



ADAPTATION FUND

AFB/EFC.14/3
14 March 2014

Ethics and Finance Committee
Twenty-third meeting
Bonn, 18-19 March 2014

Agenda item: 4

OPTIONS FOR THE ACCREDITATION OF SMALL ENTITIES

Background

1. As part of the fourteenth report of the Accreditation Panel (the Panel), the Panel brought to the attention of the Board the difficulties that smaller entities face in trying to meet the current fiduciary standards of the Adaptation Fund (the Fund), highlighting in particular its experience with an application from NIE039. Based on the Panel's experience and recommendation, the Board at its twenty-second meeting, decided to:

(a) Allow for further review of NIE039 through a field visit to develop a case example for the need of a "small grant window" or similar mechanism; and

(b) Request the Accreditation Panel to work in conjunction with the secretariat to provide options for how such a mechanism could be operationalized at the twenty-third Board meeting.

(Decision B.22/2)

2. Following the Board decision, one expert panel member and a staff member from the secretariat conducted a field visit to NIE039 from 13-17 January 2014 to develop the case example and explore options for accrediting smaller entities. Taking into account findings from the field visit, the present paper presents three options for the Board to consider. Details of the findings from the field visit are outlined in Annex I.

Proposed options for accrediting small entities

3. During the fifteenth Accreditation Panel meeting, the NIE039 case was presented and the Panel spent time discussing various options for accrediting smaller entities. The Panel agreed to present the Board with three separate options for consideration:

- a. *Option 1: Status quo.* This option would continue business as usual. No changes would be made either to the fiduciary standard or the accreditation process.
- b. *Option 2: Streamlined process.* This option would maintain the fiduciary standards as is but would delineate compensatory measures for each standard that align with the risk profile of small entities. Most notably though not exclusively, when assessing the standards for smaller entities the Panel would take into consideration minimum compensating measures, controls, and practices to determine whether or not such entities meet the requirements needed to demonstrate the capacity to comply with the fiduciary standards for the particular risk profile associated with smaller entities.
- c. *Option 3: Separate process for small entities.* In this option, the Panel would develop a set of standards tailored to the risk profile of small entities. The standards would be based on the current fiduciary standards but would be tailored specifically to the operations and institutional capacity of smaller organizations, based on the Panel's experience of handling applications from the smaller entities in the last four years.

4. At the meeting there was consensus that the newly approved environmental and social standards as approved in the Environmental and Social Policy (the Policy) would apply under each of the three options. Therefore under each option the compliance to be demonstrated with the Policy would be the same. The following paragraphs elaborate on each of the three options and Table 1 provides a summary of each option's advantages and disadvantages.

5. Option 1: Status quo. The status quo option is simply that the Fund continues as it has since the accreditation process became operational in 2010. There would be no change to the fiduciary standards, no change to the process, and no change to the interpretation of the standards. The main advantages of this option are (i) there will be no perception that the standards of the Fund are being compromised or diluted (ii) no additional work for the Panel or secretariat will be required and (iii) no limits imposed on project size or disbursement amounts.

6. Under this option, it is unlikely that entities such as NIE039 could be accredited without substantial investment and several years of instituting newly developed systems and policies. For such organizations, undertaking changes to fit standards built for larger financial institutions may not make business sense. It would in all likelihood require recruiting people with a specific skill set beyond the normal course of business. This may limit the type of institutions the Fund can engage with and even the countries that can access the Fund through direct access. It could also present a lost opportunity to engage smaller countries, including Small Island Development States (SIDS), which may not have larger financial institutions to nominate. These countries may however have strong institutions working at a smaller scale that could implement effective and impactful adaptation projects.

7. Option 2: Streamlined process. The streamlined option would entail no changes to the fiduciary standards but instead would institute alternative acceptable requirements needed for smaller entities to demonstrate the required competencies. Specifically, the requirements for demonstration would be commensurate with the type, size, and risk profile of the institution. If the entity successfully demonstrates fulfillment of the standards but there is recognition that the organization's capacity and past experience means the entity can only manage smaller amounts of money, the Panel could specifically recommend to the Board that the entity be accredited to manage projects up to a certain size and with disbursements within a certain limit.

8. The advantages of this option include the following (i) increased opportunities for small sized entities to access funding; (ii) increased flexibility in the application of the fiduciary standard requirement; (iii) increased efficiency in processing applications for both the applicant and Fund by clearly outlining expectations; (iv) build on experience to date with smaller entities; (v) provide clear demonstration measures based on type of applicant; and (iv) reduced risks associated with having two parallel application processes (option 3).

9. The main disadvantages of this option are (i) the potential perception that a streamlined process will water down the requirements (ii) the possibility of introducing greater subjectivity to the fiduciary standards and (iii) the political difficulty of an entity accepting a lower limit after applying for accreditation.

10. Option 3: Separate process for accreditation of small entities. The option for a separate process would entail the design of a set of fiduciary standards that are tailored to the characteristics of small entities and reflect the risks of disbursing funds to such entities. Under such an option, a country would nominate an entity specifically for accreditation via a "small entity" process. An accreditation under this option would restrict an entity to applying for only small projects (under US\$1 M) and to a yearly disbursement cap of US\$500,000. In terms of size, "small" is defined as an entity with less than 20 professional staff members, less than US \$550,000 annual administrative and operating budget, and a level of project management competencies concentrated on handling project amounts under US\$ 100,000. Such a process would allow the Fund to evolve the direct access modality based on the Fund's experiences to date.

11. If the Board were to approve such an option, it could be rolled out initially as a pilot with two to three entities and tested. The advantages of rolling out a new process include (i) expanding the Fund's reach to engaging a wider range of organizations; (ii) standards crafted for the specific risk profile of smaller organizations; (iii) build on experience to date with smaller entities; (iv) increased opportunities for small entities to build their project management capabilities by managing adaptation funding on a smaller scale; (v) provides flexibility for countries to decide which option to nominate an entity under; and (vi) positions the Fund to continue as pioneer of direct access.

Table 1: Summary of options for accrediting small entities

Option	Advantages	Disadvantages
<p><i>Option 1: Status quo</i></p> <p>No changes to the fiduciary standards</p> <p>No modifications to accommodate the systems of smaller entities</p>	<ol style="list-style-type: none"> 1. Positive perception that AF standards are not diluted 2. <u>Time/ monetary costs</u>: None 	<ol style="list-style-type: none"> 1. Dictating standards that may not make business sense for smaller organizations 2. Opportunity cost of not engaging smaller countries 3. Increased frustration from smaller countries not able to access AF funds directly 4. Lost opportunity to learn from lessons to date
<p><i>Option 2: Streamlined process</i></p> <p>No changes to the fiduciary standards</p> <p>Systematize compensatory measures for current fiduciary standards based on smaller entities' institutional risk profile</p>	<ol style="list-style-type: none"> 1. Builds on existing requirements for the fiduciary standards while understanding the resource limitation of small entities. 2. Provides opportunity for access by larger number of countries and wider range of organization types 3. Reduces complications of having two parallel application processes since the conclusion for accreditation is to emerge from the same application process 4. Introduces flexibility into AF's system 5. Formalizes mitigation measures for specific standards 	<ol style="list-style-type: none"> 1. Perception that may be diluting fiduciary standards 2. Potential for increased subjective judgement introduced 3. <u>Time/monetary costs</u>: further development of compensatory measures by Panel (Panel members time). Approx. 10 days each for 4 Panel members (US\$30-35,000)
<p><i>Option 3: Separate process for accreditation of small entities</i></p> <p>Develop set of fiduciary standards to reflect risks associated with smaller entities</p>	<ol style="list-style-type: none"> 1. Allows for building standard based on risk profile instead of a standard built for larger multilateral institutions 2. Takes into consideration resource limitation of small entities 	<ol style="list-style-type: none"> 1. Perception that small entities do not meet rigorous standards 2. Complication of two separate application processes. 3. <u>Time/monetary costs</u>: development of a set of fiduciary standards for small entities and

	<ol style="list-style-type: none"> 3. Provides opportunity for access by larger number of countries and wider range of organization types 4. Builds capacity of smaller entities commensurate with business model 5. Allows countries the opportunity to decide whether to apply as a small entity 6. Establishes one size standard doesn't fit all 7. Positions AF as the continued pioneer of direct access 	<p>development of separate application.</p> <p>–Panel members (approx. 15 days for 4 Panel members) US\$50-55,000</p> <p>–Developers (application & process programmed workflow) US\$10-15,000</p> <p>TOTAL: US\$60-70,000</p>
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Recommendation

12. After reviewing document AFB/EFC.14/6, the EFC may wish to consider the options presented in the document and recommend a way forward to the Board for approval.

Annex I: NIE039 Case Study

13. NIE039 was nominated by a small country (population less than 200,000) to apply for accreditation to the Adaptation Fund. The entity has less than 10 staff members and provides grants for projects on the order of magnitude of US\$16-50,000. The initial assessment of the application by the Panel found major gaps in most of the capabilities required by the Fund's fiduciary standards.

14. After the initial few communications the entity developed an action plan with timelines for fulfilling the gaps and it was decided that the Panel and the entity would interact on a regular basis to support the development of the entity's capabilities. The entity also agreed to provide regular updates on its progress. Consequently, the Panel regularly interacted with the entity through email and also comprehensive teleconferences. Based on all the intensive interactions the Panel concluded the following, prior to the field visit:

- a. The entity, after much effort, was able to develop an internal audit system based on outsourcing of internal audit and took steps for putting in elements of an internal control framework. These however were difficult for the entity to operationalize.
- b. The entity currently handles procurements of an order of magnitude in the hundreds to thousands of dollars. While it has defined and documented some guidelines for procurement, given the small procurement needs it is unable to demonstrate use of the guidelines. Further, given the size of the projects it currently handles there is no need for it to exercise formal control over the procurement activities of its executing agencies. Nevertheless, all expenditures on projects are reviewed before the next tranche of funds are released.
- c. Given the size of the entity and the environment in which it operates, the majority of the projects it handles involve an outlay of less than US\$ 50,000. Several of the systems and processes are either informal or designed to handle projects of US\$ 16-50,000 in value. The current level of procedures and competencies also appears to be appropriate for handling such projects. The entity is also of the opinion that it is not likely to handle larger projects in the foreseeable future.
- d. The entity has some policies and guidelines in the area of transparency, fraud and other forms of mismanagement. This includes strong provisions reflecting the tone at the top for the full Board of Directors. However, there are still some gaps in its meeting the full requirements of the fiduciary standard as it relates to third parties complaints.
- e. Given the organization's small human resource base it would require considerable effort and substantial resources to develop new capabilities.

15. During the field visit, the team was able to confirm many of the Panel's prior conclusions. Several additional observations were made during the visit, including:

- 1) The projects funded by NIE039 are well structured, produce results, and have an impact on the local communities.
- 2) The strength of the organization lies in its understanding of local conditions and how best to support communities, its strong relationships with other local NGOs, and its partnerships with international conservation organizations. It also partners with external foundations which provide it with trust funds.
- 3) Based on the above, NIE039 appears to be well positioned to carry out an effective community based adaptation project.

- 4) The absorptive capacity not only of NIE039 but of the country itself is low.
- 5) With a population of fewer than 200,000, any larger scale project would need access to external/international expertise.
- 6) Given the population size, smaller amounts of money can produce strong outcomes.
- 7) NIE039 would need to invest considerable resources and likely access international expertise to fully meet standards
- 8) Given NIE039 current capacity, the organization would still need to institute certain changes but could likely handle approximately US\$ 500,000 in disbursements per year (an amount which it approximately disburses currently each year).