ADAPTATION FUND

AFB/EFC.16/8
8 April 2015

ADAPTATION FUND BOARD
Ethics and Finance Committee
Sixteenth Meeting
Bonn, 7-8 April 2015

REPORT OF THE SIXTEENTH MEETING OF THE ETHICS AND FINANCE COMMITTEE FOR BOARD REPORT

Agenda Item 1: Opening of the meeting

1. The outgoing Vice-Chair of the Ethics and Finance Committee (EFC), Ms. Irina Helena Pineda Aguilar (Honduras, Group of Latin American and Caribbean Countries) opened the meeting and greeted the participants at 9.30 a.m. on 7 April 2015.

Agenda Item 2: Transition of the Chair and the Vice-Chair

2. Ms. Irina Helena Pineda Aguilar (Honduras, Group of Latin American and Caribbean Countries) took over the Chairmanship of the EFC. Ms. Tove Zetterström-Goldmann (Sweden, Annex I Parties) took over the Vice-Chairmanship from Ms. Pineda Aguilar.

3. At the invitation of the Chair, Ms. Zetterström-Goldmann described her background and said that she looked forward to contributing to the work of the EFC.

Agenda Item 3: Organizational matters

(a) *Adoption of the agenda*

4. The agenda below was based on documents AFB/EFC.16/1 (Provisional agenda) and AFB/EFC.16/2 (Annotated provisional agenda).

5. The Vice-Chair requested that an item on development of a gender policy and action plan for the Fund be added to Other Matters.

6. At the invitation of the Chair, the Manager of the secretariat proposed the addition of four items to Other Matters: a request by UNDP to approve material changes in the budget allocation

for the projects in Maldives, as per paragraph 4.03 of the legal agreement; an amendment to the Project Performance Report (PPR) template for including space for implementing entities to report on the investment income generated by the project grant; approval of the third tranche of funds for the Adaptation Fund project in Eritrea (UNDP); and approval of the fourth tranche of funds for the project in Nicaragua (UNDP).

7. Thus amended, the agenda was adopted.

1. Opening of the meeting
2. Transition of the Chair and the Vice-Chair
3. Organizational matters
    (a) Adoption of the agenda
    (b) Organization of work
4. Modified accreditation process for small entities
5. Evaluation of the Fund
6. Complaint handling mechanism
7. Implementation of the code of conduct
8. Financial issues
    (a) Guidelines for the monetization of carbon assets;
    (b) Financial status of the Trust Fund and CER monetization;
    (c) Work Plan for the fiscal year 2016;
    (c) Board and secretariat, and trustee budgets for the fiscal year 2016.
9. Other matters
10. Adoption of the recommendations and report
11. Closure of the meeting

(b) Organization of work

8. The Committee adopted the organization of work proposed by the Chair.

9. The Chair welcomed four new Board members to the EFC: Ms. Tove Zetterström-Goldmann (Sweden, Annex I Parties); Ms. Umayra Taghiyeva (Azerbaijan, Eastern Europe); Mr. Naresh Sharma (Nepal, Least Developed Countries); and Mr. Samuela Vakaloloma Lagataki (Fiji,

Small Island Developing States). At the invitation of the Chair, the new members briefly introduced themselves.

10. In accordance with paragraph 29 of the rules of procedure, the Chair then called upon all EFC members to orally declare any conflict of interest that they might have with any item on the current meeting agenda. One member said that he might have a conflict of interest when a particular MIE was discussed.

Agenda Item 4: Modified accreditation process for small entities

11. The representative of the secretariat gave a presentation on the topic. At its 23rd meeting the Board had decided to continue its consideration of approval for accreditation of small national implementing entities on the basis of a streamlined accreditation process (Decision B.23/17). Based on the update from the Accreditation Panel on its experience in operationalizing the streamlined accreditation process and on advising two applicants on compensatory measures to address the requirements of the fiduciary standards, the Board in decision B.24/22 had encouraged the Panel to finalize its work on the two cases considered applicable for a streamlined approach and to present a standardized streamlined accreditation process for consideration by the Board at its 25th meeting.

12. Document EFC.16/7 presented a proposed streamlined accreditation process.. The process was based on five key areas: assessment of risks; emphasis on identifying alternate ways to meet standards; added flexibility for the applicant; reduced time and effort needed by applicants; and alignment (where possible) with the fit-for-purpose approach of the GCF.

13. The characteristics of a small NIE were that it was executing or implementing projects up to US$1 million per project; that it had up to 25 professional staff and that it had annual administrative expenses of up to US$1 million. However, those characteristics were just a guideline: there was room for flexibility on the numbers.

14. The features of the proposed process were that in the early stages of an accreditation application, if it were discovered that mitigating control measures were going to be necessary, these would be put in place and the entity would continue into the streamlined process. It was anticipated that the streamlined accreditation process should take less time than regular accreditation, upfront costs would be reduced, and the entity could be accredited using its own systems. If a small NIE was finally accredited, there would be a monetary limit on the size of project it could apply for.

15. The representative of the secretariat listed the mitigating controls that would need to be applied, in the areas of financial statements; audit committee; accounting package used; internal audit; internal control framework; procurement; project approval and appraisal; and project monitoring and evaluation during implementation.

16. The Committee welcomed the presentation. Questions were asked about the timing of the accreditation process for small entities; about how many NIEs a country would have (it was pointed out that if a small country needed a larger amount of funding, it could turn to an MIE or RIE); whether the control measures created were satisfactory and sufficient; whether the streamlined accreditation process would in fact increase costs, and whether it would increase the workload of the secretariat.

17. The representative of the secretariat stressed that the accreditation standards were not changing; only the way the standards were demonstrated would be changed. It was agreed that as the streamlined process was a new process, it should be revisited to see how it was working. It was also agreed that for the time being a country would only be eligible for one national implementing entity (whether that entity was accredited with monetary limits or not).

18. Following the discussion, the Ethics and Finance Committee recommended that the Board:

a) Approve the streamlined process as outlined in document AFB/EFC.16/7/Rev.1;

b) For any proposed streamlined accreditation, request the Accreditation Panel to recommend the appropriate monetary limit and describe the compensatory measures applied for the small national implementing entity; and

c) Revisit the streamlined process at the 28th Board meeting

(Recommendation EFC.16/1)

Agenda Item 5: Evaluation of the Fund

19. The representative of the secretariat introduced the item. The Board at its 23rd meeting had decided to approve the option of a two-phase evaluation of the Fund with the aim of completing Phase I (process evaluation) in time for discussion at the 24th meeting. Owing to complications with setting up the evaluation parameters and finalization of the terms of reference, the evaluation did not start until October 2014.

20. Dr. Charles Ehrhart, the lead technical evaluator, speaking via Skype, presented some preliminary findings The selected evaluators are a consortium from Tango International and the Overseas Development Institute (ODI)

21. Explaining that the evaluation was structured around the OECD Development Assistance Committee (DAC) criteria of Relevance, Effectiveness, Efficiency, and Sustainability, he gave the following overarching conclusions: the Fund was progressing towards its overall objective; it was demonstrating steady gains in effectiveness and efficiency; secretariat staff and systems were under strain, limiting further improvement and risking degradation; the Fund's future depended on its ability to define and successfully occupy a strategic niche; and the Fund's strategic niche was at the nexus of innovation and learning about adaptation.

22. Under the heading of Relevance, Fund design was coherent with and highly complementary to other adaptation efforts under the UNFCCC; the Fund was amplifying financial support to developing countries and helping to close the adaptation finance gap; and the Fund's major features were relevant and appropriate - with the exception of resource mobilization.

23. Under Effectiveness, the Fund was quickly becoming an effective institution; main processes were generally effective, except for *resource mobilization* (where existing and planned modalities were ineffective), and *knowledge management*, which was especially important because adaptation projects and programmes were still relatively new and the Fund was piloting various direct access modalities; the Fund secretariat was effective but chronically overstretched, requiring more resources to meet its strategic responsibilities. Also, the Fund's interim institutional arrangements were effective, and there was greater harmony between the approaches of the

Adaptation Fund and the Green Climate Fund than between the Adaptation Fund and the GEF. However, greater delegation of decision-making authority to the EFC and the Accreditation Panel could enhance efficiency, and the role of the PPRC should be re-assessed.

24. Under Sustainability, he suggested that the best way to achieve financial sustainability was through operational linkages with the GCF. Institutional sustainability was threatened by changes in the global climate finance architecture and weaknesses in the secretariat's capacity; however, integration into the GCF would not be the best way to achieve institutional sustainability.

25. Finally, he explained that the results of the e-survey would be incorporated in the next draft of the evaluation report, that structured, progressive feedback would be gathered on that draft, and that the closing report would be finalized and submitted by the end of June 2015.

26. Questions were asked about possible solutions to the chronic work overload on the secretariat, about why the direct access modality was expensive, and about what should be done with the PPRC.

27. Dr. Erhart replied that concrete suggestions would be forthcoming. The cost of accreditation for the Fund lay in the hiring of very senior consultants, field visits, and in the elapsed time required to help entities be ready for direct access. He suggested that the steps to be taken to reach that stage should be codified in detail, which would then allow a more junior consultant or secretariat member to take over the detailed review responsibility (similar to how a major accounting firm works, with junior staff undertaking detailed reviews and supervision/final reviews being done by more seasoned accountants). With regard to the PPRC, he said that many stakeholders now felt that that the committee was no longer the place where key decisions were being made, it having been somewhat superseded by the secretariat itself. The tasks of the PPRC should be examined closely, and it might even be advisable to wind it up.

28. The Chair thanked Dr. Erhart and the Ethics and Finance Committee <u>took note</u> of the presentation.

Agenda Item 6: Complaint handling mechanism

29. The Manager of the secretariat reported on two cases of complaints that had been brought to the attention of the secretariat.

30. Case 01: review by the Accreditation Panel of the fiduciary standards on transparency, anti-corruption measures and self-investigative powers at the request of the Board (decision B.24/25). Since the recommendation by the Panel to suspend of the entity's accreditation, the entity appointed a new Director General, who has been taking corrective actions and providing information requested by the Panel. The new Director General may present the steps taken to address any inadequacies in the fiduciary standards at the next EFC meeting.

31. Given the new information provided by the entity, the EFC took note of the information and allowed more time for the implementing entity to complete the implementation of the corrective actions currently under way. The secretariat will report either intersessionally or at the next EFC meeting on any new information that it receives on this issue.

32. Case 02: issues related to the community consultation process during implementation of the coastal protection component of the project currently under implementation, and to the design of the intervention to be funded. Complaints raised by members of a local industry.

33. Following numerous discussions and consultations with the secretariat, the two sides of the dispute agreed to have a meeting facilitated by a local mediator. The community members allegedly have filed a complaint consistent with the internal procedures applicable to the implementing entity. The secretariat will keep the Board informed of any relevant developments.

Agenda Item 7: Implementation of the code of conduct

34. The Chair drew the attention of the Committee to the code of conduct posted on the Fund website. No matters were raised under this item

Agenda Item 8: Financial issues

(a) Guidelines for the monetization of carbon assets

35. The representative of the trustee introduced the topic. The Board at its 24th meeting had decided to request the trustee to monetize other carbon assets (specifically AAUs and ERUs) for the Fund, in addition to CERs. The trustee and the CMP had amended the Terms and Conditions of Service of the trustee by CMP Decision (1/CMP.10) and subsequent adoption by the World Bank's Board of Directors. In addition, amendments to the Adaptation Fund's current CER Monetization Guidelines had been required, to incorporate the monetization of other carbon assets to be added to the Fund share of proceeds and reflect other developments and Board guidance.

36. The representative of the trustee presented the revised Carbon Assets Monetization Program Guidelines, as contained in document AFB/EFC.16/3, to replace the CER Monetization Guidelines. In addition to the changes necessary to cover the addition of AAUs and ERUs to the Adaptation Fund Share of Proceeds by CMP Decision, further revisions to the Guidelines had been needed, including those made to reflect requests by the Board to pursue additional sales channels. The representative of the trustee noted that the principles of revenue optimization, limiting financial risks, enhancing transparency, and use of the most cost-effective approaches would continue to apply.

37. One Committee member asked why in the revised guidelines the requirement to purchase a minimum of 500,000 tons had been removed. The representative of the trustee explained that the minimum requirement limited the scope for generating price premia through opportunistic sales, but that the cost-benefit principle would continue to apply.

38. Following the presentation and discussion, the Ethics and Finance Committee recommended that the Board approve the Carbon Assets Monetization Program Guidelines (Document AFB/EFC.16/3).

(Recommendation EFC.16/2)

(b) Financial status of the Trust Fund and CER monetization

39. The representative of the trustee reported on activities of the trustee since the previous meeting, and the financial status of the Adaptation Fund Trust Fund. At the end of February 2015, total revenue to the Adaptation Fund had amounted to US$ 471.9 million, of which US$ 190.9 million was from CER sales, and US$ 277.2 million from donations (and US$ 3.7 million in investment income). Funds available for new project and programme approvals amounted to US$ 177.0 million. The representative of the trustee reported that opportunistic sales of CER

sales were continuing and donation agreements were being processed, with two pledges still outstanding. During the preceding quarter the trustee had sold 1.26 million tons and generated US$ 3.2 million of sales proceeds. The average price achieved in the quarter had been EUR 2.24, significantly above the market price for CERs. Since the 31 December 2014 trustee report, donation agreements had been finalized with Luxembourg, France and Germany.

40. The Ethic and Finance Committee took note of the trustee's report.

(c) *Work plan for the fiscal year 2016*

41. The Manager of the secretariat presented the work plan contained in document AFB/EFC.16/5.

42. She stressed that the climate finance readiness programme (Phase II) would be submitted to the Board for approval at the present meeting; consequently the work plan was to be understood as submitted to the Committee subject to the Board's approval of the readiness programme.

43. She drew attention in particular to plans for two portfolio monitoring mission for FY16 (target project, possibly Uruguay and Argentina, and to Pakistan or Mongolia, to be confirmed at a future meeting), and to the planned webinars for peer-to-peer learning.

44. Following the presentation, the Ethics and Finance Committee recommended that the Adaptation Fund Board approve the work programme and the tentative work schedule contained in document AFB/EFC.16/5.

(Recommendation EFC.16/3)

(d) Board and secretariat, and trustee budgets for the fiscal year 2016

45. A representative of the secretariat presented document AFB/EFC.16/6, showing the Board and secretariat budgets for FY 2015.

46. She drew attention in particular to plans to hire additional secretariat staff: an Operations Officer and a Junior Professional Associate (JPA). The proposed new positions would cover the secretariat's work on readiness support and accreditation, thus replicating the structure currently in place for project/programme review and monitoring. The Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) at its 10th meeting had requested the Board to consider specific options for enhancing the access modalities of the Fund under the readiness programme and invited further support for the programme. Implementation of that mandate and of the proposed Phase II of the programme as presented in document AFB/B.25/5 would require secretariat staff dedicated to those activities. The position of programme coordinator originally proposed in Phase I of the programme had been vacant since 1 August 2014. Given the increasing complexity of the programme, a more stable arrangement for the position was required. In addition, the position would back up the work of the Operations Officer (Accreditation). The JPA would provide support in those two areas. She noted that World Bank staff rules would not allow hiring of any JPAs from 1 July 2015. (Instead of a JPA, an Extended Term Consultant might be hired if a suitable candidate were identified for the position.)

47. The representative of the trustee presented the proposed budget for the trustee, noting that in several areas, such as external legal counsel services, the amounts proposed were significantly lower than in past years.

48. Having considered the budget proposal by the secretariat and trustee, the Ethics and Finance Committee recommended that the Board approve, from the resources available in the Adaptation Fund Trust Fund:

a) The proposed budget of US$ 4,049,165 to cover the costs of the operations of the Board and secretariat over the period 1 July 2015 to 30 June 2016, comprising US$ 2,824,165 for the secretariat administrative services (the main secretariat budget), US$ 200,000 for the overall evaluation (Phase II), US$ 460,000 for accreditation services and US$ 565,000 for the readiness programme (Phase II) subject to approval by the Board of the readiness programme (Phase II); and

b) The proposed budget of US$ 669,000 for trustee services to be provided to the Adaptation Fund over the period 1 July, 2015 to 30 June 2016.

(Recommendation EFC.16/4)

Agenda Item 9: Other matters

a) Gender policy for the Fund

49. The Vice Chair proposed that the secretariat should be requested to develop a gender policy and action plan for the Fund.

50. Some Committee members expressed doubts that such a step was necessary. It was pointed out that gender considerations were included in several of the project/programme review criteria of the Fund. Moreover, the environmental and social policy included a specific principle on gender equity. It was true, however, that the Fund lacked a stand-alone gender policy and action plan such as other funds like the GEF or the GCF have.

51. One member said that the issue was to demonstrate that the work of the Fund was empowering men, women and children on the ground. However, to announce the development of a policy would seem to imply that the Fund had not already been having such beneficial effects.

52. The Ethics and Finance Committee recommended that the Board request the secretariat to prepare a compilation and analysis of any of the Fund's gender-related policies and procedures in order to inform the next meeting of the EFC.

(Recommendation EFC.16/5)

b) Material changes in the budget allocation for the project in Maldives (UNDP)

53. The representative of the secretariat reported that UNDP had submitted to the secretariat PPRs for this project that indicate material changes at the output level in the original budget allocations exceeding 10% of the total budget. According to paragraph 4.03 of the legal agreement such changes shall be approved by the Board:

> *"4.03. Any material change made in the original budget allocation for the Project by the Implementing Entity, in consultation with the Executing Entity, shall be communicated to the Board for its approval. "Material change" shall mean any change that involves ten per cent (10%) or more of the total budget."*

54. UNDP had submitted a request of change in the original budget allocation, for consideration by the EFC. The secretariat had requested the endorsement of the Designated Authority and additional information on the proposed budget, which have not yet been received.

55. Several members of the Committee expressed the view that, rather than a shift of expenditures within the project, the changes proposed by UNDP had the effect of creating a completely new project that required further examination by the PPRC.

56. Following the discussion, the Ethics and Finance Committee recommended that the Board:

a) Request UNDP to provide the secretariat with the necessary information on the budget breakdown in order for the secretariat to conduct a full review of the revised project;

b) Request the PPRC to review, intersessionally between the twenty-fifth and twenty-sixth meetings of the Board, the changes made to the project design and their impact in achievement of the project results;

c) Revert to the EFC with regard to the proposed changes in the budget with a view to making a decision at the twenty-sixth meeting of the Board; and

d) Request the secretariat to communicate to UNDP that the Board expects that during the project design phase implementing entities will give due consideration to all the factors that may impact the project design and budget.

(Recommendation EFC.16/6)

c) Amendment to PPR template

57. The Manager of the secretariat proposed that the EFC should consider recommending an amendment to the PPR template to allow implementing entities to report on any investment income generated by cash held by the IEs in respect of the project grant. According to the legal agreement any investment income shall be returned to the AF trust fund upon termination. She said that reporting of investment income by implementing entities is standard practice among other funds, but this had not been required by the Fund thus far.

58. One Committee member asked how much investment income might be involved.

59. The Manager of the secretariat replied that was not known; that was one of the reasons for the proposed amendment to the PPR template.

60. The representative of the trustee said that almost US$ 115 million had so far been transferred to implementing entities, and confirmed that reporting by implementing entities of any investment income earned was standard practice for similar funds.

61. The Chair suggested that a letter should be sent to all implementing entities, alerting them to the change in the template.

62. Following the discussion, the Ethics and Finance Committee recommended that the Adaptation Fund Board request the secretariat to:

(a) Send a letter to the accredited implementing entities currently implementing projects/programmes requesting them to inform the Secretariat of any investment income generated from the Fund's grant; thus far; and present it to the EFC broken down by implementing entity type (MIE/RIE/NIE) at its next meeting for further consideration.

(b) Present, for consideration by the Board during the intersessional period, an amended project performance report (PPR) template that would allow implementing entities to report on the investment income generated by the project grant on an annual basis.

(Recommendation EFC.16/7)

d) Report on project/programme implementation: Eritrea

63. The representative of the secretariat reported that the secretariat had received the second annual project performance report (PPR) for the project Climate Change Adaptation Programme in Water and Agriculture in Anseba Region implemented by the United Nations Development Programme in Eritrea. The secretariat had undertaken a review of the PPR following the process approved by the Board, found that the information provided was complete and cleared the PPR.

64. Following the clearance by the secretariat of the second annual project performance report provided by the United Nations Development Programme (UNDP), the Ethics and Finance Committee recommended that the Adaptation Fund Board:

a) Approve the third tranche of funds requested by the United Nations Development Programme (UNDP) for the implementation of the project Climate Change Adaptation Programme in Water and Agriculture in Anseba Region, Eritrea, in the amount of US$ 2,124,702;

b) Request the trustee to transfer to UNDP US$ 2,124,702 as agreed to in the disbursement schedule included in the project agreement.

(Recommendation EFC.16/8)

e) Report on project/programme implementation: Nicaragua

65. The representative of the secretariat reported that the secretariat had received the third annual project performance report (PPR) for the project Reduction of Risks and Vulnerability Based on Flooding and Droughts in the Estero Real River Watershed implemented by the United Nations Development Programme in Nicaragua. The Secretariat had undertaken a review of the

PPR following the process approved by the Board, found that the information provided was complete and cleared the PPR.

66. Following the clearance by the secretariat of the third annual project performance report provided by the United Nations Development Programme (UNDP), the Ethics and Finance Committee recommended that the Adaptation Fund Board:

a) Approve the fourth and last tranche of funds requested by the United Nations Development Programme (UNDP) for the implementation of the project Reduction of Risks and Vulnerability Based on Flooding and Droughts in the Estero Real River Watershed, Nicaragua, in the amount of US$ 362,595;

b) Request the trustee to transfer to UNDP US$ 362,595 as agreed to in the disbursement schedule included in the project agreement.

(Recommendation EFC.16/9)

Agenda Item 10: Adoption of the recommendations and the report

67. The present report was adopted based on the draft report of the Committee contained in document AFB/EFC.16/L.1, as orally amended.

Agenda Item 11: Closure of the meeting

33. The meeting closed at 2.15 p.m. on 8 April 2015.

ANNEX I

Ethics and Finance Committee
Sixteenth Meeting
Bonn, Germany, 7 and 8 April 2015

EFC members present in the meeting

Ms. Irina Helena Pineda AGUILAR (Chair) (Honduras, Latin America and the Caribbean)

Ms. Tove Zetterström-Goldmann (Vice-Chair) (Sweden, Annex I Parties)

Mr. Hans Olav IBREKK (Norway, Western Europe and others)

Mr. Zaheer FAKIR (South Africa, Africa)

Mr. Petrus MUTEYAULI (Namibia, Africa)

Mr. W. L. SUMATHIPALA (Sri Lanka, Asia)

Ms. Umayra TAGHIYEVA (Azerbaijan, Eastern Europe)

Mr. Aram TER-ZAKARYAN (Armenia, Eastern Europe)

Mr. Philip WEECH (Bahamas, Latin America and the Caribbean)

Mr. Naresh SHARMA (Nepal, Least Developed Countries)

Mr. Samuela Vakaloloma LAGATAKI (Fiji, Small Island Developing States)

Ms. Ana FORNELLS DE FRUTOS (Spain, Annex I Parties)

Ms. Patience DAMPTEY (Ghana, Non-Annex I Parties)

Ms. Wenhang HUANG (China, Non-Annex I Parties),