

REPORT OF THE FINANCE AND AUDIT SUB-COMMITTEE ON OIG MATTERS

PURPOSE:

This report summarizes the deliberations of the Finance and Audit Committee (FAC) Sub-Committee on OIG Matters at its meeting on 8-9 November 2011 and in related communications. It recommends the approval of a Voluntary Dispute Resolution Process to provide Principal Recipients of Grant funds with a non-binding alternative to arbitration to resolve disputes related to OIG final audit or inspection reports.

PART 1: INTRODUCTION

1.1 The Finance and Audit Committee (FAC) Sub-Committee on OIG Matters met in Geneva on 8-9 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, while Karlo Boras attended representing the Ethics Committee, and Pradeep Kakkattil represented the Portfolio Implementation Committee (PIC)

1.2 This report contains the following topics for Board Decision:

Part 2: Voluntary Dispute Resolution Process

1.3 This report contains the following topics for Board Information

Part 3: OIG Progress Update

Part 4: Secretariat Update on OIG Matters

Part 5: Losses and Recoveries from OIG Audits/Investigations

Part 6: Privileges and Immunities

Part 7: UNDP

1.4 This report contains the following Attachments:

Attachment 1: Secretariat Update on OIG Matters

Attachment 2: Report on Losses and Recoveries

PART 2: Voluntary Dispute Resolution Process

Decision

2.1 The Sub-Committee received a revised paper on the Voluntary Dispute Resolution Process at the meeting (GF/FAC17/23). It was noted that the development of this process had been lengthy but was worthwhile, and the OIG and Secretariat had benefitted from the leadership of the FAC Chair to facilitate the finalization of this process.

2.2 The Sub-Committee noted that the Voluntary Dispute Resolution Process is a method to mediate disputes arising from OIG reports and not to litigate them. It was further noted that the process is not designed to be adversarial but to be more of a collaborative mediation process focused on resolving disputes.

2.3 The Sub-Committee noted that the original work on this paper included a procedure for handling of complaints against staff but that this had now been segregated from the final paper and therefore further work may be needed on that particular issue.

2.4 The Sub-Committee was pleased to note that the process was fully agreed between the OIG and the Secretariat, and that it reflected the intention of the Board for a process prior to arbitration.

2.5 The Sub-Committee queried the budgetary implications in 2012, and it was clarified that no specific amount is included, but as the intention was to manage the 2012 budget as an envelope, any costs would be covered from within this envelope. Any exceptional costs would be reported to the Finance and Operational Performance Committee.

2.6 The Sub-Committee expressed the view that this process is a very progressive and innovative approach to dealing with disputes, and is possibly unique in the development world. The Sub-Committee expressed the view that this approach is another example of how the Global Fund is unique and prepared to do business differently.

Draft Decision Point: Approval of Voluntary Dispute Resolution Process

The Board approves the adoption of a Voluntary Dispute Resolution Process as described in GF/FAC17/23 to provide Principal Recipients of Grant funds with a non-binding alternative to arbitration to resolve disputes related to OIG final audit or inspection reports.

PART 3: OIG Progress Update

Information

Introduction

3.1 The Sub-Committee determined that when deliberating on the OIG audit and investigation reports, they would adopt the following approach that reflects the High Level Independent Review Panel recommendations:

- Request clarifications and make observations on OIG findings; and
- Consider whether next steps are clear (OIG recommendations + Secretariat response);
- Consider how lessons learned are identified and taken on board;
- Consider whether disagreements between OIG and Secretariat had been disclosed/addressed; and
- Consider when decisions need to be made whether it is clear who will decide and when.

3.2 The Sub-Committee welcomed the update from both the Inspector General and the Executive Director noting the comments that they have been meeting regularly and had, in their own view, “turned the page”. The Sub-Committee further noted that the Secretariat and the OIG were working together to develop a joint protocol governing the principles for how the OIG and Secretariat work together.

3.3 The Sub-Committee noted the recent appointment of Elmar Vinh Thomas, formerly Team Leader of the East and Pacific region at the Secretariat, as the Director of Audit at the OIG and welcomed him to the meeting.

3.4 The Sub-Committee members noted that many of the issues discussed at the meeting were sensitive and confidential in nature.

Overarching Issues

3.5 The Sub-Committee noted that the OIG Progress Update (GF/FAC17/02) focused on responding to the High Level Independent Review Panel Report and that the OIG had taken the recommendations on-board in relation to focusing on areas of highest risk and more recent transactions, timeliness of reports and behavior of OIG teams including establishing processes to obtain feedback on this issue from the Country. Subsequent OIG follow up actions are identified in the Consolidated Transformation Plan (CTP).

3.6 The Sub-Committee noted that the OIG plans to strengthen its capacity in the area of Public Health and Procurement and Supply Management by recruiting specialists in these areas, and to increase the number of Audit managers to improve timeliness.

3.7 The Sub-Committee noted that the OIG has reflected on the issue of differentiation of reports for different audiences in terms of Investigations, but will seek clarity on the practicalities of this from the High Level Panel, noting the OIG's comments that the pursuit of cases by national authorities can benefit from a full report.

3.8 The Sub-Committee noted that the cross-cutting issues identified by the OIG in the most recent audits and investigations were not new. This could be a first indication that the Board has a relatively complete overview of the issues at hand. Programmatic results on the whole are very strong, however weaknesses in financial management and systems, procurement and supply management and sub-recipient management continue to be identified. The Sub-Committee noted that while LFA performance in the past has not been as good as it should be, there are some signs that it is improving.

3.9 The Sub-Committee noted that currently there are 12 large investigations ongoing that will take the OIG well into 2012 to conclude. Poor record keeping continues to result in delays to the investigation. Drug theft continues to be a key risk and there is evidence of a sophisticated and organized effort to distribute goods on the black market. There are currently 10 cases ongoing in relation to bed nets ranging across locations and involving either diversion, thefts, counterfeiting, missing nets, or collusion in procurement. The Sub-Committee noted the OIG's comments that the same issues, patterns and levels of misappropriation continue to be found, particularly in the West and Central Africa regions.

3.10 The Sub-Committee inquired as to how the OIG was interpreting the High Level Panel recommendation on turning the page related to concentrating work on Round 6 and subsequent grants. The Sub-Committee noted the explanations from the OIG that in their view, this applied to new work and not existing work. It was also clarified that where suspected fraud is identified in the OIG's work, it will be pursued.

3.11 The Sub-Committee raised the issue of older grants (Pre-Round 6) and the practicalities of pursuing recoveries on ineligible and undocumented expenditure considering the length of time involved and the fact that at the time, the Global Fund and the implementers were in emergency mode. The Sub-Committee recommends that Secretariat and OIG develop a draft process that clarifies who in the Global Fund is mandated to take a final decision in such cases, and through which mechanism the Global Fund could consider writing off amounts on a case-by-case basis for deliberation by the Audit and Ethics Committee.

3.12 The Sub-Committee further noted that there are still ongoing discussions between the Secretariat and the OIG on the issue of categorization of losses and that these matters should be documented for the Audit and Ethics Committee.

3.13 The Sub-Committee also noted that the Audit and Ethics Committee may wish to consider exploring the topic of requesting recipients pay for any additional expenditure incurred by the OIG as a result of a lack of cooperation with the OIG. The Sub-Committee noted that another option and one which is being currently discussed by GAVI is to request payment of the entire Audit or Investigation cost in cases where substantial evidence of misuse of funds is identified.

3.14 The Sub-Committee queried whether it was possible for other partners to contribute resources towards the issue of tackling drug theft given that it was a common problem. The OIG clarified that, while cooperation was ongoing with partners in certain countries, the reality was that the Global Fund, both OIG and Secretariat, were currently the driving force on this issue. The Sub-Committee noted that the OIG's engagement with Interpol on this matter may produce results in this area.

3.15 The Sub-Committee acknowledged the continuing challenge of information sharing and communications on investigations. The Sub-Committee noted that the Secretariat faced challenges in communication when forced to take strong measures to protect assets in

country such as freezing disbursements, without informing the country of the reason, due to the ongoing and sensitive OIG work. The Sub-Committee noted the Executive Director's comments that when the Secretariat takes strong actions based on preliminary OIG evidence, the OIG should make this particular case their highest priority. A query was also raised as to whether OIG reports were looked at by the Legal Unit of the Global Fund before being sent to the Board ahead of their publication.

Investigations

3.16 The Sub-Committee noted the brief overview of the Investigation cases completed in Mauritania, India and Nigeria that are further outlined in the progress update. (GF/FAC17/02)

3.17 The Sub-Committee queried whether French translations were available for Francophone countries and it was clarified that they are in progress.

3.18 The Sub-Committee noted that in two of the investigation cases (Nigeria and Mauritania), there were issues of concern with the LFA work. The OIG clarified that in cases related to earlier grants, the LFAs often take a position that they were not directed to look at the issues that were identified or that their mandate is not to detect fraud. The Sub-Committee did however note that in recent times, the pace of LFA referrals to the OIG has increased substantially and the Secretariat has also taken action to replace or retender LFAs. The Sub-Committee noted that it was too early to judge whether sufficient progress was made with LFAs but that the signs were positive. The Sub-Committee further noted that the LFAs viewed this type of work as high risk and as such, the number of potential LFAs was limited.

3.19 The Sub-Committee noted the OIG's observations that while the Secretariat response to the investigations took longer than anticipated, the OIG was pleased with the responses.

3.20 The Sub-Committee concluded that there was now real consistency in the Investigation reports and it was becoming easier to compare them. They did note that further progress is still required. The Sub-Committee was also pleased with the quality of the Secretariat responses that are also clearer and more consistent and this leads the Sub-Committee to believe that the Secretariat has a strong understanding of the issues and is taking appropriate action.

Audits

3.21 The Sub-Committee considered the eight country audits and the internal review of the Travel and Travel- related Health and Security arrangements at the Secretariat, keeping in mind the issues listed in paragraph 3.1.

3.22 The Sub-Committee welcomed the more detailed commentary in the reports from the Principal Recipients and the Secretariat. It was further noted that there was a much greater attention to the tone and style of the reports.

3.23 The Sub-Committee was pleased to note that the audit of the Dominican Republic was very positive. The Sub-Committee noted that there was no amount to be recovered and that overall, the program was very well managed.

3.24 The Sub-Committee noted the significant weaknesses in financial management, procurement and supply management and in monitoring and evaluation of the Nigeria grants. The Sub-Committee did note the OIG's comments that the actions taken by the Secretariat were immediate and appropriate and that very clear risk mitigation measures had been put in place.

3.25 The Sub-Committee queried the appropriateness of having approximately the same number of recommendations in the Nigeria report as the Dominican Republic report despite significantly different outcomes. The Sub-Committee noted that the OIG does note

the criticality of each recommendation made but will try to feature this more prominently in future.

3.26 The Sub-Committee noted that in relation to Population Services International (PSI), the OIG identified that they are a very well performing PR operating in difficult circumstances. It was further acknowledged that they have strong internal controls. The Sub-Committee did however acknowledge concerns regarding social marketing and initial challenges with access to internal audit reports.

3.27 The Sub-Committee queried whether the recent policy on overheads (Indirect Cost Recovery) approved by the Secretariat was useful, and noted the OIG's comments that it had been very helpful in bringing clarity to an area that was treated inconsistently, but that it was still recent and too early to tell how effective it would be.

3.28 The Sub-Committee noted that it was too early to report progress on recoverable amounts as the audit reports were very recent, however it was noted that the Secretariat will pursue vigorously any recoverable amounts that have been determined by the Legal Unit.

3.29 The Sub-Committee did note the risk that with increasing requirements on implementers, there was a very real risk that some implementers would no longer wish to work with the Global Fund.

3.30 The Sub-Committee noted in relation to the Sri Lanka audit that weaknesses in financial management were present in both the Government and Civil Society PRs. The Sub-Committee noted that progress had been made on implementing recommendations before the report was finalized and that the responses from the country and the Secretariat were satisfactory.

3.31 In relation to the Swaziland audit, the Sub-Committee noted that programmatically, the HIV and malaria programs were strong but that the TB program had encountered difficulties. Severe control weaknesses in financial management were noted and the overall recoverable amount was US\$5.8m. The Sub-Committee noted that the Secretariat was actively working with partners to strengthen grant management capacity.

3.32 The Sub-Committee noted that the review of the travel procedures at the Secretariat identified no major issues of concern. However it was noted that improvements could be made in relation to travel-security and travel-related health procedures. The Sub-Committee further noted that this review was an example of a differentiated report, where the executive summary went to the Board with the detailed report going to the Secretariat where it was most relevant. It was noted that this approach was more akin to how an Internal Audit unit would function.

3.33 In concluding the discussion on audits in general, the Sub-Committee inquired as to the usefulness of the external audit reports in identifying issues highlighted by the OIG. It was noted that to date, they had not been particularly useful. The Sub-Committee noted the comments from the Secretariat that there are limits to the usefulness of external audits (as normally they are focused on giving a "true and fair" opinion on the financial statements, and the primary focus is not on detecting fraud) in relation to identifying misuse of funds and that the focus should be on building the capacity of implementers' Internal Audit functions.

3.34 The Sub-Committee also queried the involvement of development partners and it was noted that the OIG regularly meets with development partners following the audit debrief of the CCM. The Sub-Committee noted that a section on development partners should be included in each audit report.

OIG Initiatives

3.35 The Sub-Committee noted that the OIG had introduced the use of exit surveys following audits as a way of obtaining feedback on the behavior of OIG staff. It was noted that the survey results were generally positive to date, but that to improve the validity of the results, the plan was to introduce follow up surveys following the actual publication of the results and that in future, the surveys could go directly to the Audit and Ethics Committee or a peer institution rather than to the Inspector General.

3.36 The Sub-Committee further noted that a peer based evaluation of the OIG's audit and investigation work (as distinct from the performance review of the Inspector General) had not taken place due to the High Level Panel report, but that a self-assessment was planned in early 2012 followed by such a peer based evaluation towards the end of 2012.

3.37 A query was raised as to whether there was appropriate accreditation of investigators such as the Associated of Certified Fraud Examiners. It was clarified that investigations rely both on technical skills and the experience of the investigators and therefore the current qualifications available do not appropriately cater for the experience elements, and therefore the peer review approach was most used.

3.38 The Sub-Committee recommended that the Audit and Ethics Committee should be involved in determining appropriate KPIs for the OIG and in approving the arrangements for evaluations of the OIG.

3.39 The Sub-Committee further noted the progress made on developing a code of conduct for OIG staff and noted that there should be alignment with the Secretariat on these codes. A case was made for specific provisions in the code of conduct related to investigations. The Sub-Committee supports the development of these codes, noting that they should be consistent between OIG and Secretariat, and should be reviewed by the Audit and Ethics Committee.

3.40 The Sub-Committee was pleased to note that the OIG had provided training at regional meetings and were considering staying on in country for an additional day following audit work to provide training.

OIG Workplan

3.41 The Sub-Committee noted that the 2012 OIG workplan was based on a combination of their own analysis of risk, the risk matrix developed by the High Level Panel, and feedback from the Secretariat.

3.42 The Sub-Committee noted that the OIG has planned for ten country audits, eight diagnostic reviews and four Secretariat reviews, noting that two of the four are follow up reviews of prior work. The Sub-Committee noted that this represented a reduction on the 2011 workplan of 15 country audits and ten diagnostic reviews, while the OIG was requesting a budget increase.

3.43 The Sub-Committee noted the explanation from the OIG that the workplan was based on a more realistic assumption of what was achievable given the need to focus on timeliness and quality of the reports.

3.44 The Sub-Committee queried whether it would be more appropriate to carry out more diagnostic reviews to obtain a wider but less intensive coverage of the portfolio. It was clarified that the results from diagnostic reviews to date were generally positive but that it was too early to evaluate their effectiveness. It was further noted that the level of assurance the OIG can provide would be limited by having too few country audits, and that what was proposed in the 2012 plan was the bare minimum necessary.

3.45 The Sub-Committee requested clarifications on the expected progression of the OIG budget into 2013 and 2014 similar to what the Secretariat had provided and additional

details on the breakdown of grades and typical costs of OIG staff. It was further noted that additional information on the implications of the investigations work would be helpful to understand better the budgetary increase proposed.

3.46 The Sub-Committee determined that the additional details should be provided to FAC for review and input, and that the detailed review of the OIG budget should be performed by the Chair and vice-Chair of FAC with a representative of the World Bank, with full consultation with the Committee members before finalizing the decision, as had been proposed the previous year. This would ensure an appropriate review but maintain the independence of the OIG as it would not be appropriate to have the Secretariat review the OIG budget.

PART 4: Secretariat Update on OIG Matters

Information

4.1 The Sub-Committee noted the Secretariat Update on OIG Matters (GF/FAC17/03) which focused on the relationship between the Secretariat and OIG, the protocols and methods of working together, and finally how the Secretariat was responding to OIG recommendations through the Consolidated Transformation Plan (CTP).

4.2 The Sub-Committee noted that the paper from the Secretariat outlined the progress on all audits and investigations to date, noting that some of the reports are very recent and therefore progress was not expected to be significant at this stage on implementing recommendations. The Sub-Committee further noted that the cross cutting recommendations from the OIG are incorporated within the CTP.

4.3 The Sub-Committee acknowledged the significant amount of work involved in responding to OIG recommendations at a time when the Secretariat was being challenged to develop and deliver on the CTP and conduct its regular operations of signing grants and making disbursements. The Sub-Committee highlighted that it was important that with all this work, that individual recommendations on OIG reports do not get forgotten about.

4.4 The Sub-Committee noted that the Secretariat was being more proactive to address the challenges it faces on pharmaceutical procurement by increasing the use of Voluntary Pooled Procurement or outsourcing to procurement agents as short term measures while capacity of PRs is built with the support of partners.

4.5 The Sub-Committee noted that the OIG and the Secretariat did not have sufficient time to adequately review and respond to each other's reports in advance of the meeting but that the discussions were a fair reflection of progress.

4.6 The Sub-Committee concluded that the issue of the Board having more time to review audits and investigations would need to be addressed by the Audit and Ethics Committee. The Sub-Committee also noted the repeated concerns of the OIG regarding the ability to recruit, retain and reward OIG staff and encouraged the Inspector General and the Executive Director to explore opportunities to resolve this, and failing that to bring this matter back to the Board.

Part 5: Losses and Recoveries from OIG Audits/Investigations

Information

5.1 The Sub-Committee was presented with a draft paper at the meeting (GF/FAC17/04) that addresses the communication and presentation of losses and recoveries arising from OIG audit and investigation reports as outlined by the Board in decision point GF/B23/DP28. The Sub-Committee noted that this was a joint paper prepared by the OIG and the Secretariat.

5.2 The Sub-Committee noted that the report contained two tables. Table 1 included the information on losses and recoveries previously presented to the Board in May 2011. The Sub-Committee noted that to date, close to US\$19 million has been recovered or accounted for and commended the Secretariat for progress in this area.

5.3 The Sub-Committee noted that Table 2 contained the most recent audits and investigations published by the OIG which were released a week before the FAC Sub-Committee meeting. Following the Sub-Committee meeting, the Legal Unit has made a determination on the recoverable amounts in line with GF/B23/DP28 and has presented this confidential determination to the Chair of the Board, Chair of FAC, Executive Director, Deputy Executive Director, and the Inspector General. The Sub-Committee noted that the information is kept confidential to ensure that any legal claims for recovery are not jeopardized due to differences in OIG reported losses and the Global Fund's determination on what can be actually recovered.

5.4 The Sub-Committee was pleased to note the intention of OIG and the Legal Unit to engage as early as possible in the development of the audit/investigation reports to ensure that the Global Fund Legal Counsel has an opportunity to provide analysis of the recoverable amounts prior to finalization of the OIG report. In this way, any differences between the OIG and the Legal Unit on the recoverable amounts should be reduced and the timelines shortened.

5.5 The Sub-Committee noted that there is a difference between a loss and a recoverable amount and therefore it is to be expected that such differences between amounts reported as lost and amounts reported as recoverable exist. The Sub-Committee also acknowledged that the OIG and Secretariat may have differences in view of what is a loss namely around issues such as ineligible expenses and that this is a sensitive matter that will need to be managed. The Sub-Committee expects that these matters will be addressed in the protocols currently being developed between the OIG and Secretariat. The Protocols could also be the appropriate vehicle to address the issue of recoverability in cases where it is not a realistic prospect that funds will be recovered and therefore may need to be written off (as also highlighted in 3.11).

PART 6: Privileges and Immunities

Information

6.1 The Sub-Committee was presented with an update on Privileges and Immunities. (GF/FAC17/22) The Sub-Committee noted that the paper was developed by the OIG with valuable input from the Legal Unit.

6.2 The Sub-Committee noted the risks and concerns raised in the paper and the reality that there is no real solution to many of the risks faced other than obtaining privileges and immunities. The Sub-Committee noted that the High Level Panel had identified the risks from not having Privileges and Immunities.

6.3 The Sub-Committee requested information on the challenges faced to date and noted that there had been some "close calls". The Sub-Committee further expressed the wish that these matters should be acted on now and that the Global Fund should not wait until an actual serious incident occurs before reacting.

6.4 The Sub-Committee noted the Executive Director's determination to engage on these matters.

6.5 The Sub-Committee supports the recommendations of the High Level Panel on Privileges and Immunities and the potential actions outlined in the paper to achieve implementation of the recommendations. The matter will be brought to the attention of the Board.

PART 7: UNDP

Information

- 7.1. The Sub-Committee noted that discussions were ongoing between the Secretariat and UNDP regarding the possibility of coming to an agreement on the use of a similar means of verification of information as is currently allowed with the European Commission. This arrangement is known as the Financial and Administrative Framework Agreement (FAFA).
- 7.2. The Sub-Committee noted that the FAFA allows access to underlying documentation that supports certain transactions that can be examined on a sample basis for the purpose of verification, and that the Secretariat had a similar arrangement in place with UNOPS who are a Principal Recipient in Myanmar. It is therefore expected that agreeing to such an arrangement will not pose a significant problem for UNDP.
- 7.3. The Sub-Committee noted that the OIG will also work with the Secretariat on FAFA given that the OIG would equally have an interest in this matter.
- 7.4. The Sub-Committee noted that now that access to UNDP audit reports was available, there was a need to finalize the protocols on such access. It was noted that the OIG had obtained access to audit reports by physically viewing them at UNDP HQ but that arrangements were being made to provide electronic access.
- 7.5. The Sub-Committee did not discuss UNDP matters further as the Inspector General had not had an opportunity to read a very recent communication from the UNDP Administrator, Helen Clarke.

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. Voluntary Dispute Resolution Process | GF/FAC17/23 Voluntary Dispute Resolution Process |
| 3. OIG Progress Update | GF/FAC17/02 OIG Progress Update |
| 4. Secretariat Response on OIG Matters | GF/FAC17/03 Secretariat Response on OIG Matters |
| 5. Losses and Recoveries from OIG Audits/Investigations | GF/FAC17/04 Losses and Recoveries from OIG Audits/Investigations |
| 6. Privileges and Immunities | GF/FAC17/22 Privileges and Immunities |
| 7. UNDP | No Document |