

**FINANCE AND OPERATIONAL PERFORMANCE COMMITTEE DECISIONS AND
RECOMMENDATIONS TO THE BOARD**

PURPOSE:

This report serves to inform the Board about decisions taken by the Finance and Operational Performance Committee (FOPC) in accordance with its Charter. It also includes FOPC recommendations to the Board. This report incorporates the FOPC deliberations at the meeting held on 8 May, 2012.

PART 1: INTRODUCTION

1.1 Since its establishment by the Board in November 2011, the Finance and Operational Performance Committee (FOPC) met three times. First, on 9-10 February 2012, the FOPC convened to discuss ways of working and initiate a preliminary discussion on the FOPC priorities and work plan. The meeting also served as an introduction to the Global Fund for new members as well as an induction for new and returning members to the new governance system established by the Board in November 2011.

1.2 The second FOPC meeting took place on 27-28 March 2012. Part of the meeting was held as a joint session with the Strategy, Investment and Impact Committee (SIIC). The Chair's Summary Report was sent to the Board on 16 April, 2012 and is accessible on the Governance Extranet (<https://extranet.theglobalfund.org/board/governance/Pages/default.aspx>) at this [link](#).

1.3 The FOPC held an additional meeting on 8 May, 2012 to deliberate on the 2011 audit and other additional issues.

1.4 This report presents to the Board two decisions taken by the FOPC in accordance with its Charter¹. One decision relates to the honorarium for independent members of the Audit and Ethics Committee. The other decision relates to the approval of the transfer of up to USD 7.6 million from the Global Fund to the Provident Fund. It also reports on the Forecast of Uncommitted Assets presented by the Secretariat to the Board and for which the FOPC has oversight responsibility as per its Charter. The report also makes two recommendations to the Board. First, the FOPC recommends that the Board endorse the 2011 Annual Report and Audited Consolidated Financial Statements. Second, the FOPC decided to recommend that the Board delegate to the FOPC the authority to determine when the Secretariat or the FOPC could approve budget adjustments that do not result in an increase to Board-approved Operating Expenses Budget for any financial year.

PART 2: DECISIONS TAKEN BY THE FOPC

Information

Honorarium for the Independent members of the Audit and Ethics Committee

2.1 At its 2nd meeting in March 2012, the FOPC was requested by the Coordinating Group to consider and recommend to the Board an appropriate honorarium for the independent members of the Audit and Ethics Committee (AEC). This was requested having regard to the FOPC's role in oversight of the financial management of Global Fund resources. The question was considered in the broader context of remuneration across governance and advisory bodies. The Committee considered the current honorarium arrangements for the Technical Review

¹ The FOPC Charter and other Core Governance documents are available at the following link : <http://www.theglobalfund.org/en/about/structures/board/>

Panel (TRP) and the Technical Evaluation Reference Group (TERG), and information provided to the FOPC on arrangements known in regard to the Audit Committee of the World Bank, a number of UN agencies, and GAVI.

2.2 Committee members believed it is important to undertake a comprehensive review of the remuneration and honorarium arrangements across the governance and advisory bodies of the Global Fund. They agreed to recommend a broader policy for Board approval at its November meeting. On an interim basis, the Committee agreed to recommend to the Board an honorarium for independent members of the AEC for the balance of the 2012 calendar year that was equivalent to the TRP arrangements of US\$ 14,000 for the Chair, and US\$ 9,000 for other members, instead of US\$ 20,000 for the Chair and US\$ 15,000 per annum for other members as initially recommended by the AEC Vice-Chair. Further, it was decided that if the review and recommendations at the end of the year resulted in a determination that the full annual honorarium for independent members should be increased, that should be applied retroactively to the start of the AEC independent member terms.

2.3 On 16 April 2012, the Board approved the appointment of five AEC independent members by electronic vote (GF/B25/EDP18), and based on the FOPC decision, approved an honorarium for the period April to December 2012 of US\$ 14,000 for the independent Chair of the AEC, and US\$ 9,000 for other independent members of the AEC. The Board noted in its decision that the FOPC will bring to the November 2012 Board meeting a comprehensive remuneration and honorarium strategy across the Global Fund's governance and advisory entities.

Other matters

2.4 Due to changes at the Secretariat, the FOPC was unable to render decisions on the Key Performance Indicators, and have requested that such decision be postponed until the November Board meeting.

2.5 The outcomes of the review of the replenishment mechanism will be ready by the end of June 2012. The FOPC will therefore deliberate later on and prior to the September mid-replenishment meeting.

PART 3: FORECAST OF UNCOMMITTED ASSETS

Information

3.1 Following the cancellation of Round 11 in November 2011 due to a downward revision of the forecast of assets as presented to the Board by the Secretariat, the Board had requested the Secretariat to develop a regular and reliable process to inform the Board of the Global Fund's financial situation. As requested, the Secretariat presented to the FOPC at its 2nd meeting in March 2012 a proposal for a new forecasting methodology to be implemented to provide monthly updates to the FOPC.

3.2 On 3 May 2012, the FOPC held a teleconference to jointly review the draft Forecast of Uncommitted Assets and provide for members to ask questions, make comments and obtain clarifications. It was emphasized that while the Forecast of Assets spreadsheet is of critical

importance to the Global Fund in making future funding decisions, the Forecast is just one part of a suite of financial analyses that will need to be consulted for the Board to obtain a comprehensive picture of the overall financial health of the Fund. It was also underlined that the first forecast update was considered to be an early version to be refined over time based on improvements to the forecast methodology.

3.3 Additionally, an information session was held during the FOPC meeting on 8 May 2012 to discuss the new format used for the Forecast of Uncommitted Assets. The new methodology was described as a bottom-up and cross-Secretariat forecasting approach. It involves various levels of accountability at the Secretariat and cross-team collaboration to collect the data. Compared to the past model, it also includes a greater degree of granularity and predictability as it is based on written confirmations from donors regarding payment schedules.

3.4 The FOPC concluded that they are comfortable with recommending the methodology to produce the forecast of assets, and again restated that this is the first iteration of the forecast to be shared with the FOPC on a monthly basis.

3.5 The FOPC agreed that the tool should be tested for at least four months to assess the level of volatility of the forecast.

3.6 The FOPC also agreed that a USD 500 million reserve should be kept as a contingency fund to take into account uncertainties related to donor contributions, foreign exchange and grants de-commitments or disbursement schedules, but this amount will have to be periodically reviewed to ensure this is a valid threshold.

3.7 While the FOPC will be testing the new methodology, the SIIC will be asked to develop new investment proposals in line with the 2012-2016 Strategy and the new funding model. The FOPC and the SIIC will first be working in parallel and then come together no later than September to issue funding recommendations.

PART 4: AUDITED FINANCIAL STATEMENTS

Decision

4.1 The auditors from Ernst & Young presented to the FOPC the 2011 Audited Financial Statements and the audit opinion. The auditors reported that the accounting closing process was problematic due to IT systems' deficiencies, which explains delays incurred in delivering the management letter to the Secretariat. Despite these difficulties Ernst & Young confirmed that they were able to issue an unqualified clean audit opinion on the 2011 Consolidated Financial Statements of the Global Fund. Major issues raised in the auditors' conclusions include control deficiencies occurring in the grant accounting process and the migration to the new Oracle IT system which is not yet fully operational. Auditors noted that internal control systems are in place though they are still ineffective for grant processes and need to be revisited.

4.2 The auditors noted that out of the twelve management letter points raised during the 2010 audit, six had been addressed during 2011, and that they had identified nine new management

letter points during the 2011 audit. Major open points include ineffective controls over grant accounting and reporting processes, audit matters in relation to the accounting of foreign currency gains and losses, the need to consider issuing a separate statutory financial statements to comply with Swiss law, and the need to improve the accounting closing process and disclosures for better clarity and comprehension of financial statements by the public.

4.3 Due to delays in the closing process, the FOPC is expected to receive the comprehensive audit report including the management letter and the draft response from the Secretariat four to five weeks following the 26th Board meeting. As part of its oversight functions, the FOPC raised the need to track improvements to be implemented by the Secretariat to address the issues raised in the auditors' 2011 management letter and open points from the past year. The FOPC will expect an update at its meeting in the fall in advance of the 27th Board meeting. In particular, with regards to the auditors' recommendation to urgently redesign and implement grant processing IT tools able to reconcile the grant database with the World Bank statements and the accounting system, the FOPC requested the Secretariat to report on progress made to implement the new IT system. Of note, the Secretariat has put in place an IT plan and convened an Executive Senior IT committee in order to address these issues.

4.4 The Secretariat informed the FOPC that in addition to the standard management representation letter to be provided by the Secretariat, the auditors have requested an additional representation letter to be signed by the Board Chair on behalf of the Board to indicate if there were material decisions taken during closed executive sessions of the Board, they have been accurately reflected in the consolidated financial statements. Additionally, the representation indicates the Board's acknowledgment of their responsibility to provide true and fair consolidated financial statements in accordance to relevant accounting requirements. The decision point was amended to reflect this acknowledgment by the Board and to form a basis for the Board Chair to make the representations sought by the auditors. The representation letters to be provided by Secretariat management and the Board Chair on behalf of the Board are important factors in the auditor's ability to give an unqualified audit opinion.

4.5 Following the discussion, the FOPC adopted the Decision Point recommending the Board to approve the 2011 Consolidated Financial Statements, as follows:

Decision Point 1: Approval of the 2011 Annual Report and Consolidated Financial Statements

1. The Board acknowledges:

- a. its responsibility for the true and fair presentation of the Consolidated Financial Statements; and**
- b. the 2011 Consolidated Financial Statements, which have been audited by Ernst & Young Ltd, give a true and fair view of the financial position, results of operations and cash flows of the Global Fund in accordance with International Financial Reporting**

Standards, and are free of material misstatements, including omissions.

2. The Board approves the 2011 Annual Report and the 2011 Consolidated Financial Statements of the Global Fund as presented in GF/B26/06.

This decision does not have material budgetary implications for the 2012 Operating Expenses Budget.

**PART 5: DELEGATION OF AUTHORITY
CONCERNING RECOVERY OF GRANT FUNDS AND RESOLUTION
OF RELATED CLAIMS**

Information

5.1 At its 2nd meeting on 27-28 March, the FOPC was presented a request for a Board delegation to the Secretariat of the responsibility and authority to: (a) design procedures and processes for the recovery of misused or mismanaged grant funds; and (b) negotiate and approve arrangements concerning the recovery of grant funds and resolution of related claims. The FOPC requested the Secretariat to recirculate the proposed paper and decision point to reflect the discussion of the Committee and expressed the need to consult with the Audit and Ethics Committee on matters within its remit around OIG work processes, communication protocols and the Voluntary Disclosure Resolution Process, to inform its recommendations to the Board.

5.2 After further deliberations within the Secretariat, the Secretariat decided on an alternative approach to accomplishing the intent in the proposed Decision Point on the Delegation of Authority Concerning Recovery of Grant Funds and Resolution of Related Claims. It has been agreed that before seeking additional authority the Secretariat would use existing authority over day-to-day operational responsibilities to pursue timely and comprehensive recovery of grant funds that may have been misused or mismanaged. The Secretariat has agreed with the OIG that the Legal and Compliance Department should evaluate all proposed losses as early as possible so that OIG reports can be issued in a timely manner and so there is a clear and consistent determination of recoverable amounts. In accordance with their respective roles and responsibilities, the Secretariat and the OIG agree that once a OIG final report is issued, the Secretariat has the responsibility to pursue recoverable amounts and resolve claims.

5.3 The Secretariat noted that a Decision Point had been proposed as a means to establish appropriate delegation to assure a timely and appropriate use of all available tools to recover funds. The Secretariat will first pursue this matter within its existing authority and assess whether or not additional guidance or clarification from the Board or appropriate Committee(s) will be necessary in the future.

PART 6: RESOURCE MOBILIZATION

Information

6.1 At the supplementary FOPC meeting on 8 May 2012, the Secretariat provided an update on Resource Mobilization and informed that intense activities had taken place in the past weeks, including visits to capitals that demonstrated renewed confidence from donors. Several events will provide further opportunities to re-establish confidence in the Global Fund including from implementing countries. A side-event will be organised on 21 September 2012 during the UN General Assembly as a platform for donors to renew their commitment to the Fund and announce new commitments in the form of additional commitments, increased counterpart financing from implementing countries or other innovative forms of contributions. The Secretariat requested support from the FOPC to encourage high level political commitment towards health MDGs from traditional donors and emerging economies. The General Manager emphasized the new concept of leveraging funds with bilateral partners, implementing countries and other financial institutions, as innovative approaches paving the way towards a successful replenishment in 2013.

PART 7: PROVIDENT FUND

Decision

- 7.1 The Global Fund Provident Fund (the “GFPP”) became effective on 1 January 2009 as a defined benefit plan to provide employees of the Global Fund with retirement, death and disability benefits. The GFPP was not established as a separate legal entity from the Global Fund.
- 7.2 The Secretariat explained how GFPP assets, including amounts accrued by employees under a separate pension fund in addition to subsequent employee and employer contributions, were held in US Dollar (USD) accounts. This exposed GFPP assets to foreign exchange risk because GFPP employee benefits are paid in Swiss Francs (CHF).
- 7.3 After a series of transactions between October 2010 and November 2011 to move amounts held in USD accounts into CHF accounts, the GFPP recognized a foreign exchange loss of approximately USD 7.6 million. The Finance and Audit Committee (the “FAC”) deliberated on the matter in October 2011 and requested further analysis to be conducted by the Secretariat. Additionally, the Office of the Inspector General expedited an in-progress audit of the GFPP. The GFPP Management Board and the Secretariat each hired separate external legal counsel to review the matter.
- 7.4 The Secretariat’s external legal counsel briefed the FOPC on potential legal and reputational concerns, including a summary of legal precedents under the International Labour Organization Administrative Tribunal (ILOAT). Accordingly, the Secretariat recommended that the FOPC approve a payment of up to USD 7.6 million from the Global Fund to the GFPP upon final determination of the actual amount of the foreign exchange loss. The Secretariat acknowledged previous analysis requested by the FAC and agreed to conduct such analysis before making a final determination on the actual amounts to be paid to the GFPP. The analysis would include a comparison of possible gains from assets held in USD

versus foreign exchange losses based on the amounts and exchange rates at the time of each currency transaction. The Secretariat assured the FOPC that the payment would not result in an increase in the 2012 operating expenses budget approved by the Board at its Twenty-Fifth Meeting in November 2011.

- 7.5 The FOPC discussed the administrative, governance and other factors that may have contributed to the foreign exchange risk and loss. The FOPC deliberated whether additional review of the structure of the GFPF should be undertaken going forward. The FOPC determined it was within their authority to approve the Secretariat's request because the amount to be paid to the GFPF would be within the operating expenses budget approved by the Board for 2012.
- 7.6 The FOPC considered whether the unique nature of the budget allocation was such that a decision should be taken by the Board irrespective of the Secretariat's indication its request would not increase the Board-approved operating expenses budget. Nevertheless, the FOPC decided it was not only within their authority to take such a decision, but also consistent with the first phase of governance reforms. Taking the decision at the committee level would free the Board to focus on strategic decisions and broader principles rather than detailed operational issues.
- 7.7 The FOPC decided to approve the Secretariat's recommendation and asked that the Secretariat prepare a plan to review and propose changes to the structure of the GFPF.

FOPC03/DP1: Approval of Payment to the Global Fund Provident Fund

- 1. The Finance and Operational Performance Committee (the "FOPC") approves the exceptional one-time transfer of up to USD 7.6 million from the Global Fund to the Global Fund Provident Fund to restore the recognized loss in GFPF asset value due to foreign exchange fluctuations. The Secretariat shall conduct additional analysis to determine the actual amount to be paid to the Global Fund Provident Fund and inform the FOPC of such determination prior to making the payment. This decision shall not result in an increase in the 2012 Operating Expenses Budget approved by the Board (GF/B25/DP15).***
- 2. The FOPC further requests that the Secretariat prepares and submits to the FOPC within 30 days of this decision a proposed plan to review and reform the administrative and governance structure of the Global Fund Provident Fund.***

This decision has a budget implication of up to USD 7.6 million, which will be absorbed within the 2012 Operating Expenses Budget.

7.8 The FOPC broadened the Provident Fund discussion to discuss the mechanics of exercising their authority to render decisions on budget adjustments that do not result in an increase in the operating expenses budget approved by the Board for any financial year. The FOPC considered the Secretariat's need through the course of a financial year to make certain budget adjustments, reallocations or additions based on operational needs. Discussions focused on the need to have clarity on when the Secretariat could make such decisions and when approval would have to come from the FOPC, provided such decisions would not result in an increase to the Board-approved operating expenses budget. The Secretariat reiterated that the FOPC has authority to approve certain budget reallocations or adjustments within the Board-approved operating expenses budget, but additional clarity would assist both the FOPC and Secretariat in managing actual expenditures.

7.9 Based on the analysis and discussion provided above, the FOPC decided to recommend the following Decision Point to the Board.

Decision Point 2: Decision-Making Authority on Adjustments within the Operating Expenses Budget

1. The Board affirms the Finance and Operational Performance Committee (the "FOPC") is authorized to approve operating expenditures that do not result in an increase in the amount of the Board-approved operating expenses budget for any financial year.

2. The FOPC is authorized to establish a framework to determine when decision-making authority on adjustments, reallocations or additions to the operating expenses budget may be taken by the Secretariat or FOPC provided that:

a. such decision does not result in an increase in the operating expenses budget approved by the Board for the relevant financial year;

b. the FOPC shall consult with the Secretariat to develop appropriate criteria and thresholds within such criteria to establish this decision-making framework; and

c. decisions taken by the Secretariat shall be reported to the FOPC and decisions taken by the FOPC shall be reported to the full Board.