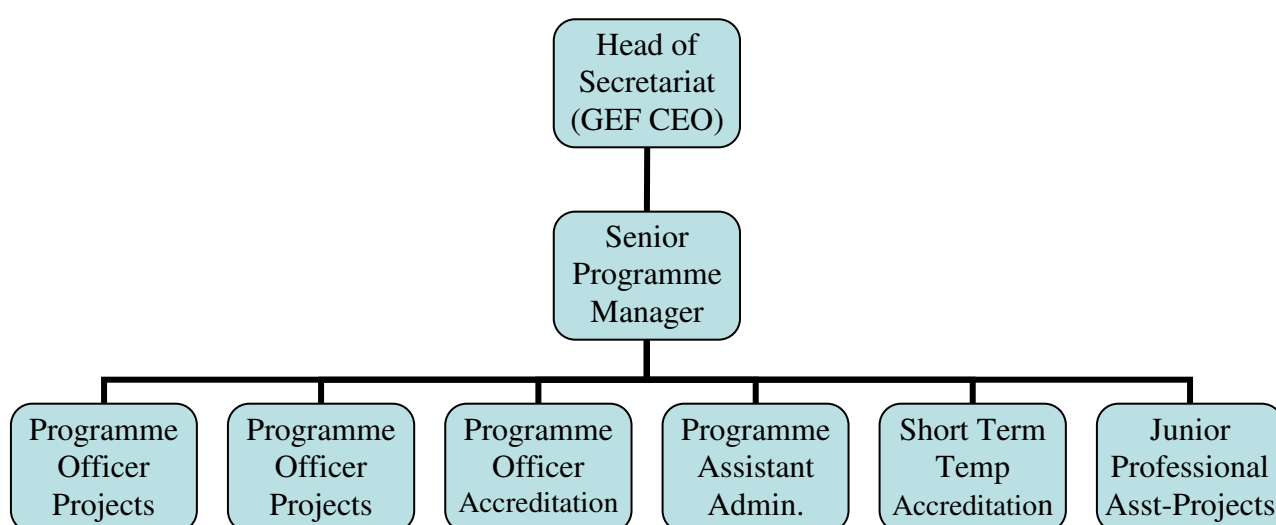
In November 2007, the GEF Council authorised the GEF CEO and Chair to communicate to the Conference of the Parties, serving as the meeting of the Parties of the Kyoto Protocol at its Third session held in Bali in December 2007, of the GEF's willingness to support a COP/MOP decision, should one be made, requesting the GEF Secretariat to function as the Secretariat of the Adaptation Fund.

Upon eventual authorisation and agreement, the GEF set up an Adaptation Fund Secretariat within its own organisation and staffed it with seven *dedicated* staff members. These represent the AF Secretariat and are holders of IBRD employment contracts and are located in the offices of the Global Environmental Facility (GEF)

which itself is physically located within IBRD offices in Washington DC. The secretariat is staffed by 7 staff members as follows:

- 1 X Senior Programme Manager
- 3 X Programme Managers
- 1 X Programme Assistant
- 1 X Short term temporary staff member
- 1 X Junior Professional

The organisation chart of the Secretariat and the respective responsibilities of the staff are as follows:



#### *Reporting and administrative arrangements of the Secretariat*

According to the Terms of Reference (Job Description) of the Senior Programme Manager of the AF Secretariat, the position reports directly to the *Chief Executive Officer* of the Global Environmental Facility (GEF), who in turn reports to the GEF Council and heads the GEF Secretariat. Paragraph 21 of the Instrument for the Establishment of the Restructured Global Environmental Facility states that: *'The GEF Secretariat shall service and report to the Assembly and the Council. The Secretariat (GEF Secretariat), which shall be headed by the CEO/Chairperson of the Facility, shall be supported administratively by the World Bank and shall operate in a functionally independent and effective manner.'*

The Adaptation Fund Board meanwhile meets on a quarterly basis at the United Nations Framework Convention for Climate Change (UNFCCC) Headquarters in Bonn, Germany with one meeting held in conjunction with the COP/MOP meeting of the UNFCCC.



As such, a portion of all administrative functions relating to the servicing of the Adaptation Fund Secretariat is handled by the GEF and includes such matters as cross support in areas such as website maintenance, communications, equipment, office space, publications etc. In relation to personnel matters, all contracts, including those of consultants, are issued by the World Bank Group's Human Resources Service Centre. The Performance Appraisal and Salary Review process however and ensuing compensation adjustments of the Manager of the Secretariat and her team is conducted by the GEF Chief Executive Officer.

Finally, the GEF Evaluation Office has been recently mandated on an interim basis to perform evaluations of the Adaptation Fund Projects within 9 months of their full implementation.

#### *Responsibilities of the Secretariat*

As per the MOU between the Conference of the Parties serving as the Meeting of the Parties of the Kyoto Protocol and the Council of the GEF regarding secretariat services to the to the Adaptation Fund Board, the GEF Secretariat shall, under the guidance and instructions of the Board, provide the following services to the Board to support and facilitate the work of the Board:

- (a) *As a dedicated team of officials, provide secretariat services to the Board in a functionally independent and effective manner;*
- (b) *Manage the daily operations of the Fund and report to the Board;*
- (c) *Assist the Board in developing strategies, policies and guidelines for the Fund;*
- (d) *Ensure timely implementation of the decisions of the Board;*
- (e) *With respect to the day to day functioning of the Fund, act as liaison between the Board and Parties and implementing and executing entities;*
- (f) *Make arrangements for the meetings of the Board, including issuance of invitations and preparation of documents and reports of meetings, and provide a secretary of the Board meeting;*
- (g) *Develop the work programme and annual administrative budget of the Fund and submit them for approval by the Board;*
- (h) *Ensure the implementation of the operational policies and guidelines of the Fund developed by the Board through, inter alia, the development of a project cycle based on criteria to be adopted by the Board;*
- (i) *Operationalize the project cycle by:*
  - (i) *Undertaking initial review and screening of project proposals to assess conformity with guidelines approved by the Board;*
  - (ii) *Presenting project proposals for Board approval;*
  - (iii) *Monitoring implementation of progress;*
  - (iv) *Periodically reporting to the Board on portfolio performance;*

- (j) *Coordinate the formulation and monitor the implementation of projects, ensuring liaison with other bodies as required;*
- (k) *Liase, as appropriate, with the secretariats of other relevant international bodies;*
- (l) *Provide the trustee with all relevant information to enable it to carry out its responsibilities, consistent with decision 1/CMP.3 and the decisions of the Board;*
- (m) *Provide services to ensure and facilitate proper communication with Parties;*
- (n) *Perform any other functions assigned to it by the Board.*

## **2.4 The Adaptation Fund Trustee**

The IBRD (World Bank) has been selected by the CMP to be the trustee of the Adaptation Fund for an interim period to perform the following responsibilities:

- (a) monetize the AF's Certified Emission Reduction (CER) certificates;
- (b) trust fund management, including financial management of the resources of the Trust Fund; investment management; and accounting and financial reporting.

In this connection, the IBRD's *CER Monetization Programme Guidelines* dated and approved in December 2008 serve to ensure predictability of revenue flow, optimise revenue while limiting financial risks and monetize the share of proceeds in the most cost effective manner.

Meanwhile the IBRD's Multilateral Trusteeship and Innovative Financing Concessional Finance and Global Partnerships (CFP) Department manage the monetized liquid assets in line with their *Investment Management of Donor Funds Guidelines*. In doing so, the latter document states:

*'The World Bank manages the liquid assets of Trust Funds in a single, co-mingled investment pool which provides several benefits to its trust fund participants, such as:*

- *Three model portfolios (in addition to cash) to cater to varying needs and risk preferences of different funds*
- *Access to a wide variety of investment products and longer maturity investments to enhance returns and investment income over time*
- *A cost-effective investment platform resulting in very low administrative costs to participants*
- *Regular review of liquidity needs across funds to optimize investments over the longer term'*

## 2.5 Legal capacity

Through an Act of Parliament, the German Government conferred legal capacity to the Adaptation Fund Board, making the Fund an independent international legal entity. This followed a memorandum of understanding between the Adaptation Fund Board and the German Government signed during the Cancun Climate Change Conference in December 2010. The act enables the Adaptation Fund Board to enter into contracts with recipients, particularly in the case of direct access to the Fund by developing countries.

The decision for the Adaptation Fund Board to be conferred legal capacity came at the Poznan Climate Change Conference in 2008, and resulted in the Adaptation Fund Board accepting Germany's offer.

### III. FINDINGS WITH RESPECT TO THE ADAPTATION FUND SECRETARIAT

#### 3.1 Legal arrangements

A *Memorandum of Understanding* between the Conference of Parties serving as the Meeting of the Parties to the Kyoto Protocol and the Council of the Global Environmental Facility regarding secretariat services to the Adaptation Fund Board was entered into in December 2008 which sets out the terms and conditions of the interim arrangements. Whilst the legal agreement covered a number of salient points, we did note the following:

##### *3.1.1 Lack of oversight over the operations of the Adaptation Fund Trustee*

It was noted that, although the Agreement between the GEF and the CMP stated a number of responsibilities for the Secretariat to perform, no oversight responsibility was noted in respect of the Trustee. In respect of the Trustee, paragraph 2 (l) stated:

- *Provide the trustee with all relevant information to enable it to carry out its responsibilities, consistent with decision 1/CMP.3 and the decisions of the Board*

Notwithstanding the presence of a robust oversight framework at the World Bank itself, comprised of Risk Management, an Internal Audit mechanism etc, the outsourcing of fund management to a 3<sup>rd</sup> party, on the part of any organisation, necessitates the presence and operation of an oversight framework within the Secretariat. Failure to oversee all activities in an organisation may cause an organisation either to fail in achieving its objectives or achieve it in an inefficient and ineffective manner.

By way of example, there is no process within the Adaptation Fund Secretariat to independently confirm that the number of CER's, due to the Adaptation Fund from the Clean Development Mechanism in the *Share of Proceeds* Account, is correct or that the number actually sold and the value credited to the AF Trust Fund is accurate. This is because there exists no independent oversight mechanism to carry out such a verification and/or reconciliation exercise (i.e. ex-IBRD). As such, for example, there is a possibility that the Clean Development Mechanism may not transfer all the CERs due to the Adaptation Fund and the latter may not flag the discrepancy.

Similarly, there should be a monthly reconciliation conducted by the AF Secretariat between the number of CERs in the *Share of Proceeds* Account at the beginning of the month and those outstanding as at the end of the month utilising the Trustee's monthly CER sales figures delivered as part of their Financial Status reporting.

Another example is illustrated under point 4.5.1 below which discusses the incompleteness of investment management reporting which is critical to ensure that funds are indeed invested as agreed by the AF Board. Independently ensuring the risk appetite of the Adaptation Fund Board is respected is critical.

As such, any outsourcing of a function must be accompanied by a mechanism which ensures the service supplied is timely, complete and accurate regardless of the capacity of the entity to which the function has been outsourced to. In this connection, we reviewed the KPMG Independent Auditors' report dated December 2010 on the Adaptation Fund Trust Fund which stated '*An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the interim Trustee's internal control over financial reporting. Accordingly, we express no such opinion.*'

As per the foregoing, the importance of a function within the Secretariat to oversee the monetization and investment management process for the Adaptation Fund cannot be overemphasized. It is therefore recommended that the Adaptation Fund Board institute the setting up of such a responsibility within the organisational structure of the AF Secretariat.

### **3.2 Adequacy of planning and implementation process of activities**

The dedicated AF Secretariat has generally delivered on its specifically tailored mandate under this section in an efficient and effective manner since its inception. However, going forward and in light of the continued growth of the organisation, the Adaptation Fund Secretariat would benefit from the recommendations made as follows.

#### ***3.2.1 Staffing requirements for project reviews and site visits***

##### *Technical review process*

Based on the Adaptation Fund Board Decision B.9/2 and the call for project and programme proposals, issued on 8 April 2010, the dedicated AF Secretariat has reviewed applications from 30 countries totalling USD199,622,290 (Refer Appendix II). Technical reviews are currently led by a core team of 3 Adaptation Fund dedicated staff supported by co-reviewers from the GEF's own staff resources.

The review has covered a sample of the projects and programmes (10 out of 30 or 33pct) to ensure that these were dealt with in an efficient and effective manner as well as complying with the Adaptation Fund's own Operational Policies and Guidelines

(OPG). This included ensuring that project eligibility was signed off by Adaptation Fund Secretariat staff. No issues were noted.

It was noted that the current complement of dedicated AF staff that review all project and programme proposals is only three. As such, the co-review of a project (i.e. the four eyes principle) is undertaken via the GEF cross-support mechanism which is chargeable. The core team of dedicated Adaptation Fund staff is therefore not sufficient to undertake the number of reviews required as well as the necessary co-reviews and is reliant on GEF staff members, who are not under the supervision of dedicated AF staff, to complete these in line with the AF's timetable. Not being in control of the entire review process represents a weakness if GEF staff members are otherwise occupied or have more pressing GEF projects.

As such, 30 proposals (and their re-submissions making 49) as at June 2011 have been lead-reviewed by 3 staff members over 12 months. It is important for a growing organisation to be self-sufficient in its staffing arrangements for its core business. Since it was noted that the GEF charge out these co-reviews, it is recommended that the Adaptation Fund Secretariat present a business case for an additional staff complement to allow itself to become independent in its project and programme technical review process.

#### *Importance of site visits going forward*

In addition to the previous paragraph, as projects are disbursed, the cycle of receipt of annual status reporting by the National/Multilateral Implementing Entity (NIE/MIE) will commence. This will necessitate that the AF Secretariat assess which projects require on-site monitoring to better measure the fulfilment of the project objectives and thereby sanction the continuation of the disbursement cycle.

In respect of the latter, the *Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund* (OPG) suitably caters for this either under Clause 53 that states: 'The Board may require a progress review from the Implementing Entity prior to each tranche transfer' or under clause 59 which states: 'The Board reserves the right to carry out independent reviews, evaluations or investigations of the projects and programmes as and when deemed necessary.'

In this connection, it is worth mentioning that on-site reviews, based on appropriate project risk assessment by the AF Secretariat (i.e. Stratifying projects to identify which require site visits to cover project reviews and/or implementation reviews), is key to ensure that the NIEs/MIEs are performing up to their previously accredited standard, projects are on track and to feed the results into the Annual Portfolio Report to the Adaptation Fund Board's Ethics and Finance Committee.

*Recommendation*

In light of the foregoing and notwithstanding that the AFB has approved the 2012 budget, it is recommended that a review of the number of dedicated Adaptation Fund Programme officers be undertaken to ensure the requisite number of staff are available for future desk-based project technical reviews (Lead and co-reviews) as well as on-site project reviews.

### **3.3 Coherence and effectiveness in the project review process in line with AFB's operational policies and guidelines**

The Secretariat has generally delivered on its specifically tailored mandate under this section in an efficient and effective manner since its inception. However, increased efficiency and avoidance of reputational risk can be earned by the adoption of the recommendations made below.

#### ***3.3.1 Project concepts to be endorsed by the AF Secretariat***

At the moment, the procedures that relate to project concepts are as follows:

The *Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund*, states in paragraph 41 that regular adaptation project and programme proposals, regardless of amount, undergo either a one-step, or a two-step approval process. In the one-step process, the proposer would submit a fully-developed project proposal. *'In the two-step process, the proposer would initially submit a project concept, which would be reviewed by the Project and Programme Review Committee (PPRC) which would then proceed to the Board for approval or otherwise.'* In the second step, the fully-developed project/programme document would be reviewed by the PPRC, and would finally require Board's approval.

In our opinion and given the experience gained by the AF Secretariat in project and programme reviews to date and to ensure fully developed projects are sent to the Board faster thus enhancing the *Direct Access* mechanism, it is recommended that the Secretariat be now authorised to endorse (but not reject) project and programme concepts by itself without having to go to the PPRC. Any projects and programmes that may be rejected would go to the PPRC in the normal manner.

In this manner and with this procedural change, all projects and programmes that would be submitted to the PPRC in the future would comprise only developed project and programme proposals as well as rejected concepts. This would improve the throughput of projects and programmes as well as reduce the administrative burden on an already small team.

### ***3.3.2 Importance of procurement reviews at disbursement***

It was noted that disbursement requests, received by the Secretariat after project and programme approval, are not accompanied with a list of successful suppliers and their contract values and the manner by which the successful suppliers were selected in line with the Procurement Policies and Rules of the NIEs/MIEs that were previously accredited by the Accreditation Panel.

In this connection, the Accreditation Application Form completed by the NIE/MIE includes the specific capability required of: *'Evidence of transparent and fair procurement policies and procedures at the national level that are consistent with recognized international practice (including dispute resolution procedures).'* The supporting documentation that is required here by the Accreditation Panel is inter alia: *'(i) the Procurement Policy ii) Detailed procedures or guidelines including composition and role of key decision making committees.'*

Since accreditation of NIEs/MIEs is valid for 5 years without review, the only method by which project/programme costs are verified is during the annual status reporting and/or prior tranche review as per clause 53 of the OPG.

In the OPG, it was noted that cost effectiveness was not stated as one of the objectives of the Final Evaluation. Rather, under Efficiency and Project Outcome, it was stated: *'Wherever possible, the evaluator should also compare the costs incurred and the time taken to achieve outcomes with that for similar projects.'*

In our opinion, this is not sufficient for the evaluator to ensure that project costs were incurred as a result of clear and internationally recognised procurement practices. Clearly, weak procurement practices would cause significant reputational damage to the Adaptation Fund's work as well as waste scarce resources.

We therefore recommend that the Adaptation Fund institutes a further control at the disbursement stage and/or prior tranche review stage whereby the NIE/MIE submits a Procurement Report to accompany the disbursement request. This report would outline the successful bidders, their share of the project components in value and the manner (i.e. procurement method) by which these firms, consultants were contracted.

In addition to protecting the Adaptation Fund from fraud in the disbursement process and the attached reputational risk, this would not slow down the disbursement process. This is because the Accreditation Panel would have signed off and approved on the Procurement Policies and Procedures, as shown above, which therefore would have included an Evaluation Report Summary as part of the accredited policies and procedures. As such, the AFB Role and Responsibilities Clause 7 (ii) would be maintained. This clause states:



*'7. The Board shall develop and periodically review operational modalities for the Fund, consistent with the following modalities, as provided in Decision 5/CMP.2:*

*(ii) Facilitative procedures for accessing funds, including short and efficient project development and approval cycles and expedited processing of eligible activities;'*

As such, the Procurement methodology followed and the successful suppliers and their winning bids, the total of which should agree to the Disbursement Request, should be attached in the subject submission.

### **3.4 Staff and officers dedicated to undertake activities assigned to the AFB Secretariat**

This point has been covered by our points 3.2.1 above.

### **3.5 Cost effectiveness of the budget allocated to non-dedicated and dedicated staff**

The review has determined as per below that the financial budgetary resources allocated to staff whether non-dedicated or dedicated are reasonable.

#### ***3.5.1 Salary and benefit levels for dedicated and non dedicated staff***

##### *Dedicated staff*

The current AF Secretariat dedicated staff members are all paid in accordance with the IBRD system of compensation and benefits given that the GEF is housed physically and administratively in the World Bank premises and has no legal capacity to contract as an independent entity.

This is notwithstanding that the Adaptation Fund is a Kyoto Protocol body and therefore should follow the UN Common System of Salaries, Allowances and Benefits.

In this connection and to ensure reasonable parity in salary costs, we have compared the IBRD Salaries & Average Benefits with its equivalent in the UN family as per below.

Table 4: IBRD : UN Salary comparison (USD)

Position	IBRD Salary*	IBRD Grade	Equiv. UN Job Family	UN Salary	Difference
Programme Manager	133,717	GG	P5	132,000	
Programme Manager	97,035	GF	P4	110,000	
Programme Manager	97,035	GF	P4	110,000	
Programme Manager	97,035	GF	P4	110,000	
Programme Assistant	53,020	GC	P2	72,000	
Short Term Temporary	53,020	STT	P2	72,000	
Junior Professional Associate	45,000	JPA	P1	50,000	
Total	575,862			656,000	USD80,138

\* The salary levels correspond to the averages of IBRD salaries for these grades as per the IBRD's Annual Report for 2010.

Based on the above, there is a differential of only USD80,000 if AF dedicated staff members were attached to a UN salary structure. This differential can be considered reasonable which leads the review to consider that the current compensation and benefits of AF dedicated staff is acceptable.

*Cross support (non dedicated GEF staff)*

It was noted that the budget line for the Adaptation Fund GEF Staff Cross Support in the FY2012 budget was USD277,627 with an actual figure of USD198,978 for FY2011 and USD221,894 for General Operations (Office Space, Equipment & Supplies) in FY2012 budget with an actual figure of USD128,018 for FY2011. These figures total USD499,521 for FY2012 budget and USD326,996 for FY2011 and represent 13pct and 15pct of the budgets for 2012 and 2011 respectively.

In this connection, we noted that the World Bank Group's Internal Audit vice Presidency had conducted an audit of the Administrative Expenses of the GEF Secretariat and of the GEF Evaluation Office during 2011 focusing on FY2010-FY2011

The scope of the audit 'was to determine whether the control processes over the administrative activities of the GEF Secretariat and the GEF Evaluation provide reasonable

*assurance that resources are used efficiently for the purpose of the office in compliance with policies, procedures, relevant contracts and agreements.'*

The overall conclusions of the audit of the GEF secretariat stated:

*'The audit found that controls over the administrative expenses of the GEF Secretariat are satisfactory. The Secretariat management closely monitors expenses and this ensures administrative funds are spent for the purpose of the office and in accordance with the approved budget and work programme.'*

As such, the review has relied on this report for the basis of forming an opinion in this area. However, in doing so, we have not assessed the basis by which transfer pricing/charge-out rates that the GEF has allocated to the AF Secretariat were set:

Table 5: Cross support charge-out percentages (Charged by GEF to AF)

<b>GEF Staff Cross Support</b>	<b>Charge-out percentage of salaries and benefits</b>
Head of AFB Secretariat (i.e. GEF CEO)	15
Accounting Support	14
AF Database, KM Strategy	10
AF Database	3
Communications and Outreach	5
HR Support	7
IT Support	5
Results Based Framework Support	12
Review of Projects x 6 staff	8
Head of Operations and Business Strategy	2

Based on the foregoing, the costs charged out by the GEF to cover support for the Adaptation Fund Secretariat are acceptable.

### **3.6 Financial practices of other secretariats**

A number of secretariats were reviewed to contrast with Adaptation Fund's interim arrangements.

*The Multilateral Fund for the Implementation of the Montreal Protocol*

The Fund is dedicated to reversing the deterioration of the Earth's ozone layer and was established in 1991 to assist developing countries meet their Montreal Protocol commitments. It is managed by an Executive Committee with equal membership from developed and developing countries. Meanwhile, the Fund Secretariat in

Montreal assists the Committee in this task. Since its inception, the Fund has approved activities including industrial conversion, technical assistance, training and capacity building worth over USD2.6 billion.

The Fund Secretariat assists the Executive Committee in the discharge of its functions as follows: Development of the 3 year business plans and budget, disbursement mechanisms, management of the business planning cycle of the Multilateral Fund; monitoring the expenditures and activities of the implementing agencies; preparation of policy papers and other documents; review and assessment of investment projects, country programmes and the business plans and work programmes of the implementing agencies; liaison between the Committee, governments and implementing agencies; and servicing meetings of the Executive Committee.

The Fund Secretariat is headed by the Chief Officer who reports directly to the Executive Committee and is comprised of fourteen professional and fourteen general service staff members. Its base in Montreal is as a result of Canada conferring legal capacity to the Fund.

The Fund Treasurer meanwhile is responsible for receiving and administering pledged contributions (cash, promissory notes or bilateral assistance), and disbursing funds to the Fund Secretariat and the implementing agencies based on the directive of the Executive Committee.

The responsibilities of the Treasurer are carried out by staff based in the United Nations Environmental Programme in Nairobi (One of the Multilateral Fund's four implementing agencies) and by the Senior Administrative and Fund Management Officer based in the Fund Secretariat. The Treasurer attends each meeting of the Executive Committee and is responsible for preparing:

- A status of contributions and disbursements for each meeting,
- The Accounts of the Multilateral Fund as well as the reconciliation of the accounts on an annual basis.

#### *The Ozone Secretariat*

The Ozone Secretariat meanwhile is the Secretariat for the Vienna Convention for the Protection of the Ozone Layer and for the Montreal Protocol on Substances that Deplete the Ozone Layer.

Based at the United Nations Environment Programme (UNEP) offices in Nairobi, Kenya, the Secretariat functions in accordance with Article 7 of the Vienna Convention and Article 12 of the Montreal Protocol. The main duties of the Secretariat include:

- arranging for and servicing the Conferences of the Parties to the Vienna Convention, Meetings of the Parties to the Montreal Protocol, related Working Groups and Committees, the Bureaux, and the Assessment Panels;
- arranging for the implementation of decisions resulting from these meetings;
- monitoring the implementation of the Convention and the Protocol and reporting to the meetings of the Parties and to the Implementation Committee of the Montreal Protocol;
- receiving, analyzing, and providing to the Parties data and information from the Parties on the production and consumption of ozone depleting substances (ODSs); and
- providing information to governments, international organizations and individuals on various aspects of the protection of the ozone layer.

As such, the Ozone Secretariat is similar to the UNFCCC Secretariat under which the Adaptation Fund is established with the difference that the UNEP hosts the Ozone Secretariat.

*Special Climate Change Funds (SCCF) and Least Developed Countries Fund (LDCF)*

By way of example, in respect of the SCCF, it was established within the GEF in accordance with the decision of the UNFCCC. As per the GEF's website, *'the SCCF was established to support adaptation and technology transfer in all developing country parties to the UNFCCC. The SCCF supports both long-term and short-term adaptation activities in water resources management; land management; agriculture; health; infrastructure development; fragile ecosystems; including mountainous ecosystems; and integrated coastal zone management.'*

The GEF Secretariat is responsible for oversight of formulation of operational policies and programming strategies of both the LDCF and SCCF funds; review and processing of project proposals for CEO or Council approval; management of the portfolio of LDCF and SCCF projects; coordination with the GEF Agencies, the Trustee and the Convention Secretariat; and reporting to the LDCF/SCCF Council and the Climate Convention.

In addition, the GEF website states:

- *For purposes of the SCCF, the GEF functions under the guidance of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP).*
- *With respect to decision making for the SCCF, the GEF Council meets as the Council for the Least Developed Climate Countries Fund (LDCF) and the SCCF (hereafter referred to as the LDCF/SCCF Council). Any GEF Council Member is eligible to take*

*part in the LDCF/SCCF Council. Any GEF Council Member may choose to participate in the LDCF/SCCF Council or to attend as an observer.*

- *The policies and procedures and the governance structure of the GEF apply to the climate change funds, unless the LDCF/SCCF Council decides it is necessary to modify such policies and procedures to be responsive to the guidance of the COP.*

As per the above, the SCCF and the LDCF, both of which are non-Kyoto Protocol funds, are within the GEF and are supported by the GEF Secretariat on a chargeable basis. For example, the GEF Secretariat's budget for servicing the SCCF and the LDCF (Excluding Evaluation expenses) for FY2011 was USD415,742 and USD656,075 respectively. However, it is unclear as to how many GEF staff members are involved in the above tasks.

#### *Climate Investment Funds (CIF)*

The World Bank, in consultation with the other MDBs, developed and developing countries and other development partners, proposed and established in 2008 the Clean Technology Fund (CTF), as one of two strategic Climate Investment Funds (CIF), along with the Strategic Climate Fund (SCF). Whilst these two funds are not in any way comparable to the Adaptation Fund in terms of fund objectives, their governance structure is worthy of note (see below).

By way of background, the Climate Investment Funds are a pair of funds to help developing countries pilot low-emissions and climate-resilient development. With CIF support, 45 developing countries are piloting transformations in clean technology, sustainable management of forests, increased energy access through renewable energy, and climate-resilient development.

The CIFs are channeled through the African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, and World Bank Group. The Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF) are each governed by a separate Trust Fund Committee having equal representation from contributor and recipient countries.

The CTF Trust Fund Committee oversees the Fund's operations, provides strategic direction, and also approves and oversees its programming and projects.

The SCF Trust Fund Committee approves the establishment of its targeted programs and advises on strategic direction. SCF targeted programs include the Forest Investment Program (FIP), Pilot Program for Client Resilience (PPCR), and Scaling-up Renewable Energy Program (SREP), each governed by its own Sub-Committee.

The Administrative Unit (similar to the Adaptation Fund Secretariat) supports the work of the CIF, the Trust Fund Committees and other committees. The Administrative Unit, composed of 21 staff members, is responsible for:

- Preparing, in consultation with the MDB Committee, all documentation required for review by the Trust Fund Committees, including developing an agenda for the Trust Fund Committee meeting.
- Making recommendations, in consultation with the MDB Committee, on program criteria and priorities and the activity cycle for approval by the Trust Fund Committees.
- Conducting background research and analysis as requested by the Trust Fund Committees.
- Preparing an annual consolidated report on the Trust Funds' activities, performance, and lessons, including details of the Trust Funds' portfolio, status of implementation, funding allocations for the previous period, pipeline of projects and funding projections, administrative costs incurred.
- Managing a comprehensive database of the Clean Technology Fund and Strategic Climate Fund's activities, knowledge management system, results measurements system and learning program.
- Servicing the meetings of the Trust Fund Committees.
- Collaborating with the Trustee to ensure that it receives all the information necessary to carry out its responsibilities.

The CIF Administrative Unit, is established within the Vice-Presidency for Sustainable Development in the World Bank.

### *Comparisons*

As noted above, there are various structures and profiles of climate change organisations with varying administrative arrangements. The Multilateral Fund and the Adaptation Fund appear to share the same profiles in that they are very specific financial mechanisms of their respective conventions' protocols unlike the others listed above. The profiles range from the very independent organisational structure to those embedded within an organisation.

By way of cost comparison, the following table illustrates, where information on staff numbers were available, the cost profile of three of these funds.

Table 6: Comparison of Administrative Expenses of various bodies (USD)

Organisation Secretariat	Administrative Expenses FY2011	No. of Staff	Cost per Staff
Adaptation Fund	2,521,301	7	360,000
Multilateral Fund	9,400,000	28	336,000
Climate Investment Fund	6,908,900	21	329,000

The above table demonstrates in general, notwithstanding the differing profiles of the organisations surveyed, that their average costs are roughly equivalent.

### 3.7 Interaction with the implementing entities and other relevant bodies of the convention and the Kyoto protocol

The Adaptation Fund Secretariat has interaction with the following relevant bodies:

#### *GEF and others*

GEF, as explained throughout the document, the World Bank Group, as employees of the Bank, UNFCCC as hosts of AFB meetings and the Secretariat of the Multilateral Fund for the Implementation of the Montreal Protocol by way of exchanging of ideas and lessons learnt from previously established bodies.

#### *CDM*

However, one area that the Secretariat should establish an increased working relationship with is the UNFCCC's Clean Development Mechanism (CDM). Since the CDM is the main source of income for the Adaptation Fund, the completeness and accuracy of the *Share of Proceeds* Account is of paramount importance. The CDM registry, which is a standardised electronic database that ensures the accurate accounting of the issuance, holding and acquisition of CERs, has set up a dedicated account for the Adaptation Fund where the two percent of each issuance of CERs is forwarded at the time of the issuance.

As such, the AF Secretariat should perform a reconciliation exercise on a regular basis between completed certified projects and the amount of CERs available to the Adaptation Fund in the *Share of Proceeds* Account.

#### *National and multilateral implementing entities*

Through the screening of accreditation applications, the Secretariat staff members have direct and frequent access to the implementing entities. It is not clear however, how the implementing entities view the dual relationship they have with both the Secretariat and the Accreditation Panel. It is therefore important to ensure that the initial screening process of the accreditation applications by the AF Secretariat does not hamper the work of the Accreditation Panel.



### **3.8 Cost effectiveness and necessity of maintaining the secretariat services against an Independent Secretariat**

Refer 3.9 for final conclusion

#### ***3.8.1 Potential overlap between the GEF's own responsibilities and those of the Adaptation Fund***

It is noted that the Adaptation Fund was established to finance concrete adaptation projects and programmes in developing country parties to the Kyoto Protocol that are particularly vulnerable to the adverse effects of climate change.

However, the Global Environmental Facility is also involved in non-Kyoto Protocol adaptation projects. This adaptation coverage and the financing of concrete adaptation projects are made through three funds as follows:

1. The Least Developed Countries Fund (LDCF)
2. The Special Climate Change Fund (SCCF)
3. The Strategic Priority on Adaptation (SPA), under the GEF Trust Fund

*According to the GEF website, 'the LDCF and SCCF now hold the largest and most mature portfolios of adaptation projects in the developing world. These Funds are a relevant source of practical operational knowledge as they have provided vulnerable countries and communities, as well as the GEF Implementing Agencies, initial resources to finance a pioneering adaptation portfolio.'*

In light of the above, the role of the GEF Secretariat and the role of the dedicated AF Secretariat, within the GEF, which is only now becoming mature in both geographic scope and operational size, may not dovetail entirely potentially leading in acute cases to conflict as opposed to complementarity.

#### ***3.8.2 GEF staff reviews of Adaptation Fund projects and programmes***

As noted in 3.2.1 above, all Adaptation Fund project and programme co-reviews are carried out by GEF staff members. For the sake of independence, undue reliance on other non-dedicated AF staff and the fact that this service is chargeable, it may an opportune time, with the project pipeline, to become self sufficient in terms of staff resources.

#### ***3.8.3 Lack of a management structure***

Good governance is one key element in improving economic efficiency and growth as well as enhancing stakeholder confidence. Good governance involves a set of

relationships between an organisation's management, its board and all of its stakeholders thus providing the structure by which the objectives of an organisation, the means of attaining those objectives and monitoring performance are determined.

In terms of best practice, the *OECD Principles of Corporate Governance* dated 1999 have since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. Whilst the OECD Principles of Corporate Governance apply in general to corporate entities as well as those in which shareholding is available to the public, it is generally acceptable that all organisations have stakeholders of various categories all of whom are well served by strong corporate governance framework.

In this connection, we noted that while the AF Secretariat, within the GEF, is tasked with many duties as per the Agreement between the AF and the GEF, there are no responsibilities which are of an executive management nature.

The lack of an executive management for the Adaptation Fund has caused the Adaptation Fund Board of Directors to become the executive body of the organisation and embody the role of executive management. Such a role is incompatible with the directors' existing full time country-specific ministerial duties and with their responsibilities as Board members of the Adaptation Fund.

By way of comparison, the above is contrasted with the full managerial role of the Chief Officer of the Multilateral Fund, who is well supported by a 21 member team comprising all the necessary functions of a Deputy-Chief Officer, project management, administrative, human resources, information management, information technology, senior monitoring and evaluation & fund management officers.

With an eye to the future and a growing portfolio and the achievement of organisational maturity, it is therefore recommended that the Adaptation Fund Board considers the importance of devolving some/all of its 'managerial' responsibilities to the Secretariat.

#### ***3.8.4 Unutilised hosting offer and potential costs***

At its 8<sup>th</sup> Meeting of the Adaptation Fund Board, it was minuted that the Board took an intersessional decision to select Germany as its host Country (decision B.7-8/1).

Presently, the Adaptation Fund Secretariat incurs the following costs:

1. USD221,894 (the GEF charge in the FY 2012 Budget for Office, Space, Equipment & supplies).

2. USD277,627 representing GEF staff cross support.
3. USD150,000 representing travel costs to Adaptation Fund Meetings held in Germany.

Should the Secretariat opt for Germany's hosting opportunity, the above total amount of USD650,000 could serve towards setting up an independent secretariat. However, we understand that the GEF Secretariat itself has come up with the additional cost of fully staffing an independent Adaptation Fund Secretariat as follows:

Table 7: GEF forecast for additional staff required to support an independent secretariat (USD)

Staff Category	Grade	No	Annual Staff Costs
Technical Staff for Project Review	3F +3G	6	1,107,000
IT Officer	F	1	157,200
Finance Manager	F	1	157,200
HR Officer	F	1	157,200
Results-based Mgmt	G	1	211,800
<b>Total</b>		<b>10</b>	<b>1,790,400</b>

Whilst this forecast has not been verified by this review, based on these figures, the potential incremental cost of an independent secretariat (excluding office costs) could be: USD1,140,000 (USD1,790,400 less USD650,000 as per above). However, this should be subject to a full budgetary assessment in line with our overall recommendation under point 3.9 below.

### 3.9 Overall recommendation

The review concludes that the Adaptation Fund Board Secretariat has carried out its duties and responsibilities in an effective and efficient manner since its recent inception. Whilst the review noted a number of operational improvements that could be made, the interim arrangements since the beginning of operations have operated well.

Going forward however and with the size of the operations of the Adaptation Fund growing as a result of an increasing monetized Certified Emission Reduction Certificate (CER) Pool (i.e. Anticipated by the IBRD to reach USD 353 Million by end of December 2012), it may be timely to consider, notwithstanding that the interim arrangements have served the Adaption Fund well in the formative early years, whether a more formal organisational approach is more appropriate. This would be

in line with a maturing organisation acquiring critical mass and thus requiring a more independent structure to operate without undue reliance on other parties.

In this connection, the growth of the Adaptation Fund's operations due to increased funding and the increase in the number and the experience of accredited national and multilateral implementing entities, may well place pressures on the current arrangements from a governance, control and operational independence point of view. Whilst the Adaptation Fund Secretariat has been headed up by GEF senior management, which has served to support the fledgling Adaptation Fund from inception to operationalisation, such arrangements may become incompatible with latter's maturity. Since each organisation has different operational objectives, funding sources, corporate profiles and legal personality, conflicts in the manner by which the Adaptation Fund is strategically positioned are more likely to arise.

The review's recommendations for the forthcoming period are as follows:

*Current Operational Improvement Recommendations*

1. The Adaptation Fund Board should review the current staffing level of the Secretariat given the now active project pipeline, the importance of dedicated AF staff for technical co-reviews of projects and programmes and the eventual need for on-site project and programme monitoring.
2. The Secretariat should take on an oversight role over the operations of the Trustee's activities for sake of increased control. By way of examples, the Secretariat should ensure that the CERs available to the Adaptation Fund in its *Share of Proceeds Account* held with the Clean Development Mechanism is complete, accurate and received in a timely manner. In the same manner, it should reconcile the amount of CERs sold by the IBRD with those remaining in the *Share of Proceeds Account*. This oversight complements the work of the IBRD and considered standard practice for financial institutions to ensure the appropriate management of their funds when outsourced to a third party.
3. The Secretariat should invoke an additional control over project disbursements to ensure that each disbursement application is supported by the requisite tender evaluation reporting as per the National Implementing Entity's/Multilateral Implementing Entity's approved Procurement Policies (i.e. those previously accredited by the Accreditation Panel). This would ensure all costs are verifiable against concrete supplies of goods and services that have been/will be contracted for in compliance with best procurement practice. Such a control would ensure that the previously accredited procurement policies are operating effectively and would therefore safeguard the Adaptation Fund from potential reputational risk if they were not.

### *Future Operational Improvement Recommendations*

Going forward, the Adaptation Fund's operational expansion may necessitate a new approach to the current interim arrangements. A new approach however should best serve the Adaptation Fund and be conducive to good governance, management control and strategic planning. Points to consider are as follows:

1. The role of the GEF Secretariat and the role of the dedicated Adaptation Fund Secretariat, which is only now becoming mature in geographic scope and operational size, may not correspond or dovetail entirely potentially leading, in acute cases, to conflict as opposed to being complementary. As such, consideration for allowing the Adaptation Fund Secretariat an independent role with managerial capacity should be considered. At the moment, management of the Adaptation Fund Secretariat rests with GEF senior management as opposed to any dedicated Adaptation Fund staff. In accordance with good governance, only dedicated full time staff of an organisation should be tasked with managing it.
2. Further to the point above, the lack of an independent executive management for the Adaptation Fund has caused the Adaptation Fund's Board of Directors to become the executive body of the organisation and embody the role of executive management. Whilst this may have been the initial interim objective, such a role is incompatible with the directors' existing full time country-specific ministerial duties and with their responsibilities as Board members of the Adaptation Fund. As the Adaptation Fund's operations expand, the requirement for a dedicated Adaptation Fund managerial capacity within the dedicated Adaptation Fund Secretariat is critical to provide effective and focused continual leadership to a growing and innovative organisation.
3. The Adaptation Fund Secretariat should have the requisite number of staff and to be sufficiently independent over the conduct of its operations and not be unduly reliant on non-dedicated Adaptation Fund staff is a critical point going forward.

### *Overall summary with respect to the Adaptation Fund Secretariat*

To summarise, the current interim arrangements of the Adaptation Fund has served it well since its inception. The current *SWOT Analysis* is as follows:

#### *Strengths*

1. Availability of a motivated core team;
2. Developed technical skills within core team;

3. Operational procedures for project and programme reviews as well as national & multilateral implementing entity accreditation operating efficiently and effectively;
4. Administrative tasks for Board meetings being carried out effectively;
5. Assistance from GEF staff where required and use of its institutional memory.

#### *Weaknesses*

1. Lack of a formal Adaptation Fund-specific management structure within the Secretariat leading to the absence of effective leadership (ex-Board) supporting the strategic positioning and control of the Adaptation Fund going forward;
2. Undue reliance on chargeable and non-dedicated Adaptation Fund staff (i.e. GEF staff) to undertake Adaptation Fund-specific technical co-reviews of projects and programmes leading to potential lack of full accountability;
3. Lack of sufficient number of own staff to undertake co-reviews if GEF staff members are not available or otherwise committed to GEF tasks;
4. Lack of jurisdiction over other elements of the Adaptation Fund's operations such as CER stock control and Trustee investment management conformance with Board of Directors' investment risk appetite.

#### *Opportunities*

1. Ability to become an independent, pioneering and leading organisation focused entirely on adaptation projects;
2. Unutilised legal capacity conferred on it which would support point 1 above.

#### *Threats*

1. Growth in operational pipeline and workload not accompanied with growth in resources;
2. Growth of operations within another entity may not lead to synergy but potentially to competition over resources and overlap leading to Adaptation Fund's objectives not being met fully.

The foregoing leads the review to note that the current interim arrangements of the secretariat, going forward, may require a new approach to bring about organisational independence, management control, transparency and accountability in its operations. Using the analogy of a baby that has grown to full term, it is now time for its natural next phase, that of its full birth. Such a change however, would still retain the services of the Trustee (Refer section IV). Should this be considered, there are two main options for the Adaption Fund going forward in a more independent and stand alone basis as follows:

*Independent Secretariat-Option 1*

Take the opportunity of the legal capacity and the hosting offer available to it and consider whether an independent and fully resourced secretariat may better serve the objectives of the organisation.

The benefits of the above would be as follows:

- Enhanced independence in the manner by which its operations are managed and implemented.
- Enhanced control over its own operations and therefore full accountability for its performance.
- Allows closer ties and links to the United Nations Framework Convention for Climate Change (UNFCCC) and potentially use of its support services (Human Resources etc).
- Benefits from the immunities and privileges conferred to it by the German Government.

*Independent Secretariat-Option 2*

In this scenario, the Adaptation Fund Secretariat could adopt a GEF-like structure by having the existing dedicated AF Secretariat remain within the IBRD organizational and physical structure but as a stand-alone body. In adopting this option, the AF Board of Directors would need to ensure that the Secretariat possesses the requisite managerial authority and additional staff depth for this independent organizational structure.

All Accounting, Human Resources and Travel services currently being received, via the GEF, would be delivered directly by the IBRD to the newly created independent Adaptation Fund Secretariat in this alternative arrangement.

The benefits of the above would be as follows:

- Enhanced independence in the manner by which its operations are managed and implemented.
- Enhanced control over its own operations and therefore full accountability for its performance.
- Avoids logistical geographical move and re-location.

Both of these options however, would entail additional costs to fully staff the missing functions and house the requisite structure. It is recommended that the AF Secretariat provide the Adaptation Fund Board with a budget for either of these two options by way of additional information to fully consider the proposals made here.

## IV. FINDINGS WITH RESPECT TO THE TRUSTEE

### 4.1 Legal Arrangements

#### *4.1.1 Risk appetite in the investment of Trust Funds*

It was noted that the Terms of Conditions of Services to be provided by the IBRD as Trustee for the Adaptation Fund stated under clause 20 the following:

*'The Trustee shall invest the funds held in the Trust Fund, pending their transfer under paragraphs 15 and 22, in accordance with the Trustee's policies and procedures for the investment of trust funds administered by the World Bank, including commingling of the resources of the Trust Fund for administrative and investment purposes with other trust fund assets maintained by the World Bank. The commingling of Trust Fund resources for administrative and investment purposes should not affect the amount of resources from proceeds of CER monetization available in the Trust Fund for transfer of funds for Adaptation Fund operations, activities, projects and programmes.'*

It continues to state that:

*'The CMP acknowledges that no warranty is given by the Trustee as to the performance or profitability of the investment of the funds held in the Trust Fund.'*

Although the IBRD's *Investment Management of Trust Funds* document outlines the different tranches and pools available for trust funds and the strategic asset allocation process, the agreement is silent on the importance of setting the risk appetite as per the client's instructions at the outset and the periodic reporting and re-evaluation of the investment strategy with the client.

In this connection, we noted that the Adaptation Fund's monetized CERs and Donations net of disbursements were initially (i.e. May 2009) placed in the IBRD's Model Portfolio 1, Tranche 1, which couples capital preservation with maximizing return while limiting the probability of a negative return with a high confidence level over a specified time horizon of one year.

Towards December 2009, the funds were switched to Tranche 0 which is the cash tranche bearing the least risk of the four portfolios. However, in doing so, neither the first allocation nor the second could be verified against Adaptation Fund Board (AFB) meeting reports to demonstrate that a risk appetite/investment strategy was initially presented by the IBRD, approved by the Board and then altered later under advice.



It is imperative that the AFB is involved in the approval process since failure to do so may render the IBRD accountable for any negative returns and/or losses as a result of unilateral investment actions.

It is therefore recommended that the IBRD should periodically (preferably semi-annually) confirm and/or re-evaluate the Board's investment risk appetite in respect of its liquid assets, obtain approval for the investment strategy, invest and report accordingly.

#### 4.2 Cost effectiveness of the administrative services rendered by the Trustee for the Adaptation Fund Board

The review could not fully ascertain the cost effectiveness of the services rendered by the IBRD as Trustee given that there was no procurement process for comparison purposes for both the CER Monetization and Investment Management services at the inception of the Adaptation Fund.

Nevertheless, it was necessary, as an alternative, to review the supporting information for costs charged to the Adaptation Fund for these services as follows.

##### 4.2.1 Cost of the salaries, overheads and benefits to service the Adaptation Fund

It was noted that the cumulative costs of the Trustee services provided to the Adaptation Fund are listed as per Table 8 below. The table also includes the FY 2012 forecast for sake of further comparison.

Table 8: IBRD annual costs as Trustee (USD)

Cost Category	FY09	FY10	FY11	FY12 (forecast)
CER Monetization	588,000	645,000	673,467	678,584
Financial & Programme Management	349,000	288,000	152,186	140,258
Investment Management	600	20,000	70,252	*
Accounting & Reporting	147,000	55,000	55,220	55,218
Legal Expenses	251,000	67,100	44,243	56,000
External Audit			42,479	
Total	1,335,600	1,075,100	1,037,847	930,060

\* Excludes investment management fees which are added towards end of year and are 3.5 basis points (0.035%) of the assets under management throughout the period.

In this connection, we reviewed the costs involved with CER Monetization (USD678,584), being the largest component, and noted that these costs were made up mainly of staff salaries, benefits and overheads of all IBRD staff involved in CER Monetization. The remainder (USD145,000) represented travel costs, brokerage and costs related to the Carbon Exchange, BlueNext. The element of staff salaries within the 2012 forecast was USD533,584 and was verifiable as follows:

Table 9: IBRD CER Monetization staff composition and total staff costs (USD)

Cost Category (A)	IBRD Cost
<b>Trading &amp; Reporting</b>	
1 senior staff	
1 senior staff	
1 mid level staff	
<b>Back Office/Administration</b>	
1 Junior staff	
1 Junior staff	
1 Junior staff	
<b>Total</b>	<b>533,584</b>

As per the foregoing, we determined that the salaries charged for the AF Monetization element were approximately as follows:

- 1 x Senior staff member at 50pct of IBRD total cost (includes overheads)
- 1 x Senior staff member at 25pct of IBRD total cost (includes overheads)
- 1 x Professional Staff member at 50pct of IBRD total cost (includes overheads)
- 3 x Analysts at 25pct of IBRD total cost (includes overheads)

Given the fee is verifiable against actual costs of staff engaged in Monetization operations, these were found to be acceptable. All other costs were also deemed verifiable and satisfactory.

#### **4.2.2 Travel component**

It was noted that all meetings of the Adaptation Fund Board are attended by World Bank staff representing all the *three* (CFP, Legal & Capital Markets) departments that service the Adaption Fund. This however has also reflected in the amount of travel costs that are charged to the AF administrative Trust Fund amounting to USD100,000 to USD140,000 annually.

It is recommended that the World Bank reviews the necessity of the present staff complement that travel to AFB meetings restricting it to one staff member with any

possibility of reverting to the Board should any director intervention require further information. This should provide savings of at least USD60,000.

#### **4.3 Cost effectiveness of the management of the CERs including its sale to the markets**

Clause 8 of The Terms and Conditions of Services to be provided by the IBRD as Trustee for the Adaptation Fund under ref FCCC/KP/CMP/2008/11/Add.2 states that *'For the purpose of the monetization of CERs for the Adaptation Fund, the Trustee, in its capacity as agent of the CMP, is hereby authorized by the CMP to administer sales of CERs under the instructions, direction and guidance of the Adaptation Fund Board consistent with its responsibility for the monetization of CERs, pursuant to paragraphs 24, 25, 26, 27 and 28.'*

The Trustee has generally delivered on its specifically tailored mandate in the area of monetization of CERs in an efficient and cost effective manner since its inception. Costs are made up of Staff, Exchange as well as Trading costs and are transparent and verifiable to source documentation.

For the purposes of this review, it was not possible for confidentiality as well as appropriateness to obtain alternative quotations for such a service short of a public Request for Proposal. However, from our limited review of the carbon credit market as well as costing the service in house, the IBRD costs are considered very reasonable.

#### **4.4 Evaluation of the Trust Fund management and disbursement policy**

Our point under 4.1.1 covers this point whereby investment management decision making should be subject to regular Board discussions and approval.

#### **4.5 Adequacy and effectiveness of the reporting to the Adaptation Fund Board**

It was noted that the Trustee submitted periodic reports on the management of the Adaptation Fund Trust Account. However, the current reporting is limited and would benefit from the disclosure of additional aspects as pointed out below.

##### ***4.5.1 Lack of detailed investment management reporting***

The IBRD has been investing the Adaptation Fund's liquid assets since the commencement of the CER monetization programme. Our review noted that reporting on the CER monetization programme is all-encompassing and complete. However, it was noted that information relating to the *strategic asset allocation* of the resultant cash proceeds (incl. donations) by instrument, counterparty and tenor was missing. To date, the Adaptation Fund has never been informed as to the destination and make up of its funds. Investment management reports should outline the

investment profile and the potential risk in a portfolio resulting from the movement of interest rates, counterparty credit quality deterioration and operational risks etc.

As such, the Adaptation Fund Board is unaware of the extent of the adherence or otherwise of the current portfolio to the various risk limits, that have been set up within the IBRD, to assure itself that the portfolio is immune from losses resulting from unrestricted movements. Whilst it is acknowledged that investment in cash carries little return risk, one of the main risks is counterparty risk resulting from the inability of a bank to return funds to a depositor post financial collapse. This risk is highest during periods of economic crisis such as being experienced now.

In the course of the review of this item, it was not possible to obtain the relevant information from the IBRD as to the distribution, by bank, of the AF deposits to adequately assess the credit rating of the counterparties and to verify that these were in conformity to the risk ratings allowed in Tranche 0. The IBRD's position is that the information is sensitive to be disclosed by a multilateral development bank and that the Bank's practice was not to provide the list of individual banks/names.

Nevertheless, for the sake of an adequate review of IBRD performance and adherence to its Trust Fund Management's Strategic Asset Allocation, such information is of critical importance to the Adaptation Fund Board to ensure its own fiduciary responsibilities are carried out. As such, it is recommended that quarterly investment management portfolio reporting is submitted to the Adaptation Fund Board for attention and discussion.

#### ***4.5.2 Liability for losses on the Adaptation Fund's investments***

The review noted that there was a lack of clarity with respect to the liability for any credit losses incurred on Adaptation Fund funds under IBRD management. This is particularly relevant considering the fact that Adaptation Fund funds are *commingled with other trust fund assets maintained by the IBRD*, with the result that within a pool of USD25 billion it will be difficult, if not impossible, to identify where the Adaptation Funds are.

In the event of failure of one or more counterparties in the IBRD model portfolio in which the Adaptation Fund had invested (e.g. Tranche 0), it is not known whether any losses incurred would be for the account of the IBRD, or whether the losses would be apportioned to the investees in that particular portfolio, and if so how they would be apportioned among the investees including the Adaptation Fund.

The Adaptation Fund is not in a position to influence the choice of counterparties in any of the IBRD Tranches it might invest in, and receives no information on the nature of investments and counterparties. It may therefore consider the IBRD as its

ultimate credit risk, as opposed to the underlying counterparties, but this may not be the view taken by the IBRD.

This matter should be resolved to avoid any unnecessary legal dispute should the event occur. As such, the Adaptation Fund Board should seek clarification from, or agreement with, the IBRD on this matter.

## **Appendix I**

### **Terms of Reference for Hiring the Consultant to Conduct an Independent Review of the Interim trustee and the Interim Secretariat Servicing the Adaptation Fund Board**

#### **Background**

At the third session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), which was held in Bali, Indonesia from 3-14 December 2007, Parties in decision 1/CMP.3 decided to establish the Adaptation Fund Board (AFB) as the operating entity to supervise and manage the Adaptation Fund, under the authority and guidance of the CMP. The AFB is fully accountable to the CMP, which decides on the overall policies of the Adaptation Fund.

Upon invitation from Parties, the Global Environment Facility (GEF) provides secretariat services to the AFB and the World Bank serves as trustee of the Adaptation Fund on an interim basis. These interim institutional arrangements will be reviewed in 2011.

At CMP 4, Parties expressed their appreciation to the AFB for having carried out the functions of its work plan, in accordance with decisions 5/CMP.2 and 1/CMP.3, and urged it to continue to do so with a view to fully operationalizing the Adaptation Fund. Parties in decision 1/CMP.4 also adopted the rules of procedure of the Adaptation Fund Board. The CMP encouraged the AFB to keep its rules of procedure under review and, if necessary, make recommendations concerning any amendments aimed at enabling the AFB to function in an efficient, cost-effective and transparent manner.

At CMP 5, Parties endorsed the decision of the AFB to accept the offer of Germany to confer legal capacity on the AFB and invited Germany to make the necessary arrangements. Parties also adopted the amendments to the rules of procedure of the AFB as contained in the annex of decision 4/CMP.5.

At CMP 6, Parties expressed appreciation to the Government of Germany for conferring legal capacity on the AFB and requested the Adaptation Fund Board to undertake independent performance reviews of the interim secretariat and the interim trustee servicing the Adaptation Fund.

#### **Objective**

As per the terms of reference established by the CMP, the objective of this initial review is to ensure the effectiveness and adequacy of the Adaptation Fund and its

interim institutional arrangements, with a view to the CMP adopting an appropriate decision on this matter at its seventh session..

In carrying out this review, the consultant shall take into account the following:

For the:

*Secretariat*

- i. Legal arrangements between the Adaptation Fund Board and the Secretariat;
- ii. Adequacy of planning and implementation process of activities;
- iii. Coherence and effectiveness in the project review process in line with the AFB's operational policies and guidelines;
- iv. Staff and officers dedicated to undertake activities assigned to the AFB Secretariat;
- v. Cost effectiveness of the budget allocated to non-dedicated and dedicated staff;
- vi. Financial practices of other Secretariats;
- vii. Interaction with the implementing entities and other relevant bodies of the Convention and the Kyoto Protocol;
- viii. Cost effectiveness and necessity of maintaining the Secretariat services against an independent Secretariat;

*Trustee*

- i. Legal arrangements between the AFB and the Trustee and the arrangements between other organizations;
- ii. Cost effectiveness of the administrative services rendered by the Trustee for the Adaptation Fund Board;
- iii. Cost effectiveness of the management of Certified Emission Reduction Certificates (CERs) including its sale to the markets;
- iv. Evaluation of the trust fund management and disbursement policy;
- v. Adequacy and effectiveness of the reporting to the Adaptation Fund Board.

In carrying out the study, the consultant will identify strengths, weaknesses, opportunities and any risks to the Adaptation Fund and will make recommendations to address and improve these arrangements between the Adaptation Fund Board and the Secretariat and the Trustee.

The consultant shall also seek the opinion of the relevant persons, in particular the Chair and the Vice Chair, and institutions and other relevant sources of information deemed useful.

## Appendix II

### List of Projects Received by Adaptation Fund since call for projects in April 2010

Project	Amount (USD)
Argentina	4,311,703
Cook Islands	4,991,000
Djibouti	4,658,556
Ecuador	7,449,468
Egypt	5,720,000
Eritrea	6,520,850
Fiji	5,728,800
Georgia	5,316,500
Guatemala	5,425,000
Honduras	5,698,000
India	5,425,000
Jamaica	9,995,000
Madagascar	4,504,920
Maldives	8,989,225
Mauritania	15,000,000
Mauritius	9,119,240
Mongolia	5,500,000
Nicaragua	5,500,950
Niue	3,465,000
Pakistan	3,906,000
Papua NG	5,227,530
Salvador	5,425,000
Senegal	8,619,000
Seychelles	6,455,750
Solomon Islands	5,533,500
Sri Lanka	7,982,555
Tanzania	9,814,517
Turkmenistan	2,929,500
Uganda	13,059,726
Uruguay	7,350,000
<b>TOTAL</b>	<b>199,622,290</b>



## Appendix III-Sample of Tests

### Sample of tests

- Identify from compendium of existing policies and guidelines whether any missing policies are required (i.e. Risk, Procurement, Work out, Budget, Project Risk Rating, Credit Policies, Environmental & Social Policies etc).
- Identify the OPG and vouch for an annual review along with all other critical AF operational policies.
- Identify operational limits where applicable and ensure that they are complete for AF operational purposes. Identify any issues arising.
- Review governance framework (including ToR's of committees) and identify any missing areas and assess accordingly gap analysis/results.
- Obtain the Secretariat organisation chart responsible for the management of the daily operations of the AF and assess the job description/responsibilities of each staff member and consider any issues.
- Obtain every annual administrative budget for the periods under review and ensure these were submitted to, discussed and approved by the AFB (and/or EFC).
- Identify Secretariat direct and indirect charges/costs & fees and assess their appropriateness.
- Identify their reporting lines and performance appraisal and remuneration structure to ensure their functional independence.
- Ensure completed Accreditation Applications Forms have been submitted for all NIEs/MIEs and that these have been screened by the Secretariat.
- Track actual project cycle against policies and procedures and identify and gaps and/or issues.
- Using OPG as a guide, ensure that all project applications are complete in terms of required information.
- Ensure projects are endorsed by relevant UNFCCC national focal points.
- Ensure that applications have had a complete technical review by the Secretariat.
- In the absence of a GEF Risk Management Department whose task is to verify the efficacy, accuracy and completeness of the application, how does the current set-up ensure that applications are not superficially assessed and/or reviewed.
- Ensure that for sample selected of completed projects, annual or semi annual status reports, where applicable, have been submitted to the PPRC.
- Assess the independence criteria utilised to select the Evaluator/s in above cases and consider whether arising issues.
- Enquire whether the underlying Fund's investments including their size, currencies, asset classes and general objectives - is formally established under

Trustee Policies & Guidelines and is being reviewed by senior Secretariat staff on a regular basis to confirm its continued appropriateness and accuracy.

- Obtain the external audit reports of the financial statements of the Trust Fund since inception and consider any relevant issues.
- Ensure that there exists approved guidelines on monetization of CERs, based on proposals submitted by the Trustee.
- Vouch for the monetization method taken by the IBRD and that it is in line with what was approved by the AFB.
- Determine and assess the procedures for reviewing the investment directives of the IBRD in light of any changes and whether this is reviewed by the Secretariat for appropriateness.
- Review the current IBRD investment directives to ensure they are consistent with the risk appetite of the Adaptation Fund.
- Obtain sample of reports received via the Secretariat from the IBRD to ensure that they were reviewed by the Secretariat. Consider whether the review of these reports is adequate to ensure that investments and commitments entered into by the IBRD comply with the express or implied risk appetite of the AF (in terms of credit and market risk mainly).
- Enquire with the Secretariat whether there have been any cases where executed trades were found to have been inconsistent with the AF's implied/express risk appetite, and if so assess the appropriateness of action taken.
- Enquire whether there are reconciliations between the Secretariat records and the IBRD's figures. If so, review a sample of 5 weekly reconciliations performed and ensure that they have been properly performed and that all discrepancies were investigated and resolved in a timely manner.

## Appendix IV-Comments on report received from the GEF as Secretariat

COMMENTS FROM THE GLOBAL ENVIRONMENT FACILITY SECRETARIAT ON THE REVIEW OF THE INTERIM ARRANGEMENTS OF THE ADAPTATION FUND NOVEMBER 02, 2011

### INTRODUCTION

1. We would like to thank the consultant, Mr. Tarek Rouchdy, for sharing the final draft report of the review with the GEF Secretariat. Our comments relate to the findings of the review associated with the performance of the GEF Secretariat in the provision of secretariat services to the Adaptation Fund Board.
2. At the outset, we are pleased that the review found neither any deficiency nor raised any concern regarding the secretariat services provided by the GEF since the inception of the Adaptation Fund Board in 2008. Therefore, we are puzzled that the conclusion of the review is not positive with regard to the continued engagement of the GEF in the provision of secretariat services to the Adaptation Fund Board.
3. We had two opportunities to provide comments on the draft versions of the report, and would like to commend Mr. Rouchdy for adjusting the report after due consideration of our feedback. While we find some merit in some of the *Current Operational Improvement Recommendations*, we cannot say the same about *Future Operational Improvement Recommendations*, where a weak argument about the maturity in geographical scope and size is employed to argue for an independent Adaptation Fund Secretariat.
4. Therefore, the overall recommendation that “the Adaptation Fund consider whether an independent and stand-alone Secretariat (both option 1 and option 2) may better serve the objectives of the organization”, is not based on a review of operational effectiveness and efficiency of the current arrangement as required by the Terms of Reference.
5. We would like to note that Mr. Rouchdy did not visit the Secretariat until towards the end of the review; even during this visit, he spent very little time with senior management of the GEF Secretariat discussing the details of provision of secretariat services. It is further disconcerting that the only discussion he had with the GEF CEO was a telephone conversation after he had written a draft of the report.
6. Please find here our detailed responses on the findings and recommendations in the areas covered by the review.

## Legal Arrangements

### *Oversight over the Operations of the Adaptation Fund Trustee*

7. The recommendation in the review regarding the oversight role of the Secretariat reflects a misunderstanding of the roles of the Secretariat and the Trustee. The Trustee is currently directly accountable to the Board, and suggesting that the Secretariat should have an oversight function over the Trustee would certainly eliminate significant 'checks and balances', precisely creating the kind of conflict of interest (basic segregation of duties would be violated) that the review repeatedly states *could* occur. The views of the Trustee's office on this issue should have been sought and integrated in the report as it is critical to this recommendation.

8. We, however, support the review's recommendation that the Adaptation Fund Secretariat should establish a process to independently confirm: (i) the number of CERs due to the Adaptation Fund from the Clean Development Mechanism in the *Share of Proceeds* account; (ii) the number actually sold; and (iii) the value credited to the Adaptation Trust Fund.

### **Adequacy of Planning and Implementation Process of Activities**

9. The review's recommendation that the Adaptation Fund staff present a business case for "an additional staff complement to allow itself to become independent in its project and program technical review process" is based on an unfounded argument regarding unreliability of GEF Secretariat staff.

10. The review's recommendation that the Adaptation Fund Secretariat undertake site visits to projects under implementation is indeed a sound way to strengthen the portfolio-level monitoring functions of the Secretariat. However, it is important to ensure that the Secretariat is not involved in the day-to-day project implementation and monitoring issues. To employ these site visits to make disbursement decisions, as suggested by the review is micromanagement of project implementation that is best left to the implementing agencies. Onsite project and program monitoring is the responsibility of the implementing entity with direct accountability to the Adaptation Fund Board, while the Secretariat focuses on the monitoring at the portfolio-level based on reports received from the implementing entities. The Secretariat then reports on the overall health of the portfolio to the Adaptation Fund Board. Furthermore, the implementing entities' risk management systems have been assessed by the Accreditation Panel as part of the review of the implementing entity accreditation application and those apply to the projects under implementation by each implementing entity. For the project risks aspect, this will be established under the portfolio monitoring framework. A section specific to risk will be available in the project report template, to inform the project risks and aggregate them at the portfolio level.

11. In order to strengthen the portfolio monitoring function at the Secretariat, the Adaptation Fund Board may want to consider an inspection function at the Secretariat to undertake field visits and spot-checks on selected projects.

### **Coherence and Effectiveness in the Project Review Process in line with AFB's Operational Policies and Guidelines**

12. The review recommends project concepts be "endorsed" by the Secretariat and forwarded to the Adaptation Fund Board without submitting them to the PPRC. We think that this recommendation, if implemented, could save considerable time at the Adaptation Fund Board meetings.

13. The Secretariat involvement in disbursements and procurement activities, on a day-to-day, as recommended by the review is not reflective of the role of the Secretariat. Disbursement and procurement activities are better left to be managed between the implementing entities and the executing entities in line with the policies and procedures approved by the Adaptation Fund Board (operational policies and guidelines) following CMP guidance. The implementing entities are directly accountable to the Board and bear full monitoring, reporting and financial responsibility. The procurement policies and procedures of the implementing entity have been assessed by the Accreditation Panel when assessing the accreditation application of each IE and deemed adequate. Moreover, the agreement between the Board and the implementing entity states: *The procurement of goods and services (including consultants' services) for activities financed by the Grant will be carried out in accordance with the [Implementing Entity's] standard practices and procedures, including its procurement and consultants' guidelines.* However, the Secretariat's inspection role referred to in paragraph 11 could be expanded to include review of procurement practices on an annual basis, randomly choosing among implementing entities that are engaged in project implementation activity.

### **Cost Effectiveness and Necessity of Maintaining the Secretariat Services against an Independent Secretariat**

14. The review's argument that the roles of the GEF Secretariat and the Adaptation Fund Secretariat 'may not dovetail entirely, potentially leading to acute cases of conflict as opposed to complementarity,' is not evidence-based. On the funding front, donors contribute resources to different funds based on strategic directions of the funds and the demonstrated track-record for delivering results. Donors also aim for complementarity between funds. In this context, the GEF has aimed to build complementarity between the different funds (see sections below) so that together they can be more synergistically employed for the benefits of recipient countries. Therefore, the Adaptation Fund benefits from its Secretariat being housed in the GEF.

15. On the programmatic front, the review fails to appreciate the complementarity between GEF programs and projects with those of the Adaptation Fund. The close working relationship that is in place between the GEF Secretariat and the Adaptation Fund Secretariat aims to avoid duplication and to seek synergies in programming. The review's finding that program review support provided by the GEF Secretariat staff could lead to conflict is based on the misunderstanding of actual complementarity. The GEF Secretariat aims to provide its best experts to undertake technical reviews of proposals submitted to the Adaptation Fund. With 20 years of experience, and thousands of projects behind it, the GEF has developed a unique set of skills and knowledge that constitutes an equally unique advantage for the 7 person strong Adaptation Fund Secretariat. The support provided by GEF experts allows for much faster, efficient and synergetic analysis/reviews than if external individuals were hired or new staff groomed into the Adaptation Fund (at cost) until the point they reach a level of expertise and experience approaching the one currently available. The Adaptation Fund Secretariat will have to hire at least 10 additional staff if it were to replace the services currently provided by the GEF Secretariat.

16. The GEF Secretariat has been supportive of the work of the Adaptation Fund Secretariat from the very beginning. It is important to recall that the work of the Adaptation Fund Board got off to a quick start in 2008 because GEF Secretariat staff members, on the basis of their knowledge and experience with the GEF, were able to help the Adaptation Fund Board establish basic institutional, policy and legal architecture within a year. In its programming strategy, the GEF is increasingly supporting countries to prepare projects that pull together resources from the GEF Trust Fund, the SCCF and LDCF, thereby implementing projects that reflect the real sustainable development needs on the ground. Given this strategic approach, the GEF would in the future like to work with the Adaptation Fund to seek synergies for countries rather than compete with it as alluded by the review.

17. One of the weaker points of the review is the cost-benefit analysis presented to support the recommendation for an independent secretariat (whether independent in Bonn, or administratively supported by the World Bank in Washington). The review estimates an annual saving of \$650,000, which is flawed due to the following reasons:

(a) First, it assumes (with no evidence) that office space and other facilities will be provided free of cost in Bonn (for option 1);

(b) Second, it assumes that services provided by the GEF Secretariat staff (currently budgeted at \$227,627) is not required. These services provide support to the Adaptation Fund Secretariat for programming, human resources management, financial management, information technology, facilities support, etc. We estimate that at least 10 full staff members, at an additional cost of \$1.8 million per year, need to be hired to replace the services currently provided by the GEF Secretariat staff; and

(c) Third, it fails to account for the higher salary rates (UN rates are 14% higher as noted in Table 4 of the review), should the Secretariat be relocated to Bonn.

## SUMMARY

18. The review's recommendation that the Adaptation Fund Board would be better served by an independent Secretariat is not based on a factual assessment of the arrangements that currently exist, but on interpretations of "potential conflict," and a weak argument of maturity of the geographical scope and size of the Adaptation Fund Secretariat. In fact, housing the Adaptation Fund Secretariat with the GEF Secretariat should help it meet its growing needs without increasing the administrative budget.

19. In comparing other funds, the review fails to compare the funds such as LDCF and SCCF that are housed within the GEF, but instead draws comparisons only with external entities. The management/provision of secretariat support for different funds under the GEF umbrella provides for better alignment, complementarity and cooperation among the different funds leading to enhanced aid effectiveness – a goal of the Paris Declaration on Aid Effectiveness. The review's interpretation of such an arrangement leading to competition is a total misreading of experience.

20. Finally, the cost-benefit analysis of an independent secretariat based in Bonn (option 1) or independently located in Washington (option 2) is flawed since it does not take into account the need for services (under both options) that are currently delivered by the GEF Secretariat staff.

21. We strongly feel that this report constitutes a missed opportunity to build on the experience and lessons learned from the past, towards a more efficient Adaptation Fund, more economies of scale and synergy with the GEF and its related funds, and towards a better service for the beneficiaries. Nevertheless we hope that our comments will be taken into consideration during deliberations regarding the future of the arrangements for the Adaptation Fund.

22. The final version of the report still contains a factual error as noted in the attachment.

### **Attachment: Error in the Final Draft Review Report**

Table 6: Comparison of Administrative Expenses on p. 27 shows cost per staff for 3 fund secretariats by simply dividing the administrative cost by the number of dedicated staff. The table implies that AFB secretariat is more expensive per staff among 3 but it doesn't consider any different settings each secretariat has. The administrative cost referred in this table is the total secretariat budget that includes everything such as travel costs of Board members, meeting organizational cost etc. As such, the administrative cost of the Adaptation Fund which entail 4 times of Board

meeting organization per year can't be compared with ones of other secretariat that organize their Board meetings in different frequencies and with the different number of Board members. Also, the Adaptation Fund receives cross staff support from GEF so the actual number of staff working for the secretariat is more than 7. Given the above-mentioned reasons, the cost per staff shown in the table is quite biased.



## **Appendix V-Comments on report received from the IBRD as Trustee**

### **Comments from the International Bank for Reconstruction and Development (the “World Bank”) as Interim trustee for the Adaptation Fund on the Review of the Interim Arrangements of the Adaptation Fund**

#### *General Comments:*

1. The World Bank, as interim trustee for the Adaptation Fund, notes that the review concludes that the Bank has carried out its work as interim trustee in an effective and efficient manner across all its duties and responsibilities since its inception and that there are no pressing issues that would require altering the existing arrangements.
2. The Bank is, however, concerned that the limited time available to the consultant to undertake the review has contributed to certain misunderstandings related to the mandate that the CMP and Adaptation Fund Board have entrusted to the trustee, particularly related to the Bank’s role in investment management of the undisbursed balances in the Adaptation Fund Trust Fund.
3. The Bank is presently trustee for 18 financial intermediary funds (FIFs), representing approximately USD 48 billion in cumulative funding and USD 18 billion of funds held in trust. The Adaptation Fund Trust Fund represents approximately USD 228 million, or about 1 percent of this total. Across all FIFs, the trustee service utilizes the established policies and procedures of the Bank for trust fund management; and the Adaptation Fund benefits from the economies of scale resulting from this standardization.
4. The report contains recommendations with respect to the Adaptation Fund secretariat that, if implemented, could have impacts on the Bank as the administrative and legal platform for the secretariat, and would require further consultation with both the secretariat and trustee if these recommendations were to be pursued. The report states that Adaptation Fund Board legal capacity would facilitate an independent secretariat in Bonn, but the Adaptation Fund itself does not have legal personality and thus would not be able to employ staff.
5. The Bank has limited its comments on the report to those areas directly impacting the responsibilities of the Bank as interim trustee, i.e. for CER monetization, trust fund management, financial management of the resources of the Adaptation Fund Trust Fund, investment management, and accounting and financial reporting.

*Verification of CERs in the CDM Share of Proceeds:*

6. The Bank welcomes the suggestion that a verification function be introduced to ensure that the CERs available to the Adaptation Fund in its Share of Proceeds Account held with the Clean Development Mechanism is complete, accurate and received in a timely manner before the CERs are made available to the trustee for monetization. This is presently neither a trustee nor a secretariat responsibility.

*Trustee controls, systems and risk management:*

7. The management of all trust funds by the Bank is subject to robust control and risk management practices. The trustee questions the appropriateness of a role for the Adaptation Fund secretariat in oversight over the trustee's activities, as recommended in the report, and would not support such a role under the present arrangements. As proposed, the recommendation may create the perception of a conflict of interest given that the Secretariat and the Trustee are both housed at the World Bank; it also runs contrary to the Terms and Conditions of Services which establish that the trustee shall only be accountable to the Adaptation Fund Board.
8. The report makes reference to the Bank's external Auditors' opinion on the June 2010 Adaptation Fund Trust Fund financial statement, correctly quoting a standard disclosure made by auditors in their audit opinions pursuant to auditing standards generally accepted in the United States of America, the basis under which the audit was engaged to be performed – i.e., that "an audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the interim Trustee's internal control over financial reporting". While this is factually correct, it may be inferred that this is a negative attribute associated with this audit, which is not the case. This qualification is present in any audit report where the purpose is not to express an opinion on internal controls. While the purpose of the financial statement audit is not to specifically assess internal controls, the external auditors are required as disclosed in said standards and do consider the internal control environment in developing their financial statement audit approach. We strongly believe this context should be provided in the report. Having said this, the Bank does undertake a separate and specific audit of Management's assertion regarding the effectiveness of internal control over financial reporting of modified cash basis trust funds (aka "The Single Audit"), to which the consultant has referred in his report. The Adaptation Fund Trust Fund is included within the scope of the Single Audit. Furthermore, the Bank has received an unqualified audit opinion on the Single Audit.

***Cost effectiveness:***

9. The trustee welcomes the assessment that its work has been carried out in an efficient manner and that costs are “very reasonable”. The trustee also welcomes the suggestion to further reduce travel costs by limiting the number of representatives to Adaptation Fund Board meetings. It should be noted, however, that the trustee Terms and Conditions provide that CMP or Adaptation Fund Board decisions related to the functions of the trustee be developed in close consultation with the trustee and that the trustee may attend meetings of the Adaptation Fund Board and CMP as the trustee deems appropriate.

***Investment Management Reporting:***

10. The report unfortunately does not reflect a complete understanding of the nature of the Bank’s investment management services as trustee. The agreement between the Bank and the CMP provides that the trustee shall invest the funds held in the Adaptation Fund Trust Fund in accordance with the trustee's policies and procedures for the investment of trust funds administered by the World Bank. The Bank separates the investment assets of trust funds into investment tranches with different investment objectives, investment horizons and risk tolerance, based on the nature of the cash flows in the trust fund. The investment objective of each tranche is to optimize investment income subject to the preservation of capital and the liquidity requirements of the underlying trust funds. Each investment tranche represents a different model portfolio to achieve that objective over the distinct investment horizons, which range from daily up to three years. All funds within the trust funds investment pool are reviewed periodically with a view to ensure that they are allocated to the most suitable investment tranche, based on multi-year cash flow projections for each trust fund. The Bank’s investment management for the Adaptation Fund Trust Fund is undertaken with preservation of capital as the dominant objective, such that resources are available for cash transfer for adaptation projects upon instruction by the Board. The investment objective for Adaptation Fund funds is “to enhance returns subject to ensuring liquidity and timely availability of cash when needed”. The trustee maintains that this provides the most appropriate, cost effective investment platform for the Adaptation Fund. The pool makes use of the Bank’s well-established custody, brokerage and trading agreements which gives it broad access to a wide range of investment strategies. In addition, it is subject to the same investment guidelines which are used for managing the World Bank's own funds. The Bank would be pleased to provide additional information to the Adaptation Fund Board on the investment strategy for the Adaptation Fund and discuss with the Board the most appropriate investment tranches based on the projected cash flow needs of the Adaptation Fund.

11. The report suggests that the IBRD is the Adaptation Fund Board's ultimate credit risk (however the trustee agreement is with the CMP, not the Adaptation Fund Board). With respect to counterparty risk, there is already agreement between the trustee and the CMP in respect of losses as a result of an IBRD's counterparty failure to return monies deposited with it in the course of IBRD's donor investment program. The Adaptation Fund and CMP acknowledged in the Terms and Conditions that no warranty is given by the trustee as to the performance or profitability of the investments of the funds held in the Trust Fund. Accordingly, in case of a loss resulting from an IBRD's counterparty failure to return monies deposited with it, the trustee will not be responsible for such a loss as long as such a loss is not incurred by a direct result of Bank's gross negligence or willful misconduct. There is no warranty given by the trustee as to the performance or profitability of the investment of the funds, and this has been clearly established in the Terms and Conditions of Service between the trustee and the CMP. This applies to all trust funds managed by the Bank. It is worth noting, however, that there has not been a negative reported investment return over any given fiscal year for the trust fund investment pool, due to the conservative risk tolerances in place for the pool.

*Other Comments:*

12. A key measure of the cost-effectiveness of the trustee that has not been reflected in the report is the trustee's performance in CER monetization. In this respect, since the trustee commenced the CER monetization program in May 2009, the average daily closing market price for CERs has been less than EUR 12. The average price achieved by the trustee through the monetization program has been EUR 12.43. This premium gained by the trustee over the 9.96 million CERs sold to date represents approximately EUR 4.8 million in additional revenue for the Adaptation Fund – an amount which far exceeds the total cumulative administrative costs for all aspects of the trustee's services to date.
13. The Bank is providing these comments only to provide further input to certain points addressed in the consultant's report. The Bank does not intend these comments to be interpreted as consultation with the Adaptation Fund Board or CMP with respect to any amendment or other issue related to the Terms and Conditions of Services or any of the trustee's functions and responsibilities as stated in such Terms and Conditions of Services.

The World Bank  
As interim trustee for the Adaptation Fund  
November 4, 2011

## Appendix VI-About the Author of the Review

*Tarek Rouchdy BA ACIB FCCA AMCT*

Tarek Rouchdy (TR), an Egyptian national, is currently founder and Managing Director of ToneStar Consulting Ltd, a financial consulting and advisory firm based in the United Kingdom. Formerly, *Head of Internal Audit* at the European Bank for Reconstruction & Development (EBRD) London for over 15 years, and *Chief Financial Officer* of the Central Bank of Egypt, TR, has over 30 years of experience in financial institutions mainly as an accountant, internal auditor & fraud investigator.

Prior to the EBRD, he worked for the Bank of Nova Scotia, Cairo & London, Italian International Bank, London (A Monte Dei Paschi subsidiary) and Bank Mees Hope NV, London (currently Mees Pierson, a subsidiary of ABN-AMRO Group) in a variety of roles covering operations, accounting and internal audit.

Working directly for 2 former IMF Managing Director's among past presidents of the EBRD (Jacques de Larosière & Horst Köhler), TR has a long track record of working in commercial, development and central banks.

A sample of his career experiences are as follows:

1. Carried out and participated in several Quality Assessments of internal audit functions of major financial institutions in accordance with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing as follows: European Investment Bank, Asian Development Bank, African Development Bank, Central Bank of Belarus.
2. Co-lead with the EBRD Controller, all fraud investigations for the EBRD between 1991-2002 including co-writing the Bank's Investigative Policies and Procedures.
5. Technical expert attached to the UNDP's *External Independent Investigative Review* Panel in 2007 that evaluated the UNDP's operations in DPRK (North Korea) known as the Nemeth Report.

Graduating from the American University in Cairo, Egypt in 1976 with a Bachelor of Arts in Economics, Mr. Rouchdy is also a Fellow of the *Chartered Association of the Certified Accountants*, United Kingdom, an Associate of the *Chartered Institute of Bankers*, United Kingdom, as well as being an Associate of the *Association of Corporate Treasurers*, United Kingdom.