Audit Report

Global Fund Treasury Management

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The Global Fund
Office of the Inspector General

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I. Executive Summary

Treasury covers the management of cash and liquidity, asset and liability, foreign exchange and investments. These activities are critical given the nature of the Global Fund multi-currency funding model. Adequate and effective treasury management processes and controls ensure that the organization's financial asset are safeguarded and sufficient cash is available to disburse to recipients. Treasury activities are therefore an essential element in mitigating the Global Fund's financial risks. At the same time, these activities also involve complex processes and transactions that, if not managed adequately, can have material adverse consequences on the organization's financial position.

Before 2014, treasury activities at the Global Fund were mostly non-existent. Since the approval in 2014 of the amended Comprehensive Funding Policy (CFP), the Secretariat has made significant progress in the development and implementation of a fully established and operational treasury function with an appropriate level of people, processes and systems. Coming from a zero base, the treasury function is fully staffed with professionals that have extensive qualifications and experience in treasury management. The Secretariat has also significantly enhanced its ability to manage its own grant and operational expenditure payments, with the establishment of five commercial banking relationships. Two additional relationships are expected to be finalized by the end of 2016.

The Secretariat has ensured that the increase in its treasury activities is supported by adequate technology such as the use of a payment processing system, which interfaces directly with the commercial banks. Most recently, an online trading platform, which gives it access to the most competitive prices when performing its trading activities has been introduced. The Secretariat has also been proactive on the implementation of security controls to ensure that payments are executed in the most secure manner.

Comprehensive frameworks have been developed to support the CFP. In particular, risk limits for the execution of foreign exchange transactions have been defined in line with best practice through the Global Foreign Exchange Framework. Those limits and broader portfolio monitoring are supported by appropriate statistical tools to reduce the foreign exchange risk faced by the organization. Within three months of the framework being approved in June 2016, the treasury team operationalized all aspects of the framework into foreign exchange activities conducted by the Global Fund. The treasury function is also supported by a financial services team and accounting team who work closely to ensure that effective controls exist across the full treasury lifecycle, from trade initiation to recording and reconciliation.

Overall, the Global Fund has established, in a relatively short timeframe, a well-functioning treasury function. The audit did not identify any material weaknesses or process failures. Whilst some significant risks and process improvement points which require management attention have been identified in this report, these should be evaluated in the context of a relatively new function built almost from scratch and still evolving.

This audit of Treasury Management sought to provide independent assurance to the Board on the adequacy and effectiveness of the governance, risk management and internal controls over the treasury activities. In the context of an evolving Treasury function at the Global Fund, with no exceptions identified in the detailed audit testing performed, the OIG concludes that the governance, risk management practices and internal controls are adequately designed and generally well implemented.

Notwithstanding this, various issues have been identified around governance and risk management, foreign exchange management and asset and liability management. These issues related, in particular, to independent oversight over trading activities for foreign exchange management, documentation of key controls, and formalization of processes. In forming its overall assessment, the

OIG has considered a combination of factors, including: the nature of these issues and the risks they present, the current level and complexity of trading activity, and the evolving nature of the treasury function. In a different context involving a mature financial institution with more significant trading volume using complex financial instruments, the combination of issues identified in this report (lack of trading limits, undefined counterparty exposure limits, and non-formalized independent oversight processes) would have been considered a significant deficiency.

However, in the specific context of the Global Fund, the OIG took into account the following factors in its overall assessment: firstly, the treasury function, which was non-existent until recently, is still being developed and the formalization of all processes requires time; secondly, the volume of trading activity at the Global Fund is relatively limited and non-complex in relation to other financial institutions. This is despite a peak of fundraising activities during a short window following the Global Fund's 5th replenishment in September 2016. Thirdly, OIG detailed testing of a significant sample of transactions, representing over 20% of the value of trades, identified no material exceptions, suggesting that controls are operating although they may not always be formalized. Whilst the overall audit ratings reflect these factors, it is critical that the Secretariat address the issues identified in this report and mitigate all the identified risks, as the consequences of risks materializing in this area would most likely be material.

Governance and Risk Management

All key treasury activities are conducted within an overarching framework that has been reviewed and approved by the Audit and Finance Committee. The framework includes appropriate financial safeguards to protect the assets of the Global Fund. The OIG review did not identify any departures from those safeguards and testing of controls did not result in any material exceptions. Governance and risk management were therefore found to be partially effective with the following issues identified that may present a moderate risk to the achievement of key treasury management objectives:

- There is limited formalization of independent oversight over treasury activities. Since July 2016, the Recoveries Officer acts as a risk control officer. He currently reports to the Head of Treasury and not to the Risk Management Department which would ensure independent monitoring and oversight. In addition, he does not have independent access to the relevant information to perform monitoring over the risk limits, called Value at risk (VaR), set by the organization to guide the execution of the foreign exchange transactions conducted by the Secretariat. The Secretariat has indicated that independent access to this information has now been provided to the risk control officer after the audit. Although he monitors the VaR limit breaches and counterparty limits, his duties do not include checks of trades completed against the approved hedging strategy, which is a typical control performed by a risk control officer. Finally, his terms of reference have also not been formalized to ensure accountability for the required checks performed.

- Similarly the Chief Risk Officer, who also has a role of risk manager to the treasury function, plays a key oversight part in monitoring the VaR limits; however, he is fully reliant on the information provided by the treasury function without having independent access to it. There is also a risk of key person dependency as the Chief Risk Officer is currently the only member in the risk management function with sufficient knowledge and experience to review treasury activities. The OIG also noted that current processes and controls for the execution of currency swaps performed for cash management purposes are not separately documented in the Treasury Management Procedure document. These transactions accounted for more than half of the trading value (54%) between October 2015 and September 2016, amounting to US$2.99 billion. However, the OIG did not identify any control exceptions in the way these transactions were executed.

Foreign Exchange Management

The Global Fund uses US Dollars as its functional and reporting currency. As a result, foreign exchange risk arises due to some of the Global Fund's financial transactions. For example, donor contributions and grant liabilities are denominated in currencies other than US Dollars which may fluctuate on the markets. The Global Fund started managing this risk in 2015 with hedging activities performed over its on-balance sheet exposures (committed assets and liabilities) to mitigate the risk of losses arising from foreign exchange fluctuations. In June 2016, the Audit and Finance Committee approved foreign exchange hedging over off-balance sheet exposures (uncommitted assets and liabilities) in anticipation of the 5th replenishment.

The OIG tested in detail hedging transactions conducted by the Secretariat in 2016. No exceptions were noted from the initiation of the hedge and the appropriate approval of the hedging strategy to the execution of the trade in the trading platform and final recording and settlement of the hedge in the treasury system. The OIG concludes that foreign exchange management is partially effective due to the following risks and controls identified that require the attention and action of the Secretariat:

- Trading limits for traders have not been defined and built into the system as a preventative control to safeguard and protect the organization's assets. Although the OIG did not identify any unauthorized trading, the absence of limits reduces management's ability to mitigate the risk of such unauthorized trading.

- The policy requires counterparty limits to be in place; however, no such limits have been defined by the Secretariat. In the past year, around 70% of all trades executed were with only two counterparties. In this context, the OIG noted counterparty limits have been difficult to define in the past years as limited commercial banking opportunities existed. However, the Secretariat has recently expanded its commercial banking base, resulting in counterparty split ranging between 15% and 25% by gross exposure across five counterparties as of 30 November 2016.

The need for multi-currency disbursements (MCDs) to countries was identified by the Secretariat as a mechanism to mitigate the foreign exchange risk faced by grant countries by matching the disbursements with the currency of the incurred expenses of Global Fund programs. Although approved by the Global Fund Board in June 2014, MCDs are yet to be operationalized. Whilst treasury, financial services and accounting teams have developed, tested and are ready to implement the solution to disburse in local currency, much work is needed at the functional and operational level before MCDs can be rolled out across the Global Fund portfolio. Significant change management processes have not started around internal grant management processes as well as dialogue with in-country implementers and country coordinating mechanisms in recipient countries. MCD's needs to be prioritized by the Secretariat in order to operationalize the Global Fund Board decision. This should include updates to key systems and processes supported by sufficient change management initiatives. In addition, the Global Fund will need to evaluate the current hedging policy and limits to ensure that it remains fit-for-purpose as it moves towards full implementation of MCDs. If this is not performed, foreign exchange risk will remain with the implementers for the 2017 – 2019 implementation period as the current window for change is very short with the next phase of grant making starting in Spring 2017.

Asset and Liability Management

Asset and Liability Management (ALM) is the mechanism by which the Secretariat matches the notional Sources and Uses of Funds on an aggregated portfolio basis for an Allocation Period. Historically ALM was not performed by the Secretariat as there were no tools in place. Nearing the end of the current allocation period (2014 – 2017), the Secretariat has developed processes and systems for active ALM, including defining and operationalizing the methodology to calculate both sources and uses of funds. The OIG concludes that ALM is partially effective with the following moderate risks identified:

- Whilst processes and controls are in place to calculate sources of funds, these have not been formalized and documented sufficiently. The forecasting and budgeting process for grant expenditure is a key input for determining the uses of funds or liabilities amount in ALM. The processes and controls are adequate in design, but are not operationally efficient and effective as forecasted amounts are consistently and materially different from the actual expenditures. This forecasting process is critical to ALM. It results in key decisions being taken about the allocation of funds to countries over the implementation period. In this context, the OIG noted that the effectiveness of this process is limited by the accuracy of data provided by Principal Recipients and country teams in grant management. However the trend has improved over the past year and the position taken by the Secretariat is a conservative one with the risk of over commitment of funds being low, which is the primary objective of ALM.

Cash, Liquidity and Investment Management

Key objectives and financial safeguards set out in the CFP include preserving asset value and maintaining adequate liquidity to ensure that funds are available to disburse to recipient countries and maintain the operations of the Global Fund. The Secretariat executes this objective through cash, liquidity and investment management activities.

The OIG concluded that cash, liquidity and investment management processes and controls are adequately designed, consistently well implemented, and effective to provide reasonable assurance that the objectives will be met. The OIG did not identify any significant issues in these areas.

II. Background

The Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Global Fund") is an international organization formed under the laws of Switzerland in 2002. The purpose of the Global Fund is to attract and disburse additional financial resources to prevent and treat AIDS, tuberculosis and malaria. The Global Fund receives pledges from donors (mainly national governments and private foundations) in various currencies; however, the functional and reporting currency is United States Dollars. As a result, the Global Fund is exposed to the variations in the market values of the various currencies. Therefore, careful and prudent management of its financial assets and liabilities is integral to the successful mission of the organization.

In March 2014, the Board approved an amended CFP. This amendment marked a fundamental shift in treasury oversight at the Global Fund, and mandated the Secretariat to transfer selected treasury management activities from the World Bank, its Trustee, to a treasury team within the Secretariat. A treasury function was established along with the development and implementation of a clear set of policies and procedures to guide, direct and reduce risks inherent to treasury activities.

The CFP includes **three specific financial safeguards** which aim at promoting robust financial management practices. These are:

i. the maintenance of an optimum balance between notional assets and notional liabilities over a fixed three-year period for the purposes of ALM;
ii. the matching of eligible assets and eligible liabilities, in value and over a rolling one-year period, for purposes of Cash Management; and
iii. a minimum liquidity reserve to enable full and timely payment of liabilities for purposes of Liquidity Management.

The areas of focus of the CFP that fall within the scope of the Treasury Management function include:

Asset and Liability Management
Every three years, donors convene at a replenishment conference to pledge financial resources to the Global Fund for the subsequent period. Announced replenishment results, subject to certain adjustments,[1] form the basis for establishing the Sources of Funds for the Global Fund for a given Allocation Period after endorsement from the Audit and Finance Committee. The Board then, based on the recommendations of the Audit and Finance and Strategy committees, apportions these amounts to the approved Uses of Funds (allocation of funds to eligible countries).

ALM is the mechanism of regularly matching the Sources of Funds to the Uses of Funds on an aggregated portfolio basis for an Allocation Period to ensure that the forecasted Uses of Funds do not exceed the Sources of Funds. The Treasury Management function housed within the Finance Division at the Secretariat is responsible for maintaining a balanced ALM forecast and report to the Audit and Finance Committee on additional adjustments as required to ensure prudency of estimates and equivalency in risk profiles when matching forecasted Sources with forecasted Uses of Funds over the Allocation Period.

Cash and Liquidity Risk Management
A forecast of cumulative cash inflows and outflows, over a rolling one-year time horizon is the basis for assessing the overall cash and liquidity position at a given point in time. The Treasury Management Department fully matches actual and expected cash inflows and outflows, based on Eligible Assets (the total cash on hand, net of the Minimum Liquidity Reserve amount) and Eligible Liabilities (the total forecasted cumulative cash outflows for grants and other operating needs). This is performed on an aggregated portfolio basis over a rolling forward-looking 12-month period.

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[1] Adjustments may be to account for such factors as alignment of donor and Global Fund fiscal years, deductions for technical assistance directly provided by the donors, other donor-specified conditions, and any other authorized sources.

The Minimum Liquidity Reserve amount is the cash balance that is required under the CFP to be maintained at all times by the Secretariat. It is defined as three months' worth of estimated cumulative cash transfers under forecasted Uses of Funds. Treasury Cash Management therefore applies to all activities associated with cash inflows and outflows to and from bank and trust fund accounts, including foreign exchange spot and forward transaction flows (hedging). The key objective is to ensure that there is enough liquidity available to meet short and medium-term cash needs and to ensure timely disbursements, with payments transacted in a secure and cost effective process.

Foreign Exchange Management
The Global Fund is exposed to the variations in the value of a variety of currencies through foreign exchange (FX) exposures. This is the result of financial commitments and cash inflows and outflows of funds that are not denominated in United States Dollars. Transactions leading to these flows include Sources of Funds, Uses of Funds and Operating Expenditures. Each of these flows presents a different accounting treatment, levels of certainty and other considerations. Foreign exchange exposure arises at different stages for each of these flows and is required to be managed accordingly to mitigate the loss that may arise due to FX fluctuations.

In June 2016, the Audit and Finance Committee approved the Global Foreign Exchange Management Framework. The sole objective of this framework is to preserve the net value of assets and liabilities against currency fluctuations to ensure the amounts from contributions and grants retain their economic value.

The framework describes the guiding principles, responsibilities, and controls applicable to hedging operations aimed to mitigate the global economic exposure faced by the Global Fund due to FX risks. The framework establishes a single, combined approach for managing FX risk, incorporating and extending principles and policies previously adopted by the (then) Finance and Operational Performance Committee. The framework sets the tone and purpose for hedging activities strictly to mitigate borne FX exposure. At no times are speculative trading positions allowed.

Hedging activity at the Global Fund

Types of instruments used by the Secretariat
In accordance with the FX Policy Part I, approved by the Finance and Operational Performance Committee in November 2014, the Secretariat's approach to managing FX risk is to first try to balance sources and uses of funds for a given currency to achieve the most cost efficient hedging strategy (natural hedging). Only after balancing will the net position for a given currency be categorized as an FX exposure to be actively hedged through the following authorized derivative instruments:

- **Foreign exchange SPOT transactions** - the purchase or sale of a foreign currency for immediate delivery. This instrument is often used to immediately convert one currency into another at the prevailing daily rate.
- **Foreign exchange forward contracts** - the purchase or sale of a foreign currency at a set date in the future. This instrument is often used when the Secretariat know that they will need to convert one currency into another at a future date.

Foreign exchange swap contracts - the exchange of one currency for another at the present moment, with the exact opposite transaction defined in the future. This instrument is often used by the Secretariat for liquidity and bridging the gap when the Global Fund has received funds earlier or later than the date of maturity of the foreign exchange forward contract.

The hedging strategy is executed through agreements with commercial banks. The Global FX Management Framework uses risk limits to guide the Secretariat in determining the level of risk that needs to be covered in the execution of the hedging strategy. The limit is measured using the Value at Risk method, or VaR, which is a statistical technique used to measure and quantify the level of financial risk over a specific period. It is measured in three variables: the amount of potential loss, the probability of that amount of loss and the period over which such potential loss could occur based on its probability. The VaR limit comprises of two risk metrics (net FX exposure for on and off-balance-sheet) which set the operational parameters of hedging activities for the Secretariat.

Investment Framework

The Global Fund investment framework (GF-Finance and Operational Performance Committee 11 – 05, June 2014) establishes the objectives for investing the funds held in the Trust Fund and describes the appropriate investment strategy to achieve the stated objectives. The framework confirms the strategies agreed upon with the World Bank as Trustee while strengthening the governance and the control of the overall investment process.

The primary investment objective is to ensure that funds are available as needed to make good on commitments on a timely basis (capital preservation and liquidity). The secondary investment objective is to maximize returns subject to prudential risk limits. In line with these objectives, and to meet the Global Fund's cash flow requirements over different periods, the funds held in its trust fund have been invested in a range of asset classes so that the pre-specified investment objectives and risk constraints are met. Based on liquidity needs, the portfolio is rebalanced on a monthly basis as needed. The strategic asset allocation is undertaken annually based on expected market conditions as well as risk constraints and discussed on a quarterly basis, although extraordinary circumstances may result in an ad hoc adjustment.

Treasury Management Function

Before 2014, most of the Global Fund's Treasury Management activities, specifically cash and liquidity management operations, were facilitated by the World Bank who is also the Trustee. The approval of the CFP in June 2014 placed increased ownership and responsibility on the Secretariat for the management of financial resources. Since 2014, the Secretariat has put in place people, processes and systems in Treasury, Financial Services and Accounting, to operationalize and support the implementation of the CFP. The Treasury Management function is headed by the Treasurer and Deputy Chief Financial Officer. She is supported by four treasury specialists who are responsible for the execution of Treasury Management activities.

Global Fund Treasury systems and risk management tools

The Treasury Management System was implemented in 2014 to support key treasury processes. This implementation provides the Global Fund with an automated processing system, all the way from order and straight through to payment. Building on this, the use of SWIFT payments, an internationally-recognized secure payments channel, was implemented in 2015 along with transition of all corporate payments and the majority of grant disbursements effected through the Global Fund's commercial banks. The Global Fund is now fully autonomous for its direct grant disbursements which are no longer handled by the World Bank as the Trustee of the Global Fund.

In addition to the cash management functions, the online trading platform has been activated. The platform enables the Global Fund to execute standard foreign exchange transactions under its hedging activities described above.

Supporting the Global Fund's hedging activities, the treasury function introduced a statistical model and analytical reporting tool called "R model". Specifically, the tool measures the VaR on the FX exposure, generates the daily Treasury Dashboard typically issued at 11am, which includes portfolio information such as exposures, FX rates, counterparty exposures, pledges and contributions for monitoring purposes.

The Global Fund has built relationships with commercial banks and the World Bank to manage its financial assets and provide appropriate liquidity and risk management.

III. Scope and Rating

01 Scope

The audit of the Global Fund's treasury function is part of the 2016 Annual Audit Plan of the Office of the Inspector General. This review is the first OIG audit of the treasury function hosted in the Secretariat.

The audit assessed the adequacy of design and operating effectiveness of governance processes, treasury systems, risk management and controls over the core Treasury Management activities defined in the background above. These include:

- Asset and Liability Management;
- Cash Management;
- Liquidity Risk Management;
- Foreign Exchange Management; and
- Investment Framework.

The audit specifically assessed whether:

1. Governance processes are adequately designed against established benchmarks and operating effectively including whether:
   - appropriate policies and procedures were in place and approved within the ambit of the Global Fund governance framework; and
   - reporting over treasury performance was systematic, accurate and complete.

2. Risks related to the management of key treasury processes were appropriately identified, mitigated with sufficient internal controls and monitored to safeguard the Global Fund assets; and

3. Treasury systems are adequately designed and operating effectively including whether:
   - systems are secure and access is restricted to authorized users;
   - recording and measurement of transactions is accurate;
   - systems are agile and interfaces are automated (or controls are set if there are manual data flows);
   - segregation of duties was applied strictly in all relevant treasury related systems and manual processes;
   - built-in controls on payments and invoices are accurate.

Methodology

For the period January 2015 to October 2016,the OIG:
- reviewed relevant documents and information;
- conducted interviews at Secretariat level and other key stakeholders;
- considered best practice against organizations and industry standards;
- considered the work performed by the Global Fund External Auditors for the 2015 and 2016 financial statement audit;
- performed walkthroughs (identification of risks and key controls) of key processes; and
- performed tests of controls and substantive tests.

02 Rating[2]

Audit Objective	**Rating**	**Reference to findings**
Governance and Risk Management	Partially effective	IV 01
Foreign Exchange Management	Partially effective	IV 02
Asset and Liability Management	Partially effective	IV 03
Cash and Liquidity Management	Effective	IV 04
Investment	Effective	IV 05

[2] See Annex A for the definition of the OIG ratings

IV. Findings and Agreed Management Actions

01 Governance and Risk Management

1.1 Policies and Procedures

At the core of Treasury Management at the Global Fund, is the CFP. It establishes the key financial framework and principles for the management and apportionment of resources provided by donors. In addition, a number of additional policies have been developed by the Secretariat and approved by the Audit and Finance Committee and its predecessor, the Finance and Operational Performance Committee to compliment the CFP. These include the Investment Framework (GF–Finance and Operational Performance Committee 11–05, June 2014) and the Global Foreign Exchange Management Framework (GF–Audit and Finance Committee 01–06, June 2016). In support of these policies, a Treasury Management Procedure document (which describes the detail procedures to be followed by the Secretariat in Treasury Management) is in place and has been approved by the Head of Treasury, July 2016.

The OIG assessed these policies and procedures for adequacy and effectiveness and noted that they have been effectively reviewed and approved by the appropriate committees. Where necessary, these policies and procedures have also been revised to cater for the evolving activities of Treasury Management at the Global Fund, for example the Global Foreign Exchange Management Framework approved in the June 2016 Audit and Finance Committee. In most cases, these revisions have resulted in more prescriptive policies and procedures with additional layers of controls added to processes in order to mitigate risks inherent to the current environment. This is indicative of a maturing control environment.

The majority of policies and procedures adequately covered the scope of activities for Treasury Management. The OIG assessed the controls over foreign exchange, cash, liquidity, investments, asset and liability management, and did not identify any non-compliance. Notwithstanding this, the OIG noted the following gaps in the documentation of the current policies and procedures against current processes and controls followed by the treasury function:

Procedures for currency swaps performed for cash management purposes are not documented: The Treasury Management Procedure document does not define the current processes and controls followed for daily cash management transactions such as foreign exchange currency swaps. These transactions accounted for more than half of the trading value (54%) between October 2015 and September 2016, amounting to US$2.99 billion; these currency swaps are performed for cash and liquidity management purposes. As a result, the criteria and circumstances under which these transactions are performed, the level of approvals required, and subsequent monitoring to be performed over these transactions need to be formalized and documented. However, the OIG did not identify any control exceptions in the way that these transactions were executed. The transactions were appropriately approved and validated by the Financial Services back office team, accurately recorded and subsequently reconciled with bank confirmations.

Policies and procedures for the measurement and monitoring of VaR are incomplete: There is no detailed reference in the policies and procedures to the statistical model used to calculate the VaR for foreign exchange hedging activities and requirements for regular review and validation of the model to ensure it is fit for purpose with the organization's hedging activities.

Approach to Stress Testing not documented: Stress testing is a risk management tool used to simulate extreme but plausible event(s) and measure how the event(s) would impact the organization's income. Stress testing is usually performed to complement the VaR which is a measure of risk in normal markets; in other words, it ignores stress events (defined as falling beyond the specified confidence interval). The Secretariat has chosen not to perform stress testing for its FX hedging activities, stating that stress testing would not provide any additional risk metric that is not currently being measured through the VaR; this was deemed due to the simplicity of the portfolio, which allows for an understanding and monitoring of each significant exposure to each currency to each balance sheet item. This approach, including the rationale for the non-performance of stress testing and the mitigating controls, has however not been formalized and documented in the policies and procedures, or reviewed on a periodic basis for appropriateness.

Policies and procedures do not contain requirements for regular review and approval: Across all the Global Fund policies and procedures reviewed in respect of Treasury Management, there are no requirements for regular review and approval. This included the Comprehensive Amended Funding Policy, Global Foreign Exchange Management Framework, Investment Framework and the Treasury Management Procedure Document. This is an important control as it ensures that the governance framework in which the Treasury Management function operates and executes strategy is up to date and fit for purpose with the current operating environment.

1.2 Reporting

The OIG performed a review of Treasury Management reports presented to the Management Executive Committee of the Global Fund, the Audit and Finance Committee and its predecessor, the Finance and Operational Performance Committee, to assess validity, accuracy and completeness. No instances of factual inaccuracies were identified and amounts presented in the reports were not materially different from the amounts recorded in the Global Fund financial system (GFS) without valid and approved adjustments. However, the OIG noted the following exceptions around reporting of Treasury Management:

Processes for producing reports are not formalized or documented: The process of producing quarterly reports to the Management Executive Committee and Audit and Finance Committee/Finance and Operational Performance Committee, from source data in GFS to reported data, was not formalized or documented sufficiently. Moreover there is currently no quality review in place to ensure that reporting is valid, accurate and complete. As a result, the OIG identified inconsistencies that, although immaterial, revealed data reported to the Audit and Finance Committee/Finance and Operational Performance Committee with different presentation methodologies applied from slide to slide, or from one report to the next.

Reporting on Treasury Management performance was inconsistent: Reporting to the Audit and Finance Committee on the performance of treasury was not consistent from period to period and also not always clearly split out from information that required decision making. For example, the Treasury Performance Update to the Audit and Finance Committee in October 2016, contained only an update on Foreign Exchange Management. Other treasury activities were reported under the Financial Performance update. However, both these reports also contained information that required decision making. Reporting of investment performance, including the risk limits, by the Secretariat to the Audit and Finance Committee is specifically required under the Investment Framework. This was not duly performed in the October 2016 Audit and Finance Committee as well as in the June 2016 meeting. In the context of there being no predefined requirements for reporting to committees in the Global Fund, the OIG notes that reporting on treasury activities specifically was done for the first time at the October 2016 Audit and Finance Committee meeting. The Secretariat has specifically asked the committee to provide feedback on the report format and what information the members would want to see in the report.

1.3 Independent oversight of the Treasury function

The inherent risk of treasury activities is high due to their complex and technical nature and the materiality of the amounts that are processed. The treasury function therefore requires strong preventative and detective controls in order to reduce the risk to an acceptable level, including independent oversight.

Risk Control Officer: Since July 2016, the Recoveries Officer has been performing the duties of a primary risk control officer for treasury activities. He has been tasked with the responsibility for monitoring VaR breaches and counterparty limits; however, his formal terms of reference have not been finalized and do not refer to these responsibilities. This is critical in order to clarify on a comprehensive basis the duties of the control officer and the associated accountability. The risk control officer also currently reports to the Head of Treasury, despite that these control and monitoring activities are normally independently performed by the Risk Management function under the Chief Risk Officer. In addition, the risk control officer does not have independent access to the relevant information to perform monitoring over the VaR limit. Finally there are currently no formalized controls performed over the compliance of executed trades against the hedging strategy, which is a typical control performed by the Risk Control Officer. During the recent replenishment period when significant foreign currency hedging activity took place, this control was performed on a weekly basis and also by exception; however, this was not documented.

Risk Management: Since his arrival, the new Chief Risk Officer performs a secondary check over the treasury function. While he engages with the treasury team at the time of important hedging decisions, has monthly updates with front office on treasury performance and monitors the hedging activities and trading portfolio including the VaR limits, he is fully reliant on the information provided by the primary control officer and the front office with no independent access to the information.

1.4 Risk and Control Matrix

In 2015, the Risk Management Department at the Secretariat initiated a process of developing and implementing a risk and control matrix for the organization as a whole, and the departments within the Secretariat. The aim of a risk and control matrix is to identify inherent risk in business processes, assess the magnitude of the risk, the mitigating controls in place to reduce the risk and then evaluate the effectiveness of those controls.

The Treasury Management Department completed a risk and control matrix approved by the Chief Risk Officer in July 2016. The OIG noted that Asset and Liability Management, Liquidity Management and Investments are not reflected in the risk and control matrix although these processes are considered mission critical and key business processes as defined under the objectives of Treasury Management in the CFP. Currently only Foreign Exchange Management and Cash Management processes are included. Whilst these are the highest risk activities, it is important for the entire risk universe to be considered and assessed regularly. This risk assessment then informs the appropriate level of risk response, including the nature and extent of preventative or detective controls that are required or the scope of monitoring over the risk.

Agreed Management Action 1:

The Secretariat will review all policies and procedures that cover the scope of Treasury activities and where necessary make adjustments to ensure that policies are principle based and that procedures are reflective of the processes and controls of the current operating environment. In addition, the Secretariat will make the necessary amendments to include the gaps identified by the OIG including:

i) Incorporating requirements for regular review of all policies and procedures;
ii) Documenting the current processes and controls for currency swaps used for cash management;
iii) Defining the measurement and monitoring of the VaR and the Secretariats' approach to stress testing; and
iv) Defining and documenting processes and controls for treasury reporting to ensure adequate and quality control is applied to Treasury reporting for the Audit and Finance Committee.

Owner: Head of Treasury Department

Target date: 30 June 2017

Agreed Management Action 2:

With the guidance of the Risk Management Department the Secretariat will review all business processes within the scope of Treasury Management. This will include production of a risk and control matrix.

The Secretariat will develop and implement processes and controls for daily treasury reporting to ensure adequate design and independent control for both levels of risk control including access to information. This will include adequate documentation of control activities performed by the risk control officer and the Chief Risk Officer.

The Secretariat will implement measures to clearly define the TOR's of the risk control officer to assure functional independence; these will include formalizing and documenting the control activities to be performed over trades executed against the hedging strategy.

Owner: Head of Treasury Department and the Chief Risk Officer

Target date: 30 June 2017

02 Foreign Exchange Management

For the period 1 October 2015 to 30 September 2016, the treasury office entered into 143 trades amounting to US$5.5 billion. Seventy-eight (78) of these trades (US$2.6 billion) comprised of foreign exchange spot and forward transactions, and 65 trades (US$2.9 billion) were foreign currency swaps which were performed for cash management purposes *(See finding 1: Governance and Risk Management for more details on foreign currency swaps done for cash management purposes)*.

The OIG reviewed a sample of hedged transactions between October 2015 and September 2016. The sampled transactions covered 21% of the value of trades (US$ 1.2 billion) during the period, and included all commercial banks used for trading, and all currencies traded. No exceptions to the current process and controls, as defined under the Global FX Framework and the Treasury Management Procedure Document, were noted.

The OIG noted that formal monitoring procedures of the VaR commenced in September 2016 with the introduction of a risk control officer and escalation procedures in place to the Chief Risk Officer and Chief Financial Officer. In addition, the treasury function introduced a statistical model and analytical reporting tool based on “R”. Specifically, the tool measures the VaR on the FX exposure, generates the daily Treasury Dashboard typically issued at 11am, which includes portfolio information such as exposures, FX rates, counterparty exposures, pledges and contributions for monitoring purposes. The model was independently validated by a Swiss financial modelling specialist.

Additional security enhancements were also made to treasury systems with the introduction of Dual Authentication Factor and unique hardware certificates to access the online trading platform. The trading platform provides access to more competitive prices for financial instruments versus the use of phone calls directly with the commercial banks. However, the OIG noted the following points requiring the attention and action of the Secretariat.

2.1 Foreign Exchange Management for Global Fund Portfolio

The Global Fund uses US Dollars as its functional and reporting currency. Foreign exchange risk arises due to financial transactions in currencies other than US Dollars resulting primarily from cash and cash equivalents, donor contributions, grant liabilities and a part of the Global Fund’s operating expenses. In addition to US Dollars, the bulk of the remaining currency exposure (over 90%) primarily comprises three foreign currencies besides the US Dollars: the Euro, the British Pound Sterling and the Canadian Dollar (by order of exposure).

In order to mitigate the risk associated with exchange rate fluctuations, the Global Fund performs hedging activities using financial instruments. These instruments, typically offered by commercial banks, aim at reducing exposure to exchange rate volatility which occurs in the global markets. To date, the Global Fund has used financial instruments such as foreign exchange spot transactions, forward contracts and swap contracts to perform its hedging activities.

Up until June 2016, the organization performed only hedging activities for on-balance sheet exposures (committed pledges and committed grants). However in July 2016, the Audit and Finance Committee approved the Global Foreign Exchange Management Framework which allows the Secretariat to perform hedging activities on off-balance sheet exposures to reduce the economic risk upon the receipt of a pledge, allocation of available sources of funds, and signature of grant agreements. These exposures include uncommitted pledges, allocated amounts, contingent liabilities and operational budget over a three-year allocation period in currencies other than US Dollars giving risk to economic risk overall. According to the Secretariat, the new framework moves from a single exposure hedging approach to portfolio hedging, which allows for the integration of all elements from sources and uses of funds that contribute to foreign exchange risk. This approach aims to mitigate the foreign exchange risk to cater for the upcoming multi-currency initiative (MCDs) by the Global Fund.

Hedging strategy is not documented in a systematic and standardized manner: The terms and conditions of approved trades to be executed were documented in an inconsistent and non-standard manner. The hedging strategy is defined in a meeting with the treasury team which includes the Head of Treasury and the Chief Financial Officer. It is then confirmed over email. In 8 out of the 20 (40%) hedging transactions, the hedging strategy emails did not document all the parameters of the trade e.g. trading limits, hedging instrument to be used and the exchange rate range.

Trading limits have not been defined and built into the system: Trading limits have not been defined and are therefore not built into the system as a safeguard to protect the organization from unauthorized trading. Although no such unauthorized trading or manual errors were detected in the sample reviewed by the OIG, it is important that adequate controls are in place to prevent such risk from occurring as any exception could be highly material. In this context, the OIG notes that there are currently only two active traders in the treasury team and therefore a strict introduction of trading limits is not deemed possible by the Secretariat from an operational, system and banking perspective. The Secretariat recognizes that alternative measures such as the introduction of trading mandate provides further reassurance and will work on its implementation.

Counterparty limits have not been defined and built into the system: The Secretariat ensures that all counterparties have a rating of A or more. The treasury policy requires counterparty limits (limits of trading with each commercial bank) but no such limits have been defined by the Secretariat. In the past year, around 70% of all trades executed were with only two counterparties. The absence of counterparty limits means that there is no restriction for the organization to perform all or a very high percentage of its trading activities with a single counterparty thereby increasing the impact of a default by the counterparty. In this context, the OIG noted that the Secretariat has recently expanded its commercial banking base, resulting in counterparty split ranging between 15% and 25% by gross exposure across five counterparties as at 30 November 2016.

The Secretariat has recently started monitoring counterparties for the risk of default through other risk metrics such as credit default swap indices of the counterparty. Whilst this index is a more agile instrument which measures and predicts adverse movements which can materialize in counterparty, this has not been formalized into the policies and daily monitoring procedures by the Secretariat.
In this context, the OIG noted that restricting the limit of trading activities with counterparties was difficult to do in the past, due to its limited commercial banking base. In the past year, the Secretariat has invested considerable effort in expanding the number of commercial banks that the organization can trade with, and a counterparty limit framework is expected to be defined during 2017.

2.2 Foreign Exchange Risk in Countries with Global Fund programs

The Global Fund is exposed to foreign exchange risk for "on balance sheet" items (committed contribution and funds), "off-balance sheet" items (uncommitted contributions and funds) and at a country level for programs funded by the organization. Since 2015, the Secretariat has put in place processes and systems to mitigate the on-balance sheet foreign exchange risk and in 2016 the off-balance sheet risk. The foreign exchange risk at the country and implementer levels, however, remains unmitigated and is not currently performed by the Secretariat. The risk arises due to Global Fund grants being denominated in US Dollars or Euros but the expenditure incurred by the implementers for program activities is based in a different currency, often the local currency of the country.

The need for MCDs was identified by the Secretariat as a mechanism to mitigate this risk through the matching of grant disbursements with the currency of expenditure incurred by the programs, and their use was approved by the Global Fund Board in June 2014. Once implemented, it would result in the mitigation of foreign exchange fluctuations at the country level and managed centrally through the hedging activities of the Secretariat.

The treasury, financial services and accounting teams have made significant inroads in this process with the development and implementation of processes and systems to be able to disburse in local currency and record the relevant transaction correctly. The Secretariat conducted an MCD pilot with the South Africa portfolio. Based on a review of the project documents, the pilot was assessed to be successful and the OIG confirmed that all post implementation technical and functional issues had been resolved. Operational policies and procedures are currently being amended to cater for MCDs. The OIG also noted that functional requirements for MCDs have been built into the scope of project AIM[3], which is expected to be implemented in the Spring of 2017.

Despite this progress, significant change management processes for internal and external processes have not yet been implemented before MCDs can be rolled out on a wider scale, especially the engagement process with the country and Principal Recipients. MCDs will fundamentally change the way the Global Fund provides grants to countries and all processes in grant management will be impacted from grant making to closure. MCD is currently classified as an initiative within the Secretariat with little to no project governance in place. Given that grant-making for the 2017-2019 period will commence in 2017, there is a very short window (12-18 months) for the Secretariat to finalize the roll out of MCDs for qualifying countries to avoid the foreign exchange risk remaining with the countries for another three years.

Although the current hedging decisions are in compliance with the Board approved Global FX Framework, which stipulates that a minimum of 75% of on balance sheet exposures (contributions and commitments) should be hedged, the hedging policy and limits will need to be evaluated by the Secretariat for continued fit-for-purpose as the Global Fund moves towards full implementation of MCDs[4] and the introduction of less frequently traded currencies.

2.3 Treasury Systems

The OIG tested the general IT controls in place for the treasury system and the online trading platform. In the course of this review, the OIG did not identify any material exceptions around (internal and external access to the system), segregations of duties built into the system and accuracy of data in the system and moving across different platforms. Interface controls and segregation of duties built into the treasury workflow were in place to ensure validity and accuracy of the transactions recorded in the system. However, the OIG noted the following exceptions around the treasury systems:

No automated interface between online trading platform and treasury system: At the start of the audit, the Secretariat highlighted to the OIG that there is no automated interface between the two systems. As a result, the trader executes the trade on the online trading platform and then records it into the treasury system. Despite the validation performed by the financial services team, this process increases the risk of manual error, and is inefficient. Despite the manual process, the audit did not identify any trades that were captured in trading platform and not in treasury system or vice versa.

Excessive failed logon attempts allowed on Treasury system: Security tests performed on the treasury system noted that a maximum of 20 failed login attempts is allowed for access. This is excessive and not in line with general industry practice of three to five times. The Secretariat has initiated a process with the supplier to reduce the number of login attempts to a maximum of five.

[3] Accelerated Integration Management to better integrate data, systems and analysis into grant management working practices
[4] For example, whilst the Secretariat has elected not to hedge the open position on the South African rand disbursement as part of the pilot, the Global Fund is exposed to FX risk for any movements of the Rand against the US Dollar between the start of the pilot (30 May 2016) to now, with US$ 7 million or ZAR 94 million still to be disbursed. In this context we noted that the South African Rand moved by 11% against the US Dollar - calculated based on movements in the spot rates, from Reuters, between the agreement date of 30 May 2016 and 2 December 2016.

The Secretariat anticipate that this will be finalized before the end of 2016 but is dependent on the supplier.

Lack of audit trail for trading over the telephone: In addition to the online trading platform, the Secretariat is able to perform trades with Banks over the telephone. In contravention with best practice, these telephone calls are not recorded to protect the interests of the organization should there be any discrepancies between the trader and the bank. It is understood that the bank records these calls, however this should not be relied upon and cannot be independently tested by the Global Fund to ensure that the recordings are reliable. The OIG noted that telephone trades currently account for less than 1% of the trades executed given the extensive use of the online trading platform.

Agreed Management Action 3:

The Secretariat will improve the controls around Foreign Exchange Management for the Global Fund portfolio including:

i) The Secretariat will develop a hedging strategy template that will cover all the parameters typically required in a hedge transaction and the appropriate signs offs as required by the process. This template will then be operationalized to support executed trades.

ii) The Secretariat will update its policies and procedures to account for the gaps noted by the OIG by specifically defining a trading mandate taking into account the traders profiles and defining a counterparty limit framework.

Owner: Head of Treasury Department

Target date: 31 December 2017

Agreed Management Action 4:

The Secretariat will put in place a formal change management roadmap to implement MCD across the Global Fund portfolio. The roadmap will be aligned with the grant making activity starting in 2017 with the change management process and will probably extend beyond 2018, depending on the grant making activities. The implementation will be done in conjunction with the grant management division.

In addition, all risks associated with MCD (including operational and foreign exchange risks) will be identified and the project governance process will ensure these risks are adequately mitigated before MCD is rolled to the entire Global Fund portfolio.

Owner: Head of Treasury Department

Target date: 31 December 2017

Agreed Management Action 5:

The Secretariat will investigate the feasibility of automating the online trading platform with the treasury system. If it is technically feasible to do and within a reasonable cost attached then the Secretariat will go ahead with the automation.

Owner: Head of Treasury Department

Target date: 30 September 2017

03 Asset and Liability Management

The mechanism by which the Secretariat matches the notional sources (assets) and uses of funds (liabilities) on an aggregated portfolio basis for an Allocation Period is clearly laid out under the CFP. This includes the methodology applied to the calculation of both sources and uses of funds. Asset and Liability Management (ALM) is a critical process for the Global Fund as it ensures that the organization has sufficient resources before it makes commitments to grantees. At the same time, if the process is adequate and effective, it should ensure that the maximum amount of funds are allocated to grantees for use over the allocation period.

Before 2014, ALM was not performed by Secretariat and no tools were in place for such an exercise. Nearing the end of the current implementation period (2014-2017), the Secretariat has now developed systems and processes for calculating asset and liabilities.

3.1 Assets
The main inputs to the assets or the Sources of Funds amount is the opening cash balance at the start of the allocation period plus the cash received from donors, donor contributions receivable and contributions forecasted. The main difference between contributions receivable and forecasted is the level of certainty the Secretariat can apply to the timing of the cash inflows.

The OIG performed a review of the asset or Sources of Funds as at June 2016 presented by the Secretariat at the Audit and Finance Committee meeting in October 2016 and the amounts presented at the Audit and Finance Committee in June 2016 for the period 1 January 2016 to 31 March 2016. Whilst no factual inaccuracies were identified, the OIG noted that the process is not formalized and documented sufficiently. Given that there are a number of material adjustments made by the Secretariat to arrive at the sources of fund that can be made available for programming, it is important that there is a sufficient audit trail to support the calculation, including the high level methodology and rationale applied to the adjustments made and the relevant approvals for those adjustments. These adjustments include cash received, adjustment of foreign exchange, contributions receivable and forecasted contributions adjusted for specific donor conditions and differences between the various donors' budget cycles and fiscal years which are not aligned.

3.2 Liabilities
For liabilities, the main inputs are the cash disbursed, grants payable and contingent liabilities (which means the funds not yet committed). The Secretariat uses the forecasting of grant expenditures to determine the contingent liabilities of the organization over the implementation period. The forecast, which has evolved from a non-existent process to a standardized activity over the past few years, is made three times a year, with a midterm plan that is updated twice a year and the annual budget prepared in September of each year, for the subsequent year. A formalized framework and set procedures for financial forecasts and budgets have been put in place with adequate controls to ensure that the forecasts are accurate and all adjustments are approved at the right level.

Whilst the forecasting process for grant expenditures is adequate in its design, it is not operationally efficient and effective as the forecasted amounts are consistently and materially different from the actual expenditures. For example in Quarter 1, 2016 Grant Expenses were US$382 million (32%) under forecast and Grant Disbursements were US$620 million (49%) under when compared to amounts that had been forecasted six months earlier. For Semester 1, 2016 grant expenses were US$209 million (11%) under forecast and grant disbursements were US$329 million (17%) under forecast. The main differences are often due to delays in the grant-making process, delays in invoicing for commodities purchased via the pooled procurement mechanism and continued low absorption on key grants resulting in reduced level of financial commitments and disbursements. This process is extremely critical to ALM and has resulted in significant decisions on the allocation for the next implementation period. On this basis, the Audit and Finance Committee determined that US$1.1 billion of unused funds from the current implementation period will be reallocated to the next implementation period.

The process is currently heavily reliant on the data provided by Principal Recipients and country teams in grant management. The data often presents the most optimistic view of spend even though the barriers to absorption are often neither known nor fully understood. This has resulted in volatile forecasted liabilities with a significant gap existing between the forecasted and actual amounts.

The forecasting process of the Global Fund is tightly linked to its operating model and the fact that the Secretariat manages its operations out of Geneva with no direct local presence. This limits its degree of control and influence to effectively implement processes such as forecasting and budgeting in the local environments and to increase financial management capabilities on the ground.

In this context, the OIG noted that the gap between forecast and actuals have improved since 2016 due to training efforts from the finance team with the Grant Management Division. The OIG also notes that, consistent with the primary objective of ALM, the position taken by the Secretariat is a conservative one which maintains a low level of risk of over commitment of funds.

Agreed Management Action 6:

The Secretariat will:

1) refine the process for the calculation of sources of funds in the asset and liability management process. The process will be documented and include the necessary controls to ensure that the computations including estimates are accurate and complete and all adjustments are valid with the appropriate level of approval.

Owner: Head of Treasury Department

Target date: 31 December 2017

2) The Secretariat will define formal measures of measuring and monitoring the accuracy and trends of the grant management forecasts and present to the MEC for review and approval. Once approved the Secretariat will implement these measures in grant management and commence monitoring of the accuracy and trends of the forecasts.

Owner: Chief Financial Officer

Target date: 31 December 2017

04 Cash and Liquidity Management

4.1 Cash Management

Before 2014, most of the Global Fund's cash and liquidity management operations were facilitated by the World Bank who also acts as the organization's Trustee. This meant that the Global Fund was reliant on the processes of the World Bank and had limited ownership, accountability and control over its financial resources. Since 2014, the Secretariat has implemented the CFP and put in place processes and systems in Treasury, Financial Services and Accounting, established a competent treasury team and implemented processes for cash inflows and outflows to support cash management activities. It has established relationships with several commercial banks and introduced the use of SWIFT as a secure payment channel to facilitate secure grant and operational expenditure payments.

The OIG reviewed in detail the commercial banking and World Bank relationship agreements with the Global Fund. All necessary agreements, including International Swaps and Derivatives Association (ISDA) agreements, were found to be in place and up to date. The Secretariat has a clear process in place for adding, amending and removing signatories (authority to transact with the banks on behalf of the Global Fund), beneficiaries and traders and no exceptions were identified.

Bank reconciliations were performed and adequately reviewed on a monthly basis for all 46 bank accounts held by the Global Fund. The number of bank accounts was found to be adequate to enable the organization to trade in multiple currencies with multiple commercial banks. Reconciling items were valid and supported by appropriate documentation. No instances of long outstanding reconciling items were identified.

Testing performed across grant (ten grant payments amounting to US$38.4 million), special initiatives (six payments amounting to US$3.8 million), operational expenditure (20 payments amounting to US$9.9 million) and pooled procurement disbursements (six payments amounting to US$201 million) did not show any exceptions. There is a clear process in place for these disbursements with two distinct levels of approval between the financial services and treasury teams. These disbursements were supported by adequate documentation archived within the financial services team.

4.2 Liquidity Management

One of the main safeguards under the CFP, is the maintenance of a minimum liquidity reserve to enable full and timely payment of liabilities. The CFP defines a minimum liquidity threshold of three months' worth of spend (which includes grant and operational expenditure). On average the Global Fund disburses approximately US$300 million per month. The OIG reviewed cash balances of the Global Fund since 2014 (including the Trust Fund balance with the World Bank as this is considered to be cash and cash equivalents in the Global Fund Annual Financial Statements). The auditors noted that the liquidity threshold was always met and sometimes reached as high as four times the mandated threshold. Whilst the excessive cash holdings can be considered inefficient, this is in line with the Board approved Comprehensive Funding Policy and the Investment Framework which prioritizes capital preservation and liquidity over investment returns.

On a monthly basis, the Secretariat performs a rebalancing of its assets portfolio from long-term to short-term with the World Bank to allow for cash and liquidity management activities. Based on a review of the monthly rebalancing performed during 2016, no exceptions were identified with the approval, documentation and reconciliations supporting these requests. Cash and liquidity positions are reported monthly to the Chief Finance Officer for review, quarterly to the Management Executive Committee and Audit and Finance Committee for review, and semi-annually to the Board.

05 Investments

The Secretariat enjoys the continued support of the World Bank as Trustee. The Finance and Operational Performance Committee endorsed an investment framework at its 11th meeting in June 2014 which guides investment strategies that have a primary focus of preserving asset value and maintaining adequate liquidity. The investment strategy has a secondary focus to maximize investment returns based on a defined risk profile and investment horizon.

The investment framework provides clear guidance for the Trustee as it implements the investment procedures and practices. It provides a risk limit for a maximum loss of less than 1% on the capital amount invested over the five-year investment horizon. Under this framework, the Secretariat plays a key role in the strategic asset allocation with the strong executional support of the World Bank as its Trustee.

The OIG's review of the Global Fund's investment portfolio highlighted that all areas of the investment framework have been operationalized and the portfolio structure is in compliance with the principles of the framework (split between cash, short-term and long-term investments). The investment portfolio is valued directly by the World Bank. Although not formalized, monitoring of the investment portfolio by the Secretariat was performed through scrutiny of investment income and performance reports, which include the valuation of assets, sent by the World Bank on a monthly, quarterly and annually by the World Bank. In addition, the World Bank provides a detailed annual performance report directly to the Audit and Finance Committee.

Over the years, the asset management fees levied by the World Bank have significantly decreased (44% decline since 2013) and have become competitive with other asset managers when assessing the average investment management fee[5] against the capital investment (0.04% of the capital investment). Investment performance and income have been positive despite a tough economic climate over the past years and income has increased from US$5 million in 2013 to US$60 million for 2016 (to date).

In this context, the OIG noted that the appointment of the World Bank as Trustee and investment manager of the Global Fund dates back to the establishment of the organization in 2002 and therefore the Secretariat has not formally assessed the World Bank. This includes confirming that services provided are optimal, adds value to the organization; and that investment management fees are competitive in ensuring overall value for money.

Agreed Management Action 7:

The Secretariat will perform a detailed assessment (by means of a formal internal or external performance evaluation) of the World Bank as its trustee and asset manager. This will include quality of services provided and competitiveness on pricing against other institutions in the industry. The Secretariat will present the assessment to the Audit and Finance Committee for review.

Owner: Head of Treasury Department

Target date: 30 June 2018

[5] Advisory HQ (an online news media that performs reviews and rankings of firms and products across the US, UK, EU and Canada and Australia) was used as a source for assessing the average investment management fee analysis.

Annex A: General Audit Rating Classification

Effective	**No issues or few minor issues noted**. Internal controls, governance and risk management processes are adequately designed, consistently well implemented, and effective to provide reasonable assurance that the objectives will be met.
Partially effective	**Moderate issues noted**. Internal controls, governance and risk management practices are adequately designed, generally well implemented, but one or a limited number of issues were identified that may present a moderate risk to the achievement of the objectives.
Needs significant improvement	**One or few significant issues noted**. Internal controls, governance and risk management practices have some weaknesses in design or operating effectiveness such that, until they are addressed, there is not yet reasonable assurance that the objectives are likely to be met.
Ineffective	**Multiple significant and/or (a) material issue(s) noted.** Internal controls, governance and risk management processes are not adequately designed and/or are not generally effective. The nature of these issues is such that the achievement of objectives is seriously compromised**.**

Annex B: Methodology

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

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

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

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

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