

## A3.1 Performance-Based Payments

### 1.0 Regulations and Rules

Financial Regulation 17.01 of the UNDP Financial Regulations and Rules.

### 2.0 Policy

#### Purpose and Definition

1. Performance-based payments (PBPs) are a type of agreement between UNDP and a responsible party to provide funding upon the verified achievement of an agreed measurable development result. No advances are provided, rather payments are made only upon the verified achievement of agreed results. This approach gives greater incentive to responsible parties to achieve results.
2. A project that uses performance-based payments for select results may use additional agreements and methods to deliver other results. For performance-based payments, the achievement of specific, pre-agreed results (outputs and/or activities) must be validated through performance measures and quality certified by an independent assessor for agreements of more than \$300,000. Given the cost associated with engaging an independent assessor, it is recommended to use performance-based payments for agreements of at least \$1 million or more per annum. The project board may verify results in cases of \$300,000 or less.
3. Circumstances that might warrant the use of performance-based payments include, but are not limited to: (a) the desire of a donor to use a this approach to ensure results are achieved and mitigate financial risk; (b) particularly volatile development situations that cannot be effectively addressed by standard agreements; (c) specific sectors where performance-based payments are established practice, such as the use of results-based payment schemes by countries for reducing deforestation as supported in various UN Framework Convention on Climate Change decisions; (d) implementation capacities and arrangements exist and can be leveraged; and (e) development approaches and best practices to address the development challenge are readily available.
4. Performance-based payments may be used under a project implemented by UNDP, where a responsible party is selected to take programmatic and financial accountability for delivering specified results. They may also be used under a nationally implemented project, where UNDP provides country office support services to the implementing partner, and those services include engaging a responsible partner using a performance-based payment arrangement.
5. There are three types of performance-based payments, which vary according to funding amount and use of working capital reimbursements. They have different conditions as noted in the table below.

	Performance-Based Payment Agreements		Low-value, Performance-Based Payments
	Without Working Capital Reimbursements	With Working Capital Reimbursements	
<b>Applicability</b>	For large projects where the responsible party will self-finance all the agreed activities until the pre-agreed results are achieved,	For large projects with payment contingent on achieving pre-agreed results that are verified and certified by the independent assessor, but where the financial	For projects with low-value, performance-based payment arrangements

	Performance-Based Payment Agreements		Low-value, Performance-Based Payments
	Without Working Capital Reimbursements	With Working Capital Reimbursements	
	verified and certified by an independent assessor (IA)	position of the responsible party limits its ability to fund the entire working capital	
<b>Funding Size</b>	Over \$300,000 <sup>1</sup>	\$5 million (total) or more	\$300,000 or less
<b>UNDP Pre-funding</b>	No	No	No
<b>Conditions for Payment to Responsible Party</b>	Payment to the responsible party is contingent solely upon achievement of specific, pre-agreed results, which are validated by the independent assessor	Payment to the responsible party is contingent upon achievement of specific, pre-agreed results, which are validated by the independent assessor  +  Partial reimbursement of working capital to the responsible party for pre-agreed activities/budget lines (limited to a maximum of 50 percent of the budget line item and 50 percent of the total performance-based payment budget)	Payment to the responsible party is contingent solely upon the achievement of the specific, pre-agreed results validated by the project board
<b>Independent Assessor</b>	Yes	Yes	No
<b>Partner Due Diligence and Capacity Assessment</b>	Partner capacity assessment tool (with PBP-specific worksheet) and HACT (micro) assessment	Partner capacity assessment tool (with PBP-specific worksheet) and HACT (micro) assessment	Partner capacity assessment tool (with PBP-specific worksheet) and HACT (micro) assessment if applicable based on capacity assessment threshold
<b>Assurance and Financial Reporting</b>	Semi-annual and final financial reports; annual and final reports with evidence of progress; audit	Quarterly and final financial reports; annual and final reports with evidence of	Progress reports including financial and narrative information; final report with

<sup>1</sup> Given the cost associated with engaging an independent assessor, performance-based payment agreements are best used for agreements of at least \$1 million per year or more.

	Performance-Based Payment Agreements		Low-value, Performance-Based Payments
	Without Working Capital Reimbursements	With Working Capital Reimbursements	
		progress; full HACT processes including audit	evidence of results achievement; audit and review at UNDP's discretion
<b>Monitoring</b>	Output monitoring	Output monitoring	N/A
<b>Incentives/Rewards</b>	Optional	Optional	No

### Key Features of Performance-Based Payments (PBPs)

6. Clarity of the result: A clear definition is essential since an achieved result is at the core of any performance-based payment.
7. Payment-linked indicator(s): The achievement of a result is established based on agreed indicators that serve as a trigger for payment. Indicator(s) must measure the exact intended result. This ensures that UNDP disburses funds only when the responsible party has delivered results that are achieved through principled performance<sup>2</sup>.
8. Self-financing: The responsible party will self-finance all or a significant portion of the project activities until pre-agreed results are achieved, verified and quality certified by the independent assessor or project board. No 'advances' or 'pre-payments' are provided, although limited working capital reimbursements of expenses incurred can be made in select circumstances for large projects, subject to the achievement of pre-defined minimum progress thresholds certified by the assessor.
9. Rebalancing of risks: While the financial risk shifts from UNDP to the responsible party, UNDP continues to carry reputational and other risks should a project not deliver its intended results. Non- or reduced payment by UNDP must be a credible consequence in case the development result is not achieved. In that sense, UNDP, the funding partner(s) and the responsible party must carefully consider the consequences of a possible non- or reduced payment before entering into such an agreement.
10. Efficient resource use: Since performance-based payments are intended to optimize the achievement of results, the amount to be paid must be commensurate with that result. Agreeing on targets and amount paid for attaining them will require detailed negotiations between UNDP and the responsible party in most instances.
11. Sustainability of results: UNDP must be able to demonstrate that the results to be achieved are sustainable and of demonstrable quality. In this respect, post agreement covenants may be necessary when the results exceed the duration of the project activities to ensure the continuation of activities and results following the conclusion of the agreements. Part of the payment may be payable upon confirmation of delivery of sustained results after a pre-agreed period has elapsed

<sup>2</sup> i.e., performance that is in line with the principles of UNDP's regulatory framework and Code of Ethics, and is in adherence with UNDP's Social and Environmental Standards.

from project completion. This will require continued monitoring of results by the IA for the pre-agreed duration after activities are completed.

12. Responsibility for result achievement: Multiple development partners often work on the same or a linked development result. The responsible party must be in a credible position to bring about the stipulated development result.
13. Provision for non-results: The non-achievement of results will result in the responsible party receiving no payment or only partial payment, depending on the terms of the contribution agreement with the funding partner(s). Funding that is not released may be returned to the funding partner(s) or alternatively allocated to another responsible party.
14. Early termination: Every performance-based payment agreement must contain a clear early termination provision for scenarios where it is determined that continuing the project will not achieve the required results. A monitoring schedule should indicate minimum progress thresholds. Where performance indicates that the responsible party cannot deliver the required level of results within the identified time frame, UNDP would terminate the agreement. Minimum progress thresholds must be defined for each year of the agreement. Early termination may also be triggered through lack of adherence to UNDP's Social and Environmental Standards.

#### **Selection and Assessment of Responsible Parties for Performance-Based Payments**

15. The selection of a responsible party for performance-based payment is a programmatic decision. Policies for the selection of responsible parties apply, along with the following provisions, given the key features of performance-based payments stated above:
  - Responsible parties, such as government entities, NGOs/community-based organizations, academic institutions, the private sector and non-UN intergovernmental organizations, require a capacity assessment, including the HACT assessment and assurance in line with prevailing policies. This includes completing [due diligence](#) for private sector entities.
  - UNDP must assess the ability of the responsible party to deliver agreed results in the required time frame. As part of the selection process, the responsible party must deliver a proposal outlining how the results will be financed and delivered. This proposal will be assessed to review if the responsible party has the required access to financing, inputs, conditions and capacities to deliver. It will also assess if the approach includes relevant safeguards to protect people and the environment.

#### **Selection of the Independent Assessor**

16. An independent assessor is required for performance-based payments of over \$300,000. The assessor provides a neutral, impartial and independent assessment of whether the agreed development result has been achieved prior to issuing the agreed payment. The selection of the assessor must be competitive and agreed between UNDP and the development partner benefitting from a performance-based payment. The process is guided by the following criteria:
  - The independent assessor must be an internationally recognized institution of repute, with no commercial relationship with any of the other parties that may impair its objectivity, impartiality or independence.
  - The institution should have no affiliation to UNDP or the development partner.

- In case a project provides for a dedicated project evaluation, the decentralized evaluation and the independent assessment functions can be combined into one contract (see also [UNDP Evaluation Guidelines](#)).
17. UNDP engages the independent assessor through a separate agreement once consensus has been reached on the choice of an institution. The independent assessor must acknowledge its role in the performance-based payment agreement as a non-party to the agreement.

### **Managing Performance-Based Payment Agreements**

18. The governance of performance-based payments follows regular UNDP programming policies and standards, including oversight through a project board. Funding partners must agree to the use of the payments, including funding the cost for establishing payment arrangements (factoring in UNDP's costs), any working capital payments, as well as the performance payments and incentives (if any) for successful achievement of specified results.
19. All costs involved with designing, monitoring and overseeing performance-based payments must be borne by the project, in line with the policy on [Delivery Enabling Services](#).
20. UNDP follows regular programme and project formulation and implementation policies in the use of performance-based payments. A responsible party and the independent assessor may be identified during the project design or implementation through the standard selection methods outlined in [Select Responsible Party and Grantees](#). Before a project document containing a performance-based payment can be signed, the project appraisal committee or project board must review:
- The choice of the proposed responsible party and the independent assessor;
  - The formulation of the result, validation method and payment-linked performance indicators submitted by the independent assessor; and
  - The draft performance-based payment agreement based on the relevant template.
21. The independent assessor, prior to the signature of the performance-based payment agreement, validates key aspects, including: (a) the theory of change explaining how the result(s) are expected to be achieved; (b) the definition of the result(s); (c) objectively verifiable indicators to measure the achievement of the result(s) as well as performance targets against these indicators that will trigger payments; (d) the adequacy of risk management measures, including for compliance with social and environmental standards; and (e) the payment terms linked to the validation of the result(s), which can include:
- Financial incentives in case the result(s) are achieved early or are surpassed;
  - Provisions for reduced or graded payments in case the result(s) are partially achieved or incomplete (i.e., 'near miss'); and
  - Any other incentives and payment conditions related to the quality and sustainability of the result(s).
22. The independent assessor, in consultation with UNDP and the responsible party, will develop a validation methodology attached to the performance-based payment agreement as an annex. It will help verify the achievement of milestones and targets reported by the development partner to validate that agreed levels of quantity, quality and sustainability were delivered. Result(s) validation must be based on independent data collection or validation of existing data on the specified indicators.

23. Since the cost of the independent assessor is programmatic and chargeable to a project budget, an advance authorization or specific provision as part of the initiation plan might be necessary. The independent assessor's validation of the theory of change may precede formal approval of the project (see [Accountability and Delegation of Authority](#)).
24. The responsible party is fully responsible for the achievement of the result(s), and free to use its own approaches, methods, capacities and resources within the parameters stipulated in the project document and performance-based payment agreement. Upon achievement of the result(s), the development partner submits substantive and other reporting required in the agreement to trigger payments.
25. In light of changes in risk, simplified substantive monitoring can be stipulated in the project document and the performance-based payment agreement in line with the methodology validated by the independent assessor. Reflecting the reduced financial risk to UNDP in PBP agreements where there are no working capital reimbursements, the HACT assurance and financial reporting processes are streamlined as follows:
  - UNDP is under no obligation to monitor the Responsible Party's expenditures or to verify the Responsible Party's use of its own funds (including financial spot checks).
  - Financial reporting to UNDP is also streamlined, and will follow a summary expense reporting approach. The frequency of reporting need not follow the regular quarterly cycle, but will instead be six-monthly.
26. PBP agreements that provide for working capital reimbursement must follow the existing HACT Framework, requiring the regular HACT assurance activities (including spot-checks) and reporting through the FACE form to help manage the risk of reimbursements.
27. Under the corporate accountability framework, performance-based payments are subject to all evaluation requirements (see UNDP Evaluation Policy, DP/2019/29).