

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
Trading & Reporting	
1 senior staff	
1 senior staff	
1 mid level staff	
Back Office/Administration	
1 Junior staff	
1 Junior staff	
1 Junior staff	
Total	533,584

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
TOTAL	199,622,290

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.