



ADAPTATION FUND

AFB/PPRC.32/22
2 October 2023

Adaptation Fund Board
Project and Programme Review Committee
Thirty-second Meeting
Bonn, Germany, 10-13 October 2023

Agenda item 11)

PROPOSED ADJUSTMENTS TO IMPLEMENTATION FEES AND EXECUTION COSTS

Background

1. The Project and Programme Review Committee at its thirtieth meeting discussed the issue raised by the secretariat in Document AFB/PPRC/30/3/Rev.1 concerning execution costs (EC) and implementing entity (IE) fees, notably related to IE's understanding of the rules regarding the calculation of IE fee and EC.

2. During the past few years, the Adaptation Fund has implemented its first Medium-term Strategy (MTS), including the development of new funding windows and modalities, including ones in the areas of innovation and enhanced direct access (EDA), for which the Board has set different caps for the IE management fees and execution costs.

3. In addition, through recent decisions the Board has sought to clarify how costs should be split and allocated among executing entities (EE), namely when one of the EEs is also the IE (i.e., Decision.38/42). The various caps on management fees and EC are set in separate Board Decisions and there is no consolidated document highlighting the fees calculation and the different fees percentage for each window.

4. As the Fund's portfolio continues to grow, including due to projects funded under the new windows, the importance of clear and accessible rules on calculating IE fees and EC is greater than ever. In light of the issues raised, at the thirty-ninth meeting of the Board, the Secretariat proposed to present a paper to consolidate and clarify the rules around costs and fees for all windows.

5. At that meeting, having considered the recommended of the PPRC the Board decided to:

[...]

(c) To request the secretariat

[...]

(iii) To consider the existing policies on implementation fees and execution costs for all financing windows, including on their use, and propose adjustments with a view to simplifying and harmonizing them, and present a recommendation on the matter to the Project and Programme Review Committee at its thirty-second meeting.

(Decision B.39/3)

6. The current document is developed pursuant to Decision B.39/3 and proposes a solution to consolidate and clarify the rules around costs and fees for all windows, with a view to simplifying and harmonizing the cost and fee limits to the extent possible.

Relevant board decisions and documents setting the caps and utilization of the fees

7. The Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund (OPG, amended in October 2022) states:

82. Every project/programme proposal submitted to the Board shall state the management fee requested by the Implementing Entity if any and shall include a budget on fee use. The reasonability of the fee will be reviewed on a case-by-case basis. The requested fee shall not exceed the cap established by the Board.

83. Every project/programme proposal submitted to the Board shall include an explanation and a breakdown of all administrative costs associated with the project/programme, including the execution costs, if any.

8. At its eleventh meeting, the Ethics and Finance Committee (EFC) considered Document AFB/B.11/Inf.6 that presented an analysis by that secretariat on a comparison of the current management fees proposed by NIEs and MIEs, including options to establish fee caps. Taking into consideration the various proposed options, the EFC decided to recommend a cap of 8.5 per cent.

9. *Having considered the recommendation of the Ethics and Finance Committee, the Board decided to:*

- (a) To set a cap for a fee of 8.5 per cent for all projects/programmes funded by the Adaptation Fund;*
- (b) That implementing entities should provide a budget on fee use in project or programme proposals, which would be considered during project and programme review; and*
- (c) That the fee policy could be reviewed and adjusted after three years, or more specifically at the meeting of the Board following the ninth session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol.*

(Decision B.11/16)

10. Subsequently, the secretariat presented an analysis and recommendation to the EFC at its fourth meeting through Document AFB/EFC.4/7, with the objective to (i) review the decisions taken up to that point by the AFB, on the issues of management fees and execution costs, (ii) clarify and harmonize the terms used to define project management direct and indirect costs, (iii) describe how other funds have defined and have set caps or exact allocations for these costs and (iv) provide recommendations on future Adaptation Fund rules to cover project management expenses.

11. *Having considered the recommendation of the Ethics and Finance Committee (EFC), the Adaptation Fund Board decided to:*

- (a) *Include in the Project/Programme monitoring and evaluation (M&E) framework a break-down of how implementing entity (IE) fees will be utilized in the supervision of the M&E function;*
- (b) *Set a cap of 9.5% of the project budget for execution costs and to require a Board approval if a project requires an additional budget beyond that limit;*
- (c) *Endorse the standardized template table developed for project execution costs as contained in the Annex to document AFB/EFC.4/7 and to circulate it to IEs for their inputs before final approval at the fourteenth meeting of the Board and inclusion in the project template. The standardized template should be used as guidance in breaking down project execution costs; and*
- (d) *Request IEs to provide budget notes along with a detailed budget for project components.*

(Decision B.13/17)

12. As mandated by the Board, the EFC considered the policy issue of IEs acting as Executing Entities, including the circumstances, conditions and criteria under which that would be possible.

13. *Having considered the recommendation of the EFC the Board decided to:*

[...]

- (f) *To cap execution costs for projects/programmes implemented and executed by the same entity at 1.5% of the project/programme cost.*

(Decision B.17/17)

14. In line with the Fund's Operation Policy and Guidelines Annex 7, "In the exceptional case when implementing entities are requested by governments to provide all or part of the execution services related to the project they seek to implement, the Adaptation Fund Board (the Board) had decided (decision B.17/17.f) to cap execution costs for projects/programmes implemented and executed by the same entity at 1.5% of the project/programme cost."

15. At its ninth meeting the EFC members had proposed requesting, in those cases where, Implementing Entities also acted as Executing Entities, that the Implementing Entity and the Designated Authority should each provide a rationale, as well as supporting documentation, to explain that overlap.

16. Consequently, at its eighteenth meeting, having considered the comments and recommendations of the Ethics and Finance Committee, the Adaptation Fund Board decided to:

- (a) *Confirm, as a principle, the separation between implementing and execution services. Execution services will only be provided by Implementing Entities on an exceptional basis and at the written request by the recipient country, involving designated authorities in the process, and providing rationale for such a request. The responsibility for these services shall be stipulated, their budget estimated in the fully developed project/programme document, and covered by the execution costs budget of the project/programme;*

(b) Request the secretariat to communicate the above to designated authorities and multilateral implementing entities;

(c) Request any Multilateral Implementing Entity currently providing such services to review its portfolio of projects/programmes and report to the Board on how the decision under (a) is being implemented; and

(d) Request the secretariat to update the document “Instructions for Preparing a Request for Project Funding” accordingly.

(Decision B.18/30)

17. More recently, the Board had considered, at its thirty-eighth meeting, clarifications of regional implementation and execution costs. Having considered the recommendation of the Project and Programme Review Committee, the Adaptation Fund Board decided:

(a) To set the upper limit for administrative costs of regional projects/programmes, at 10 per cent of the project/programme cost for implementing entity (IE) fees and at 10 per cent of the project/programme cost for execution costs;

(b) To request IEs, in the exceptional cases where an IE provides part or all of the execution services:

(i) To provide justifications to demonstrate its advantages compared to other entities, agencies or organizations that could provide the selected execution services, particularly for the execution of activities at national or subnational level;

(ii) To limit the execution costs of the IE to 1.5 per cent of the cost of the part of the project or programme executed by the implementing entity of the project/programme cost;

(iii) Where the actual execution costs of the IE exceed the 1.5 per cent cap, to require the IE to provide justification as part of its proposal submission if requesting costs beyond the cap on an exceptional case-by-case basis.

(Decision B.38/42)

Cost and Fees Calculation

18. As per webpage “Costs and Fees”, the following formula is used for calculating the execution cost and implementing entity fee:

Project/programme activities cost = A
 Project/programme execution cost ¹ = B
 Total project/programme cost ² = A+B
 Implementing Entity Fee³ = C
 Total amount of funding requested, or the grant amount=A+B+C⁴

19. It should be noted that, as per the OPG, a proponent may request an amount in IE fees that is below the 8.5% cap or limit, but not above it, and the proponent needs to include in the proposal justifications for the amount requested. However, it has been a common practice to request the full amount under the limit.

20. The rules around the EE cost limits are set in Decision B.13/17 and B.38/42 for single-country and regional projects, respectively. Decision B.13/17 provides flexibility in cases where a project requires additional budget beyond the 9.5% cap or limit (“[...] *Set a cap of 9.5% of the project budget for execution costs and to require a Board approval if a project requires an additional budget beyond that limit [...]*”).

21. Such flexibility as above is not spelled out for regional projects, where the 10% limit on EE cost is treated similarly as the rigid cap on the IE fee in Decision B.38/42 (“[...] *to set the upper limit for administrative costs of regional projects/programmes, at 10 per cent of the project/programme cost for implementing entity (IE) fees and at 10 per cent of the project/programme cost for execution costs[...]*”).

22. As per Decision B.38/42, in cases where the IE also serves as EE, or one of them, the IE’s specific EE costs are capped at 1.5% with the option of flexibility such that, with justifications, it is possible to go above the limit (*[...] Where the actual execution costs of the IE exceed the 1.5 per cent cap, to require the IE to provide justification as part of its proposal submission if requesting costs beyond the cap on an exceptional case-by-case basis[...]*).

23. It can be expected that differences in the approaches laid out in the rules can lead to misinterpretation of the rules and, potentially more importantly, shying away from exercising the full potential offered by the flexibility, which was provided in the first place presumably in order to

¹ The project execution cost (B), or project management costs, includes the main items supported by the Adaptation Fund for project management including consultant services, travel and office facilities, etc covering the direct costs for administration of the day-to-day activities of projects. Specific costs include: Staffing costs, and project related activity expenditures (Monitoring and evaluation costs; Costs related to drafting progress reports and financial reports; Consultation with project stakeholders (meetings, workshops); Communication, Travel).

² The total project/programme cost is the cost of all project activities/components and the project execution cost (A+B).

³ The implementing entity fee (C) is the fee requested by Implementing Entities for project cycle management services including project supervision. The fee covers: Corporate activities fees related to engagement with donor (Policy support, Portfolio management, Reporting, Outreach and knowledge sharing) and Project cycle management fees (Project preparation and management oversight including financial management and quality insurance, Implementation reports supervision, and Project completion and evaluation oversight).

⁴ The amount of funding requested, or the grant amount excludes any co-financing and includes the total project/programme cost along with the implementing entity fee (A+B+C).

better serve the full range of unique project contexts and adaptation needs, through a variety of modalities offered by the Adaptation Fund currently, and potentially in the future.

24. Flexibility in relation to fees and costs is expected to be particularly relevant for certain types of projects⁵, such as those with higher need for EE involvement, multiple EEs, yet-identified EEs, special monitoring and/or evaluation needs, as well as those with innovative and devolved-finance based project design, and potentially others.

25. Overall, the flexibility extended through some of the decisions may be especially important for certain funding windows, namely Enhanced Direct Access and Innovation. This rationale was indeed behind the establishment of an exceptional policy for EDA whereby IE fees and EE costs limits differ from those that apply to the other funding windows (Annex 1, Table 2). However, in light of similar flexibility being needed for other projects and funding windows, current and potentially in the future, the Secretariat proposes that, for better clarity and efficiency, a more harmonized approach concerning limits on fees and costs would work better, while at the same time clarifying the rules around flexibility for projects that need it.

26. As per document AFB/EFC.4/7/Rev.1, Table 3 in Annex 1 displays the activities that can be covered by the IE fees and execution costs.

Issues Observed in the Application of Cost Fee Caps

27. The Secretariat carried out an analysis of the application of cost and fee caps or limits, looking at the portfolio of submissions, and following up with a consultation with NIEs on EDA window specifically.

28. The analysis showed that in general, the large majority of the project proposals for the regular action window and the innovation window present IE fees and EE costs within the caps (8.5% and 9.5% respectively for single country projects, and 10% for regional projects). In cases where the review of a proposal finds that the fees or costs are not in line with the respective caps, in the vast majority of cases the IE is able to make adjustments and revise the fees and/or costs so that they conform to the established limits (rather than presenting justifications, in the case of EE costs, as to why the proposal should be allowed to exceed the EE cost limit.)

29. As outlined in Table 2, Annex 1 a higher Execution cost limit (up to 12%) has been put in place for Enhanced Direct Access (EDA) projects which are distinguished from “business-as-usual” projects by clearly demonstrating that the proposed EDA approach enables organizations at the sub-national level, including small, local organizations to identify their adaptation needs by themselves and implement the adequate measures to address those needs, thereby facilitating the streamlining of decision-making across multiple levels. The nature of EDA projects which often involve local communities directly accessing funds from a national or sub-national institution requires additional capacity-building efforts at the local level e.g., to do with financial management, proposal development and reporting beyond what is normally delivered for regular projects.

⁵ Especially those related to enhancing capacity of local organizations, small and mediums enterprises (SME)s, Micro Small and Medium Enterprises (MSMEs) etc. acting as EEs.

30. In contrast to the above rationale, the review of the projects submitted so far under the Enhanced Direct Access (EDA) modality, identified that half of them did not request execution costs to the maximum level allowed by the cap, as presented in Table 4 in Annex 1. It is important to note that given that this window is relatively new, few projects have been submitted and only one project has been approved so far.

31. The caps of the EE costs and IE fees percentages for the EDA proposals are designed to be higher to cover for particular needs from nature of EDA as described in paragraph 29 above, including capacity building for EEs and communities.

32. So far, no proposal has exceeded 10 percent in EE cost and several proposals only used 1.5% because the IEs were executing a part of the project. Furthermore, the IEs were set to provide execution services only because EEs could not be identified at the time of formulation of the project. One exception is the EDA proposal for India, which “earmarked” EE cost for 12% for when EEs would be identified during implementation. However, it should be noted that, at approval, at least one EE has to be identified and consequently listed in the agreement between an IE and the Fund.

33. During the consultation carried out by the Secretariat at the EDA workshop in May 2023 in Rwanda, many NIEs were not aware that EDA window enabled higher fees – this may be the reason why only one proposal asked for 12% of EC. Some IEs showed a misunderstanding of the applicability of the EE costs.

34. Another issue related to project costs that IEs have brought to the attention of the secretariat is the size of project formulation grants. Some IEs highlighted the need for capacity building with the community during the project development stage to ensure that the project is locally led. This would require increased PFG grants for EDA as more work is needed to better define the project at local level. The need for PFG grants for developing concept notes could be considered for EDA as the Fund further enhances the integration of LLA principles.

Consistency and Clarity in Language used for Calculating the Costs and Fees

35. The Secretariat notes that the language used in the review templates in Annex 5 of the Operational Policies and Guidelines of the Fund (OPG), Board decisions, and formula for calculating the fees are not always consistent, which may lead to a lack of clarity.

36. In light of a future review of the OPG to reflect the main changes in the Fund's policies and Board decisions, such review should also propose review to the templates in Annex 5 of the OPG to clearly reflect the fees calculation.

Proposal for Harmonization

37. The following proposal to harmonize the EE costs and IE fees across the various windows aims to reduce confusion for IEs and simplify calculations by IE as well as reduce risk of errors in the review and oversight process by Secretariat.

38. The proposal to streamline fees is as follows:

(a) Regarding IE fees, the limit is to be:

- i. For single country projects and programmes, 8.5% of total project/programme cost for all funding windows;
- ii. For regional projects and programmes, 10% of total project/programme cost for all funding windows;

(b) Regarding the EE costs:

- i. Where the EE is different from the IE, for single country projects and programmes, the limit is to be 9.5% of total project/programme and, for regional projects and programmes, 10% of total project/programme cost **for all windows**, with the following specifications:
 1. In line with Decisions B.13/17 and B.38/42, to require the IE to provide justification as part of its proposal submission if requesting costs beyond the cap on an exceptional case-by-case basis;
 2. For EDA and innovation projects, reflecting the need for added flexibility, to require the IE to provide justification as part of its proposal submission if requesting costs beyond the cap on a case-by-case basis;
 3. For EDA and innovation projects which may require additional investments to support execution, certain activities may be eligible to be charged under a project component when the EE or EEs in those cases is/are not yet identified. The IE would be required to provide justification as part of its proposal submission if requesting costs beyond the cap on a case-by-case basis.
- ii. Maintain the principle of the separation between implementing and execution services and that EE costs would be capped at 1.5% if IE executes the projects or part of it pursuant to Decisions B.17/17, B.18/30 and, also recalling the option of flexibility with justifications on a case-by-case basis, Decision B.38/42.

39. Regarding the (b) 3. above, a list of these eligible activities is proposed in Table 1. These include: salary for staff of EE to manage specific components; salary of staff/ consultants to deliver technical assistance, result-based management and data collection for specific indicators related to efficiency of adaptation measures; some travel related to project execution. The Secretariat would propose regular updates to this list, as needed, to reflect the potentially evolving needs of these projects.

Table 1: List of execution activities covered by execution costs and/or as project component

Cost item	Type of support	
	Covered by project execution costs as per AFB/EFC.4/7/Rev.1	Execution activities eligible to be charged as project component (<i>proposed</i>)
Staff	Salary of project staff	Salary of project staff to manage specific components Salary of staff/consultant to deliver technical assistance
Monitoring and evaluation	Project financial reports	RBM (partial)
	RBM	
	Final Evaluation costs	
	Office facilities, equipment and communications	
Travel	Travel related to project execution	Travel related to project execution (partial)
Audit	Project financial audit	-

Proposed Recommendation

40. Having considered document AFB/PPRC.32/22, the PPRC may wish to consider and recommend to the Board to:

- (a) Approve the proposal for harmonization of implementing entity (IE) fees and execution costs (EE costs) as presented in para 38 of AFB/PPRC.32/22;
- (b) Request the secretariat to:
 - (i) Prepare a guidance document compiling the relevant information related to costs and fees and add it to the project preparation documentation;
 - (ii) Revise the review templates for all windows and update any reference to the IE fees and EE costs, with a view to consistency and clarity;
 - (iii) Request the secretariat to monitor, over the next [three] review cycles, proposal submissions for the proposed use of eligible costs that may be charged under project components for specific types of projects that may need additional support during their implementation;

(iv) Consider, including through a consultative process, changes to the size of the project formulation grants for projects that require enhanced capacity building during the project preparation stage;

(d) Report to the Board at its forty-fourth meeting on the observations made on items under sub paragraphs (i)-(iii) above.

Annex I

Table 2: Cost and fee caps by funding window to-date in effect

Window / Project	Project cap (USD)	Execution cost cap	IE Fee cap
Regular - Single country	10 million	<ul style="list-style-type: none"> • 9.5% of (A+B) • 1.5% of part of (A+B) if IE is executing 	8.5% of (A+B)
Regular - Regional	14 million	<ul style="list-style-type: none"> • 10% of (A+B) • 1.5% of part of (A+B) if IE is executing 	10% of (A+B)
EDA	5 million	<ul style="list-style-type: none"> • 12% of (A+B) • 1.5% of part of (A+B) if IE is executing* 	10% of (A+B)
Innovation – Single Country	5 million	<ul style="list-style-type: none"> • 9.5% of (A+B)* • 1.5% of part of (A+B) if IE is executing 	8.5% of (A+B)
Innovation - Regional	5 million	<ul style="list-style-type: none"> • 10% of (A+B) • 1.5% of part of (A+B) if IE is executing* 	10% of (A+B)
Small innovation grant	250,000	<ul style="list-style-type: none"> • 9.5% of (A+B) • 1.5% of part of (A+B) if IE is executing 	8.5% of (A+B)
Learning grant	150,000	N/A	8.5% of (A+B)
Scale-up grants	100,000	<ul style="list-style-type: none"> • 9.5% of (A+B) • 1.5% of part of (A+B) if IE is executing 	8.5% of (A+B)

Table 3: List of activities to-date funded by AF grant and covered by IE fees and execution costs

Cost item	Type of support		
	Covered by IE fees	Covered by project execution costs	Not covered by AF grant
Staff	IE staff salary or time for project development, monitoring and supervision	Salary of project staff	Government-seconded staff
Monitoring and evaluation	Mid-term Evaluation costs, if mandatory for IE Supervision of preparation of annual project reports and project evaluation reports	Project financial reports RBM Final Evaluation costs Office facilities, equipment and communications	Independent reviews or evaluations of the projects and programmes by AF Board
Travel	Project supervision missions and steering committee meetings	Travel related to project execution	
Audit	Ensure compliance with audit requirements	Project financial audit	

Table 4: Costs and Fees in EDA proposals submitted to-date

EDA Proposal	Country	EE Cost	IE Fee
AFB/PPRC.31/41	Belize	1.5%	10%
AFB/PPRC.31/42	India	<ul style="list-style-type: none"> ○ Less than 1% for components executed by IE ○ Earmarking 12% for EC- as EE are not yet identified 	10%
AFB/PPRC.29/32	Tanzania	9.4%	8%
AFB/PPRC.30/41	Peru	1.5%	6.9%
AFB/PPRC.30/40	Rwanda	9.6%	9.5%
AFB/PPRC.32/X	Honduras	10%	9.9%
AFB/PPRC.32/X	Armenia	1.56%	10.96%