

REPORT OF THE FINANCE AND AUDIT COMMITTEE

PURPOSE:

This document summarizes the deliberations of the Finance and Audit Committee (FAC) at its meeting on 4-5 October and 7-9 November 2011 and in related communications.

Notes:

This document contains two reports. GF/B25/14/a summarizes the deliberations of the FAC at its meeting on 7-9 November 2011. GF/B25/14/b summarizes the deliberations of the FAC at its meeting on 4-5 October 2011 and in related communications.

The deliberations of the FAC Sub-Committee on OIG Matters at its meeting on 8-9 November are summarized in a separate report (GF/B25/15)

GF/B25/14/a
Board Decision

REPORT OF THE FINANCE AND AUDIT COMMITTEE

PURPOSE:

This report summarizes the deliberations of the Finance and Audit Committee (FAC) at its meeting on 7-9 November 2011 and in related communications.

PART 1: INTRODUCTION

1.1 The Finance and Audit Committee (FAC) met in Geneva on 7 November 2011 for the second part of its 17th meeting. The Chair was Peter van Rooijen (Developed Countries NGO) and the Vice-Chair was Lars Kjaer Knudsen (Point Seven). Brian Hackett (United States) attended as an invited observer.

1.2 This report contains the following topics for Board Decision:

- Part 2: 2012 Operating Expenses Budget
- Part 3: Medium Term Human Resources Strategy

This report contains the following topics for Board Information

- Part 4: Forecast of Asset Available
- Part 5: Provident Fund Matters
- Part 6: Health Campus

1.3 This report contains the following Annexes:

- Annex 1: Guidance on Location of Further Information

1.4 This report contains the following Attachments:

- Attachment 1: 2012 Operating Expenses Budget

1.5 This report should be read in conjunction with GF/B25/14/b as this summarizes the deliberations of the FAC at its meeting on 4-5 October and in related communications.

PART 2: 2012 Operating Expenses Budget

Decision

2.1 The FAC noted that the budget preparations had been discussed at the first part of the 17th FAC meeting in October (GF/B25/14/b) and in a conference call held on 4 November where interested Board constituencies participated. Queries and comments provided by these constituencies are addressed in the FAC deliberations.

2.2 The FAC noted that the budget has been developed by the Secretariat using a conventional zero based, activity based budgeting process across 81 teams in six clusters. The budget is supported by comprehensive work plans for all teams, using standard activities and cost drivers. Activities have been classed as either discretionary or non-discretionary, and have been further prioritized in relation to the Consolidated Transformation Plan (CTP).

2.3 The FAC acknowledged that much of the budget relates to the routine recurrent costs of operations for the Global Fund which are mainly salaries and other non-discretionary costs (e.g. Trustee Fees, Office Rent etc.). It was noted that the Secretariat will de-prioritize any discretionary costs (primarily in Professional Fees) as required during 2012 to ensure the successful implementation of the CTP.

2.4 The FAC noted therefore that the Secretariat will consider the 2012 budget as an envelope and will commit to delivering on the CTP from within that envelope with regular reporting to the Finance and Operational Performance Committee on the use of funds as determined by the Board and Committee. The FAC acknowledged that this approach was in line with the High Level Independent Review Panel position and information provided at the Twenty Fourth Board Meeting that the CTP should be implemented within the existing budget and headcount.

2.5 The FAC further noted that Secretariat costs will increase from 2011 but this only reflects the (temporary) full year costs rather than the partial year budgeting of the extra 25 staff that was approved by the Board in July 2011 for implementing the Reform Agenda (now CTP), and a significant provision for any separation costs linked to the efforts to redeploy the existing headcount to meet the needs of the CTP.

2.6 The FAC further noted that Secretariat costs should completely flat line in nominal terms for 2013 and 2014 as the headcount is reduced back to early 2011 levels and as efficiencies from the CTP offset rising costs linked to inflationary effects.

2.7 The FAC noted that any flat lining of the Secretariat budget will be before adjustments for foreign exchange movements between the USD and the Swiss Franc, and that any decision to increase the OIG budget will not be made at the expense of the Secretariat's budget.

2.8 The FAC further noted that the OIG workplan would be considered by the FAC Subcommittee on OIG Matters. In line with the prior year's decision to ensure appropriate independence of the OIG, the OIG budget would be reviewed by the Chair and vice Chair of the FAC along with the FAC representative from the World Bank (with full consultations with Committee members). This review took place following the FAC meeting. Due to scheduling difficulties, the World Bank were not able to participate, however the Chair and vice Chair of FAC reviewed the OIG Budget (GF/FAC17/25) in detail and informed the FAC of the following:

- i. The OIG budget paper is responsive to the FAC deliberations and provides the additional information that was requested as well as a rationale behind certain costs - like investigation and audit costs. In their view, the information provided in the paper, including the additional information shared with individual FAC members is satisfactory.
- ii. The Inspector General clarified, that in 2013 and 2014, the OIG budget will be flat on the audit and investigation side, unless the investigation caseload of large cases involving significant alleged misappropriation continues to rise. It is assumed that the Audit and Ethics Committee will monitor this and review resource implications for 2013 taking into account any matter arising from the planned external evaluation of the OIG (further discussed in GF/B25/15).
- iii. The commitment puts the proposed increase in a clear perspective: the increase is intended to build the capacity level of the OIG in 2012 to the level that it can respond to the audits and investigations case load as planned for/estimated in 2012 and the following years. It is acknowledged that the volume of the work on investigations always has an uncertainty given that this work responds to the number of cases identified.
- iv. They have reviewed the details of the budget, and discussed in more detail whether it was reasonable to expect to realize the challenging increase of around 40%. In this context, two factors that seem to inhibit the process of further development of the Office: the current recruitment arrangements and the lack of an advanced case management or data analysis system were discussed in more detail.

- v. In relation to both issues, it was agreed that solutions can and must be found. They noted that the current situation necessitates hiring consultants in certain positions (e.g. team leaders) which in the end is less effective and more costly. The obstacles in recruitment could potentially be addressed with a specific arrangement for a limited number of positions. Similarly, the obstacles in the IT department seem solvable. In relation to the latter it was noted that although understandable as an expression of frustration, the language in paragraph 3.5 of GF/FAC17/25 (last sentence) was unhelpful.
- vi. They committed to addressing both issues with the OED and/or the Board leadership, with the aim to find appropriate solutions on a timely basis.
- vii. They agreed that the proposed budget reflects an estimate of funds needed to fully develop the required capacity level of the OIG. However, given the uncertainties identified, it was agreed on including a proposal to have a contingency of US\$3 million in the budget on Professional Fees that would only be used if needed. A request for use of the contingency would need to be discussed with the Audit and Ethics Committee.

2.9 FAC noted the conclusions and recommendations of the FAC Chair and vice-Chair regarding the OIG budget for 2012. Some FAC members noted that year to date expenditure (as at end of Q3) was 56% of the year to date budget (year to date budget as at the end of Q3) and expressed reservations regarding the size of the increase proposed. It was noted that the total OIG budget for 2012 proposed is US\$ 28 million (including the US\$ 3 million contingency). If approved, the OIG budget for 2012 will increase by 35% when compared on a like-for-like basis with 2011. For comparison to the 2011 budget, one needs to deduct US\$ 1.2 million in costs previously included in the Secretariat budget. The 2011 budget of US \$19.8 million also contained a US\$ 3 million contingency.

2.10 The FAC noted that 2012 operating expenses as a percentage of overall expenditure is expected to increase to 9.7% in 2012, but further noted that the increase is primarily related to the timing of grant signing which significantly decreases the total level of expenditure (used as the denominator). It was acknowledged that operating expenses as a percentage of disbursements will improve from the budgeted 2011 level of 10.6% to 9.5% in 2012, and that operating expenses as a percentage of the value of active grants will continue to remain stable from previous years at 2.5%. As the FAC noted in (GF/B25/14/b), the usefulness of the current KPIs should be examined by the Finance and Operational Performance Committee.

2.11 The FAC requested some clarifications and additional details on specific items in the budget presentation (GF/FAC17/21) and these items have been reflected in the updated budget presentation included in Attachment 1.

2.12 The FAC acknowledged the continued foreign exchange impact of the declining USD during 2011 against the Swiss Franc (as the majority of operating expenses, including salaries, are denominated in Swiss Francs), and noted that this has increased the budget by US\$ 18.3 million, based on the exchange rate of 27 October 2011. The impact of the exchange rate is to increase the budget from US\$359.4 million to USD\$377.7 million. The FAC further noted that the final impact on the 2012 budget and consequently the finalization of the total budget amount will only be made following the signing of the foreign exchange forward contract which will be made following Board approval of the budget.

Draft Decision Point 1: 2012 Operating Expenses Budget

- 1. The Board approves the 2012 Operating Expenses Budget in the amount of US\$ 377.7 million, as set out in Attachment 1 to the Report of the Finance and Audit Committee (“FAC”) to the Twenty-Fifth Board Meeting (GF/B25/14), based on the exchange rate outlined in Attachment 1 of the Report of the FAC (GF/B25/14).**
- 2. Following approval of the budget, the Secretariat shall enter into a forward contract with a reputable bank. In the event that the exchange rate determined on the date of signature of the forward contract results in a change in the budget amount, the Secretariat shall notify the Board of such change. The new amount shall thus be deemed to be the approved Operating Expenses Budget for 2012.**
- 3. The use of any amount in the US\$ 3.0 million contingency within the OIG budget for 2012 is conditional upon the advance approval of the Audit and Ethics Committee.**

The budgetary implications of this decision amount to US\$ 377.7 million in 2012, which covers the cost of five additional staff positions for the Office of the Inspector General, one additional staff position for support to the Board leadership for 2012, and the full-year cost of the 25 additional staff positions already approved under GF/B23/EDP/07.

PART 3: Medium Term Human Resources Strategy

Decision

3.1 The FAC expressed their appreciation and satisfaction with the significant amount of work that has gone into developing the Medium-Term Human Resources (HR) Strategy and the outstanding HR procedures required to implement it. The FAC noted that this was a long standing issue arising out of the transition from the Administrative Services Agreement with the World Health Organization.

3.2 The FAC noted the strategic importance of the HR Strategy in relation to delivering on the Consolidated Transformation Plan, in particular the development of procedures on Performance Management, Promotion, Reassignment, and Ending Employment.

3.3 FAC members raised queries on the application of the performance related pay procedure and noted that mechanisms would be in place to ensure that it would be implemented in an equitable way.

3.4 The FAC suggested that the Finance and Operational Performance Committee should monitor the application of the procedure, particularly the actual distribution of increases based on performance against the budgeted distribution.

3.5 The FAC further noted that the budget for performance related increases and cost of living allowances (COLA) would be merged under this procedure. The FAC noted that this may mean underperforming staff would not receive automatic salary increases linked to inflationary, and noted the shift in emphasis from one of entitlement to one of performance. The FAC further noted the EMT’s position that this was more reflective of the performance based funding principles that are applied to grant implementers.

3.6 The FAC raised a clarification on the authority to use an amount of savings (USD 300k) on the 2011 budget allocated for COLA for performance related payments. The FAC noted that this was probably appropriate and within the mandate of the Executive Director

but did suggest that the Finance and Operational Performance Committee and the Secretariat should have a discussion on the authority to make adjustments in separate specific budget lines and their reporting thereof, to ensure that there is no ambiguity. FAC also noted that this had not been disclosed to FAC in detail, but was included in the summarized reporting to the FAC on the use of budget.

3.7 The FAC questioned the statement in the HR strategy paper (GF/FAC17/17) that the HR headcount be protected. The FAC noted the explanation that this was in reference to the overall headcount necessary to implement the HR strategy and not to individuals. The FAC noted the explanation and also acknowledged that this was an issue for the Secretariat management.

3.8 The FAC noted that the HR procedures outlined in the attachments to GF/FAC17/17 were operational in nature, however the overall HR Strategy itself was of strategic importance and therefore while deciding to approve the HR Strategy in line with FAC authority on these matters, the FAC recommend that the Board should also endorse the strategy given its strategic importance in relation to the Consolidated Transformation Plan, the Global Fund Strategy, and the Board's own obligations as an employer.

Draft Decision Point 2: The Global Fund Medium-Term Human Resources Strategy

The Board approves the Global Fund Medium-Term Human Resources Strategy as described in GF/FAC17/17.

The budgetary implications of this decision are included in the proposed 2012 Operating Expenses Budget.

PART 4: Forecast of Assets Available

Information

4.1 The FAC discussed the forecast of uncommitted assets available for grant approvals (GF/FAC17/08) at a conference call on 19 October. The FAC recognized the fluid environment that affected the assets available and therefore discussed a draft of the updated forecast that would be submitted to the Twenty Fifth Board Meeting during the second part of the 17th FAC meeting.

4.2 The FAC noted the significant change in forecasting methodology which was to include an adjustment for the known and quantifiable risks related to already pledged amounts. This results in a more realistic and prudent forecasting methodology. The FAC was informed that the Secretariat has always risk adjusted its projected contributions based on the latest available information.

4.3 The FAC noted the sensitivities around these matters, and especially concerns around disclosing information on reductions to individual donor's contributions. The FAC acknowledged the challenge of balancing the risk of other donors followed the lead of those that had reduced their contributions with the need to ensure the credibility of the forecast by being as transparent as possible

4.4 The FAC requested and received clarification on the impact of the proposed application of the "1+1+1" mechanism of commitments (i.e.: making commitments of grant renewals on an annual basis), noting that this made additional commitment authority available earlier and increased assets available in the current replenishment period by

deferring an equivalent amount to the next replenishment period. It was further noted that the mechanism for commitment itself was not a cumbersome process for grant implementers and did not involve an additional new negotiation process

4.5 The FAC noted that under the risk adjusted scenario at the date of the FAC meeting, there is a potential shortfall in assets available of approximately US\$ 0.6 billion at the end of 2013. The FAC note and alert the Board that if no measures are taken to free up additional resources for commitment purposes, it will result in the need to place funds in the commitment reserve to ensure that funds may be committed for grant renewals and continuity of services. The impact of this would be that funds available to sign Round 10 grants would be extremely limited and therefore grant signing could be significantly delayed.

4.6 The FAC further noted that even if measures are taken, including those currently discussed by the Round 11 working group, to free up assets for commitment purposes, the timing of contributions and commitments may result in significant quarterly shortfalls that impact the ability to commit funds for both Round 10 and grant renewals. The FAC therefore noted that earlier contributions from donors are critical to alleviating this problem.

4.7 The FAC acknowledged that if all the measures, including those currently under discussion by the Round 11 working group, were adopted they could generate an estimated US\$ 1.2 billion in funds available for commitment, which after clearing the expected US\$ 0.6 billion shortfall under the risk adjusted scenario, would provide the Board with approximately US\$ 0.6 billion that could be made available for new rounds or any other purposes such as expanded exceptional extension funding or continuity of services. The FAC noted that there was an expectation that an additional US\$ 0.1 billion would be required for continuity of programming but that this could not be included in the forecast as the Board has not yet made any decision on any extension to the exceptional extension funding decision already made.

4.8 The FAC reemphasized that under the Comprehensive Funding Policy, funds are not committed to sign grants unless they are actually available. In this way, the Board can approve new funding rounds based on a forecast, but no commitments will be made unless the funds are actually available. It was also noted that the amount of funds approved for new rounds exclude projections and only consider available uncommitted assets and confirmed pledges.

4.9 The FAC noted with concern that the weaknesses in the current replenishment process had manifested itself in the volatility of the forecast of assets and that in the current environment there was no longer 100% certainty that pledges would be fully converted into commitments. The FAC noted that this problem was sometimes compounded by the sensitivity surrounding disclosing information on specific donors that were not in a position to fulfill their pledge in full, and therefore concluded that the current replenishment mechanism needs to be reviewed in light of these weaknesses and risks.

4.10 The FAC concluded that the new method of presenting the forecast of assets available should be supported by FAC as it better reflected the risks and uncertainties now inherent in presenting the forecast. The FAC further noted the importance of the Board paper on this matter (GF/B25/9) and the critical relationship between this paper and the paper from the Round 11 working group (GF/B25/8).

5.1 The Chair of FAC updated the FAC that the agenda item relating to the analysis of the foreign exchange loss and request for a supplementary payment to the Provident Fund could not be discussed at this time.

5.2 The FAC then discussed the two remaining Provident Fund related matters, the employer deficit funding contribution, and Amendments to the Provident Fund Benefits Rules.

5.3 The FAC noted that the audited financial statements of the Provident Fund for 2010 showed a deficit of CHF 534,440 and that under rule 6.3 of the Provident Fund's Constitutional Declaration & Benefits Rules, the employer was obliged to make an employer deficit funding contribution over a period not exceeding 3 years.

5.4 The FAC noted that this was an advance that was repayable by the Provident Fund and would be reflected in the Financial Statements of the Global Fund as a loan. A query arose on whether interest would be due on this advance and it has since been clarified that in conformity with Swiss pension practices there is no provision in the Benefits Rules for interest on this type of deficit contribution. . The FAC also noted that there were sufficient funds available to make the payment.

FAC Decision Point: Employer Deficit Funding Contribution

Under authority delegated by the Board, the Finance and Audit Committee approves the immediate one-time payment by the Global Fund to the Global Fund Provident Fund of Employer Deficit Funding Contributions in the amount of CHF 534,440 in accordance with the Global Fund Provident Fund's Constitutional Declaration and Benefits Rules as set out in GF/FAC17/24.

The budgetary implications of this decision for the 2011 Operating Expenses Budget are zero, since the requested payment of CHF 534,440 is an advance by the Global Fund to the Global Fund Provident Fund.

5.5 The FAC also approved changes to Article 6.1 of the Benefits Rules related to a request from the external auditors to clarify the language in the policy related to the presentation of surpluses or deficits in the "Survivor and Disability Benefits and Administrative Costs" and how they are reflected in the Investment Fluctuation Reserve.

5.6 The FAC further approved the language of a new Article related to Divorce Proceedings.

FAC Decision Point: Amendment to the Global Fund Provident Fund Benefits Rules

Under authority delegated by the Board, the Finance and Audit Committee approves the amendments to the Global Fund Provident Fund Constitutional Declaration and Benefits Rules as set out in GF/FAC17/19.

This decision does not have material budgetary implications.

PART 6: Update on Health Campus

Information

6.1 The FAC had discussed and approved the Secretariat to negotiate an extension to the Health Campus building in the first part of its 17th Meeting in October (GF/B25/14/b), noting that it had the potential of providing extra space if required but no obligation, and that it had the potential for additional reductions in rental costs.

6.2 The FAC noted that this negotiation has resulted in an expected additional annual saving of CHF 133,000 per year when the building is finalized and approved the decision to sign the amended Revocable and Conditional Promise to Lease.

FAC Decision Point: Addendum to the Development Contract

The Finance and Audit Committee endorses the Addendum to the Development Contract to be signed with Implenia, and its corresponding annexes (Annexes 13.01 and 16), and authorizes the Executive Director (or his / her designee) to sign the Addendum.

The Finance and Audit Committee also authorizes the Executive Director (or his / her designee) to sign the Revocable and Conditional Promise to Lease as amended to reflect the provisions of the Addendum to the Development Contract

This decision does not have material budgetary implications

This document is part of an internal deliberative process of the Global Fund and as such cannot be made public until after the Board meeting.

GUIDANCE ON LOCATION OF FURTHER INFORMATION

The below table indicates where further information on items dealt with in this report can be found:

All documents listed below are available on the FAC password-protected website:

<http://www.theglobalfund.org/protected/committees/fac/>

Item:	Further information available:
2. 2012 Opex Budget	GF/FAC17/21 2012 Operating Expenses Budget GF/FAC17/25 OIG Supplemental Budget Submission GF/B25/14 Attachment 1
3. HR Strategy	GF/FAC17/17 Global Fund Human Resources Strategy
4. Forecast of Assets Available	GF/B25/9 Forecast of Uncommitted Assets Available for Grant Approvals
5. Provident Fund Matters	GF/FAC17/19 Amendments to Provident Fund Benefits Rules GF/FAC17/20 GFPPF Governance Arrangements GF/FAC17/24 Employer Deficit Funding Contribution.
6. Health Campus	GF/FAC17/18 Secretariat Office Space Update.

REPORT OF THE FINANCE AND AUDIT COMMITTEE

PURPOSE:

This report summarizes the deliberations of the Finance and Audit Committee (FAC) at its meeting on 4-5 October 2011.

PART 1: INTRODUCTION

1.1 The Finance and Audit Committee (FAC) met in Geneva on 4-5 October 2011 for its 17th meeting. The Chair was Peter Van Rooijen (Developed Countries NGO) and the Vice-Chair was Lars Kjaer Knudsen (Point Seven).

1.2 This report contains the following topics for Board information:

- Part 2: Matters Arising from the High Level Independent Review Panel Report and Governance Reforms
- Part 3: Update on OIG Matters
- Part 4: Operating Expenses Update (1 Jan 2011 – 30 June 2011)
- Part 5: 2012 Operating Expenses Budget Preparation
- Part 6: Update on Resource Mobilization
- Part 7: Update on Health Campus
- Part 8: Other Financial Matters
- Part 9: Provident Fund Matters
- Part 10: Human Resources Strategy

1.3 This report contains the following Annexes:

- Annex 1: Guidance on Location of Further Information

1.4 Prior to the FAC meeting on 4-5 October, the FAC held a conference call on 16 September to consider a proposal to accept a long-term promissory note issued by the Gates Foundation (GF/FAC17/13).

PART 2: Matters Arising from the High Level Independent Review Panel Report and Governance Matters Information

2.1 The Chair of the Board attended the FAC meeting and provided the FAC with an overview of the governance work underway and the relationship with the High Level Panel (HLP) report. The FAC noted the three committee structure and that there was still work to be done on finalizing committee terms of reference, agreeing on selection of members, delegated authority, how to take forward the work of the AMFM and MDC committees, the formalization of Board/Committee leadership roles, and the role of partners.

2.2 The FAC noted that there were three important questions for consideration:

- What can be decided by committees versus what should the Board decide on?
- What can be delegated to the Secretariat?
- What are the conditions necessary to have the right accountability framework and trust in order for all parties to advance their work?

2.3 The FAC commenced by discussing the proposed committee TORs.

Committee TORs

2.4 The FAC raised the question of risk management and the involvement of the committees. The FAC noted that initial thinking on this matter is that there are specific areas of a new comprehensive risk management framework (with a holistic approach to risk that goes beyond the country programs specific risk work) that would be allocated to each committee, and the Coordinating Group's role is to ensure a cohesive approach to how risk is assessed and reported up to the Board. The FAC recommended that both the Audit and Ethics Committee, and the Finance and Operational Performance Committee should have a role in looking at emerging risks and providing feedback to the Coordinating Group.

2.5 The FAC reviewed the proposed committee TORs and concluded that it should not be the role of the Finance and Operational Committee to review CCM performance.

2.6 The FAC noted that on fiduciary control, both the Audit and Ethics Committee and the Finance and Operational Performance Committee had a role to play and recommended that there is very clear guidance developed regarding these respective roles.

2.7 The FAC noted that both Committees had a role in relation to the audited financial statements of the Global Fund. The FAC understands and supports that the Audit and Ethics Committee will be responsible for auditor selection and oversight of their work, while the Finance and Operational Performance Committee will consider the content of the financial statements and matters arising from the audit itself.

2.8 The FAC noted that there was a need to formalize the relationship between the proposed new Committees and the Staff Council, Legal Counsel, and the Ombudsman. The FAC noted that the Finance and Operational Performance Committee would be the logical committee to be responsible for this relationship.

2.9 The FAC discussed the role of the Audit and Ethics Committee in relation to external auditors of implementers and noted that it would be a relevant committee responsibility to approve the policies and standards expected but not to approve the selection of the external auditors of the implementers themselves.

2.10 The FAC also considered the practical aspects of having the Audit and Ethics Committee reviewing OIG audit and investigation reports prior to their release, noting the Inspector General's concerns that this may risk delaying the reports and risk impinging on the independence of the OIG. The FAC noted that what was critical was consideration of the sensitivity of the report and that communication was vital in relation to publication of OIG reports.

2.11 The FAC noted that this matter would be considered again by the Sub-Committee on OIG Matters at its next meeting on 8th November, and therefore requested the OIG and Secretariat to prepare a draft paper on a proposed approach to the release and communication around OIG Audit and Investigation reports, building on the work that has been undertaken in this context by the Board Chair, Martin Dinham. The FAC noted that this should be a concise paper if possible and that the Legal Unit should be consulted at an appropriate stage.

2.12 The FAC noted that responsibility for the oversight of Operating Expenses of the OIG related to the Audit and Ethics Committee.

2.13 In relation to authority to sign Memorandum of Understandings, the FAC noted that currently the OIG has this authority and therefore believe it should be for the incoming committee to consider the appropriate level of involvement in these matters.

2.14 The FAC further noted that the recommendations they were making should in no way pre-empt the work of the incoming committees, who should not be precluded from reviewing their roles and responsibilities and providing fresh ideas.

Annex S of the High Level Independent Review Panel Report

2.15 The FAC noted in relation to recommendation 1.1 regarding Fiduciary Documentation and Ethical Behavior, that the intent of this recommendation was already well captured by the comprehensive reform work in terms of having an accountability framework and appropriate minimum standards at the country level. The FAC recommended that the language used in the comprehensive reform work be reflected in the Consolidated Transformation Plan (CTP)

2.16 The FAC discussed recommendation 1.2 regarding the mandatory training required in relation to implementation of recommendation 1.1. The FAC noted that if the minimum requirements required of implementers were increased, it would have implications for the number of implementers who would be able to meet these requirements. The FAC further noted that there was not much focus in the HLP report on assisting implementers reach these standards through building local capacity and expressed their hope that this would be reflected in the CTP. A FAC member raised the question of complexity regarding Enhanced Financial Reporting (EFR) and it was clarified that while this was a unique Global Fund reporting requirement, it was a necessary one and that further developments/improvements of EFR would be considered as part of the CTP. The FAC further noted that the mandatory aspect of the training proposed in recommendation 1.2 may not be feasible nor necessary at all times.

2.17 The FAC agreed with recommendation 1.3 in relation to protocols and methods of work between the OIG and Secretariat. The FAC further noted that in responding to Recommendation 1.3 the OIG and the Secretariat were working on some simple ground rules (rather than elaborate protocols) on the methods of work between the OIG and Secretariat and which would also cover communication issues referred to above.

2.18 In relation to recommendation 1.4 on adopting policies in relation to the release of different categories of OIG reports, the FAC agreed on the need for a differentiated approach which should be documented in the protocols.

2.19 In relation to recommendation 1.5 regarding the need to create written products differentiated by need and audience, the FAC recognized the potential delay this could create in releasing OIG reports that were nearing finalization. The FAC noted that a balance needed to be struck between implementing the recommendation and not delaying reports, noting that delays in the release of reports were potentially damaging at the country level. The FAC confirmed its recommendation that accompanying notes from the Board Chair be released with each investigation report, and suggested the Board leadership to consider accompanying notes with audit reports that would be released before the next Board meeting. It was seen as important that all upcoming releases are well understood in the context of the HLP report. The FAC further noted that the OIG should take implementation of recommendation 1.5 seriously going forward and looked forward to hearing his ideas on this matter at the next meeting of the Sub-Committee on OIG matters on 8th November.

2.20 The FAC noted that the OIG can implement recommendation 1.6 regarding documenting disagreements with Secretariat management in the reports immediately.

2.21 In relation to recommendation 1.7 regarding OIG validated reports of Secretariat implementation of OIG recommendations, the FAC noted that it may not be feasible to have this ready in time for the 25th Board Meeting but that this should be in place for the first meeting of the new Audit and Ethics Committee.

2.22 In relation to recommendation 1.8 on briefing the Audit Committee on OIG activities and the findings of external auditors of grant implementers, the FAC noted the IG's statement that OIG will address all HLP recommendation in the upcoming progress report and that this matter will also be discussed further with the new committee.

2.23 The FAC noted recommendation 1.9 in relation to the relationship with UNDP. The FAC noted that this was a matter for the incoming committee to consider and that in the meantime, the Secretariat and OIG would continue following up with UNDP on these recommendations. FAC noted, after consultation with the Board Chair, that – in contrast to earlier FAC decisions - involvement of the FAC leadership was not seen as required at this stage.

2.24 In relation to recommendation 1.10 on access to information regarding internal investigations, the FAC noted that this matter was being dealt with by the OIG and Secretariat and no FAC role was envisaged.

2.25 On recommendation 2.1 and 2.2 concerning a new risk management framework, the FAC noted that no action was required from FAC prior to the 25th Board Meeting. The FAC further noted that significant work is underway in the Secretariat to develop an Operational Risk Management Framework.

2.26 The FAC noted recommendation 2.3 on defining “Country Ownership” was not within its remit.

2.27 The FAC noted that the categorization of recipient countries into groupings by risk as recommended in 2.4 would initially build on the HLP analysis but would eventually be replaced by a more sophisticated analysis.

2.28 In relation to 2.5, the FAC noted that recommendations to apply differentiated safeguards would be part of the Operational Risk Management Framework and that the expected timeframe of 3 months may not be realistic.

2.29 The FAC noted that the OIG was already implementing recommendation 2.6 regarding focusing resources on the highest areas of risk and highlighted the need to align the risk matrix used by the OIG with the work of the Secretariat in this area.

2.30 The FAC noted that recommendations 2.7, 2.8, 2.9 and 2.11 were not within their remit.

2.31 In relation to recommendation 2.10 that calls for tailoring the LFA scope of work, the FAC noted that 3 months may not be totally realistic given that risk analysis needs to take place first.

Committee Member TORs

2.32 The FAC recognized the challenge of having committee members with relevant technical expertise but who could also have the necessary political authority to make decisions as part of a committee and noted that this would be an issue for consideration in defining the committee TORs.

2.33 The FAC also noted that the new Governance structure with fewer members would lead to a need for different ways of working of the Committee leadership, exploration of enhanced and wider communication and information sharing in advance of Committee meetings and opportunities for engagement of delegations before committee meetings.

PART 3: Update on OIG Matters

Information

3.1 The FAC noted that the OIG expects to release nine audit and three investigation reports commencing in mid-October and that this would present a significant communication challenge.

3.2 The FAC further noted that the OIG will address the HLP recommendations in the progress update and that following release of the upcoming reports, there will remain approximately 10 additional reports in the pipeline for release before the end of the year.

3.3 The FAC noted that the OIG work related to Bed nets was expected to conclude in early 2012 and a number of additional full time staff had been assigned to complete the assignment.

3.4 The FAC noted that the OIG is committed to the success of the mediation process and urged finalization of the document so that FAC can review.

3.5 The FAC further discussed the challenges created by a lack of Privileges and Immunities noting with great concern that this continued to create safety and security issues for staff and also prevented savings on grants through tax exemptions. The FAC agreed to examine this issue again at the Sub-Committee meeting on OIG matters on 8th November. The OIG and Legal Unit will prepare for this subject.

PART 4: Operating Expenses Update

Information

4.1 The FAC noted that actual expenditure was 20 percent below budget for the first 6 months of the year, and that this pattern was similar to 2010. The FAC noted the explanation from the Secretariat that expenditure in the second half of the year is usually higher and the expenditure rate is expected to increase substantially.

4.2 The FAC commented on the lower than expected expenditure in the first six months of the year and the link between this and KPIs on grant signing and disbursements that were also behind during the same period. The FAC further expressed that the KPIs as shown appeared to indicate that it was costing the Global Fund significantly more money to manage fewer grants in a longer timeframe, although noting that the number of grants are affected by grant consolidations.

4.3 The FAC noted the explanation from the Secretariat and in particular the Director of Country Programs (DoCP) who explained that the analysis was correct if considering just the first six months of 2011. The DoCP further noted that this was a period where staff were not sufficiently focused on disbursing funds due to OIG findings that had created both a heightened need for fiduciary controls and sense of nervousness. The FAC noted the DoCP's comments that the entire year figures are expected to be substantially improved. The DoCP further noted that FAC should be aware that Fund Portfolio Managers (FPMs) have become scared and risk averse, but that the development of the Operational Risk Management Framework will provide a framework to empower them to make decisions.

4.4 Members of the FAC recognized these concerns from feedback at the country level, and the FAC further recognized that certain additional Board requirements also contributed to the delays in grant signing. The FAC noted that the KPIs need to be adjusted to make them more useful.

4.5 The FAC further noted the explanations from the Secretariat on the disruption of activities related to implementation of the Q1 Review in terms of rebalancing staff, and the review of the IT Unit, that had also contributed to a decision to slow down certain projects and as a result was contributing significantly to the underspend.

4.6 The FAC expressed concerns that they had requested the Board to approve additional funds to support the implementation of the comprehensive reform agenda and that these funds may not appear necessary at this stage. The FAC noted the Secretariat's assurances that indeed the funds are necessary due to the consolidated transformation plan that is being put in place to address the HLP recommendations and the comprehensive reform agenda, noting that expenditure is expected to significantly increase in Q4 of 2011.

4.7 The FAC further noted that the KPI on donor performance was also a concern as there was a trend of donors deferring contributions until Q4 of the calendar year. The FAC recommends that donors should seek to translate their pledges into cash as early as possible in the calendar year as this impacts the availability of assets to sign already approved proposals into grants.

PART 5: 2012 Operating Expenses Budget Preparation

Information

5.1 The FAC noted that normally the budget would be discussed at the current meeting but due to the budgetary implications of the Consolidated Transformation Plan that was under development, a summary of the process to date was provided.

5.2 The FAC agreed that the process for review of the 2012 Budget was for an initial discussion on the preparations and assumptions to date, followed by submission of the formal budget paper in advance of the FAC meeting on 7th November. The FAC will hold an initial conference call shortly after the budget paper is released, followed by a further call with interested Board delegations in advance of the 7th November meeting.

5.3 The FAC noted that preparations to date included a zero-based, activity based, comprehensive work plan from all teams using standardized costs and cost drivers. The detailed budget includes more than 6,500 individual lines.

5.4 The FAC noted that the HLP report recommended that the cost of implementing the recommendations could be made within existing headcount and budget. The FAC acknowledged that while it was expected that there would be significant shifts in the allocation of resources within the budget, the size of the budget itself was not expected to substantially change.

5.5 The FAC noted the proposed reductions in professional fees were primarily linked to Information Technology, while the increase in LFA fees reflected an increase in the number of active grants, an increased level of verification, and an additional focus on quality of services and data quality. The use of tailored LFA scopes of work had resulted in far more work for the LFA at Sub Recipient level and reviewing pharmaceutical procurement and supply systems. The FAC noted that savings are expected in the procurement and contracting processes of LFAs. The FAC further noted that the expected LFA budget had already factored in the reform agenda deliverables and as these were similar to the HLP recommendations, the LFA budget was already well aligned. The FAC also noted the proposed two step iterative process for proposals was not reflected in the budget and that depending on the timing of implementation of this recommendation, it would have an effect on the LFA budget.

5.6 The FAC again noted the continued depreciation of the US Dollar against the Swiss Franc and acknowledged that this would increase the budget if the US Dollar remained lower than the rate used in 2011.

5.7 The FAC noted that the proposed budget would adversely affect the KPI on Operating Expenses as a percentage of total expenditure, and further noted that the usefulness of the current KPIs may need to be examined. The FAC acknowledged that this trend reflected the fact that additional scrutiny on grant management was being made and this came at a cost of having more people and resources involved in this work.

PART 6 Update on Resource Mobilization

Information

Trustee Investment Report

6.1 The FAC noted that returns to date on the portfolio were 1.4% compared to 2.7% at the same period in 2010. The FAC noted that this still outperformed the benchmark of the 2 year US Treasury Yield.

6.2 The FAC agreed that the Trustee should perform a retrospective review of the effect on returns, if a 10% equity allocation had been included in the portfolio.

6.3 The FAC also recognized that with increased use of Multi Year Contribution Agreements (MYCAs) and the potential use of Long Term Promissory Notes, there will need to be increased focus on the cash position of the portfolio as less cash may be available for investment. Also, the disbursement coverage, as measured by the number of months of cash coverage, may decline.

Resource Mobilization Update

6.4 The FAC noted the recent donor developments and in particular acknowledged that the US administration has requested US\$ 1.3 billion in its Financial Year 2012 budget proposal to Congress. The FAC further noted that this allocation may be subject to reductions as the US budget is finalized.

6.5 The FAC noted that the EC audit had been shared with the Board and that this was positive but unusual because the EC normally considers these documents as internal.

6.6 The FAC noted that the Secretariat's focus would continue to be on converting pledges into contributions, engaging with donors that have yet to pledge, increasing predictability of funding through the use of MYCAs, and expanding Debt2Health to new creditors/debtors.

6.7 The FAC noted that proposed conditions in MYCAs potentially reduce the intended benefits of the MYCA which was increased commitment authority and predictability of funding, as these conditions may not satisfy the Comprehensive Funding Policy (CFP) requirements. The FAC agreed to raise the issue of the important benefits of MYCAs and bring this issue back to the Board's attention.

6.8 The FAC noted that the Mid-Term Replenishment (MTR) scheduled for Q1 of 2012 may be pushed back slightly. This would allow for progress on the Consolidated Transformation Plan to be shared with donors as well as providing further information on the expected demand under Round 11. The FAC expressed concern that it was important that resource mobilization efforts also considered the upcoming Global Fund Strategy and that efforts should be made to present an appealing business case to donors by also highlighting strategic innovation within the Global Fund.

6.9 The FAC noted that continuing efforts were being made to cultivate relationships with emerging economies but that these were not traditional donors and therefore the Board may need to consider ways of making their contributions more attractive, such as earmarking.

6.10 The FAC acknowledged the progress made on Debt2Health initiatives, and the progress on the Exchange Traded Funds (ETF), noting that the ETF would not generate significant resources but would be a proof of concept for similar initiatives. The FAC also noted some of the ideas on the innovative financing mechanisms and that the Secretariat hoped to be able to talk to this in November as part of the resource mobilization element of the Global Fund Strategy.

6.11 The FAC discussed the latest developments on the Financial Transactions Tax, and agreed that the Global Fund should continue preparations to engage itself in the discussions at the opportune moment. The Global Fund should be prepared to provide information and support to advocates who are following the development of this initiative.

6.12 The FAC also noted that progress on the US based charity to allow for tax efficient donations was being made and that the US Internal Revenue Services were reviewing the application and it may be approved before the year end.

6.13 The FAC noted the progress with Product Red and discussed the appropriateness of establishing a relationship with a premium vodka brand. The FAC acknowledged that the necessary due diligence had been performed and the arrangement were in line with the approved screening process for private sector partners.

6.14 The FAC were informed that the agreement with the Bill & Melinda Gates Foundation on the Long Term Promissory Note had not yet been concluded as the Gates Foundation was continuing their internal deliberations. The FAC noted that they had made considerable efforts in a short timeframe to review and approve the proposed agreement prior to a 30th September target that had been requested by Gates to facilitate their fiscal year end.

Forecast of Assets Available

6.15 The FAC noted that the Forecast of Assets Available had already been provided to the Board at its 24th Board Meeting on the 26th of September. As the time available for further discussion was short, the FAC agreed to review the Forecast of Assets and a proposal on how to enhance the model and communication by teleconference prior to its next meeting on 7th November.

PART 7: Update on Health Campus

Information

7.1 The FAC noted that the development of the Health Campus was on track and approved the decision to sign the irrevocable promise of lease. The FAC noted that the Global Fund is protected in this arrangement as the rent that the Global Fund will pay is based on a rate of return on the investment cost and this rate of return is capped at a specific amount. Should the proposed rent exceed the ceiling established, the Global Fund has the right not to proceed with the agreement. The FAC were reminded that the move to the new health campus was expected to generate significant savings in rental costs.

FAC Decision Point: Revocable and Conditional Promise to Lease

The Finance and Audit Committee endorses the Revocable and Conditional Promise to Lease to be signed with Implénia and authorizes the Executive Director to sign the Revocable and Conditional Promise to Lease.

This decision does not have material budgetary implications

7.2 The FAC further noted the opportunity to extend the building size to create an additional 80 workspaces, but that Global Fund would continue to commit to 700 workspaces with the right to rent more space if it so chose. The benefit of extending the building is that it was expected to lead to a potential reduction in the cost per workspace while providing the Global Fund with additional flexibility regarding its space requirements after 2015.

7.3 The FAC acknowledged the potential benefits and approved the Decision Point

FAC Decision Point: Extension of Health Campus building

The Finance and Audit Committee (FAC) requests the Secretariat to negotiate with Implénia the possibility of extending the North & South wings of the future building without modifying the original Global Fund space commitment, as set forth in the Development Contract (DC) signed on 18 August 2010.

The results of the negotiations will be set out in an addendum to the DC, to be presented to the FAC for review and approval at its next session. Similarly, the Conditional and Revocable Promise of Lease will be amended, if need be, to reflect the provisions of the addendum.

This decision does not have material budgetary implications

7.4 The FAC further noted that the lease on the current building has been extended to 2018 but that the Global Fund now has a breakaway clause from 1 July 2015 that will coincide with the expected completion of the health campus (and can be exercised every six months after that date).

PART 8: Update on Other Financial Matters

Information

Foreign Exchange Rates for Grants

8.1 The FAC noted that the decision at the 9th Board Meeting allowed for a change in the currency of proposals in Phase 2 between dollars and euro, and that this change was to be recorded using the International Monetary Fund (IMF) rates. However as the Secretariat has recently commenced use of the core financial management system to record grant transactions, the IMF rate is no longer an acceptable rate under International Financial Reporting Standards (IFRS) and the use of rates from “Oanda” , a financial website was proposed as an alternative solution.

FAC Decision Point – Use of a Single Foreign Exchange (FX) Rate Source for Transactions

As the grant finance transactions are now being made in the core financial system GFS, the Global Fund Corporate rate applies to those transactions in the same way as it applies to any of the OPEX transactions.

There needs to be one FX rate being used for all parts of the organization. That FX rate will be sourced daily from Oanda (including changes to grant currency from dollars to euros or vice versa).

This decision does not have material budgetary implications

Proposal to Open a New Banking Relationship with UBS

8.2 The FAC noted that Decision Point (GF/B19/DP24) states “all operating expenses are now required to be paid through the Global Fund’s Credit Suisse bank account,” but that the Secretariat needs to enter into a relationship with UBS to facilitate the need to have procurement cards, particularly for online purchases and hotel bookings. The FAC further noted that payments to cover the cost of the procurement cards at UBS will be made from the Credit Suisse account.

8.3 The FAC notes the Secretariat’s plan to open an additional account with UBS to facilitate use of procurement cards. The administration of the new account will comply with all applicable Finance and Corporate Procurement Regulations.

8.4 The FAC encouraged the Secretariat to the extent possible and practically feasible to review similar past Decision Points that may no longer be practical or relevant and to bring these matters to the attention of the FAC Chair and vice-Chair to develop a solution that would avoid unnecessary time at FAC on minor administrative matters.

Update of Foreign Exchange Hedge in 2011

8.5 The FAC noted that the decision to hedge the Swiss Franc element of the Global Fund’s operating expenses budget made at the 22nd Board Meeting in Sofia in December 2010 had so far in 2011 (September) avoided additional currency related expenses of US\$ 11.7 million.

8.6 The FAC noted that a similar hedge would be put in place for the 2012 operating expenses budget but that the current rate is less favorable than the rate in 2011 due to the continued depreciation of the US Dollar against the Swiss Franc. The FAC requested that the budget paper clearly show the effect of hedging at a different rate than in 2011.

PART 9: Provident Fund Matters

Information

9.1 The FAC noted the request from the Provident Fund Board Management, endorsed by the Executive Management Team for the FAC to approve a supplementary payment of CHF 6.7 million to compensate the Provident Fund for exchange losses arising from transfer of the US Dollar funds initially held at the World Bank to the Provident Fund Investment Managers. The FAC noted that the Provident Fund assets and liabilities are denominated in Swiss Francs as this is the currency of employee benefits.

9.2 Following the presentation of the “Request for Compensation to global Fund Provident Fund for Foreign Exchange Losses over the period January 2009 – September 2011” by the Secretariat, FAC convened in an Executive Session to discuss the request and the steps forward given the sensitivity of the request.

9.3 FAC members agreed that FAC cannot approve the request at this point and that an additional step-by-step analysis of how GPF Board assessed and managed the situation and the risks involved would be required, including a comparative financial analysis of the returns and risks involved should the funds have been kept in CHF instead of USD. An analysis of the governance arrangements, including the GPF’s Constitution document, would also be required in order to understand the GPF’s Board duties and responsibilities as well as the role, responsibilities and involvement of the FAC and Global Fund Board.

9.4 FAC agreed that it should review the situation up to October 2010 when the GPF Board was equipped to take decisions as part of the investment policy and the transition arrangements previously approved by FAC.

9.5 FAC members would like to know whether and how the staff was kept informed of the GPF situation. Finally, it was agreed that the analysis would be provided by the GPF Board for FAC’s consideration at the FAC’s November meeting.

9.6 This analysis and additional information would need to be clarified in order for FAC to be able to determine the Global Fund’s responsibilities that would legitimize compensation to the GPF for the incurred losses.

9.7 Given the sensitivity of the issue, it was agreed that the Global Fund’s Board would be consulted.

9.8 At FAC’s request, the Inspector General agreed to prioritize and present part of the OIG audit of the ASA transition process to FAC for consideration along with the analysis from the GPF Board.

9.9 Based on the comments received from FAC members, it was decided that:

- The requested analysis will be presented by a delegation of the GPF Board at the next FAC meeting on 7 November.

- The GFPP board will present a step-by-step analysis of how GFPP Board assessed and managed the situation and the risks involved, including a comparative financial analysis of the returns and risks involved should the funds have been kept in CHF instead of USD. An analysis of the governance arrangements, including the GFPP's Constitution document, would also be presented with the view of understanding the GFPP's Board duties and responsibilities as well as the role, responsibilities and involvement of the FAC and Global Fund Board.
- GFPP Board will explain how staff were kept informed of the situation in the GFPP.
- FAC will verify whether the decision to compensate the GFPP is within the FAC's responsibility.
- FAC leadership will consult the Global Fund's Board leadership.
- FAC will review the GFPP Board's analysis along with the results of the OIG's audit report.

9.10 The FAC will reconsider the request at its next meeting on 7th November.

PART 10: Human Resources Strategy

Information

10.1 The FAC noted that the work on this area had taken significantly longer than anticipated. The FAC were informed of the HR review that had taken place in the Secretariat during 2011 including involvement of the OIG, and that a final paper will be presented for FAC consideration at its next meeting on the 7th November

10.2 The FAC noted the proposed five pillars of the proposed HR strategy as outlined in GF/FAC17/11 and the comprehensiveness of the proposed approach. The FAC queried how this linked to the consolidated transformation plan and noted that it was an important part of the plan, linked to fixing internal management.

10.3 The FAC noted that the upcoming paper will address the current realities and practices at the Global Fund, describe lessons learned, what changes will be necessary and how the Secretariat will implement those changes. The FAC noted that this strategy will focus on the actions that can be taken in the medium term to allow the Global Fund to operate successfully over the longer term.

10.4 The FAC also noted that the Ombudsman's annual report was being finalized and would be shared with the Executive Director. The Ombudsman and the Board Chair will discuss the best way for sharing this information with the Board.

10.5 The FAC also noted that the Secretariat would provide by email, an update on the latest developments with the Tax Equalization policy.

This document is part of an internal deliberative process of the Global Fund and as such cannot be made public until after the Board meeting.

GUIDANCE ON LOCATION OF FURTHER INFORMATION

The below table indicates where further information on items dealt with in this report can be found:

All documents listed below are available on the FAC password-protected website:

<http://www.theglobalfund.org/protected/committees/fac/>

Item:	Further information available:
2. Matters arising from the High Level Independent Review Panel Report and Governance Matters	GF/FAC17/15 Board Leadership Update on Governance Reform Initiative
3. Update on OIG Matters	No Paper
4. Update on OPEX	GF/FAC17/06 Operating Expenses Review (First Six Months 2011)
5. 2012 Budget Preparation	GF/FAC17/07 Operating Expenses Budget Process
6. Resource Mobilization Matters	GF/FAC17/08 Forecast of Uncommitted Assets GF/FAC17/09 Trustee Investment Report GF/FAC17/10 Update on Resource Mobilization
7. Health Campus	GF/FAC17/12 Secretariat Office Space Update
8. Update on Other Financial Matters	GF/FAC17/16 Rev1 Update on Other Financial Matters
9. Provident Fund Matters	GF/FAC17/14 Global Fund Provident Fund Matters
10. HR Strategy	GF/FAC17/11 Global Fund HR Strategy
Other	GF/FAC17/13 Approval of Long Term Promissory Note Issued by the Gates Foundation