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The Global Fund

To Fight AIDS, Tuberculosis and Malaria

The Office of the Inspector General

Review of Principal Recipient audit arrangements

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Office of the Inspector General

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Acronyms

AfDB	African Development Bank
ASP	Additional Safeguard Policy
CCM	Country Coordinating Mechanism
CPE	Continuous Professional Education
DFID	Department for International Development
DRC	Democratic Republic of Congo
FMS	Financial Management and Systems
FPM	Fund Portfolio Manager
GF	The Global Fund
GPR	Grant Performance Report
HIV	Human Immuno Virus
INTOSAI	International Organisation of Supreme Audit Institutions
ISA	International Standards on Auditing
LFA	Local Fund Agent
M&E	Monitoring & Evaluation
OAI	Office of Audit and Investigations
OIG	Office of the Inspector General
PO	Program Officer
PR	Principal Recipient
PSM	Procurement Supply Management
SAI	State Audit Institution
SR	Sub Recipient
SWAp	Sector Wide Approach
UN	United Nations
UNICEF	United Nations Children's Fund
UNDP	United Nations Development Programme
UNOPS	United Nations Office for Project Services
WHO	World Health Organisation

Executive Summary

Introduction

1. Given the need to rely on Principal Recipient audit arrangements to provide assurance to the Global Fund Secretariat as well as other stakeholders on the proper use and accountability of disbursed funds, the Office of Inspector General (OIG), as part of its 2009 work plan, undertook a review of the PR audit arrangements, and presents the results of that review in this report.

2. The Global Fund had received funding of \$18.9 billion, and committed \$ 15.3 billion through seven proposal rounds by February 2009. As a financing mechanism, the GF has put in place a number of fiduciary arrangements to ensure that grant proceeds are used for the intended purposes and that results are achieved without imposing unnecessary burdensome requirements on grant recipients.

3. In order to successfully demonstrate financial and programmatic accountability for a grant, PRs need certain minimum capacities and systems. The Global Fund does not prescribe specific implementation arrangements. Rather, the Fund encourages the use of Principal Recipient's existing systems, in so far as they meet the required minimum capacities. Before agreeing to enter into a grant agreement with an entity that has been nominated to be PR through a Country Coordinating Mechanism(CCM), the Global Fund assesses whether that entity has (or has access to) the required minimum capacities. One of the defined minimum capacities is the requirement that PRs are subject to acceptable auditing arrangements.

4. To counter risks that funds provided may not be used for the intended purposes; may be misappropriated or; may not be properly recorded in the books of account, the GF has instituted a mitigation strategy which requires the PRs to have annual financial audits. The GF Secretariat receives assurance from the LFAs that these audits have in fact been conducted by qualified professionals in a timely manner and that they provide reasonable assurance that the above risks have been properly managed.

Objectives of the review

5. The purpose of this review was to assess the effectiveness of the different audit arrangements employed by Global Fund recipients in accordance with signed grant agreements. The review objectives were to:

- (a) assess the effectiveness of audit arrangements that PRs have put in place to ensure that grants are managed well;
- (b) assess the level of compliance by PRs to conditions relating to audit as set out in the grant agreement;
- (c) review the soundness of systems, policies and procedures within the GF Secretariat in ensuring that audit arrangements are complied with; and
- (d) assess the risks the GF grants are exposed to due to ineffective audit arrangements and adequacy of measures taken to mitigate them.

Scope and methodology

6. The review covered the audit arrangements in place for PRs as set out in the grant agreements signed with the GF and the relevant guidelines in place at the Global Fund Secretariat. This review did not cover audit arrangements for the Global Fund Secretariat.

7. The sample selected covered Round 4 and 5 grants. This gave the OIG sufficient coverage of grants that have been in operation for more than two years. It also ensured that the sample did not go so far back to the past where information may not have been readily available and systems may not have been as developed as they are today. However, in those cases where the grants under Rounds 4 and 5 did not provide adequate coverage, earlier/later grants were considered.

8. A total of fifty (50) grants covering all the clusters in Country Programs were reviewed. Appendix A provides a list of the grants reviewed. The sample selected ensured that the review had coverage of the different types of program implementation and their related audit arrangements namely:

- (a) Audit arrangements specific to GF programs;
- (b) Audit arrangements based on donor harmonization efforts where GF co-finances a program with other donors (e.g., as part of a SWAp arrangement) and a single audit report is produced for all funders;
- (c) Audit arrangements where UN agencies such as UNDP and UNICEF are PRs; and
- (d) Audits arrangements for countries under the Additional Safeguard Policy.

9. The sample selected also covered the:

- (a) Adequacy of Internal Audit arrangements of PRs and SRs that receive substantial amounts of GF Funds, and the
- (b) Adequacy of External Audit arrangements for SRs that receive substantial amounts of GF Funds.

10. The work done drew on best practice and also compared GF audit arrangements with other financing organizations that have been in operation longer e.g. the World Bank, African Development Bank etc.

11. Recommendations have been prioritized. However, the implementation of all recommendations is essential in mitigating identified risks and strengthening the audit arrangements. The prioritization has been done to assist management in deciding on the order in which recommendations should be implemented. The categorization of recommendations is as follows:

- (a) *High priority*: Material concern, fundamental control weakness or non compliance, which if not effectively managed, presents material risk and will be highly detrimental to the organization's interests, significantly erodes internal control, or jeopardizes achievement of aims and objectives. It requires immediate attention by senior management;
- (b) *Significant priority*: There is a control weakness or noncompliance within the system, which presents a significant risk and management attention is

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required to remedy the situation within a reasonable period. If this is not managed, it could adversely affect the organization's interests, weaken internal control, or undermine achievement of aims and objectives; and

- (c) *Requires attention*: There is minor control weakness or noncompliance within systems and proportional remedial action is required within an appropriate timescale. Here the adoption of best practice would improve or enhance systems, procedures and risk management for the organisation's benefit.

Summary of findings

12. This section briefly highlights the findings and conclusions arising from the review. The detailed findings are contained in the rest of the report. It is, however, essential that this report is read in its entirety in order to comprehend fully the approach to and findings of OIG's work.

Review of policies on audit arrangements

13. The GF Operations Manual sets out policies that guide audit arrangements. These cover auditor selection and acceptability, audit terms of reference, due date for audit report, audit fees, format for audit reports, programs with co-financing, sub-recipient audits, follow up on audit findings and roles and responsibilities in the oversight of audit arrangements.

14. Guidelines for the annual audit of recipient financial statements prescribe international audit standards as a requirement for the audits. The LFA assesses capacity of the auditor to apply audit standards. However there is no tool for use by the LFA to systematically evaluate the capacity of auditors to apply these standards.

15. Global Fund policy accepts audit policies of multi-lateral organizations. The multi-lateral organizations that serve as PR to Global Fund grants include UNDP and UNICEF. The Organisations within the United Nations can only be audited by the United Nations Board of Auditors and the Internal Audit units of those entities and even then the result of the audits cannot be shared with entities external to the UN fraternity. Because these entities have not shared their annual financial audits with the Global Fund the latter is unable to gain assurance about the use of program funds.

16. The existing policy does not provide for a review of the acceptability of the work done by the auditor even when the auditor is the State Audit Institution (SAI). From the OIG's review of audit reports submitted by SAIs as well as the work done by the World Bank and African Development Bank, the quality of work done by some of the SAIs is not sufficient to provide the GF with assurance about the use of its funds.

17. Global Fund policy accepts a single audit report covering the entire program, including all sources of funds, as long as Global Fund grant and expenditures for program purposes can be clearly identified. This policy requirement is not appropriate in cases where the PR is a major government department, such as the Ministry of Finance or the Ministry of Health. In such cases the proportion of Global Fund grants as a proportion of the rest of the organization's funds may not be

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material. An audit undertaken under such circumstances will provide limited coverage of the Global Fund grants.

18. The Global Fund policy requires the audit of all sub-recipients. In reality PRs have different numbers of sub-recipients to whom varying amounts are disbursed. Some PRs have as many as ninety (90) sub-recipients, some of whom receive less than US\$ 10,000 from the PR. The policy assumes similar audit arrangements for all sub-recipients without considering the funds disbursed to each. This policy may not be particularly appropriate in the case of ‘pass through’ PRs and their substantive SRs.

Review of structures for oversight of audit arrangements

19. The Fund Portfolio Managers and Program Officers in the Country Programs Cluster usually lack the required knowledge and skills to review audit arrangements, including audit plans, terms of reference, and audit reports. In consequence audit reports get filed without an assessment of the appropriateness of audit opinions, reliability of financial statements and the financial management systems that produce them. The key information is not used for decision making in the grant making process.

20. The guidelines for recipient audit arrangements clearly define the role of the LFA. However OIG noted that overall the LFAs are not effectively undertaking their responsibilities to:

- (a) Assess the suitability of the auditors;
- (b) Review auditor terms of reference;
- (c) Follow up timely submission of audit reports;
- (d) Review audit reports; and
- (e) Ensure action plans that result from audit report recommendations are implemented by the PR.

Review of tools used for oversight of audit arrangements

21. The Financial and Management Systems (FMS) assessment tool does not provide guidance to the LFA on what should be the basis of determining whether the auditor is able to meet the requirements of international or other appropriate auditing standards. As a consequence, LFAs do not report on the capacity of the auditor in the PR Assessment Reports.

22. The definition of what issues raised in audits are major is left to the LFA to make on a subjective basis. All issues that recur from year to year should be identified as issues that indicate FMS weaknesses due to a weak internal control environment.

23. The standard template for the PR assessment report does not capture the existence and capacity of the internal audit department. Internal audit should, in the OIG's view, be required for grants above a specified level of funding.

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24. The Grant Performance Report (GPR) provides information to stakeholders of each grant's compliance to set requirements including audit arrangements. During the review, OIG noted that out of the selected sample of 50 grants, the status of audits undertaken was documented for only 19 grants.

Review of the compliance to existing policies for audit arrangements

25. The Principal Recipient is expected to select an auditor prior to Grant Agreement signing. If this is not the case, the selection of the auditor should be done within the first six months of program implementation. However from the review the following was noted:

Details	Complied with grant agreement?	Number	Percentage
New PR audit arrangements accepted by GF	Yes	11	22
PR audit arrangements relate to UNDP standard provisions	Yes	6	12
PRs where own audit arrangements were accepted by GF	Yes	7	14
PR audit arrangements were not documented	No	26	52
		50	100

26. GF Policy requires that the audit report, including the management letter noting deficiencies in the PR's internal controls, should be received by the Global Fund from a Principal Recipient within six months of the end of the PR's financial year. However the review revealed the following:

Details	Grants	Number of reports
Audit reports submitted	43	86
Reports not submitted	7	9
One audit report outstanding	5	5
Two audit reports outstanding	2	4

27. OIG also noted that for ten (10) out of the reviewed sample of 50 grants, audit reports submitted only comprised a statement of income and expenditure without the management letter.

28. Six (6) grants were noted, for which the reports submitted were in formats and content that did not meet the specifications in the guidelines.

29. The Global Fund does not have a mechanism to monitor and follow up that audit reports are submitted within the required period of 6 months.

30. As part of its monitoring of grant implementation by a Principal Recipient, the Local Fund Agent is expected to receive and review the PR's audit report and management letter. However, the review revealed the following exceptions:

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Details	Grants	Number of reports
Audit reports reviewed by LFA	15	35
Audit reports not reviewed by LFA	21	34
Audit reports submitted	36	69
Action plans from audit report agreed with PRs	22	49
No action plans from the audit reports	14	20
	36	69

31. Audit plans for sub-recipients were not documented for 44 of the 50 grants reviewed by the OIG.

Review of grants with special audit arrangements

32. Before 2009, the audits of GF programs for which UNDP is PR were covered as part of the OAI's internal audit of UNDP country offices. The OAI's internal audit of country offices is not fund-based (or fund-driven), but covers all aspects of a country office's activities irrespective of the source of funds. An audit that is not specific to GF programs would not adequately address GF program specific risks.

33. Starting 2009, OAI has engaged an auditor who will specialize in conducting audits of GF related activities. In the OIG's view one auditor is not able to adequately cover the entire portfolio of over 20 GF Programs. Further, without access to the results of the audit it is not possible for OIG to provide assurance that risks to GF programs are adequately addressed by UNDP's audit arrangements.

Summary of recommendations

34. The GF Secretariat should increase vigilance in monitoring compliance with the required audit arrangements. Standard templates to aid follow up of each requirement as per the grant agreements and GF policy for audit arrangements should be developed and included in the LFA Manual.

35. The GF policy for audit arrangements should be reviewed to include actions that will be taken when the PR does not comply with provisions for annual audits in the grant agreement. The policy should include a requirement for the LFA to submit to the GF Secretariat a review of the major issues arising out of the annual financial report of the SRs for each PR, by the end of the sixth month after the end of the SR's financial year.

36. During the Phase 2 review of compliance with the GF policy on audit arrangements, the LFA should provide specific comments on compliance with each of the provisions of the GF policy as well as those audit findings that may affect the GF decision to invest. Any major areas that result in failure to obtain assurance on the use and accountability of funds will affect the GF's decision to invest.

37. The Program Finance Unit is positioned independently of the Country programs Cluster and, in OIG's view, should in future be given the authority to

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objectively review the PR audit reports for appropriateness and ensure that issues arising from these reports are assessed for risk to GF Programs.

38. The LFA should always assess whether the PR's audit arrangements meet the GF's requirements. Should gaps be identified then the GF can agree on how to address the auditor related issues or select another auditor. In cases where the audit arrangements are not adequate then a separate audit of GF programs should be undertaken. However where the PR's audit requirements are adequate or more stringent, these may be adopted.

39. The GF should dialogue with the United Nations Agencies that act as PR for with a view to providing assurance to the Global Fund on the use and accountability of funds disbursed. At the 19th session of the GF Board a decision was taken to call on the Chair of the Board to dialogue with his counterpart in UNDP to secure access to the full text of audit reports. For countries under Additional Safeguards Policy (ASP), the special audit arrangements envisaged should be applied in practice and monitored by Countries Programs with the support of the LFA. Consideration should also be given to enabling Secretariat to call for special audits for all grants when particular risks emerge.

40. The GF Secretariat should provide the LFA with guidance on the assessment of the suitability of auditors. Detailed criteria have been proposed in Appendices B and C of this report. The LFA should evaluate the auditor's ability to meet these minimum requirements. If they are not, decisions should be made about whether there is a need to change auditors.

41. The policy on PR audits should be reinforced by requiring major sub-recipients of 'pass through' PRs to comply with the audit conditions similar to those of PRs..

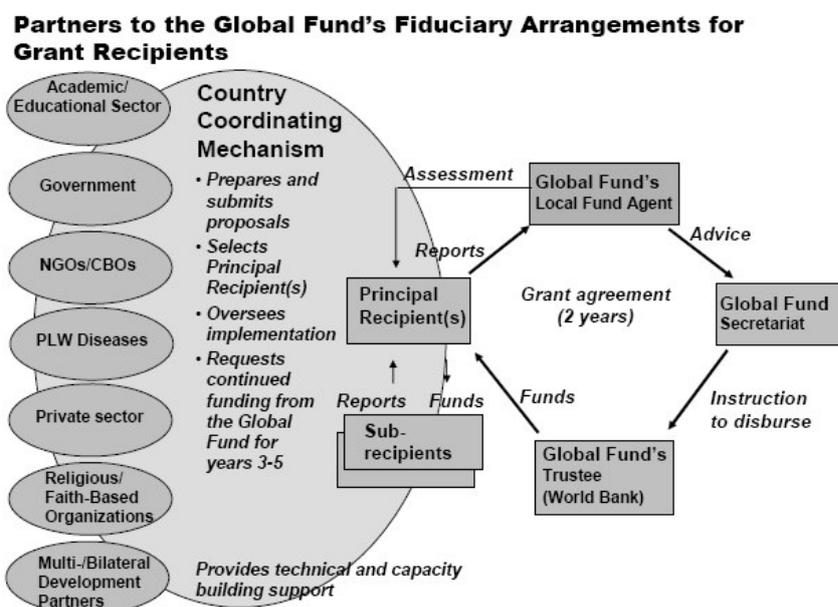
42. The GF should encourage the PRs/SRs that receive funds above a set threshold to have independent Internal Audit units as part of effective internal control systems. The capacity of the internal audit units should be assessed by the LFA.

Conclusion

43. Based upon this review, the OIG concludes that the mitigation strategy of relying on audit arrangements while conceptually sound is not working in an effective manner and therefore does not provide assurance that funds are utilised for the intended purpose and that other risks are being effectively managed.

GF Architecture in relation to PR audit arrangements

44. As a financial instrument rather than an implementing entity the Global Fund:
- Relies on local stakeholders at the country level to implement programs;
 - Promotes rapid release of funds to assist target populations;
 - Monitors and evaluates program effectiveness and makes decisions on future funding based on program performance and financial accountability; and
 - As far as possible encourages the use of existing standards and processes in grant recipient countries.
45. There are various key stakeholders in the GF fiduciary arrangements as illustrated in the diagram below:



The Global Fund's fiduciary arrangements for grant recipients comprise of Principal Recipients (PRs) and sub-recipients (SRs) implementing the programs. The implementers are overseen by a Country Coordinating Mechanism (CCM). A Local Fund Agent (LFA) provides assurance on programs to the Secretariat, and the World Bank is the Global Fund's Trustee, in terms of holding the funds awaiting disbursement.

46. By relying on local stakeholders at the country level to implement programs and manage grant proceeds and encouraging the use of existing standards and processes in grant recipient countries, the GF applies a "light touch" to grant management. The "light touch" nature of the Global Fund poses several financial risks which include:
- The risk that funds disbursed may not be used efficiently, effectively and economically; and
 - Misappropriation of funds disbursed.

The GF has put in place certain fiduciary arrangements to ensure that the financial risks above are mitigated without imposing unnecessary new burdensome requirements on grant recipients.

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47. A core component of the GF's fiduciary framework is the audit of PRs and SR program financial statements. In accordance with the relevant sections of the Grant Agreement, the expenditures of PRs and SRs are required to be externally audited on an annual basis. The PR budgets for program funds include a component for annual financial audits.

Stakeholders involved in enforcing the audit arrangements

The GF has defined the roles of the different stakeholders in its fiduciary arrangements in enforcing the audit arrangements. Where these roles have been executed as prescribed, the audit arrangements have provided good information for decision making. However, in many cases key stakeholders do not fully execute their roles. This means that a key component in the oversight of GF fiduciary arrangements is ineffective.

48. According to GF policy, the PR is responsible for ensuring that annual financial audits are undertaken. The party responsible for enforcing audit arrangements are the Global Fund Secretariat through the Country Programs Cluster. The Program Finance and Legal teams play an advisory role. LFAs should provide important inputs and the CCM have oversight responsibilities. The policy that defines responsibilities for the different parties regarding audit arrangements is the *Guidelines for Annual Audits of Program Financial Statements*.

The Global Fund Secretariat

49. As part of its need to remain accountable to its funding sources, the GF Secretariat requires PRs to undertake annual audits. The GF determines the acceptability of the auditor, audit Terms of Reference (ToRs) and SR audit plan and on appropriate remedial actions in response to audit findings and recommendations. Within the GF Secretariat, the Country Programs Cluster, specifically the Fund Portfolio Managers (FPMs), are responsible for enforcing audit arrangements.

Good Practice

In the case of Indonesia Round 4 HIV grant 2007 audit, the FPM reviewed and documented remarks on the audit report made by the LFA. Further, the FPM determined the acceptability of the auditor and ToRs. Once the audit report was presented, the FPM obtained comments from the LFA on why they had not brought the audit findings to the attention of the Country Programs team.

50. A review of the grants sampled revealed that many of the FPMs and Program Officers (POs) do not have financial management training and experience. As a result, they lack the requisite knowledge and skills to effectively assess the appropriateness of auditors selected, as well as the suitability of audit plans and interpretation of audit findings. At both the World Bank and the African Development Bank, the selection and engagement of auditors, providing assurance on the suitability of auditors including their independence, and competence to perform the work is undertaken by Financial Management Specialists (FMS) at country and head quarter level. The GF has made a provision for LFAs to review and provide recommendations about the audit arrangements to FPMs. However, in most

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instances either LFAs do not review the audit arrangements as required or where they do, they have not provided good information to guide grant related decision making.

51. Within the GF structure, the FMS equivalent would be the Program Finance team. However while the Program Finance team have the requisite skills, the work load that this would create for the team would be considerable. To mitigate the risk, Program Finance has held several audit related training programs but these have not been well attended.

52. The review of the grants sampled revealed a lack of evidence that the suitability of auditors and country audit plans was assessed and approved by the FPM. Audit reports in many cases were just filed without analyzing the impact of the findings on grant implementation. There was also no evidence seen of the audit findings being taken into consideration in informing the grant decision making process.

Recommendation 1 (High)

The outputs of PR financial audit should at least cover an audit opinion, financial statements on which the audit opinion is based and a management letter communicating any conditions identified during the course of the audit that the auditors may want to bring to the attention of the PR's management. LFAs should be provided with a template that requires them to give specific comments on the reports provided by the auditor.

53. The Program Finance unit, as part of its support to the grant management process, provide plays an advisory role to the Country Programs Cluster but only on request. Where Program Finance is not informed of findings and resultant risks, the advice provided to Country Programs may be based on insufficient information. This may result in wrong decisions. The Legal team reviews and provides input in to the grant agreement before final signature. GF policy requires cases of breach of the grant agreement to be brought to the attention of the Legal team. No evidence has been seen that this was done for the 50 grants reviewed.

54. Currently there is also no defined policy that guides communication between Country Programs and Program Finance or Legal in relation to audit arrangements. This leaves various stakeholders to decide on what is appropriate communication. This has resulted in instances where matters should have been elevated to the two teams remaining un-dealt with.

Recommendations 2 (High)

A policy that clarifies responsibilities and communication between Country Programs, Program Finance and Legal in relation to audit arrangements should be developed. Consideration should be given to:

- *Transferring key responsibilities to the Program Finance Unit for: assessment of the type of audits required to address PR specific risks; review of adequacy and implementation of PR and SR audit plans; review of audit reports and*

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comments submitted by LFA; and tracking of submission of audit plans and reports;

- *Clarifying when the Legal Unit should provide input to reviewing of audit arrangements; and*
- *Specifying the consequences for non-compliance to audit arrangements.*

All Fund Portfolio Managers and Program Officers should attend finance related training organized by the Program Finance Unit which should include awareness raising on all arrangements related to audit.

Local Fund Agent

Whereas LFAs are a key pillar for oversight of audit arrangements, the review found a high level of non-compliance with the requirement for LFAs to review the proposed auditor's ToRs (92% non-compliance) and annual audit reports of (67% non-compliance).

55. The LFA has a central role in enforcing PR audit arrangements. This includes:
- (a) Confirming that the nominated PR has an auditor in place;
 - (b) Reviewing the acceptability of the auditor, the Terms of Reference and the PR's sub-recipient audit plan;
 - (c) Reviewing the audit reports when received from the PR and advising the GF on how the findings can be remedied;
 - (d) Reviewing the audit reports of SRs. As part of its monitoring activities, the LFA reviews the PR's implementation of the audit findings and recommendations.
56. The policy describes the role of the LFA, which if properly executed provides a sound basis for enforcing PR audit arrangements. However OIG noted that the execution of the policy varied across the different LFAs and across countries. In countries where the LFA has undertaken its role as prescribed in the policy, good insight on the results of the audit can be derived by a non-finance user. Many cases were noted where there was non-compliance with the policy:

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Region	No of grants reviewed	Grants for which LFA did not review auditor ToR	Grants for which LFA did not review audit reports
East Asia and Pacific	5	4	1
Eastern Africa	7	7	5
Eastern Europe and Central Asia	5	4	3
Latin America and Caribbean	8	8	5
North Africa and Middle East	3	3	1
South and West Asia	4	4	3
Southern Africa	7	5	7
West and Central Africa	9	9	7

Recommendation 3 (High)

Country Programs should ensure that the policy requirement for the LFA to review the suitability of the auditor and terms of reference of the auditor is implemented. LFAs should review audit reports as required by the policy and report to the GF within the required period of six months after year end.

Country Coordination Mechanism

57. The CCM nominates a PR that meets minimum capacities and systems, one of which is having acceptable audit arrangements. The CCM in its oversight role also has a responsibility to ensure that audits are undertaken in accordance with the signed grant agreements. OIG found little evidence in the 50 grants reviewed of CCMs paying attention to audit arrangements.

Recommendation 4 (Significant)

As part of its fiduciary arrangements, emphasis should be given by the CCM for each country to ensure that audits are undertaken for each of the grants on an annual basis as required by grant agreements. The GF Secretariat should remind CCMs that they have a responsibility for ensuring compliance with requirements for annual audits.

Principal Recipient

58. The full responsibilities of PRs in regard to audit arrangements are set out in the GF's grant agreement. The PR's audit arrangements are set out in *guidelines for annual audits of program financial statements*. A PR engages the auditor using Terms of References, facilitates the audit, and submits the audit report to the GF, through the Local Fund Agent. The PR should respond to and implement audit findings and recommendations, as appropriate. Where the PR makes grants to sub-recipients, the PR is responsible for developing and implementing an adequate audit

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plan for the sub-recipient program expenditures. The PR forwards the audit reports received from sub-recipients to the LFA.

Recommendation 5 (Significant)

The fiduciary requirement of PRs relating to audit arrangements are only as effective as the oversight arrangements in place. The GF Secretariat should therefore increase vigilance in following up compliance with audit arrangements. Standard templates to aid follow up of each requirement as per the grant agreements and GF policy for audit arrangements should be developed and included in the LFA Manual. Templates should be designed for the following aspects of audit arrangements:

- *Acceptability of the auditor; and*
- *Acceptability of audit plans for principal recipients and sub recipients.*

Review of GF policies relating to audit arrangements

An audit report is only as good as the auditor and the methodology followed during the audit process. GF policy recognizes this fact and requires a review of the acceptability of the PR's auditor and where the auditor is not acceptable to GF, a competitive transparent recruitment process is expected. The review found that this policy is not applied. Moreover the existing GF policy does not provide adequate guidance to external auditors of PRs on the audit objectives of the Global Fund. The result is that overall the quality of audit reports submitted by PRs does not provide adequate assurance on the use and accountability of GF resources.

59. The Global Fund policy regarding audit arrangements is contained in the Operations Manual. This manual also contains guidelines for annual audits for financial statements. The provisions in these guidelines are then communicated to the PRs in the grant agreement signed with the GF. The audit related responsibilities for the LFA are contained in the LFA Manual. The policies for audit arrangements were reviewed for appropriateness in communicating and guiding the fiduciary requirements for annual financial audits. The review of existing policies and guidelines follows in tabular form.

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Area	Current policy	Issue	Recommendations
Standards for audit	While applicable international audit standards should be used for conducting the audit, national standards are acceptable where these are consistent with the international standards in all material respects.	<ul style="list-style-type: none"> • Although the policy prescribes international audit standards, the policy does not address the ability of the auditor to meet this requirement. The quality of audit reports provided in some cases demonstrated the auditor's inability to apply the required standards. 	<p>Recommendation 6 (Significant)</p> <p>Auditors should be assessed on their ability to meet criteria set by the International Standards on auditing (ISA) or the International Organization of Supreme Audit Institutions (INTOSAI).</p>
Acceptability of auditor	As part of the Financial Management and Systems Assessment performed by the LFA prior to the signing of a grant agreement, the LFA reviews the PR's selected auditor and advises the Global Fund on the acceptability of that auditor.	<ul style="list-style-type: none"> • The policy does not provide guidance of the GF's minimum acceptable standards for an auditor. • The OIG also noted that during the FMS assessment, the LFA did not in practice comment about the suitability of the auditor, although this is a policy requirement. • Review and documentation of the suitability of the PR's auditor and SR audit plans is a critical requirement for the GF to place reliance on the audit reports issued by the auditors. The high level of non-compliance with GF requirement to evaluate suitability of the auditor is an indication of ineffective audit arrangements. It was noted that some auditors produced very poor quality audit reports which 	<p>Recommendation 7 (Significant)</p> <p>The LFA should seek evidence and report on the suitability of auditors proposed for the Global Fund programs. Areas that the LFA may take into consideration include:</p> <ul style="list-style-type: none"> • independence of the audit team, firm, or institution; • competence, training, and development of audit staff assigned; • audit methodology and testing techniques applied; • quality control and documentation procedures etc. <p>.Appendices B and C provide further guidance of typical questions that can be asked.</p>

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Area	Current policy	Issue	Recommendations
		<p>reflects on the competence of the auditors. This however should have been detected by the LFA.</p>	
<p>Co-financing with other donors</p>	<p>Where the Global Fund co-finances a program with other donors (e.g., as part of a SWAp arrangement), a single audit report covering all program expenditures is acceptable as long as the Global Fund grant and expenditures for program purposes can be clearly identified.</p>	<ul style="list-style-type: none"> • The purpose of annual financial audits is to ensure that grant proceeds are used for the intended purposes and results are achieved without imposing unnecessary new burdensome requirements on grant recipients. This GF policy addresses the latter part of the purpose for audits but does not tackle the ethos of why GF requests for audits. Confirming grant income and expenditure in the audit report does not give the GF assurance that the grants are used for intended purposes. • This policy does not cover the need to assess appropriateness of the auditor and influence their terms of reference. This is contrary to the grant agreements signed with the PRs. It is crucial in the case of SWAps to assess the audit arrangements given the need for the GF to know that the money has been used for the intended purposes especially when the GF cannot track disbursed funds through the PR's systems. 	<p>Recommendation 8 (Significant)</p> <p>The policy relating to audit arrangements should be applied to all funding arrangements. Where other donor requirements are more stringent, these may be adopted. However, in cases where there are less than optimal, the GF should work with other funders to ensure that the audit arrangements are strengthened. This should include ensuring that audit coverage includes GF monies and provides assurance that the grants are used for intended purposes.</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
		<ul style="list-style-type: none"> In most cases, SWAp audits are undertaken by State Audit Institutions (SAIs). However, the capacity of these SAIs and their ability to audit the complexities associated with SWAps is questionable. 	<p>The GF should seek to rely on assessments undertaken by other institutions such as African Development Bank and the World Bank in deciding whether the work done by the SAIs can be relied up on by TGF. In cases where SAIs lack capacity to audit GF Programs they should be encouraged to sub contract the audit work to a firm with the requisite capacity.</p>
Where PR is multi lateral organization	For exceptional cases where multilateral organizations assume the role of Principal Recipients, the audit policies of these organizations will apply. The multi- lateral organizations that serve as PR to Global Fund grants are UNDP, and UNICEF.	<ul style="list-style-type: none"> This is another area where the policy is based on the need not to impose unnecessary new burdensome requirements on grant recipients but fails to reflect on why the GF calls for audits. As is the case with SWAps, the GF should not waive the need to assess the appropriateness of the auditor and influence these key aspects where they are assessed as being inadequate. United Nations multi- lateral entities do not have annual audits and even when they are undertaken, the results of audits are not shared outside the organization. This policy therefore does not support the GF's need to have annual financial audits for its grants as 	<p>Recommendation 9 (High)</p> <p>The GF should have dialogue with the United Nations Agencies that act as PR for with a view to providing assurance to the Global Fund on the use and accountability of funds disbursed. Where audits are undertaken such reports should be shared with the GF.</p> <p>For countries under Additional Safeguards Policy (ASP), the special audit arrangements policy should be agreed with the UNDP and monitored by Countries Programs with the support of the LFA. Consideration should also be given to enabling the Secretariat to call for special audits for all grants when particular risks emerge.</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
		<p>part of its fiduciary arrangements. If the outcome of audits are not availed, then it defeats the ethos of having an audit.</p> <ul style="list-style-type: none"> • There is also the single audit principle that prohibits any third party from auditing UN organizations. The GF audit requirement should be to have GF programs audited and not the UN organisation itself. Although the audit of GF programs cannot be separated from the UN organizations that manage them, it may help to draw a distinction between the two in arriving at a decision of whom and what GF needs audited. • This is also a concern as UNDP is often managing GF programs that are under the Additional Safeguards Policy (ASP). The ASP is part of the GF's risk management strategy, which is invoked when the existing systems cannot ensure accountable use of Global Fund financing and suggest that Global Fund monies could be placed in jeopardy without the use of additional measures. In such circumstances, the GF needs even more assurance that GF monies have been used for their intended purposes. The Secretariat 	

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
		<p>can call for special audits by independent auditors but this provision has been rarely invoked.</p>	
<p>Auditors acceptable to other donors</p>	<p>If a PR's existing auditor is acceptable to other donors, that auditor will be acceptable also to the Fund. In cases in which a PR does not have experience with donor-financed projects or the existing auditor is not acceptable to other donors, the LFA will advise the Global Fund on the acceptability of the auditor.</p>	<p>This policy provides for reliance on the choice of other donors in selecting an auditor and provides a blanket clearance without looking at the following:</p> <ul style="list-style-type: none"> • Level of assurance other donors are looking for vis a vis what GF requires; • Whether the risks GF programs are exposed to are similar to those of these donors; • Size of funding provided by other donors vis a vis the GF etc. <p>Donors typically have their own individual financial reporting and auditing requirements. Attempting to comply with all of them places a heavy burden on recipient countries and limits their ability to build their own internal capacity. This situation has been addressed as part of the harmonization agenda and this has been taken into consideration by the GF policy that states that GF will use the auditors of other donors without having to first assess their appropriateness or having a say in their terms of reference.</p>	<p>Recommendation 10 (Significant)</p> <p>The LFA should assess the suitability of the auditor and ToRs. Should the choice of auditor or ToRs be found to be inadequate in meeting the GF audit objectives, the GF should in consultation with other donors try to agree on the auditor and have common terms of reference. However where other donors audit requirements are adequate or more stringent, these should be adopted.</p>
<p>Single audit by</p>	<p>In most cases, the same</p>	<ul style="list-style-type: none"> • The policy does not provide for a 	<p>Recommendation 11 (Significant)</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
State Audit Institution (SAI)	auditor who performs the annual audit of a Principal Recipient will also be the auditor for the Global Fund program so that a single, comprehensive audit can be performed. For public sector entities, this is likely to be the country's Supreme Audit Institution	<p>review of the basis on which a PR has selected their auditor or their suitability to audit GF programs.</p> <ul style="list-style-type: none"> The existing policy does not provide for a review of the acceptability of the work done by the auditor when the auditor is the SAI. SAIs have often been assessed by other development partners as lacking in capacity to undertake an effective audit and actions in place to strengthen capacity of SAIs. From OIG's review of audit reports submitted as well as the work done by development partners, the quality of work done by some of the SAIs is of poor quality and does not provide sufficient audit assurance. <p>Country SAIs will inevitably be auditors to the GF programs especially those implemented through PRs or SRs that are part of country governments. Reviews undertaken by other funders e.g. the World Bank and AfDB revealed a range of difficulties faced by SAIs:</p> <p>(a) challenges to their independence posed by their funding arrangements, lack of control over their personnel, and uncertainty of tenure for the SAI head;</p>	<p>There should be other considerations taken into account in deciding whether the PR's auditors meet the GF's minimum requirements for an auditor e.g. level of assurance required by the PR vis a vis what GF requires, what risks GF programs are exposed to, size of funding provided by the GF in comparison to that of the PR, what audit arrangements are there for other donor funded programs etc.</p> <p>Recommendation 12 (Significant)</p> <p>The LFA should assess the ability of the PR's audit arrangements to meet the GF's requirements. Should gaps be identified then the GF can agree on how to address the auditor related issues or select another auditor. In cases where the audit arrangements are not adequate then a separate audit of GF programs should be undertaken. However where the PR's audit requirements are adequate or more stringent, these may be adopted.</p> <p>Recommendation 13 (High)</p> <p>Based on this, LFAs should review SAI</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
		<p>(b) quality of audit work, which suffers from their insufficient numbers of skilled personnel and lack of access to modern technology and audit methods; and</p> <p>(c) limitations on the scope of their work, with portions of the public sector in some countries not subject to SAI oversight.</p>	<p>capacity or review the assessment by other funders and advise the GF on whether the SAIs can undertake the audits effectively. In cases where this is not the case, the SAI should be asked to sub contract the audit of GF programs to a private firm. The OIG has provided some considerations in Appendices B and C.</p>
<p>Coverage of program audit reports</p>	<p>Program financial statements should cover the entire program, regardless of the financing source. In such cases, a single audit report covering the entire program, including all sources of funds, is acceptable, as long as the Global Fund grant and expenditures for program purposes can be clearly identified</p>	<ul style="list-style-type: none"> • This policy requirement is not appropriate in cases where the PR is a major government department, such as the Ministry of Finance or the Ministry of Health. In such cases the proportion of Global Fund grants in relation to the rest of the organization's funds may not be significant. • The work done by the auditor in relation to the GF grant in circumstances where the grant amount is insignificant in relation to the whole program may be insufficient. Should the coverage of the Global Fund grants be inadequate, it will not provide assurance that GF monies were used for their intended purposes. • With inadequate coverage of GF programs, weaknesses that relate to 	<p>Recommendation 14 (Significant)</p> <p>The LFA in assessing audit arrangements should advise the GF on whether providing a single audit report of the PR will give adequate assurance of the use of GF funds. Where such assurance can't be given by a single audit report, a specific audit of GF funds should be required and specified in the grant agreement.</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
		<p>GF funds may not be identified.</p> <ul style="list-style-type: none"> This audit requirement is in the spirit of ensuring that PRs are not overburdened by funding requirements, but that the GF relies upon existing systems. In view of the need to mitigate the financial risks related to use and accountability of GF disbursements, there is still need to implement effective audit arrangements. 	
<p>Audit approach for sub-recipients</p>	<p>The annual audit of a Principal Recipient should cover the PR's receipts and expenditures, not a consolidated financial statement of the PR and sub-recipient receipts and expenditures. As part of its monitoring of grants to sub-recipients, a Principal Recipient must require all sub-recipient programs to be audited using an approach that is similar to the Global Fund's Guidelines for Annual Audit of Program Financial Statements</p>	<ul style="list-style-type: none"> PRs have varying numbers of SRs. Some PRs have as many as 50 SRs, some of whom receive less than US\$ 10,000 from the PR. The policy assumes similar audit arrangements for all SRs without considering the nature of SR or the amount of funds. 	<p>Recommendation 15 (Significant)</p> <p>A cost benefit analysis should be undertaken to determine when an audit of a SR is required. Where the funds are disbursed to low risk SRs are below a certain amount, the audit requirement may be waived. In this case, disclosure should be made in the PR financial statements.</p> <p>The policy should be amended to take into consideration 'pass-through' PRs for which the program implementation mainly takes place at the SR level. The policy should also provide guidance for the audit of entities for which large amounts are disbursed to lower level</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
			recipients.
Requirements for audit of sub-recipients	<p>The PR must provide the Global Fund with a plan of how the audits of the sub-recipients will be carried out. The audits of the sub-recipients are submitted to the PR, who forwards a copy of these audit reports to the Local Fund Agent. The LFA, as part of its monitoring of PR implementation, reviews the PR's audit policies and implementation of those policies</p>	<ul style="list-style-type: none"> • In several cases, the PR is a conduit of the funds for GF, but the major implementing agency is the sub-recipient. In such cases, the policy does not provide adequate guidance on how assurance should be provided to the GF for disbursed funds. An example is where the PR is the Ministry of Finance and the Ministry of Health is the main SR. • The OIG also noted cases where sub-recipients are a major recipient of funds, but disburses these to other entities such as provinces or districts. The policy does not provide guidance on the level of assurance desired in this case. 	<p>Recommendation 16 (Significant)</p> <p>The policy should be reinforced by requiring major sub-recipients of pass through PRs to comply with the audit conditions similar to those of PRs.</p>
Audit Terms of Reference	<p>Appendix 1 of the <i>guidelines for annual audit of program financial statements</i> presents specimen terms of reference for an auditor of annual financial statements of a grant program. The ToR has the following sections:</p> <ul style="list-style-type: none"> • Background 	<p>The terms of reference do not prescribe the expected type of audit</p>	<p>Recommendation 17 (Significant)</p> <p>The specimen terms of reference should be strengthened in the following aspects:</p> <ul style="list-style-type: none"> • Definition of the objective of the audit; • Definition of the scope of activities or transactions to be reviewed; • The nature of the opinion sought; • The type of report to be prepared;

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
	<ul style="list-style-type: none"> • Principal Recipient (PR) • Accounting Standards • Reporting standards • Access to books and records • Audit scope • Audit report • Management letter 		<ul style="list-style-type: none"> • The party to whom the report is to be addressed; • The period to be covered; and • Date by which the report should be made. <p>An agreement between the PR and the auditor should be a requirement and the Terms of Reference should form part of agreement.</p>
Appointment of auditor	<ul style="list-style-type: none"> • Auditor should be appointed within 6 months of signature of grant agreement. • Audit report to be submitted to GF Secretariat within 6 months from the end of the PR's fiscal period. 	The policy does not prescribe any consequences if the PR fails to comply with these requirements.	<p>Recommendation 18 (High)</p> <p>Where the PR does not have an auditor acceptable to the GF at the time of grant negotiation, the requirement for appointment of an auditor should be included in the grant agreement as a condition precedent to disbursement.</p>
Internal audit	Currently the GF policy on audit arrangements does not cover recipient internal audit.	The existence of a competent independent Internal Audit unit at a PR or SR level, in cases where large amounts are disbursed at this level provides additional assurance on the use and accountability of funds.	<p>Recommendation 19 (Significant)</p> <p>The GF should require PRs/SRs that receive funds above a set threshold to set up independent Internal Audit units as part of effective internal control systems. Their capacity should be assessed by the LFA (See recommendation 24).</p>

Review of Principal Recipient audit arrangements

Area	Current policy	Issue	Recommendations
Acceptability of audit report	The policy does not provide for steps to be taken if the provisions stipulated therein are not complied with.	Without guidance on the consequences of non-compliance the GF Secretariat is not well equipped to deal with PRs that do not comply with the provisions of the Grant Agreements in regard to audit arrangements.	<p>Recommendation 20 (Significant)</p> <p>The policy should prescribe minimum standards for acceptable audit report that would meet the GF's audit objective. In addition, actions to cover the following should be written into the policy:</p> <ul style="list-style-type: none"> • Late submission of audit reports; • Failure to submit audit reports; and • Audit reports submitted are not of acceptable quality.
Scope of the annual audits	The policy does not give guidance on the minimum scope of work for the auditor.	In the absence of minimum standards for quality of work to be undertaken by the auditor, poor performance by the auditor may be blamed on weak TOR which does not spell out expected scope of work.	<p>Recommendation 21 (High)</p> <p>Auditors should provide as part of the financial audits of program financial statements the following outputs i.e. an opinion on the fair statement of income and expenditure; financial statements; and a management letter that covers any issues that may have come to the attention of the auditor in the areas of internal control, value for money, compliance with the grant agreements and policies and procedures etc..</p>

Review of tools and processes used for oversight of audit arrangements

The GF policy includes several tools to be used in assessing and monitoring audit arrangements. These tools are however not consistently and effectively applied, and in consequence the desired objectives are not met. At the time of disbursement, an opportunity to review compliance to audit arrangements arises. However, even then policy requirements are not enforced, and funds are disbursed without any review of the status of compliance to annual audit requirements.

Oversight tools

60. The policies as stated in the Operations Manual are implemented with the use of tools and processes which are applied by the various parties in implementing and enforcing principal recipient audit arrangements. Tools are important in providing a uniform standard of assessment, implementation and monitoring of policy requirements. The appropriate tools would ensure guidance to all parties which would result in consistent application of GF policy. The tools used for audit arrangements include:

- (a) LFA assessments of Financial Management and Systems
- (b) Disbursement Decision Making Forms
- (c) Phase 2 assessments
- (d) Grant Performance Reports

(a) LFA assessments of Financial Management and Systems

61. After acceptance of funding proposals by the TRP and approval by the GF Board, the LFA undertakes a capacity assessment of the Program Management, Financial Management and Systems (FMS), Procurement and Supply Management (PSM) and Monitoring and Evaluation (M&E) systems. The standard template that the LFA uses to assess FMS capacity has a section for external and internal audit arrangements of the PR. The LFA reports the results of the capacity assessments in a PR assessment report. During the review the following weaknesses in the FMS assessment tool were noted:

Question posed	OIG analysis
Are the nominated PR's annual financial statements audited by an independent auditor and to appropriate auditing standards?	<ul style="list-style-type: none"> • The FMS assessment tool refers to the guidelines for annual audits of program financial statements for the requirements of GF policy. The guidelines however do not describe how the LFA will determine if the independent auditor can meet requirements for appropriate audit standards. This ambiguity results in inadequate assessments of PR audit arrangements.
Were there any major issues brought out in the audit report or management letters in the past 3 years? Has the nominated PR's management	<ul style="list-style-type: none"> • The definition of what issues are major is left to the reviewer to make. All issues that recur from year to year should be identified as issues that indicate FMS weaknesses due to a weak internal control environment.

Review of Principal Recipient audit arrangements

Question posed	OIG analysis
subsequently followed up and addressed these issues?	
Internal audit arrangements	<ul style="list-style-type: none">• Although the FMS assessment tool questions the existence and capacity of the PR's internal audit department, the standard template of the FMS Assessment report does not include a section on Internal Audit. As a consequence the LFA does not report on the existence, capacity and / or competence of the PR's internal audit department. The work done by Internal Audit is something that the OIG always covers in its country audits.

Recommendation 22 (High)

Guidance should be provided to LFAs in the LFA assessment forms on the areas that should be covered under audit arrangements such as

- (a) *Evidence of independence of the firm and key personnel,;*
- (b) *Qualifications and experience of key personnel,*
- (c) *Time and personnel requirements for the audit*
- (d) *Experience with donor funded programs in health sector*
- (e) *Evidence of peer reviews, quality control , Continuous Professional Education (CPE) requirements of the firm*

Recommendation 23 (High)

The LFA should review the TOR in cases where the PR already has an appointed auditor and advise on:

- (a) *Adequacy of ToRs*
- (b) *Compliance of reports submitted to the ToRs*
- (c) *Timeliness of submission of the audit reports in the past*
- (d) *Actions implemented as a result of past audit reports*

Recommendation 24 (High)

The LFA should review and report on the work done by the Internal Audit unit where the PR has one, with a view to advising the GF on how much reliance can be placed on the work done by internal auditors. In assessing the internal audit department, the LFA should consider among other aspects:

- (a) *Governance and reporting of internal audit department i.e. its independence*
- (b) *Existence of an internal audit charter and manuals*
- (c) *Applied Internal Auditing Standards*
- (d) *Multi-year or annual auditing plans*
- (e) *Approach to internal auditing*
- (f) *Qualifications and skill of internal auditors*

(b) Disbursement Decision Making Forms

62. During the decision making process to determine whether funds should be disbursed to a PR in response to a disbursement request, a disbursement decision making form is completed. The form includes a question as to whether there are any outstanding audit reports, the answer to which is meant to trigger follow up of outstanding reports or resolution of major weaknesses in the PRs financial and management systems.

Recommendation 25 (High)

The disbursement decision making form should be enhanced to include comments on the key audit findings that have not been cleared by the PR. These comments should be taken into consideration in making a decision to disburse funds. Where these issues remain outstanding for long period the CCM should be notified and consideration given to suspending disbursements.

(c) Phase 2 assessments

63. At the end of Phase 1 of a grant, the performance of a PR is assessed for Program Management, Financial Management and Systems (FMS), Procurement and Supply Management (PSM) and Monitoring and Evaluation (M&E) systems capacity. In terms of audit arrangements, the LFA is asked to comment on the question “please comment on whether the PR has complied with the Global Fund’s auditing requirements”.

64. During the OIG review, it was noted that even where the Phase 2 FMS assessment was undertaken, and established that the PR did not comply with GF audit requirements, it did not influence the decision of whether the grant should proceed to phase 2 or not. Moreover the Phase 2 assessment did not consider the findings emerging from the audits and whether these would affect the GF decision to invest more money in the country.

Recommendation 26 (Significant)

During the Phase 2 review of compliance with the GF policy about audit arrangements, the LFA should provide specific comments on compliance with each of the provisions of the GF policy as well as those audit findings that may affect the GF decision to invest. Any major areas that result in failure to obtain assurance on the use and accountability of funds may affect the decision to disburse until the issues are resolved.

(d) Grant Performance Report

65. The Grant Performance Report (GPR) is intended to provide the Secretariat, Principal Recipients, partners, and all other Global Fund stakeholders with a thorough and transparent summary of a grant throughout its lifetime. The report is supposed to be updated with important grant information about the initial PR assessments, the grant agreement, implementation progress, intended results and

Review of Principal Recipient audit arrangements

results achieved to date. In accordance with the Operations Manual, GPRs need to be updated for each of the following Grant Management Cycle events: grant signature; disbursement decisions; audit report; annual review; Release of Invitation to Submit the CCM Request for Continued Funding (end of month 16); and Grant closure.

66. During the review, OIG noted that out of the sample of 50 grants reviewed, the status of audit arrangements were updated for only 19 grants. Poorly updated GPRs provide insufficient information to stakeholders for decision making.

Recommendation 27 (Significant)

The GPR should be regularly updated with the status on compliance with requirements for annual financial audits. The GPR should be used to communicate the status of records held at the Secretariat as a way of encouraging compliance to provisions of the grant agreement and ensuring that there is sufficient information for decision making

Roles and Responsibilities for Oversight

67. The PR engages the auditor using Terms of Reference and procedures acceptable and approved by the GF, then facilitates the carrying out of the audit, and submits the audit report to the GF through the LFA. The PR responds to the audit findings and implements recommendations, as appropriate. Where the PR makes grants to SRs, the PR is responsible for developing and implementing an adequate audit plan for the sub-recipients program expenditures. The PR forwards the audit reports received from sub-recipients to the LFA.

68. Although the policy and grant agreement set out the requirements for annual audits, it does not state what actions should be taken if the responsibilities are not undertaken.

69. The responsibilities of oversight of audit arrangements for sub-recipients lie with the PR. However there is no provision in the policy for the PR or LFA to report to the GF Secretariat that the audits of SRs have been conducted, and to flag the issues arising out of such audits that have an impact on implementation of GF Programs.

Recommendation 28 (Significant)

The GF policy for audit arrangements should be reviewed to include actions that should be taken when the PR does not comply with provisions for annual audits in the grant agreement. The policy should include a requirement for the LFA to submit to GF Secretariat a review of the major issues arising out of the annual financial report of the SRs for each PR, by the end of the sixth month after the end of the SR's fiscal year.

70. The LFA is responsible for review of acceptability of the auditor, the Terms of Reference and the Principal Recipient's sub-recipient audit plan. When the audit reports are received from the PR, the LFA reviews the audit findings and

recommendations and advises the GF on potentially necessary actions. The LFA also reviews the audit reports of sub-recipients, as received from the PR. As part of its monitoring activities, the LFA reviews the PR's implementation of the audit findings and recommendations. The LFA is also responsible for the review of Progress Update / Disbursement Request (PU/DR) Reports periodically submitted by the PR to GF Secretariat. In this tool, the LFA brings to the attention of GF issues and recommendations for decision making.

71. GF policy requires the LFA to advise GF on the existence and suitability of acceptable audit arrangements within the first six months of grant implementation, and submits to GF Secretariat reviewed PR audit reports six months after end of PR's fiscal period. The policy however does not provide for actions that the LFA should take where the PR does not comply with these provisions of GF Policy. As a consequence non-compliance and the reasons for this are not reported to the GF Secretariat.

Recommendation 29 (High)

Policy should inform the LFA of actions to take when the PR does not comply with requirements of the grant agreement as they relate to audit arrangements. During the regular PU/DR reports, the LFA should inform GF secretariat of the non-compliance and the reasons for this.

72. The Country Programs Cluster of the GF Secretariat is responsible for approving the acceptability of the auditor, Terms of Reference and SR audit plan and on appropriate remedial actions in response to audit findings and recommendations.

73. There is not a standard system to follow up compliance to requirements for annual audits as stated in the grant agreements with PRs. There is also no guidance on what kinds of issues should be escalated to the regional team leader, unit director or the director of country programs. The consequence is that audit reports may be reporting such issues with significant impact on the grant programs, but which do not get appropriate attention and action. In constantly dealing with a program staff for a particular grant program, the country program staff at the GF Secretariat may gradually lose objectivity in critiquing the results of annual audit reports. This would further contribute to audit findings not resulting in appropriate action by the GF Secretariat.

Recommendation 30 (High)

The Country Programs Cluster should implement a process for monitoring and enforcement of audit arrangements to ensure PR's compliance to GF policy. This oversight process should include checks and balances to ensure that:

- (a) Compliance to GF policy is monitored by the LFA in a timely manner;*
- (b) The work done by the LFA is reviewed by the Fund Portfolio Manager;*
- (c) The Finance Unit provides support to the FPM to ensure that audit reports inform grant management;*
- (d) Failure to comply with grant agreement by the PR is brought to the attention of the legal unit; and*

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- (e) Failure to meet requirements for annual audit results in consequences including suspension of disbursements.*

Note: If Recommendation 2 is accepted, these responsibilities would pass to the Program Finance Unit.

Review of the compliance to existing policies for audit arrangements

- (a) Audit arrangements were not documented for 26 out of 50 (52%) of the grants reviewed,
 - (b) SR audit plans were not filed at the GF Secretariat for 33 grants, (66%) of the grants reviewed,
 - (c) For 20 out of 50 (40%) grants reviewed had audit reports filed, for which review by the LFA was not documented,
 - (d) Audit reports are due but not filed for 7 out of the 50 grants reviewed (16%).
- This level of non-compliance to existing policy indicates an overall weakness in the oversight of fiduciary arrangements at the GF.

74. The OIG reviewed the level of compliance to the policies and guidelines covering GF audit arrangements. A sample of 50 grants across the eight Country Programs Regional Teams was selected and their audit arrangements reviewed. The sample covered different PR types and their related audit arrangements.

Documentation of audit arrangements

Good Practice

Out of the 50 grants reviewed, audit arrangements for PRs and Sub-Recipients were documented for Cambodia Round 4 HIV, China Round 5 TB, Tanzania Round 4 HIV, Peru Round 5 TB, Malawi Round 5 HIV, Malawi Round 5 Health Sector Support, and Mozambique Round 2 HIV.

75. The OIG reviewed compliance to the following key policy requirements for documentation of recipient audit arrangements:

The preferred approach is that the auditor is selected by a Principal Recipient prior to Grant Agreement signing. If this is not the case, the selection of the auditor should be done within the first six months of program implementation.

The Local Fund Agent then reviews the PR's audit Terms of Reference and advises the Global Fund on the acceptability of the Terms of Reference.

The table below provides a summary of compliance with the two conditions above, appendix D contains details of the grants for which audit arrangements are not documented:

Details	Complied with grant agreement?	Number	Percentage
New PR audit arrangements accepted by GF	Yes	11	22
PR audit arrangements relate to UNDP standard provisions	Yes	6	12
PRs where own audit arrangements were accepted by GF	Yes	7	14

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PR audit arrangements were not documented	No	26	52
		50	100

Recommendation 31 (Significant)

The LFA should always document, and report on adequacy of existing audit arrangements for each grant within six months of the grant commencement date. After completion of the annual audit of the PR, the LFA should review adherence to the ToRs for the auditors. The FPM should monitor the LFA's compliance to these policy requirements.

Timing for submission of audit report

76. The OIG reviewed compliance to the following policy requirements for timelines in submitting audit reports:

The audit report, including the management letter noting deficiencies in the PR's internal controls, should be received by the Global Fund from a Principal Recipient within six months after the end of the PR's fiscal year. The Local Fund Agent receives the audit report on behalf of the Global Fund.

An audit of a PR's overall financial statements without specification of the program sources and uses of funds is not adequate.

Good Practice

All audit reports were filed for all eight grants selected from the Latin America & Caribbean team. The grants reviewed were Brazil Round 5 TB, Haiti Round 5 HIV, Multi-country Americas (CRN+) Round 4 HIV, Multi-country Americas (Meso) Round 4 HIV, Peru Round 5 TB, Suriname Round 4 Malaria, Bolivia Round 3 Malaria, and Bolivia Round 3 HIV.

At the time of the review OIG noted the following cases where audit reports were not filed:

Country	Grant	Fiscal years outstanding
Cambodia	CAM-405-G05-H	2007
Tanzania	TNZ-405-G04-H	2007
Burundi	BRN-405-G03-T	2008
Zambia	ZAM-405-G13-M, ZAM-405-G11-H	2007
India	IDA-102-G01-T-00	2008
Afghanistan	AFG-506-G03-M	2007, 2008

77. Currently there is no mechanism to ensure that audit reports are submitted within the required period of 6 months. The trigger for recording the submission of audit reports is the progress update and disbursement request form and the disbursement decision making form, the completion of which does not coincide with the timing for submission of the audit report.

Recommendation 32 (High)

The LFA should monitor and advise the FPM if the annual audit of the PR's financial statements is on schedule as per the grant agreement. There should be sensitization within the Country Programs cluster of the importance and tools for monitoring and enforcing audit arrangements. Sanctions should be imposed on PRs that persistently fail to comply with GF audit requirements.

78. It was also noted that out of the 50 grants reviewed, 9 of the audit reports submitted only included a statement of income and expenditure without a report on internal controls. These included China Round 5 TB, Eritrea Round 5 HIV, Kenya Round 4 Malaria, Turkey Round 4 HIV, Ukraine Round 6 HIV, Russia Round 5 HIV, CRN+ Round 4 HIV, Mali Round 4 HIV, and Afghanistan Round 5 Malaria.

79. Six (6) grants were noted, for which the reports submitted were in formats and content that did not meet specifications in the guidelines. These had been cleared by the LFA and FPMs despite not meeting specifications. Details are provided below:

Country	Grant	Comment on report
Papua New Guinea	PNG-405-G02-H	Report simply referred to one weakness in internal controls, without an audit opinion or financial statements.
Russia	RUS-506-G05-H	Audit report comprised audit opinion, with no financial statements attached, and no management letter.
Turkey	TUR-405-G01-H	Audit report comprised an audit opinion, with no financial statements attached, and no management letter.
Brazil	BRA-506-G02-T	Report is only three pages, comprising only an audit opinion and does not include a management letter.
Suriname	SUR-404-G02-M	Although the report highlights some internal control weaknesses, no recommendations are made by the auditor to resolve identified weaknesses.
Zambia	ZAM-405-G13-N	Consolidated Government of Zambia financial statements were filed. There was no coverage of GF grants as these were not material in relation to government accounts.

Recommendation 33 (Significant)

Timeliness in receipt of the audit report is an important aspect of audit assurance. The Secretariat needs to establish a mechanism that will flag cases where audit reports are due, but have not been submitted.

Format of the audit report

80. The OIG reviewed compliance to the following policy requirement for timelines in submitting audit reports:

As part of its monitoring of grant implementation by a Principal Recipient, the Local Fund Agent receives and reviews the PR's audit report and management letter. The LFA also receives and reviews the audit reports of sub-recipients as forwarded by the PR. Where the audit findings identify capacity building needs or inappropriate expenditures financed by the Global Fund, the LFA recommends remedial actions to the Global Fund. Audit findings and recommendations will be discussed with the PR. PRs are encouraged to engage their development partners or other sources to assist in fulfilling necessary improvements in internal controls and other capacity building needs.

Good Practice

For all the grants selected from the Latin America and Caribbean cluster all audit reports filed were accompanied by action plans in response to the audit recommendations and were filed. The grants reviewed were Brazil Round 5 TB, Haiti Round 5 HIV, Multi-country Americas (CRN+) Round 4 HIV, Multi-country Americas (Meso) Round 4 HIV, Peru Round 5 TB, Suriname Round 4 Malaria, Bolivia Round 3 Malaria, and Bolivia Round 3 HIV.

81. Following its review the LFA is required to advise the Global Fund on the compliance of the audit report with to GF guidelines. The LFA is also expected to review audit reports of sub recipients to confirm compliance to GF guidelines and also advise the GF Secretariat of any major weaknesses that may affect the grants. Audit plans for sub-recipients were not documented for 33 of the 50 grants selected. Of the 6 that did have plans there was evidence of implementation of those plans for 4 grants.

82. The review of audit reports by the LFA is performed in various forms to differing levels of detail. There is no template to guide the LFA on what to include in the review of the audit reports. There is also no tool to aid follow up of action plans from audit reports.

83. The table below shows compliance by LFAs to the policy requirement to review audit reports:

Details	Grants	Number of reports
Audit reports reviewed by LFA	16	36
Audit reports not reviewed by LFA	20	33
Audit reports submitted	36	69

Review of Principal Recipient audit arrangements

84. The table below shows compliance by LFAs to the policy requirement to agree and follow up action plans from audit reports with the PR:

Details	Grants	Number of reports
Action plans from audit report agreed with PRs	22	49
No action plans from the audit reports	14	20
	36	69

Recommendation 34 (Significant)

The policy should provide guidance on the nature and timing of a report from the LFA to the GF Secretariat reporting on the implementation of audit arrangements of the principal recipient. This report should be submitted by the sixth month after the PR's fiscal year-end, and where the PR has not completed the annual audit, reasons should be investigated by the LFA. The report should explain reasons for non-compliance and advise on its implications to the Financial and Management systems of the PR.

The LFA should also be encouraged to meet with the PR's auditors to obtain such clarifications as are required for the contents of the audit report before submission of report to GF Secretariat.

Review of grants with special audit arrangements

There was no compliance to requirements for annual audits in cases where the PR is a UN agency. As a result, GF does not obtain assurance of the use and accountability for such funds.

85. One of the principals of The Global Fund is ‘Country led processes’. This means that funded programs are designed by the stakeholders in each country who form a Country Coordinating Mechanism (CCM). However where the government and civil society organizations in a country do not have the capacity to manage GF programs, UN agencies or International NGOs may be proposed as PRs. Special audit arrangements arise in cases where:

- a) GF funds are disbursed through a national budget support mechanism,
- b) GF funds are pooled together with funds from other development partners,
- c) UN agencies are PR

Budget support:

86. Support to national budgets is usually through the Ministry of Finance utilises government systems. This may be through general budget support, where funds are not earmarked or sector budget support, where funds are earmarked for a specific sector. Audit arrangements for budget support are usually structured around the national State Audit Institution (SAI). Where program funds are earmarked an audit report can be issued by the SAI for the state department, to which funding is given. Since the GF is a performance based funding mechanism, grants are not given under non-earmarked budget support.

Pooled (“basket”) funding:

87. This is an arrangement in which donors pool funding for specific purposes such as health products or to support particular provinces or districts. The arrangements are normally agreed jointly by the donors and involve the Ministry of Health, although in some cases the management responsibilities lie with one donor. In many ways the pooled funding mechanism is in line with the guiding principles of the Global Fund. “Basket” funding is characterized by:

- a) A common sector policy and strategy for programs;
- b) Formalized country led process for donor co-ordination. Common governance and management arrangements for all partners;
- c) Harmonized sectoral medium-term expenditure programme and annual budget for allocation of resources in pursuit of sector policy;
- d) A common performance-monitoring system to measure progress towards the achievement of policy objectives and results; and
- e) An agreed process for moving towards harmonized systems for reporting, budgeting, financial management and procurement

88. Sector-Wide Approaches (SWAp) in the form of “basket” funding mechanism have become prevalent in Sub-Saharan Africa. This is in line with donor harmonization initiatives and is likely to increase. The following grants which were reviewed are managed under SWAp mechanisms Malawi (MLW-506-G04-S and MLW-506-G03-H), and Mozambique (MOZ-202-G02-H).

Policy Requirement

89. Where the Global Fund co-finances a program with other donors (e.g., as part of a SWAp arrangement), a single audit report covering all program expenditures is acceptable as long as the Global Fund grant and expenditures for program purposes can be clearly identified.

Good Practice

From the review it was noted that the SWAp audit arrangements for Malawi (grants MLW-506-G04-S and MLW-506-G03-H) drawn up by the development partners led by DFID resulted in effective annual audits and procurement audits undertaken for each of the past periods to 30 June 2008. An operational guidelines manual was jointly agreed for the program by all stakeholders, Terms of Reference for the auditors were drawn up and agreed among development partners

90. The effectiveness of audit arrangements under the SWAp mechanism call for rigorous oversight. Under the SWAp mechanism, weak audit arrangements pose a major risk to GF investments, because once funds have been disbursed, they are placed in a pool with funding from other sources and there is no way of establishing that they have been used for the purpose for which they were approved by the Global Fund Board.

91. As noted in the case of Malawi, DFID as the lead on financial management and audit obtained agreement from all partners about the selection of the auditor, review of audit reports and the timeliness of the audit reports. Where no partner takes the lead in overseeing audit arrangements in a SWAP arrangement, there is a greater risk of default due to a lack ownership.

Recommendation 35 (Significant)

The OIG recommends that even when the grant funding is made through a SWAp mechanism, minimum requirements should be communicated to the PR. In this case, where a partner has stricter audit arrangements than the GF, these should be adopted for the grant.

Additionally, at the time of grant negotiation, there should be dialogue between the stakeholders in the SWAp mechanism and the GF on the common requirements for financial accountability, monitoring & evaluation and annual financial audit. Audit requirements should be reviewed by the LFA and the Program Finance Unit of the GF Secretariat to ensure that minimum standards for financial assurance are addressed.

UN Agencies as PR

92. In some cases, GF asks United Nations agencies to act as PRs, particularly where there are capacity constraints in health infrastructure. UNDP is PR in over 20 countries and UNICEF is PR in Somalia. UN Agencies are guided by the single audit principle which states that *“The United Nations Board of Auditors and the appointed*

Review of Principal Recipient audit arrangements

External Auditors of the specialized agencies and of the International Atomic Energy Agency retain the exclusive right to carry out external audit of the accounts and statements of the United Nations Organizations. If special reviews are required, governing bodies should request the appointed External Auditor to carry out specific examinations and to issue separate reports to them on the results”.

93. Whilst GF can access the generalised reports of the work undertaken by the UN Board of Auditors UNDP policy does not allow GF access to the reports of the Office of Audit and Investigations on the basis of the single audit principal and policy on confidentiality. The UNDP asserts that internal audit reports are confidential and may only be disclosed to member states in limited situations. Since the GF is not a member state, it is not eligible to review such reports.

94. The OIG has held several discussions with UNDP to seek appropriate access to program sites, records and audit reports. This has culminated in some improvements in the arrangements for access but not to the level that provides reasonable assurance. The UNDP currently proposes:

- (a) Investigations:
 - (i) to notify the OIG at an early stage of any investigation undertaken with respect to GF grants;
 - (ii) to maintain consultation and exchange of information about the matter under investigation throughout the process; and
 - (iii) where appropriate, to invite the OIG to participate in the investigation “or to conduct coordinated and parallel investigative work in each office’s area of authority”.
- (b) Audit: to explore, on a case by case basis, whether audits of activities funded by the Global Fund can be done simultaneously by the UN OAI and the OIG. The OIG and the UNDP OAI plan to undertake simultaneous Country Audits, with the first such initiative planned for May and June 2009 in Democratic Republic of Congo.
- (c) Reports: to consider sharing with GF summaries of audit reports into activities funded by GF.

95. Grant agreements for UN Agencies require that;

- (a) For Principal Recipient Audits

“The Principal Recipient shall have financial audits conducted of Program expenditures in accordance with its internal and external auditing practices. The Principal Recipient agrees to provide to the Global Fund a copy of biennial financial statements, as audited by its external auditors, the UN Board of Auditors.”
- (b) For sub-recipient audits

“The Principal Recipient shall submit to the Global Fund a plan, acceptable to the Global Fund, for the audit of the expenditures of Sub-recipients under the Program. The Principal Recipient shall ensure that Sub-recipients are audited in accordance with the plan, unless the Global Fund and the Principal Recipient agree otherwise in writing. Upon request, the Principal Recipient shall furnish or cause to be furnished to the Global Fund a copy of reports of audits carried out under the plan.”

Review of Principal Recipient audit arrangements

Policy Requirement

For the exceptional cases where multilateral organizations assume the role of Principal Recipients, the audit policies of these organizations will apply.

96. Of the total of 50 grants reviewed by the OIG six grants where UNDP is the PR were selected for review.

97. It was noted that during the entire lifetime of the grant below, no audited assurance has been obtained by the GF of the funds disbursed to all six PRs as required:

98.	#	Country	Grant Number	PR
	1	Democratic Republic of Congo (DRC)	ZAR-506-G04-T	UNDP
	2	Bosnia & Herzegovina	BIH-506-G01-H	UNDP
	3	Angola	AGO-405-G03-H	UNDP
	4	Central African Republic	CAF-405-G04-M	UNDP
	5	Guinea Bissau	GNB-404-G02-H	UNDP
	6	Sudan	SUD-506-G06-T	UNDP

Good practice

For the financial year to 31 December 2005, the Round 4 HIV grant for Guinea Bissau was audited by an independent auditor (Audit Revision Comptable). However no annual audits of the program were undertaken since this initial audit.

For, Guinea Bissau – GNB-404-G02-H an audit plan for the SR was presented, as this was a condition precedent to 2nd disbursement. However the plan was never implemented.

99. Until the beginning of 2009, the audit of GF programs for which UNDP is PR were covered as part of the OAI's internal audit of UNDP country offices. The OAI's internal audit of country offices is not fund-based (or fund-driven), but covers all aspects of an office's activities irrespective of the sources of fund. Consequently, the audit reports do not present observations and recommendations in a fund-specific manner. Starting 2009, OAI has engaged an auditor who will specialize in conducting audit of GF related activities where UNDP is a PR. These audits will mainly focus on additional safeguard countries.

100. Although allocation of OAI resources to audit GF programs will result in increased specific coverage of GF programs managed by UNDP, in the OIG's view, one auditor is not able to adequately cover the entire portfolio of over 20 GF Programs. Further, without access to the results of the audit it is not possible for OIG to provide assurance that risks to GF programs are adequately addressed by UNDP's audit arrangements.

Recommendation 36 (High)

The GF should liaise with UN agencies that operate as PRs with a view of obtaining assurance for the use and accountability of funds disbursed for GF programs. For UNDP, two internal auditors have been committed to GF activities. However in the

Review of Principal Recipient audit arrangements

OIG's view this is unlikely to be sufficient to provide appropriate audit assurance and UNDP need to consider increasing the resources devoted to GF audits. In high risk countries, joint audits should be undertaken with the OIG to provide greater assurance to the GF Board.

Audit arrangements for grants under the Additional Safeguard Policy

101. The Global Fund addresses portfolio risk by applying a range of risk management measures as part of its day-to-day management of the Global Fund grant portfolio. Managing grants under the ASP is part of the Global Fund's compendium of risk management tools. The Policy was approved by the Board in March 2004 and can be invoked in part or in full based on risks identified in the country where a Global Fund grant is being implemented. Generally, a grant will be managed under the ASP when the systems to ensure accountable use of Global Fund financing suggest that Global Fund monies could be placed in jeopardy without the use of additional measures beyond the routine risk-mitigating measures.

102. Grant agreements for grants managed under ASP have the following provisions in relation to audit arrangements:

- (i) The Principal Recipient shall have annual financial audits conducted of Program expenditures. Subject to the approval of the Global Fund, which approval shall not be unreasonably withheld, the Principal Recipient shall select an independent auditor to conduct the audits and set the Terms of Reference pursuant to which they shall be conducted. The cost of such special audit shall be borne by the Program.
- (ii) Should the Global Fund have reason to request a special purpose audit on the use of Global Fund resources, UNDP agrees to be responsible for: (i) securing the appointment of a mutually agreed independent auditor; and (ii) preparing mutually agreed audit Terms of Reference which reflect, as necessary, circumstances giving rise to the Global Fund's request for said audit. The cost of such a special audit is borne by the Program.

103. However from the review the OIG noted out of the 13 audit reports due from the PR (UNDP) the GF Secretariat only received reports for 5 grants. This finding shows that even for the grants that have been categorized as high risk, there are significant weaknesses in compliance with set audit requirements.

Recommendation 37 (High)

The GF Secretariat should negotiate with UNDP that agreements for non-ASP grants contain the same provisions that are currently included in grant agreements for ASP grants. The FPMs should follow up compliance to provisions of the grant agreement that relate to audit arrangements, and non-compliance should be handled through a formal process that allows for escalation of matters to senior management.

Conclusion

104. The annual audit of GF program funds to Principal Recipients and sub-recipients is a core component of the Fund's fiduciary framework, aimed to mitigate the following financial risks:

- (a) The risk that funds disbursed may not be used for intended purposes as stated in the grant agreement,
- (b) Misappropriation of funds disbursed;
- (c) The risk that the use of funds may not properly recorded in books of account as required by the grant agreement.

105. Based up on this review, the OIG concludes that the mitigation strategy of relying on audit arrangements, while conceptually sound, is not being implemented in an effective manner and therefore does not provide assurance that the risks above are being effectively managed.

Appendix A - List of grants reviewed

East Asia & the Pacific Region

#	Country	Grant Number
1	Cambodia	CAM-405-G05-H
2	China	CHN-506-G08-T
3	Indonesia	IND-405-G04-H
4	Papua New Guinea	PNG-405-G02-H
5	Timor-Leste	TMP-506-G03-H
6	Ukraine	UKR-607-G06-H

Eastern Europe & Central Asia

#	Country	Grant Number
1	Azerbaijan	AZE-405-G01-H
2	Bosnia and Herzegovina	BIH-506-G01-H
3	Russian Federation	RUS-506-G05-H
4	Turkey	TUR-405-G01-H

Latin America & the Caribbean

#	Country	Grant Number
1	Brazil	BRA-506-G02-T
2	Haiti	HTI-506-G05-H
3	Multi-country Americas (CRN+)	MAN-405-G01-H
4	Multi-country Americas (Meso)	MAM-405-G01-H
5	Peru	PER-506-G04-T
6	Suriname	SUR-404-G02-M
7	Bolivia	BOL-304-G02-M
8	Bolivia	BOL-307-G07-H

North Africa & the Middle East

#	Country	Grant Number
1	Mali	MAL-405-G02-H
2	Mauritania	MRT-506-G03-H
3	Sudan	SUD-506-G06-T

South Asia

#	Country	Grant Number
1	Afghanistan	AFG-506-G03-M
2	Bangladesh	BAN-506-G05-T
3	Sri Lanka	SRL-102-G04-T-00
	India	IDA-102-G01-T-00

Review of Principal Recipient audit arrangements

Sub-Saharan Africa: East Africa

#	Country	Grant Number
1	Burundi	BRN-405-G03-T
2	DRC	ZAR-506-G04-T
3	Eritrea	ERT-506-G03-H
4	Kenya	KEN-405-G06-M
5	Madagascar	MDG-405-G06-M
6	Tanzania	TNZ-405-G04-H
7	Ethiopia	ETH-405-G04-H

Sub-Saharan Africa: Southern Africa

#	Country	Grant Number
1	Angola	AGO-405-G03-H
2	Malawi	MLW-506-G04-S
3	Malawi	MLW-506-G03-H
4	Mozambique	MOZ-202-G02-H-00
5	Swaziland	SWZ-405-G04-H
6	Zambia	ZAM-405-G13-M
7	Zambia	ZAM-405-G11-H

Sub-Saharan Africa: West & Central Africa

#	Country	Grant Number
1	Cameroon	CMR-506-G06-M
2	Central African Republic	CAF-405-G04-M
3	Congo (Republic of the)	COG-506-G01-H
4	Cote d'Ivoire	CIV-506-G04-H
5	Equatorial Guinea	GNQ-506-G02-M
6	Guinea	GIN-506-G03-T
7	Guinea-Bissau	GNB-404-G02-H
8	Nigeria	NGA-404-G05-M
9	Sierra Leone	SLE-405-G03-M

Appendix B – Evaluation of suitability of independent auditors

The following questions should be answered by the LFA in order to conclude on the suitability of the independent auditor for GF funds:

1. Start date of audit practice
2. Name/address of foreign affiliation, if any.
3. Number of shareholders or partners
4. Number of managers
5. Number of supervisors and seniors
6. Number of other professional staff
7. Number of certified staff (excluding shareholders or partners)
8. Review the experience and qualification of each of the partners, managers and supervisors,
9. Indicate which of the following services are provided by the firm and show approximate share of each service to the firm’s total fee income for the last fiscal year by each client category:

SERVICE	% of Fee Income				
	World Bank & other funding agencies	International Development Organisations	Private Sector	Government	Total
Auditing					
Accounting Services					
Management Consultancy					
Other (please specify)					

10. Is the firm registered with a local (or regional) legal association of accountants or auditors authorized to issue certificates in the country?
11. Does the firm have an annual conflict of interest disclosure policy? If yes, evaluate its effectiveness (annual certification).
12. Does the firm have a training plan for its staff?

Review of Principal Recipient audit arrangements

13. Is staff required to have certain credit hours of training annually? If so, state in the comment section, the sources of these training.

14. Has the firm performed any audits jointly with international audit firms? If so, please provide details.

Audit Client.

International Firm

Appendix C – Evaluation of suitability of SAIs

The following questions should be answered by the LFA in order to conclude on the suitability of the State Audit Institution as independent auditor for GF funds:

1. Start date of audit office in its current legal form
2. Legal Name of Supreme Audit Institution (SAI).
3. Number of senior management.
4. Number of seniors and supervisors.
5. Number of other professional staff
6. Number of certified professionals.
7. For the Auditor General(AG) and senior management, provide a separate attachment with their names and a brief summary of their qualifications and experience, including:
 - Academic and professional qualifications
 - Memberships of professional audit or accounting associations
 - Details of audit and accounting work experience on donor funded projects and work experience outside the country
 - Written and spoken fluency in English, French or other languages
8. Is there an independent Head of SAI with security of tenure and legal immunity
9. Does the SAI have financial, managerial and administrative autonomy
10. The recommendations of the SAI and/or the Public Accounts Committee are being followed up and reported on regularly and take appropriate corrective action where necessary
11. There are tools at the SAI to measure its productivity and also report on its activities and performance against predetermined objectives.
12. State the independence of SAIs from key governmental policies and practices.
13. Review and comment on the appropriateness and effectiveness of the statutory framework under which the SAI operations.
14. Review the adequacy of SAIs training plans and the implementation of these plans.
15. Does the SAI has recognised training programmes in place.

Appendix D – Grants reviewed for which PR audit arrangements are not documented

East Asia & the Pacific Region

#	Country	Grant Number
1	Timor-Leste	TMP-506-G03-H

Latin America & the Caribbean

#	Country	Grant Number
1	Brazil	BRA-506-G02-T
2	Haiti	HTI-506-G05-H
3	Multi-country Americas (CRN+)	MAN-405-G01-H
4	Multi-country Americas (Meso)	MAM-405-G01-H
5	Suriname	SUR-404-G02-M
6	Bolivia	BOL-304-G02-M
7	Bolivia	BOL-307-G07-H

North Africa & the Middle East

#	Country	Grant Number
1	Mauritania	MRT-506-G03-H

South Asia

#	Country	Grant Number
1	India	IDA-102-G01-T-00

Sub-Saharan Africa: East Africa

#	Country	Grant Number
1	Burundi	BRN-405-G03-T
2	Eritrea	ERT-506-G03-H
3	Kenya	KEN-405-G06-M
4	Madagascar	MDG-405-G06-M
5	Ethiopia	ETH-405-G04-H

Sub-Saharan Africa: Southern Africa

#	Country	Grant Number
1	Swaziland	SWZ-405-G04-H
2	Zambia	ZAM-405-G13-M
3	Zambia	ZAM-405-G11-H

Sub-Saharan Africa: West & Central Africa

#	Country	Grant Number
1	Cameroon	CMR-506-G06-M
2	Central African Republic	CAF-405-G04-M
3	Cote d'Ivoire	CIV-506-G04-H
4	Equatorial Guinea	GNQ-506-G02-M
5	Guinea	GIN-506-G03-T
6	Nigeria	NGA-404-G05-M
7	Sierra Leone	SLE-405-G03-M

MANAGEMENT RESPONSE

1. Introduction

The OIG of the Global Fund, as part of their 2009 work plan, undertook a review of Principal Recipient audit arrangements. The purpose of this review was to assess the effectiveness of the different audit arrangements employed by Global Fund recipients in accordance with signed grant agreements. The review objectives were to:

1. assess the effectiveness of audit arrangements that PRs have put in place to ensure that grants are managed well;
2. assess the level of compliance by PRs to conditions relating to audit as set out in the grant agreement;
3. review the soundness of systems, policies and procedures within the GF Secretariat in ensuring that audit arrangements are complied with; and
4. assess the risks the GF grants are exposed to due to ineffective audit arrangements and adequacy of measures taken to mitigate them.

The sample selected covered Round 4 and 5 grants. This gave the OIG sufficient coverage of grants that have been in operation for more than two years. A total of fifty (50) grants covering all the clusters in Country Programs were reviewed.

2. Summary of recommendations and conclusions

After having carried out a thorough review of a sample of audit arrangements applied by the Global Fund secretariat, the OIG made the following recommendations:

a) Summary

- Increase vigilance in monitoring compliance with the required audit arrangements.
- The GF policy for audit arrangements should be reviewed to include actions that will be taken when the PR does not comply with provisions for annual audits in the grant agreement.
- During the Phase 2 review of compliance with the GF policy on audit arrangements, the LFA should provide specific comments on compliance with each of the provisions of the Global Fund policy as well as those audit findings that may affect the Global Fund decision to invest.
- The Program Finance Unit is positioned independently of the Country programs Cluster and, in OIG's view, should in future be given the authority to objectively review the PR audit reports for appropriateness and ensure that issues arising from these reports are assessed for risk to GF Programs.
- The LFA should more systematically assess whether the PR's audit arrangements meet the GF requirements.
- The GF should dialogue with the United Nations Agencies that act as PR for with a view to providing assurance to the Global Fund on the use and accountability of funds disbursed.
- The GF Secretariat should develop criteria for assessing the suitability of auditors.
- Audit arrangements should be defined for pass through PRs.
- The GF should put in place a requirement for all PRs/SRs that receive funds above a set threshold to have independent Internal Audit units as part of effective internal control systems.

- "That the Global Fund Secretariat reminds CCMs that they have a responsibility for ensuring compliance with requirements for annual audits" (Recommendation 4).

b) Conclusion

Based upon this review, the OIG concludes that the mitigation strategy of relying on audit arrangements while conceptually sound is not working in an effective manner and therefore does not provide assurance that funds are utilized for the intended purpose and that other risks are being effectively managed.

3. Risk management in the GF

As a financing institution, the GF model is based on three main principles: funding through grants, country ownership and performance based funding. In light of the current challenges faced by the international financial crisis, comprehensive accountability mechanisms and detailed, systematic follow up regarding the use of funds is required by the donors. The effective implementation of accountability and follow up mechanisms will play a pivotal role, yet not exclusively, in decision-making processes of donors regarding the continuation of funding for our institution at the same level as precedent years.

The risk management system of the GF is built on various elements which operate either regularly or materialize when a situation of risk has been identified. The GF counts on evaluations systems and control regulators which include (i) local presence of independent agents, contracted by GF to operate as verifiers of the grants (Local Fund Agents, hereafter "LFAs"); (ii) the evaluation of PR capacities and systems by the LFA; (iii) periodical performance updates prepared by the PR and verified by the LFA (including mid-term reviews for Phase 2 and RCC, through which a comprehensive analysis of the program is conducted); (iv) annual on-site data verification carried out by the LFA for all grants; (v) Monitoring and Evaluation System Strengthening (M&ESS) Tool, in order to identify gaps and strengthen the national M&E systems performed by independent consultants every two years, (vi) yearly financial reporting through Enhanced Financial Reporting (EFR); and (vii) periodical verification reviews covering such areas as procurement, programmatic progress and risk mitigation carried out by the LFA for each PR operating in each country.

One of the characteristics which makes the GF unique is the organizational adaptability to each different national context in which it is operating, acknowledging and respecting the national agenda and national autonomy. Consequently this diversity results in situations which can be considered as 'risks' which possibly can complicate the systemization of risks. The evaluation of these risks are under the direct responsibility of the Regional Teams as they have the contextual knowledge and capacity to identify, evaluate and determine a risk situation, applying the context of the risk management tools and mechanisms available in the GF. These instruments are (i) Data Quality Audit (DQA), performed by independent audit firms contracted by the GF; (ii) financial and/or management examinations, carried out by the LFA whenever requested by the Fund Portfolio Manager (FPM); (iii) PR Repeat Assessment, whenever requested by the FPM and, specifically for countries in which the situation is particularly complex, it is possible to request the application of the (iv) Additional Safeguard Policy, which includes a set of measures in order to strengthen control systems; and in the case of highly complex circumstances, the last resort is (v) to report a high risk situation to the OIG which can start an investigation.

As we can see, the GF relies on a variety of comprehensive tools which, when applied effectively, should provide for a relatively secure framework in our operations. Within this context, annual financial audits of the PR (subject to auditing of the OIG) are an integral part of the risk management system of GF, operating systematically and concurrently with all administrative tools developed for grant portfolio management form the core of the risk management system of our institution.

4. Audit system within the framework of programs financed by GF

The findings presented by the OIG report regarding (i) the policy of GF related to the type and quality of audits and (ii) the PR audit arrangements employed by Country Programs (CP) reveal a series of weaknesses which require special attention.

Therefore, the GF Secretariat has decided to put into place a series of measures strengthening the current PR audit arrangements in place. During the design of these measures various assumptions are made in order to reflect the principles of the Global Fund. These basic assumptions are:

- The strengthening of the PR audit system should be systematized; meaning that operations financed by the GF should be subject to an annual financial audit, as established in the corresponding OPN and also contained in the Grant Agreement.
- The strengthening of the PR audit system should avoid where possible new administrative channels; instead it should rely on existing systems in place, increasing their utility and effectiveness.
- The strengthening of the PR audit system should not operate solely as an optimization of the GF risk management system, but also contribute to improving the management approach of the PRs.
- The PR audit arrangements should be based on the development of local capacity, reflecting the philosophy of the GF.

Based on the above-mentioned assumptions, the secretariat will immediately implement the following measures strengthening the management approach regarding PR audits.

4.1. Update the current audit system

4.1.1. *First step: evaluation of current situation*

- Each Regional Team will map the existing audit reports of the past two years for each country. Hereby each regional team will have a clear view regarding the completed and not yet completed or submitted audit reports. This will allow the FPMs to take the necessary follow up measures in case audit reports have not yet been delivered;
- Each regional team will analyze the level of follow-up carried out based on the recommendations of the audit firms;
- The result of this exercise will be a regional table in which country by country, grant by grant (i) the existence or non-existence of audit reports and (ii) follow-up actions taken during the last two years are clearly outlined; and
- The eight regional tables will be consolidated by the CP Support team. The focal point will be the newly recruited CP Risk Management Officer.

4.1.2. *Second step: the development of a regulation and follow up plan*

- CP will elaborate a regulation plan for cases where no audit reports have been identified. This can be due to either the PR not having submitted the corresponding

audit or because the audit has not been conducted. Each case shall be analyzed accordingly; and

- Depending on each case, it will be analyzed if in the future, subsequent follow-up actions will be included. The final result will be the update of the current situation regarding audit reports for the whole of CP, in full detail.

4.2 Future approach

Currently the Secretariat is designing a new approach for managing annual financial audits. This approach will (i) increase the rigor and follow up of certain practices recommended by the OIG. In particular the new approach will focus on two main areas:

4.2.1. Policy of GF regarding the type and quality of the audits

The current policy will be adjusted and adapted to a series of measures which shall ensure a solid audit management system, including:

- The implementation of effective administrative channels in relation to the PR audit system;
- The implementation of stricter measures for cases where audit arrangements do not comply;
- Redefining areas of interaction between CP and the transversal technical Teams (Finance, Legal, Procurement and M&E) in the management of audits, with Finance being systematically involved in the process;
- Development of criteria for assessing the suitability of auditors (some of which have been proposed by the OIG in annex 3 of the report);
- Systematization of the LFA assessing whether the PR's audit arrangements are meeting the GF's requirements, and identifying gaps; and
- We will strengthen the LFA reporting tools and guidance for financial management assessments and the review of annual audits of program financial statements. This will ensure more consistent LFA review of a) audit arrangements, including evaluation of suitability of the proposed auditor, ToR and the PR's audit plan as well as the internal audit arrangements. This will include situations where (i) PR's existing auditor has been accepted by existing donors and (ii) State Audit Institutions (SAIs) are performing the audit; and b) review of audit findings and recommendations, LFA review of SR audit reports and LFA advice to GF. The LFA tools will mention existing documents that can be reviewed, e.g. previous audit reports, assessments of SAIs carried out by other donors.

4.2.2. PR audit system should be implemented by CP

The main part of the recommendations in the report of the OIG does not require major changes in the current operating mechanism, but do require adjustments in the effective accomplishment and application of the policy.

The audit processes will be carried out in the following manner:

4.2.2.1. Audit planning

- Each FPM will elaborate a yearly work plan regarding the to-be-conducted audit reports for each Grant. This work plan needs to be completed by 30 November 2009.
- In order for the work plan to be realistic, the various audit process steps need to be taken into consideration (cf. point 4.2.2.2. *Audit process steps*).

- The work plans of each FPM will be consolidated and each Regional Unit will have a corresponding plan (Africa, Asia and ELM). Each Team Leader will be responsible for consolidating the information and communicating it to the Unit Director.
- When the planning has been completed and approved by the TL, it will be communicated to each PR, LFA and CCM in order to confirm the deadlines for each audit report.
- Each Unit Director will be responsible for consolidating the Regional Unit planning, which will be completed and communicated to the Support Team of CP before 15 December 2009.
- The CP Support Team will consolidate the three unit work plans, which will be finalized by 31 December 2009. The focal point for this task will be the appointed Risk Management Officer of the CP Support Team.

4.2.2.2. Audit process steps

The management of PR audits includes the following steps, in which the PR, CCM, FPM and Finance, LFA and selected audit firm participate:

- PR sends the ToRs for the audit review to the FPM via LFA;
- LFA reviews the ToRs and provides comments if necessary;
- Analysis and No Objection of the ToRs by FPM/Finance team;
- PR selects audit firm and communicates this to the FPM; the LFA forwards its assessment of the suitability of the auditor to the FPM;
- No Objection of the audit by FPM/Finance team;
- Audit review;
- Audit analysis. Report reviewed by LFA. Report sent to FPM;
- Audit analysis. Report reviewed by the FPM/Finance team and relevant recommendations identified, specifically in relation to potential risk elements which can impact Grant implementation; and
- Follow-up to these recommendations will be communicated to the PR, LFA and CCM.

4.2.2.3. Audit analysis and follow up

The role of the audit arrangement focal points in each Regional Team:

- Each Regional Team will monitor and track audit reports relevant to its region. This is a transversal task, and the main objective is to maintain control of the timely delivery of the audit reports. The analysis and substantive follow up is the responsibility of each FPM together with the Finance team;
- The responsibility of the focal point is maintaining an effective communication flow with the FPMs, informing them of the agreed upon deadlines in order to ensure the FPMs will prioritize the follow up and timely delivery of the audit reports;
- The focal point will base the audit alert system on the Regional Team planning.
- The focal point will communicate by email to FPMs when deadlines are approaching and send, if necessary, reminders. FPMs will ensure that reminders are communicated to the PR, LFA and/or CCMs as necessary (in case of delayed audit, for example).

Management of the audit reports:

- Once the audit report has been produced the PR will send it to the LFA ;
- The Secretariat will update the LFA tools and guidelines to ensure more consistent LFA review of (i) audit arrangements and (ii) audit reports and management letters;
- A component on 'LFA review of adherence to audit ToR' will be integrated into the LFA audit review template;
- The Secretariat will ensure LFA compliance to review audit arrangements and reports by (i) ensuring audit review is budgeted in Work Orders and (ii) follow-up by FPM for particular countries and by LFA team in form of raising awareness of audit review work among LFA HQs;
- In the new PU/DR template, the PR and LFA are requested to state whether the audit has been done as planned, and if delayed, why and when it will be completed;
- The management action section of the PU/DR can reflect actions to be taken and followed up;
- The Program Finance team will take on additional responsibilities(Referring to 4.2.2.5) and, with Country Programs, ensure compliance with the revised policy;

4.2.2.4. Sub-Recipients' audit arrangements

SR audit plans: The PR should indicate in its SR audit plan (i) where it is not cost effective to have an SR audit due to size of grant to SR; (ii) audit arrangements for SRs when the PR is a pass-through PR; and (iii) audit arrangements below SR level for entities which are receiving a significant grant amount. The GF will then review, and accept or modify the SR audit plan.

4.2.2.5. Work Dynamics within the Secretariat

The decision regarding the type and opportunity of conducting a specific audit (or any other risk mitigation tool) is part of the responsibility of the Regional Team. The technical support of the transversal teams (Finance, Procurement, Legal & M&E) is fundamental, providing expertise and a specific view in their areas of competence.

The Secretariat will work to fix the issues identified in the audits (or any other risk mitigation tool), and will define a policy which will then be applied and monitored. As part of this policy, Finance team will be systematically involved and responsible alongside

the FPM for audit ToRs to be set properly, audit reports received, and recommendations acted upon (see section 4.2.2.2 on Audit process steps).

4.2.2.6. Filing

The filing system to be implemented is not only a critical issue in the management of audit reports but as well as for general relevant documentation of the grant portfolio.

CP has developed a new filing protocol which for now only contemplates filing hard copies. As document attached there is a list specifying which documents need to be archived. We will also take this opportunity to classify hard copies including the new documents. Considering the number of new countries and grants we have, we will implement the updated filing system as of Round 8. This does not include the classification in shared point. Electronic archiving will be discussed once the new system goes live. The goal should be a 100% electronic record.

4.3 Training to TLs, FPMs and POs

CP and Finance Unit will jointly organize regular training sessions which all members of Country Programs will be required to attend.

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Annex 2

Contents Section	Recommendation	Response	Responsible official	Completion date
GF Architecture in relation to PR audit arrangements	<p>Recommendation 1 (High)</p> <p>The outputs of PR financial audit should at least cover an audit opinion, financial statements on which the audit opinion is based and a management letter communicating any conditions identified during the course of the audit that the auditors may want to bring to the attention of the PR's management. LFAs should be provided with a template that requires them to give specific comments on the reports provided by the auditor.</p>	<p>Agreed.</p> <p>We will develop an LFA template to ensure more consistent LFA review of (i) audit arrangements and (ii) audit reports and management letters</p>	LFA Manager	
	<p>Recommendations 2 (High)</p> <p>A policy that clarifies responsibilities and communication between Country Programs, Program Finance and Legal in relation to audit arrangements should be developed. This policy should:</p> <ul style="list-style-type: none"> • Transfer key responsibilities to the Program Finance Unit for: assessment of the type of audits required to address PR specific risks; review of adequacy and implementation of PR and SR audit plans; review of audit reports and comments submitted by LFA; and tracking of submission of audit plans and reports, • Clarify when the Legal Unit should provide input to reviewing of audit arrangements, • Specify the consequences for non-compliance to audit arrangements, <p>All Fund Portfolio Managers and Program Officers should attend finance related training organized by the Program Finance Unit which should include awareness-raising on all arrangements related to audit.</p>	<p>Agreed.</p> <p>The revised policy will clarify the role of the Program Finance team in these areas, the role of Legal (and other teams if audits highlight other areas of concern, eg: procurement) and the consequences of non-compliance.</p> <p>The Program Finance team will organise regular training sessions which all members of Country Programs will be required to attend.</p> <p>We agree with the recommendation to have Finance play a systematic and increased role in reviewing Audit TORs and Audit Reports. We have detailed the proposed approach in the attached Management Letter.</p>	Unit Directors of Country Program and Finance	

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Contents Section	Recommendation	Response	Responsible official	Completion date
GF Architecture in relation to PR audit arrangements	Recommendation 3 (High) Country Programs should ensure that the policy requirement for the LFA to review the suitability of the auditor and terms of reference of the auditor is implemented. LFAs should review audit reports as required by the policy and report to the GF within the required period of six months after year end.	Agreed. Monitoring of implementation of the policy will be a key focus of the revised policy.	RTLs and Program Finance manager	
	Recommendation 4 (Significant) As part of its fiduciary arrangements, emphasis should be given by the CCM for each country to ensure that audits are undertaken for each of the grants on an annual basis as required by grant agreements. The OIG therefore recommends that the GF Secretariat reminds CCMs that they have a responsibility for ensuring compliance with requirements for annual audits.	Agreed. CCMs will be supported in performance on their oversight role, including their role in ensuring the implementation of annual grant audits, and the follow up on audit results.	CCM Team/ Country Programs regional teams	Ongoing
		Updated versions of CCM guidance documents and support tools produced by the Secretariat will reinforce the emphasis on the importance of grant audits, and the role of the CCM in ensuring compliance with audit requirements.	CCM Team	Ongoing

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GF Architecture in relation to PR audit arrangements	<p>Recommendation 5 (Significant)</p> <p>The fiduciary requirement of PRs relating to audit arrangements are only as effective as the oversight arrangements in place. The GF Secretariat should therefore increase vigilance in following up compliance with audit arrangements. Standard templates to aid follow up of each requirement as per the grant agreements and GF policy for audit arrangements should be developed and included in the LFA Manual. Templates should be designed for the following aspects of audit arrangements:</p> <ul style="list-style-type: none"> • Acceptability of the auditor, • Acceptability of audit plans for principal recipients and sub recipients 	<p>Agreed.</p> <p>We will develop an LFA template to ensure more consistent LFA review of:</p> <p>a) audit arrangements, including evaluation of suitability of proposed auditor, ToR and PR's SR audit plan. This will include situations where (i) PR's existing auditor has been accepted by existing donors and (ii) State Audit Institutions are performing the audit; and</p> <p>b) review of audit findings and recommendations, LFA review of SR audit reports and LFA advice to GF</p> <p>The template will mention existing documents that can be reviewed, eg: previous audit reports, assessments of SAIs carried out by other donors.</p>	LFA Manager	
Review of GF policies relating to audit arrangements	<p>Recommendation 6 (Significant)</p> <p>Auditors should be assessed on their ability to meet criteria set by the International Standards on auditing (ISA) or the International Organization of Supreme Audit Institutions (INTOSAI).</p>	<p>Agreed.</p> <p>This can be done during the LFA's review of suitability of auditor (by reference to previously issued reports) and during monitoring of audits completed under GF grant agreements.</p>	LFAs	

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Review of GF policies relating to audit arrangements	<p>Recommendation 7 (Significant)</p> <p>The LFA should seek evidence and report on the suitability of auditors proposed for the Global Fund programs. Areas that the LFA may take into consideration include:</p> <ul style="list-style-type: none"> • independence of the audit team, firm, or institution; • competence, training, and development of audit staff assigned; • audit methodology and testing techniques applied; • Quality control and documentation procedures etc. 	<p>Agreed.</p> <p>We note that these criteria would normally be evidenced and reviewed during the regular tender process for audit services.</p>		
	<p>Recommendation 8 (Significant) (co-financing with other donors)</p> <p>The policy relating to audit arrangements should be applied to all funding arrangements. Where other donor requirements are more stringent, these may be adopted. However, in cases where there are less than optimal, the GF should work with other funders to ensure that the audit arrangements are strengthened. This should include ensuring that audit coverage includes GF monies and provides assurance that the grants are used for intended purposes.</p>	<p>Agreed.</p> <p>This is commonly the way we deal with co-funding arrangements. Obviously in a pooled funding arrangement we can ask for separate identification of GF income to the program but we would not seek separate attribution of GF expenditure in the financial statements. For pooled funding arrangements which are wider than the focus of grant activities (eg: a HIV grant in a health sector pool, there needs to be arrangements (possibly outside the audit of the financial statements) to identify the money spent on the disease component.</p>		

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Review of GF policies relating to audit arrangements	<p>Recommendation 9 (High)</p> <p>The GF should have dialogue with the United Nations Agencies that act as PR for with a view to providing assurance to the Global Fund on the use and accountability of funds disbursed.</p> <p>For countries under Additional Safeguards Policy (ASP), the special audit arrangements policy should be agreed with the UNDP and monitored by Countries Programs with the support of the LFA. Consideration should also be given to enabling the Secretariat to call for special audits for all grants when particular risks emerge.</p>	<p>This is an ongoing issue that we are discussing with UNDP, one of our key implementation partners, to ensure we can arrive at a mutually satisfactory arrangement.</p>		
	<p>Recommendation 10 (Significant) (PRs auditor is acceptable to existing donors)</p> <p>The LFA should assess the suitability of the auditor and ToRs. Should the choice of auditor or ToRs be found to be inadequate in meeting the GF audit objectives, the GF should in consultation with other donors try to agree together on the auditor and have common terms of reference. However where other donors audit requirements are adequate or more stringent, these should be adopted.</p>	<p>Agreed.</p> <p>See response to recommendation 5.</p> <p>GF audit requirements are based on internationally-accepted standards. Other donors' requirements are based on similar standards.</p>		
	<p>Recommendation 11 (Significant) (State Audit Institutions as auditor)</p> <p>There should be other considerations taken into account in deciding whether the PR's auditors meet the GF's minimum requirements for an auditor e.g. level of assurance required by the PR vis-à-vis what GF requires, what risks GF programs are exposed to, size of funding provided by the GF in comparison to that of the PR, what audit arrangements are there for other donor funded programs etc.</p>	<p>Agreed.</p> <p>See response to recommendation 5.</p>		

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Review of GF policies relating to audit arrangements	<p>Recommendation 12 (Significant) (SAI)</p> <p>The LFA should assess the ability of the PR’s audit arrangements to meet the GF’s requirements. Should gaps be identified then the GF can agree on how to address the auditor related issues or select another auditor. In cases where the audit arrangements are not adequate then a separate audit of GF programs should be undertaken. However where the PR’s audit requirements are adequate or more stringent, these may be adopted.</p>	<p>Agreed.</p> <p>See response to recommendation 5.</p> <p>The revised policy will specifically address the procedures to follow when an auditor (SAI or otherwise) is found to be inadequate.</p>		
Review of GF policies relating to audit arrangements	<p>Recommendation 13 (High) (SAI)</p> <p>Based on this, LFAs should review SAI capacity or review the assessment by other funders and advise the GF on whether the SAIs can undertake the audits effectively. In cases where this is not the case, the SAI should be asked to sub contract the audit of GF programs to a private firm.</p>	<p>Agreed.</p> <p>SAIs will go under the same level of scrutiny as any other auditor and we will review any previous assessments of the auditor (see response to recommendations 5 and 7).</p> <p>If an SAI was found to be inadequate but legally required to conduct the audit we would negotiate to have the work sub-contracted to a private audit firm.</p>		
	<p>Recommendation 14 (Significant)</p> <p>The LFA in assessing audit arrangements should advise the GF on whether providing a single audit report of the PR will give adequate assurance of the use of GF funds. Where such assurance can’t be given by a single audit report, a specific audit of GF funds should be required and specified in the grant agreement.</p>	<p>Agreed.</p> <p>This will form part of the LFA review of adequacy of audit arrangements</p>		

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Review of GF policies relating to audit arrangements	<p>Recommendation 15 (Significant)</p> <p>A cost benefit analysis should be undertaken to determine when an audit of a sub recipient is required. Where the funds are disbursed to low risk sub recipients are below a certain amount, the audit requirement may be waived. In this case, disclosure should be made in the PR financial statements.</p> <p>The policy should be amended to take into consideration ‘pass-through’ PRs for which the program implementation mainly takes place at the SR level. The policy should also provide guidance for the audit of entities for which large amounts are disbursed to lower level recipients.</p>	<p>Agreed.</p> <p>The PR should indicate in its SR audit plan:</p> <ol style="list-style-type: none"> 1. where it is not cost effective to have an SR audit due to size of grant to SR 2. audit arrangements for SRs when the PR is a pass-through PR 3. audit arrangements below SR level for entities which are receiving a significant grant amount <p>The GF will then review, and accept or modify the SR audit plan.</p>		
	<p>Recommendation 16 (Significant)</p> <p>The policy should be reinforced by requiring major sub-recipients of pass through PRs to comply with the audit conditions similar to those of PRs.</p>	<p>Agreed</p> <p>The revised policy will clearly define situations which constitute “pass-through” PRs and the audit process will then apply to the implementing SR(s).</p>		

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Review of GF policies relating to audit arrangements	<p>Recommendation 17 (Significant)</p> <p>The specimen terms of reference should be strengthened in the following aspects:</p> <ul style="list-style-type: none"> • Definition of the objective of the audit; • Definition of the scope of activities or transactions to be reviewed; • The nature of the opinion sought; • The type of report to be prepared; • The party to whom the report is to be addressed; • The period to be covered; and • Date by which the report should be made. <p>An agreement between the PR and the auditor should be a requirement and the Terms of Reference should form part of agreement.</p>	<p>Agreed.</p> <p>The specimen ToRs for audits will be reviewed and strengthened to give clarity on these specific points.</p>		
	<p>Recommendation 18 (High)</p> <p>Where the PR does not have an auditor acceptable to the GF at the time of grant negotiation, the requirement for appointment of an auditor should be included in the grant agreement as a condition precedent to disbursement.</p>	<p>Agreed.</p> <p>This will be reflected in the revised policy.</p>		
	<p>Recommendation 19 (Significant)</p> <p>The GF should require PRs/SRs that receive funds above a set threshold to set up independent Internal Audit units as part of effective internal control systems.</p>	<p>Agreed.</p> <p>As part of its efforts to promote capacity-building and good governance, the Global Fund will encourage this.</p> <p>The absence of an internal audit unit for large PRs is taken into account when assessing the oversight arrangements (including audit) in light of the FMS assessment of the PR.</p>		

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Review of GF policies relating to audit arrangements	<p>Recommendation 20 (Significant) (consequence of non compliance)</p> <p>The policy should prescribe minimum standards for acceptable audit report that would meet the GF's audit objective. In addition, actions to cover the following should be written into the policy:</p> <ul style="list-style-type: none"> • Late submission of audit reports; • Failure to submit audit reports; and <p>Audit reports submitted are not of acceptable quality.</p>	<p>The auditing standards (which include reporting) required are already clearly specified in the guidelines.</p> <p>Agreed: the revised policy will address the actions required when there is non compliance.</p>		
	<p>Recommendation 21 (High) Auditors should provide as part of the financial audits of program financial statements the following outputs i.e;</p> <ul style="list-style-type: none"> • an opinion on the fair statement of income and expenditure; financial statements; • and a management letter that covers any issues that may have come to the attention of the auditor in the areas of internal control, value for money, compliance with the grant agreements and policies and procedures etc. 	<p>Agreed.</p> <p>The management letter, issued by the auditor in conjunction with their audit opinion, will address issues to the extent that the auditor uncovered them in the course of their financial statement audit.</p> <p>The revised policy will require a risk assessment of the PR audit arrangements which may require additional work in these types of areas for a particular grant or implementer.</p>		

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Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 22 (High)</p> <p>Guidance should be provided to LFAs in the LFA assessment forms on the areas that should be covered under audit arrangements such as:</p> <ul style="list-style-type: none"> a) Evidence of independence of the firm and key personnel, b) Qualifications and experience of key personnel, c) Time and personnel requirements for the audit d) Evidence of peer reviews, quality control, Continuous Professional Education (CPE) requirements of the firm. 	<p>Agreed.</p> <p>See also responses to Recommendations 5 & 7.</p>		
	<p>Recommendation 23 (High)</p> <p>The LFA should be required to review TOR where the PR already has an appointed auditor and advise on:</p> <ul style="list-style-type: none"> (e) Adequacy of ToRs (f) Compliance of reports submitted to the ToRs (g) Timeliness of submission of the audit reports in the past (h) Actions implemented as a result of past audit reports 	<p>Agreed.</p> <p>See response to recommendation 5.</p>		

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Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 24 (High)</p> <p>The LFA should be required to review and report on the work done by the Internal Audit unit where the PR has one, with a view to advising the GF on how much reliance can be placed on the work done by internal auditors. In assessing the internal audit department, the LFA should consider among other aspects:</p> <ul style="list-style-type: none"> (g) Governance and reporting of internal audit department i.e. its independence (h) Existence of an internal audit charter and manuals (i) Applied Internal Auditing Standards (j) Multi-year or annual auditing plans (k) Approach to internal auditing (l) Qualifications and skill of internal auditors 	<p>Agreed.</p> <p>The current FMS Assessment Tool already requires the LFA to review the PR's internal audit arrangements. We will update the template for the FMS assessment report to strengthen the focus on internal audit.</p>		
	<p>Recommendation 25 (High)</p> <p>The disbursement decision making form should be enhanced to include comments on the key audit findings that have not been cleared by the PR. These comments should be taken into consideration in making a decision to disburse funds. Where these issues remain outstanding for long period the CCM should be notified and consideration given to suspending disbursements.</p>	<p>Agreed.</p> <p>The FMS issues to report section of the DDMF can be used to reflect significant audit issues.</p>		

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Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 26 (Significant)</p> <p>During the Phase 2 review of compliance with the GF policy about audit arrangements, the LFA should provide specific comments on compliance with each of the provisions of the GF policy as well as those audit findings that may affect the GF decision to invest. Any major areas that result in failure to obtain assurance on the use and accountability of funds may affect the decision to disburse until the issues are resolved.</p>	<p>Agreed.</p> <p>More detailed guidance and questions on audit outcomes and PR's follow-up actions will be integrated into the revised LFA Phase 2 assessment template.</p> <p>Also, audits are currently taken into consideration during Phase 2 reviews. Finance and regional teams always refer to significant audit findings when making continued funding recommendations (Mozambique, included in the sample, is a very good example of this).</p>		
	<p>Recommendation 27 (Significant)</p> <p>The GPR should be regularly updated with the status on compliance with requirements for annual financial audits. The GPR should be used to communicate the status of records held at the Secretariat as a way of encouraging compliance to provisions of the grant agreement and ensuring that there is sufficient information for decision making.</p>	<p>Agreed.</p> <p>This will be included in the revised policy (in the section dealing with monitoring the application of the policy).</p>		

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Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 28 (Significant)</p> <p>The GF policy for audit arrangements should be reviewed to include actions that should be taken when the PR does not comply with provisions for annual audits in the grant agreement. The policy should include a requirement for the LFA to submit to GF Secretariat a review of the major issues arising out of the annual financial report of the SRs for each PR, by the end of the sixth month after the end of the SR's fiscal year.</p>	<p>Agreed.</p> <p>This will be included in the revised policy (in the section dealing with monitoring the application of the policy).</p> <p>The LFA audit review template will request LFAs to review issues coming out of audit reports, including from SR audit reports. When the FPM reviews this, major issues emerging from the audit can then be more easily made part of management letters to PRs.</p> <p>In the new PU/DR template, there is now a section on management issues and their implementation.</p>		
	<p>Recommendation 29 (High)</p> <p>Policy should inform the LFA of actions to take when the PR does not comply with requirements of the grant agreement as they relate to audit arrangements. During the regular PU/DR reports, the LFA should inform GF secretariat of the non-compliance and the reasons for this.</p>	<p>Agreed.</p> <p>In the new PU/DR template, the PR and LFA are requested to state whether the audit has been done as planned, and if delayed, why.</p> <p>The management action section of the PUDR can reflect actions to be taken and followed up.</p>		

Management Response and Action Plan to the recommendations made within the Office of the Inspector General’s Review of Principal Recipient audit arrangement

Contents Section	Recommendation	Response	Responsible official	Completion date
Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 30 (High)</p> <p>The Country Programs Cluster should implement a process for monitoring and enforcement of audit arrangements to ensure PR’s compliance to GF policy. This oversight process should include checks and balances to ensure that:</p> <ul style="list-style-type: none"> (f) Compliance to GF policy is monitored by the LFA in a timely manner; (g) The work done by the LFA is reviewed by the Fund Portfolio Manager; (h) The Finance Unit provides support to the FPM to ensure that audit reports inform grant management; (i) Failure to comply with grant agreement by the PR is brought to the attention of the legal unit; and (j) Failure to meet requirements for annual audit results in consequences including suspension of disbursements. <p>Note: If recommendation 2 is accepted, these responsibilities would pass to the Program Finance Unit.</p>	<p>Agreed.</p> <p>As per recommendation 2, the Program Finance team will take on additional responsibilities and, with Country Programs, ensure compliance with the revised policy.</p>		
	<p>Recommendation 31 (Significant)</p> <p>The LFA should always document, and report on adequacy of existing audit arrangements for each grant within six months of the grant commencement date. After completion of the annual audit of the PR, the LFA should review adherence to the ToRs for the auditors. The FPM should monitor the LFA’s compliance to these policy requirements.</p>	<p>Agreed.</p> <p>Possible solutions include:</p> <ul style="list-style-type: none"> ▪ Integrating a component on ‘LFA review of adherence to audit ToR’ into new LFA audit review template. ▪ Ensuring LFA compliance to review audit arrangements and reports by (i) ensuring audit review is budgeted in Work Orders and (ii) follow-up by FPM for particular countries and by LFA team in form of raising awareness of audit review work among LFA HQs. 		

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Review of tools and processes used for oversight of audit arrangements	<p>Recommendation 32 (High)</p> <p>The LFA should monitor and advise the FPM if the annual audit of the PR's financial statements is on schedule as per the grant agreement. There should be sensitization within the Country Programs cluster of the importance and tools for monitoring and enforcing audit arrangements. Sanctions should be imposed on PRs that persistently fail to comply with GF audit requirements.</p>	<p>Agreed.</p> <p>See response to Recommendation 31 above.</p>		
	<p>Recommendation 35 (Significant)</p> <p>Timeliness in receipt of the audit report is an important aspect of audit assurance. The Secretariat needs to establish a mechanism that will flag cases where audit reports are due, but have not been submitted.</p>	<p>Agreed</p> <p>Will form part of the revised policy.</p> <p>See responses to recommendations 31 & 32.</p>		

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<p>Review of tools and processes used for oversight of audit arrangements</p>	<p>Recommendation 36 (Significant)</p> <p>The policy should provide guidance on the nature and timing of a report from the LFA to the GF Secretariat reporting on the implementation of audit arrangements of the principal recipient. This report should be submitted by the sixth month after the PR’s fiscal year-end, and where the PR has not completed the annual audit, reasons should be investigated by the LFA. The report should explain reasons for non-compliance and advise on its implications to the Financial and Management systems of the PR.</p> <p>The LFA should also be encouraged to meet with the PR’s auditors to obtain such clarifications as are required for the contents of the audit report before submission of report to GF Secretariat.</p>	<p>Agreed</p> <p>We agree that an LFA audit review template would be helpful to ensure more systematic LFA review and reporting. As part of this tool the LFA should advise the GF on proposed PR actions coming out of the audit report. These would then be integrated into management letters and sent to the PR. Follow up on actions in the Management letter will be ensured through the new PU/DR template.</p> <p>Reasons for delayed PR submission of audit report have to be stated in the new PU/DR template and followed up by the LFA.</p> <p>The LFA should comment on issues raised by the audit report and management letter and should be encouraged to discuss issues with the PR’s auditors.</p>		

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Review of grants with special audit arrangements	<p>Recommendation 37 (Significant)</p> <p>The OIG recommends that even when the grant funding is made through a SWAp mechanism, minimum requirements should be communicated to the PR. In this case, where a partner has stricter audit arrangements than the GF, these should be adopted for the grant.</p> <p>Additionally, at the time of grant negotiation, there should be dialogue between the stakeholders in the SWAp mechanism and the GF on the common requirements for financial accountability, monitoring & evaluation and annual financial audit. Audit requirements should be reviewed by the LFA and the Program Finance Unit of the GF Secretariat to ensure that minimum standards for financial assurance are addressed.</p>	<p>Agreed.</p> <p>See response to recommendation 8.</p>		
	<p>Recommendation 38 (High)</p> <p>The GF should liaise with UN agencies that operate as PRs with a view of obtaining assurance for the use and accountability of funds disbursed for GF programs. For UNDP, two internal auditors have been committed to GF activities. However in the OIG's view this is unlikely to be sufficient to provide appropriate audit assurance and UNDP need to consider increasing the resources devoted to GF audits. In high risk countries, joint audits should be undertaken with the OIG to provide greater assurance to the GF Board.</p>	<p>See response to recommendation 9.</p>		

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Review of grants with special audit arrangements	<p>Recommendation 39 (High)</p> <p>The GF Secretariat should negotiate with UNDP that agreements for non-ASP grants contain the same provisions that are currently included in grant agreements for ASP grants. The FPMs should follow up compliance to provisions of the grant agreement that relate to audit arrangements, and non-compliance should be handled through a formal process that allows for escalation of matters to senior management.</p>	See response to recommendation 9.		