



Audit Report

Global Fund Internal Controls

Compliance with Key Internal Policies Including Operational,
Financial and Procurement Controls

GF-OIG-16-007
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Geneva, Switzerland

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I. Background

Since 2012, the Global Fund has undergone significant organizational reform with the formalization of policies and procedures and an increase in internal controls. A project called “Step Up” has contributed to better internal controls around financial processes while many other strategic initiatives have further improved the internal controls around key processes of the organization.

The organization initiated three strategic initiatives in 2015: Accelerated Integration Management,¹ Differentiation² and Risk and Assurance.³ Once complete, these initiatives are expected to fundamentally improve the Global Fund internal control landscape at an entity and a process level.

Following recommendations from the Global Fund Board and the Audit and Ethics Committee, the Secretariat has subsequently adopted the international COSO⁴ framework for risk management and internal control and has committed to implementing the framework for its operations. The adoption of the framework was approved by the Management Executive Committee in September 2012.

An OIG audit on Internal Financial Controls (GF-OIG-15-005) noted that progress on the COSO implementation by the Secretariat has been slow and limited. In response to this, Secretariat management committed to making key processes COSO-compliant in 2015. The Risk Department will make sure that the key processes and controls for the organization are prioritized.

This compliance process is being finalised by the Risk Department. Twelve (60%) out of 20 core processes have undergone a thorough risk and control review against the requirements of the COSO internal control framework. As an outcome of the assessment, gaps in internal controls have been identified and internal controls supporting these processes have been formalized or developed where they previously did not exist.

This comprehensive internal control assessment as well as a complete strengthening of internal controls is still underway at the Secretariat to ensure full compliance with COSO. The process is championed by the Risk Department using a self-assessment review approach by business and process owners supported and reviewed by the Risk Department to ensure ownership and strengthening of controls at the first line of defence.⁵

The following key processes have been defined by the Global Fund Secretariat as critical for the delivery of the organization’s mission and the achievement of its strategic objectives:

- Fundraising, advocacy, contract and donor relationship management
- Strategy, Investment and Impact
- Grant management
 - Pre Disbursement
 - Post Disbursement (Grant monitoring and oversight)

¹ Project AIM will streamline grant management processes and also develop and implement information systems to support the processes.

² Differentiation – The differentiation projects will assess the current resources and processes adopted for grant portfolios and perform adjustments to align resources and processes with size and complexity of grant portfolios.

³ Risk and Assurance – Involves the assessment of risks in grant portfolios to the achievement of grant objectives, designing controls and assurance mechanisms over the controls.

⁴ The COSO framework defines internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide "reasonable assurance" regarding the achievement of objectives in the following categories: Effectiveness and efficiency of operations; Reliability of financial reporting; Compliance with applicable laws and regulations; Safeguarding of Assets

⁵ The three lines of defense model is used as a primary means to demonstrate structure, roles, responsibilities and accountabilities within an organization for decision making, risk and control to achieve governance, risk management and assurance. The first line consists of your business' frontline staff. They are charged with understanding their roles and responsibilities and carrying them out correctly and completely. The second line is created by the oversight function(s) made up of compliance and risk management. These functions set and police policies, define work practices and oversee the business frontlines with regard to risk and compliance. The third and final line of defense is that of auditors and directors.

- Grant support
- Finance
 - Financial reporting including Forecasting and Budgeting
 - Cash and liquidity management
 - Information technology
 - Sourcing (procurement and supply chain management)
- Human resources

II. Scope and Rating

01 Scope

In 2014, the OIG performed extensive reviews covering grant management processes and controls (grant monitoring and oversight) through several country audits (Myanmar, Kenya, Ethiopia, Rwanda, South Sudan, Guinea Bissau and Ecuador). In addition, the OIG has also audited grant financial processes, information technology and sourcing processes and controls.

In 2015, the OIG obtained audit coverage and assurance over key processes. Assurance on controls related to Strategy, Investment and Impact was obtained through the Allocation, Strategy Planning, Implementation and Monitoring and Key Performance Indicators audits. Also, assurance over grant management processes and controls was obtained through the country audits and an audit on grant-making. A follow up Information Technology review was also performed by the OIG in 2015 to provide assurance over the design and effectiveness over controls.

In 2015, the Secretariat engaged in various projects such as Accelerated Integration Management, Differentiation and Risk and Assurance meant to better define, streamline and control grant management processes. As an observer on these projects, the OIG also monitors on a continuous basis the organisation progress to enhance the internal control environment.

In addition, the Global Fund's external auditors also perform annual reviews around the organization's key processes and their financial controls which include Grant Management, Finance and Human Resources.

As part of its mandate and role as the third line of defence for the Global Fund, the OIG is required to annually provide assurance to the Global Fund Board on the design and effectiveness of key internal controls. Taking the above audit coverage into consideration, the OIG performed a follow up review over the design and effectiveness of key internal controls tested under previous audits as well as new processes and controls introduced recently into the organization.

The audit scope took into consideration the relevant key controls tested by the OIG in the Internal Financial Controls audit (GF-OIG-15-005) and Procurement and Supply Chain Management (GF-OIG-15-008) and agreed management actions taken or underway by the Secretariat to address the control deficiencies previously reported:

1. Internal Control Framework
2. Internal financial controls over grant processes
 - a. Financial controls over grant processes (grant signing and disbursements)
 - b. Post disbursement financial controls (financial monitoring and oversight)
3. Sourcing controls
 - a. Pooled Procurement Mechanism
 - b. Corporate Procurement

The audit also focused on the following processes and controls, which were developed and implemented during 2015:

4. Cash and Liquidity Management
5. Forecasting and budgeting

02 Rating⁶

Audit Objective	Rating	Reference to findings
1. COSO Internal Control Framework	Full Plan to Become Effective	IV 01
2. Internal financial controls over grant processes		
2.1 Pre Disbursement Controls	Generally effective	IV 02
2.2 Post Disbursement Controls	Full Plan to Become Effective	IV 02
3. Sourcing internal controls (PPM and Corporate procurement)	Partial plan to become effective	IV 03
4. Cash and Liquidity Management controls	Generally effective	IV 04
5. Forecasting & Budgeting controls	Generally effective	IV 05

⁶ See Annex A for the definition of the OIG ratings

III. Executive Summary

Since 2012, the Global Fund has made significant efforts to enhance the internal control environment, following governance and control concerns flagged by the Board and the High-Level Panel Report.⁷ The enhancements included the formalization of policies, procedures and controls particularly related to financial management. Grant management processes have also been improved with several monitoring and oversight tools (the Executive Grant Management Committee⁸, the Semester Progress and Disbursement Report⁹ and Expenditure and Financial Report¹⁰) introduced by the Secretariat to ensure that funds are used properly to meet the objectives of grants.

The process of improving the internal control environment for the organization has, however, been done in an ad hoc and fragmented manner, leaving key control gaps and exposing the Global Fund to potential misuse of funds. These gaps have been flagged in previous OIG audit reports such as the Procurement and Supply Chain Management Audit, IT Audit and OIG Investigations Reports¹¹.

It is therefore critical for the organization to formalize an internal control framework as recommended by the Board in 2012 as well as the AEC. This will ensure that the organisation has adequate and effective controls at the entity level as well as the process level. A COSO-compliant internal control framework also requires an organization to annually assess the internal control environment. This will ensure that as the Global Fund evolves, its key activities and processes are fit for purpose and, where necessary, control enhancements can be made.

COSO Internal Control Framework

In this context, the Secretariat, led by the Risk Management department, has made some inroads by formalising key processes and internal controls of the Global Fund. The Secretariat is also currently performing an assessment to finalise the internal control framework.

Internal Financial Controls over Grant Processes

Also significant efforts to address control deficiencies identified under the post-disbursement process in the Internal Financial Controls audit (GF – OIG – 15 – 005) have been made by the Secretariat. The OIG has concluded that these efforts are adequate but that they require time to become fully embedded within the organization and operationally effective. However, some agreed actions and control enhancements to this process remain outstanding. In these cases, the Secretariat has a full plan in place to address the control deficiencies.

Sourcing Internal Controls

Similarly, the Secretariat has made a number of improvements around corporate procurement processes in response to the control exceptions identified under the Procurement and Supply Chain Management audit (GF – OIG – 15 – 008). The design of the controls were adequate and testing performed on a sample basis did not identify any material exceptions. However, the number of non-competitive procurements identified by the OIG remains high, as identified in its 2015 audit. As well as ensuring that non-competitive procurements are exceptional, further time is required for

⁷ The paper summarizes for the record the establishment of a High-Level Independent Review Panel on the Global Fund's fiduciary controls and oversight mechanisms. It includes an overview of the establishment, membership, Terms of Reference, timing, process, resources and requirements of the Independent Review Panel (GF/B32/21).

⁸ Senior governance committee within the Global Fund Secretariat that oversees grant management activities and the development of operational policies supporting grant management activities.

⁹ A PUDR is a tool used by the Global Fund that supports in the following: Reviewing implementation progress of grants and assigning overall grant rating; Identifying implementation issues and potential future risks as well as corresponding risks mitigation measures and the process of committing grant funds to be disbursed.

¹⁰ Financial information regarding the implantation of grants and being able to report "where the money is going" and "how it is being spent".

¹¹ <http://www.theglobalfund.org/en/oig/reports/>

the processes and controls to be fully embedded within the organization before they can be considered operationally effective.

Whilst the key controls around the Pooled Procurement Mechanism ¹²(PPM) process were found to be adequate and effective, the OIG found that the controls for the delivery of PPM orders are inadequate, which are the responsibility of the Principal Recipient. There are currently no control measures in place to ensure that procurement orders and payments made to procurement service agents are accurate and that deliveries to Principal Recipients are complete. The Global Fund does not have any assurance mechanism in place to ensure that the PR reconciles the number of goods ordered and received. Reconciliations of procurement deliveries to orders need to be performed on a regular basis. Given the magnitude of PPM orders (more than US\$ 1 billion annually) as well as the fact that the delivery of health commodities to countries is critical for the achievement of the Global Fund mission, the Secretariat has committed to placing additional assurance mechanisms in place over the delivery of health commodities from PPM orders.

In addition, a number of control deficiencies highlighted in the Procurement and Supply Chain Audit (GF – OIG – 15 – 005) are yet to be addressed by the Secretariat. These relate to adequacy and effectiveness of the Global Fund's procurement and supply chain management strategy in meeting the Global Fund's vision and strategic objectives. In addition the execution and oversight over procurement and supply chain management activities between the different departments at the Secretariat and in country.

Cash and Liquidity Management and Forecasting and Budgeting Controls

The audit also noted that processes and controls for new and refined processes such as Cash and Liquidity Management and Financial Forecasting and Budgeting were adequate and effective. However, these processes are still maturing and controls are continuously being refined and therefore require further embedment within the organization.

¹² The Pooled Procurement Mechanism (PPM) enables the Global Fund Secretariat to aggregate order volumes from Principal Recipients (PRs) to leverage the Global Fund's market spend for purchasing health products. The Global Fund facilitates the procurement of health products for PRs through the PPM using the services of Procurement Services Agents (PSAs), which include the IDA Foundation (IDA) and the Partnership for Supply Chain Management (PFSCM).

IV. Findings and Agreed Management Actions

01 COSO Internal Control Framework

In 2015, an OIG Internal Financial Controls Audit flagged slow and limited progress on the implementation of the COSO internal framework across the Global Fund. In addition, it noted that the Secretariat's initial attempt at identifying key processes was not complete with some core business activities not identified as such. Finally, the full list of processes and controls required an assessment for COSO compliance.

The OIG followed-up on the Agreed Management Actions taken by the Secretariat to respond to the issues raised around the implementation of a COSO internal control framework.

The OIG noted that the Secretariat has completed and formalized the exercise of identifying key processes. The assessment concluded that the processes are complete and a fair reflection of the current business activities conducted by the Global Fund.

The internal control assessment to ensure COSO compliance was in progress at the time of the audit and key areas such as grant management and procurement and supply chain management still required an assessment. The AMA shall remain open until COSO compliance has been achieved.

02 Internal financial controls over grant processes

The OIG audit of key internal controls related to Grant Management focused primarily on financial processes performed by the Secretariat. These include activities from grant agreement signing, annual commitment and disbursement decision processes and subsequent disbursements. These also include post-disbursement financial processes.

Audit coverage over grant management operational processes, which include governance and oversight, financial and fiduciary management, programmatic and performance management and health services and products was obtained through country audits in 2015, as well as a Grant Making audit. These include controls performed at a country level as well as at the Secretariat.

2.1 Adequate and effective internal financial controls performed in relation to pre disbursement processes

Grant management financial processes and controls for pre disbursement, which were rated as generally effective in 2014, have largely remained consistent in 2015. These include controls around the approval of grants, grant signing, approval of annual commitment and disbursement decision and disbursement processes.

Based on audit tests of key internal controls in 2015, the OIG concludes that pre-disbursement controls are adequate and operating effectively.

However, the Global Fund experienced some operational incidents (errors) around the grant subsequent disbursement process during the year. Following this, the Finance Department further enhanced controls around this process by implementing more preventative controls versus detective controls. The OIG tested the design and operating effectiveness of the new controls and concluded they appropriately addressed the risk from the deficiencies identified and are operating effectively.

2.2 Although new internal controls were designed over post disbursement procedures, the organization needs some time to embed these controls into its operations in order to continuously mitigate the risks.

The 2015 Internal Financial Controls Audit highlighted a number of control deficiencies around grant management post disbursement processes and controls. In addition to a process walkthrough and observation, the OIG followed up on the agreed management actions taken by the Secretariat to respond to these control deficiencies. Where the Secretariat completed the Agreed Management Action, the OIG assessed the design and the operational effectiveness of the key controls introduced into the process.

- The Global Fund needs to improve oversight over grant expenditures, especially at the sub-recipient level.

In 2014, the OIG noted that controls over sub-recipient grant expenditures were inadequate. In addition, there were no controls in place over expenditures before new cash transfers were made to both the Principal Recipient and sub-recipients. Following this, the Secretariat has developed and implemented quarterly expenditure reporting processes and controls for the top 20 highest funded countries of the Global Fund. This has enhanced the Secretariat's ability to effectively monitor significant budget variances and ineligible expenditures. Results of this monitoring activity will impact the disbursements made to both Principal Recipients and sub-recipients. In addition, the Secretariat has requested that consolidated external audits be performed for all Principal Recipients from 2016 onwards. This will include the review of sub-recipient expenditures.

- The financial capacity of the Principal Recipient is not formally reviewed regularly to inform management practice.

Due to delays experienced in the Risk and Assurance Project at the Global Fund, limited progress has been made around updating risk tools to assess Principal Recipient financial capacity. In the second half of 2015, the Global Fund Secretariat launched Project AIM, which seeks to streamline grant management processes and systems. The assessment of the financial capacity of Principal Recipients is expected to be embedded in the revised grant management processes. The OIG maintains the AMA as outstanding and will continue to track the Secretariat's progress throughout the implementation Project AIM.

- Material amounts of cash are held at the Principal Recipient or sub-recipient level, giving rise to financial risks.

The Secretariat has made significant efforts in the second half of 2015 around managing cash balances at the Principal Recipient and sub-recipient level. This includes restricting disbursements to a quarterly basis which is monitored and checked by the central finance team at the Secretariat and getting to 99% compliance with the requirement for quarterly cash balance reporting by the Principal Recipient. In addition, the finance team reports quarterly to the Management Executive Committee and the Finance and Operational Performance Committee on the level of cash balances held at the country level and includes the amounts reserved for the procurement of health commodities. As a result, the Secretariat has managed to decrease cash balances from US\$ 1.6 billion in country to US\$ 600 million for working capital and US\$ 596 million for procurement commitments. As the revised processes and controls are still new to the organization, they require time to become fully embedded within the organization, specifically with Principal Recipients before they can be considered operationally effective. In addition, the Secretariat will continue to pursue the possibility of issuing letters of credit to Principal Recipients with commercial banks which will allow the organization to become more efficient in its utilization of cash.

- Financial escalation triggers are neither clearly defined nor formally escalated to the next level of authority.

The Secretariat has developed and implemented additional governance and oversight measures for financial processes at the Global Fund. This includes the Signature and Authority Procedure document, which defines the delegation and authority for financial transactions.

- The role of the Finance Officer within the Country Team should be better defined, communicated and aligned to avoid inconsistent interpretation.

In 2015, the Secretariat also developed and implemented a finance officer procedure manual which clarifies the roles and responsibilities of finance officers in the country teams. The revised roles and responsibilities of finance officers are expected to be fully embedded within the organization by March 2016.

Whilst the Secretariat has made significant efforts to enhance the control environment, specifically around grant management financial controls, including post disbursement in 2015, there are number of actions that still need to be completed or fully embedded within the organization. Management has full plans in place to ensure that the internal controls are adequate and effective.

03 Sourcing internal controls

The Global Fund's biggest investments relate to health commodity procurement, which accounts for an estimated 40% of annual disbursements. Procurement and supply chain management of health products are, therefore, critical to the Global Fund's fight against the three diseases. The OIG audit of Procurement and Supply Chain Management (GF-OIG-15-008) identified significant and material issues related to the Secretariat's oversight of procurement and supply chain management related activities and the effectiveness of controls in supporting the implementation of procurement and supply chain management strategies. The OIG audit of internal controls performed follow up procedures and tests of controls on the actions taken by the Secretariat to address the control deficiencies.

The Secretariat has since tightened its oversight over corporate procurement and pooled procurement and made several improvements to the control environment. Whilst this represents an improvement, the processes and controls require more time to integrate within the organization before they can be considered fully effective.

However, the Secretariat still needs to address the deficiencies highlighted by the OIG around supply chain management. These included the Board and Management Executive Committee levels not providing strategic direction and comprehensive oversight to supply chain management-related activities at either the Secretariat or country level. In addition, there is no established function for supply chain management activities at the Secretariat. In 2015, the Secretariat developed a steering committee to address procurement and supply chain management strategic matters and has prioritized the development of an in-country supply chain strategy. A draft strategy was presented to the committee in November 2015. The committee agreed to engage with external consultants to review the draft strategy and assist the Secretariat with an implementation plan. This strategy is expected to guide the Secretariat's approach and role in supply chain system investments in different country contexts.

3.1 Pooled Procurement Mechanism (PPM)

The Pooled Procurement Mechanism (PPM) enables the Global Fund Secretariat to aggregate order volumes from Principal Recipients (PRs) to leverage the Global Fund's market spend for purchasing

health products. The Global Fund facilitates the procurement of health products for PRs through the PPM using the services of Procurement Services Agents (PSAs), which include the IDA Foundation (IDA) and the Partnership for Supply Chain Management (PFSCM).

In May 2015, the Secretariat issued a new operational policy note, which introduced a number of changes in internal controls over the PPM process. The OIG performed a process walkthrough and observation of the revised process. In addition, the OIG tested the internal controls from approval of the price quotation for a PPM order to the delivery of the commodities to the principal recipients in country and noted the following:

Despite the manual control environment and potential for operational errors, the controls over price quotations, working capital advances and grant chargebacks were adequate and effective

The OIG performed tests of controls over the 1) review and approval of price quotations, 2) calculation and payment of working capital advances to PSA's and 3) the calculation and processing of grant chargebacks¹³. The testing included 25 PPM orders from May 2015 which amounted to US \$ 117 million. Based on the audit, the OIG did not note any control exceptions across the sample tested. The OIG noted the following improvement points for management consideration:

The current control environment for PPM price quotations, working capital advances and grant chargebacks is of a highly manual nature. The file used as a basis for determining the chargeback every month does not have restricted access and there is a risk that the file could be altered or tampered with inadvertently, leading to incorrect chargebacks. Although the OIG did not identify any control exceptions related to grant chargebacks to indicate that such activity had taken place, the process can be improved by implementing access controls on the files and also password protection to lock the spreadsheet against unauthorized editing.

The Secretariat obtains monthly cash needs forecast reports from the PSAs, which is in part for purposes of calculating working capital advances. Given that the forecasting abilities of the PSAs have often been unreliable and inflated, there is a risk that the Global Fund is using inaccurate and insufficient data to calculate the working capital advance for the PSA. At this time, the Global Fund manually adjusts the cash needs request from the PSAs according to their judgment and knowledge of this PSA's business in order to arrive at the working capital advance, which creates inefficiencies for the Global Fund. As such, the Global Fund is working directly with the PSAs to improve their forecasting abilities in order for the Sourcing Department to be able to rely upon the cash needs requests from the PSA to calculate the working capital advances. In this context, the OIG did not note any working capital advances provided to PSA's that were materially under or over inflated.

Inadequate controls over the delivery of PPM orders

The PPM process begins with the price quotation order and finalizes when the product is delivered to the PR. It is imperative that the final goods delivered are reconciled with the original order to ensure that orders have been fulfilled completely and to determine whether any adjustments are necessary for purposes of the grant chargebacks in the Global Fund's accounting systems.

In the current process, the PR confirms delivery to the PSA via a delivery confirmation form. Any issues regarding the delivery are resolved between the PR and PSA. The Global Fund currently does not control this process in any way. The Global Fund is copied on email communications between the PR and PSA concerning deliveries and any events requiring intervention or adjustment are brought to the Global Fund's attention by the PR. Once resolved, any necessary adjustments would be reflected in a monthly Pooled Disbursement Mechanism (PDM) report sent to the Global Fund by the PSA on a monthly basis and subsequently included in the grant chargeback calculations. If the

¹³ Grant chargebacks is a process for accounting for payments made by the Global Fund on behalf of a specific country for a specific approved grant of the Global Fund

PR doesn't raise any issues around delivery, no further action is taken between the PSA and the PR. The current process adopted by the Global Fund is considered to be in line with standard commercial practices and with defined roles between the PSA and the PR.

Through this process, the Global Fund does not have any assurance mechanism in place to ensure that the PR reconciles the number of goods ordered and received. The Global Fund relies entirely upon the PR and PSA to bring discrepancies to their attention. If no match (reconciliation) is performed between the goods ordered and delivered, there is a risk that goods have been paid for but not received by the PR and/or that grants have not been charged the appropriate amount. The process currently relies on the PR to flag exceptions around delivery even if the PR doesn't monitor this. In the case of the Nigeria portfolio, the OIG identified significant discrepancies between the PPM orders and deliveries at the Central Medical Store in Lagos (US\$ 3.7 million in ARVs and US\$ 500,000 of ACTs). In these cases, the differences could not be explained by the PR due to the lack of reconciliation between orders and deliveries. The discrepancies could also not be explained by the Global Fund due to the absence of an assurance mechanism over this process. Similar discrepancies were also identified in the OIG audits of Tanzania and Uganda.

Agreed Management Action 1:

The Secretariat will develop a plan to oversee reconciliation of PPM orders to deliveries at country level.

Owner

Mark Edington and Christopher Game
Head of Grant Management and Chief Procurement Officer

Target date: 30 September 2016

3.2 Corporate procurement

Corporate procurement focuses on the procurement of goods and services to efficiently and effectively enable the operational activities of the Secretariat. Typically, procurement includes building leases and maintenance, the employment of translation or communication services and consultancy services.

Improvements made to the processes and controls over corporate procurement were adequate. However, the organization needs time to embed these controls into its operations.

In response to the issues raised in the 2014 OIG audit of Procurement and Supply Chain Management at the Global Fund, the Secretariat has updated its Procurement Regulations as of March 2015 and implemented additional financial controls around corporate procurement activities in May 2015.¹⁴

The Secretariat also uses a tool, Business Intelligence Apps (BI Apps), to extract on-demand PO reports on a regular basis to monitor procurement activities. At this point, there are also several initiatives, which are being implemented to improve management information systems to capture relevant data and to support procurement related decision making.

¹⁴ Procurement and Supply Chain Management at the Global Fund, GF-OIG-15-008, published in May 2015.

The OIG performed a walkthrough of the revised corporate procurement process and audit tests of key internal controls. The process included selecting suppliers through a competitive and transparent process, submitting purchase orders, rendering supplier services, extending supplier services and goods, and paying of suppliers. Testing was performed across eight key controls for 28 corporate procurement transactions from May to October 2015 (i.e. after the new procurement regulations were implemented) amounting to US\$ 20 million. Whilst the OIG identified isolated and immaterial control exceptions, the number of non-competitive procurements identified by the OIG remains high, as identified in our 2015 audit.¹⁵ Although these were adequately approved, 28% (8 out of 28) of tested contracts were awarded with an “exception to competition” memorandum. For consultancy contracts, the percentage of non-competitive procurements was around 60% of the tested sample. As well as focusing on ensuring that non-competitive procurements are exceptional, further time is required for the processes and controls to fully embed within the organization before they can be considered operationally effective.

The OIG also noted improvement points for management consideration around preferred suppliers, as well as the contract extension processes. The organization would benefit from maintaining and using a centralized listing of preferred suppliers selected through a competitive process. In addition, the supplier contract extension process can also be enhanced by validating that the current contract extension is with a supplier that has historically been vetted via a competitive process taking into consideration the cumulative amount of procurement contracts undertaken to date. Better due diligence in analyzing the reasons for an “exception to competition” memorandum should be applied at all levels of approval.

04 Cash and Liquidity Management

The Treasury Department is a relatively young department within the Global Fund. The department was created with the purpose of protecting the funds of the Global Fund, addressing the economic exposure of the contributions committed by donors, and also ensuring that the liquidity needs of the entity are met for the purpose of disbursement to countries. Up to 2013, the Global Fund facilitated payment instructions to the World Bank for PRs through uncontrolled faxes. This resulted in false payment instructions being sent to the World Bank by PRs without any prevention or detection measures. The creation of the Treasury Department is indicative of a maturing control environment for financial management at the Global Fund.

The Treasury Department focuses on the following core components:

- Liquidity management¹⁶
- Grant disbursements using commercial banks
- Hedging activities¹⁷

The OIG notes that the current activities of the Treasury function are relatively simple with limited risk taking as per decision point GF/FOPC11/DPO2 by the FOPC. Twenty-three hedge contracts were taken on by the Treasury department in 2015 on behalf of the Global Fund, most of which were spot¹⁸ and forward¹⁹ trades. In addition, liquidity management decisions and cash movements are performed on a monthly basis. However, all long term funds are accessible immediately should the need arise based on the Global Fund’s agreement with the World Bank. Finally, the movement of funds from the World Bank to commercial banks does not give rise to any market risk exposures or foreign currency exchange risks. In fact, the Treasury function has enhanced the Global Fund’s

¹⁵ Procurement and Supply Chain Management at the Global Fund, GF-OIG-15-008, May 2015.

¹⁶ **Liquidity management** is an organization’s ability to meet cash and collateral obligations without incurring substantial losses. Liquidity management describes the effort of investors or managers to reduce liquidity risk exposure.

¹⁷ A **hedge** is an investment to reduce the risk of adverse price movements in an asset. Normally, a **hedge** consists of taking an offsetting position in a related security, such as a futures contract.

¹⁸ The purchase or sale of a foreign currency or commodity for immediate delivery. **Spot trades** are settled "on the spot", as opposed to at a set date in the future. Futures transactions that expire in the current month are also considered **spot trades**.

¹⁹ A customized **contract** between two parties to buy or sell an asset at a specified price on a future date. A **forward contract** can be used for hedging or speculation, although its non-standardized nature makes it particularly apt for hedging.

functionality with the ability to now directly handle the inflows and outflows of funds from the donors directly to the PRs.

Internal controls around cash and liquidity management processes were adequate and effective.

Since the creation of the Treasury Department, the roles and responsibilities of the key players in the organization have been documented and defined. Additionally, activities of the Treasury function are well defined and documented in an operational policy note.

Based on audit tests performed, the OIG concluded that key internal controls over the hedging process at the Global Fund were adequate and effective. These included controls over the initiation of the hedge, placing/calling the hedge, and accounting for hedge transactions.

Controls over liquidity management, which included tests on the approval and justification for the monthly rebalancing requests made with the World Bank and the monthly reconciliation of cash balances, were also found to be adequate and effective.

Finally, the controls over approval, processing and reconciliation of payments from the World Bank to commercial banks and from commercial banks to PRs were found to be adequate and effective.

The OIG notes that the current control environment, whilst largely manual and reliant on a small number of key individuals, is fit for purpose. However, there is a potential risk that as the activities of the Treasury function increase in both volume and complexity, potential risks that could impact the organization might not be identified, mitigated and monitored in a timely fashion. Regular review of the Treasury function processes and key internal controls is therefore recommended specifically around the limited application of segregation of duties due to the size of the Treasury team. In addition, the inclusion of the risk management function is an oversight mechanism over the hedging processes. However, as no control deficiencies were identified during the audit, no agreed management action is required.

05 Forecasting & Budgeting

In its attempt to improve the internal control environment, the Global Fund has formalized a forecasting and budgeting function within the Finance Department. Whilst the Global Fund has always performed financial forecasting and budgeting, this function developed and implemented a formalized framework and set procedures for performing financial forecasts and budgets. The forecast and budget are comprised of three main components: grants expenditure, operational expenditure and cash flow forecasting. The forecast is performed three times a year, with a midterm plan that is updated twice a year and the annual budget prepared in September of each year. Only a small number of iterations of the forecast and budget have been completed to date, and the process is continuously being refined and improved.

Internal controls around forecasting and budgeting were adequate and effective.

The OIG notes that the controls in place for forecasting and budgeting are adequate and operating effectively. These included controls over actual data input into forecasts and budgets prepared, grant data, operational expenditure data, assumptions and calculations into forecasts and budgets and finally approval from the Management Executive Committee and the Financial and Operational Policy Committee. Whilst this represents a significant improvement in the internal control environment for the Global Fund, the financial forecasting and budgeting process is still maturing in terms of inputs, calculations and usage and requires further embedment in the organization before it can be fully effective and used to accurately manage the financial affairs of the Global Fund.

In particular, there is a potential risk that the organization might not utilize the outputs of forecasts and budgets for financial planning and decision making (grant disbursement decisions, operational expenditure decisions and liquidity management) or utilize it incorrectly. It is therefore important that the function formalizes the budgeting and forecasting process by determining the final usage of the forecasts e.g. strategic decisions at the Global Fund.

In addition, the effectiveness of the grant forecasting and budgeting process is significantly reliant on PRs implementing this in line with expectations set forth in the budgets, which is often not the case and causes volatility in the process. This increases the risk of forecasts and budgets being inaccurate and management should make efforts to improve the accuracy of the process.

The Secretariat has already flagged these areas as key risks and has commenced plans to mitigate which including working with principal recipients and country teams to improve financial data. Also in 2015, the Secretariat also piloted across a few departments zero based budgeting ²⁰for the 2016 operational expenditure financial planning process. However, as no control deficiencies were identified during the audit, no agreed management action is required.

²⁰ A method of **budgeting** in which all expenses must be justified for each new period. **Zero-based budgeting** starts from a "zero base" and every function within an organization is analyzed for its needs and costs.

Annex A: General Audit Rating Classification

<p>Highly Effective</p>	<p>No significant issues noted. Internal controls, governance and risk management processes were adequate, appropriate, and effective to provide assurance that objectives should be met.</p>
<p>Generally Effective</p>	<p>Some significant issues noted but not material to the overall achievement of the strategic objective within the audited environment. Generally, internal controls, governance and risk management processes were adequate, appropriate, and effective. However, there is room to improve.</p>
<p>Full Plan to Become Effective</p>	<p>Multiple significant and/or (a) material issue(s) noted. However, a full SMART (<i>Specific, Measurable, Achievable, Realistic and Time-bound</i>) plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee. If implemented, this plan should ensure adequate, appropriate, and effective internal controls, governance and risk management processes.</p>
<p>Partial Plan to Become Effective</p>	<p>Multiple significant and/or (a) material issue(s) noted. However, a partial SMART plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee. If implemented, this plan should improve internal controls, governance and risk management processes.</p>
<p>Ineffective</p>	<p>Multiple significant and/or (a) material issue(s) noted. Internal controls, governance and risk management processes were not adequate, appropriate, or effective. They do not provide assurance that objectives will be met. No plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee.</p>

Annex B: Methodology

The Office of the Inspector General (OIG) performs its audits in accordance with the global Institute of Internal Auditors' (IIA) definition of internal auditing, international standards for the professional practice of internal auditing (Standards) and code of ethics. These Standards help ensure the quality and professionalism of the OIG's work.

The principles and details of the OIG's audit approach are described in its Charter, Audit Manual, Code of Conduct and specific terms of reference for each engagement. These help our auditors to provide high quality professional work, and to operate efficiently and effectively. They also help safeguard the independence of the OIG's auditors and the integrity of their work. The OIG's Audit Manual contains detailed instructions for carrying out its audits, in line with the appropriate standards and expected quality.

The scope of OIG audits may be specific or broad, depending on the context, and covers risk management, governance and internal controls. Audits test and evaluate supervisory and control systems to determine whether risk is managed appropriately. Detailed testing takes place across the Global Fund as well as of grant recipients, and is used to provide specific assessments of the different areas of the organization's' activities. Other sources of evidence, such as the work of other auditors/assurance providers, are also used to support the conclusions.

OIG audits typically involve an examination of programs, operations, management systems and procedures of bodies and institutions that manage Global Fund funds, to assess whether they are achieving economy, efficiency and effectiveness in the use of those resources. They may include a review of inputs (financial, human, material, organizational or regulatory means needed for the implementation of the program), outputs (deliverables of the program), results (immediate effects of the program on beneficiaries) and impacts (long-term changes in society that are attributable to Global Fund support).

Audits cover a wide range of topics with a particular focus on issues related to the impact of Global Fund investments, procurement and supply chain management, change management, and key financial and fiduciary controls.