
OPEX Evolution 2020-2022 Budget Ceiling Revision

45th Board Meeting

GF/B45/02

11-12 May 2021, *Virtual*

Board Decision

Purpose of the paper: Following AFC recommendation, this document provides a narrative complement to the 2020-2022 Operating Expenses ceiling revision presentation (GF/B45/02_Annex 2) for Board approval.

Decision

Decision Point: GF/B45/DPXX: Operating Expenses for the 2020-2022 Allocation Period

Based on the recommendation of the Audit and Finance Committee, the Board approves the increase of forecasted aggregate operating expenses available for the 2020-2022 allocation period by US\$ 30 million, in order to facilitate the implementation of critical activities in 2022; such that the amount made available for operating expenses for the 2020-2022 allocation cycle shall be US\$ 930 million.

Executive Summary

Context

The operating expenses (“OPEX”) budget and corporate workplan for 2021 were presented to the Board for approval in November 2020.¹ The Secretariat proposed a budget of US\$ 315M for 2021, reflecting the high-level principles agreed under the ‘OPEX Evolution’ framework. The recommended budget ensures that Secretariat resourcing supports programmatic performance, fully leverages operational investments, continues organizational maturity, and reflects the current Secretariat scope of work and ambition in the COVID-19 context. The Board approved the recommended budget with the understanding that a discussion on a potential revision to the 2020-2022 OPEX budget ceiling – currently at US\$ 900M – would be discussed at the 15th Audit and Finance Committee (“AFC”) meeting in March 2021 and subsequently at the Board meeting in May 2021. At its 15th meeting in March 2021, the AFC reviewed the Secretariat analysis and voted unanimously in favor of recommending the expansion of forecasted aggregate operational expenditure for the 3-year period.

Input Sought

The AFC recommends to the Board to approve the increase of forecasted aggregate operating expenses available for the 2020-2022 allocation period by US\$ 30M, as recommended by the Audit and Finance Committee per the Decision Point presented on page 2.

Summary of what this paper addresses

Inputs from the Board and AFC have been integrated into the Secretariat analysis of the historical evolution of the OPEX cost base since 2015. This includes a view by operational activities and illustrates the Secretariat’s continuous progress in achieving value for money and efficiency to enable reinvestment to strengthen strategic capabilities in key priority areas agreed with AFC and Board. Since 2015, the focus has been on building in-house competencies, reinvesting in programmatic capabilities, digitalization and IT security, while increasing overall organizational maturity. This has had a net positive impact on corporate key performance indicators (KPI) for Global Fund core operations.

Benchmarking for operational efficiency² with peer organizations clearly positions the Global Fund as having a very lean cost structure. Sampled peer organizations³ have operational efficiency ratios ranging from 7% to 37%, while the Global Fund’s current ratio is 5.4%.

With 2022 marking the end of the current strategy cycle and representing the transition to the next, and in a context where COVID-19 will still have a disruptive impact on core programs, the Secretariat will continue investing in strategic areas already prioritized in 2021:

- strategic capabilities
- reinforcing financial performance
- digital transformation, and IT infrastructure and security

¹ <https://www.theglobalfund.org/board-decisions/b44-dp03/>

² Considering the ratio of Secretariat OPEX in relation to level of pledges and adjusting for differences in risk and assurance models.

³ Organizations sampled include Gavi, IFAD, Stop TB and Unitaids, Analysis was based on publicly available information.

- effective responses to challenges related to Covid-19 in terms of emergency preparedness and business continuity
- organizational maturity, risk and assurance management, overall business process improvement initiatives to facilitate simplification and agile approaches

Additional priority initiatives related to the business/strategic cycle such as the 7th replenishment or preparations for implementation of the new strategy will need to be integrated into the Secretariat 2022 workplan. As part of the preparations for transitioning to the new strategy, organizational focus will shift to emerging work areas, including but not limited to, scaling-up health financing efforts, rolling out the new M&E and KPI frameworks, implementing the Market Shaping Strategy as well as the Supply Chain Roadmap, advancing on Global Health Security and further incorporating climate and environmental considerations into the Secretariat's operational and strategic work.

Despite the significant disruption experienced in 2020 due to Covid-19, 98% OPEX utilization has been achieved through implementation of adaptation responses and investment in business continuity activities. As these investments will need to be maintained in 2021, a high level of budget execution is expected in 2021 before considering any further adaptations that may be required in response to the evolving COVID context. Even after factoring in potential residual underspend from 2021, the funding need for 2022 would amount to US\$ 319M or a total of US\$ 930M over the 2020-2022 period (3.3% increase in line with the increase in budget level in 2021 vs. 2020). Resourcing needs related to C19RM 2.0 will be addressed separately and funded through a dedicated mechanism.

Alternatively, maintaining the 3-year US\$ 900M budget ceiling will require unsustainable trade-offs with a high risk of backsliding on achieved gains in a Covid-19 context and an absence of critical enablers and capabilities as the Global Fund transitions to the new strategy cycle. This approach would require a timely scale back of the 2021 workplan to ensure a better balance between the 2021 and 2022 OPEX budget levels. The impact on staff workload and well-being will also need to be carefully considered.

A decision by the Board in May 2021 will facilitate the organizational planning process which is aligned to the governance timelines relating to annual OPEX budget approval. A delay in a decision would provide uncertainty for the organizational planning process and in a US\$ 900M scenario, will create a challenging operational context where the Secretariat will need to cost and rapidly scale-down or even halt implementation of budgeted 2021 activities.

Input Received

Following a robust discussion at the 15th AFC meeting, Committee members unanimously agreed to:

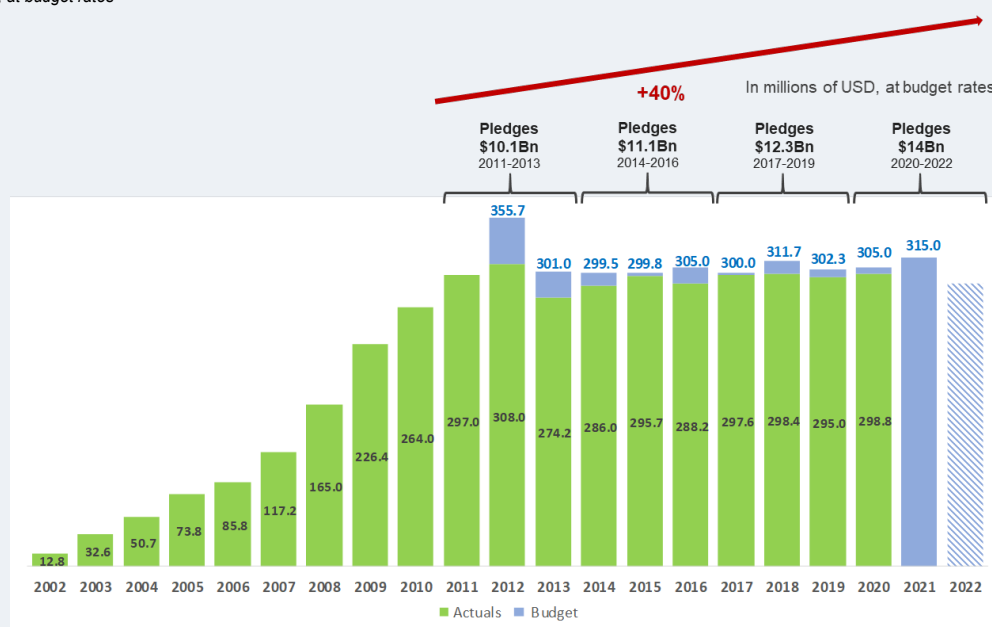
- vote in favor of recommending the expansion of forecasted aggregate operational expenditure for the 3-year period.
- agreed that the additional US\$30 million, if approved by the Board, does not address the additional management and operational costs needed for implementation of C19RM mechanism 2.0

The Secretariat also noted that the OPEX cap is a useful tool in maintaining management discipline and consideration was given to further refining the theoretical cap by having a costing done ahead of each strategy cycle to determine the respective ceiling for the period. AFC Decision is presented in Annex 1.

What is the need or opportunity?

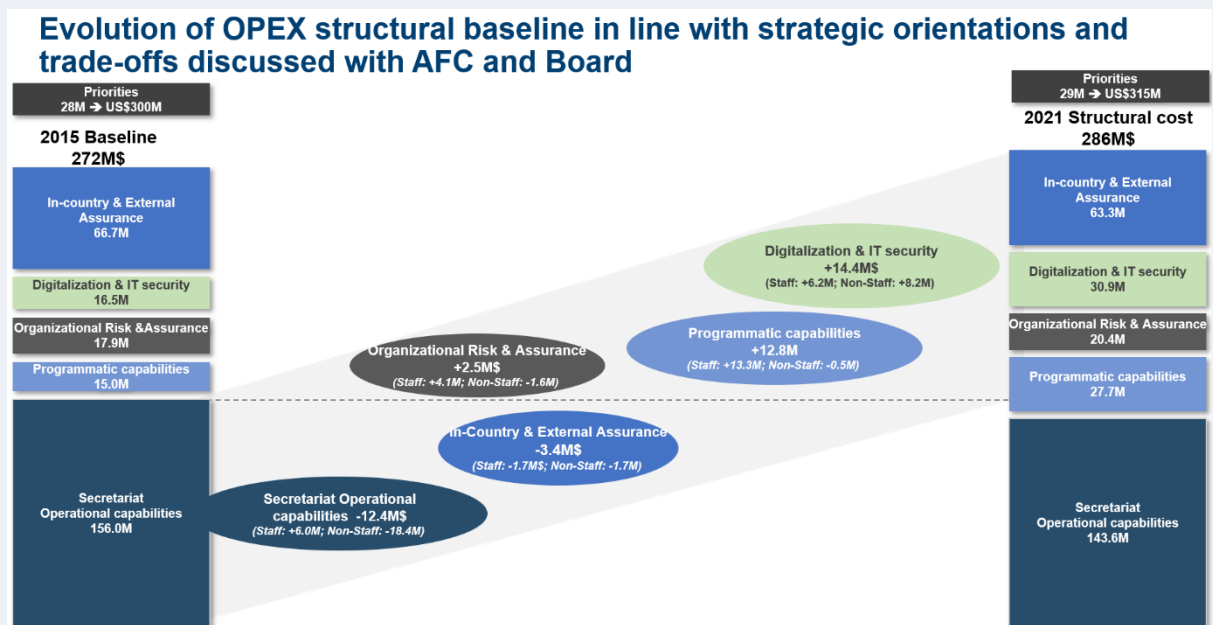
- At the end of 2019, health programs supported by the Global Fund partnership had saved 38 million lives and has contributed to reductions in HIV, TB and malaria deaths, as well as helped scale up treatment and prevention coverage for the three diseases and strengthen health and community systems. The Secretariat has continuously strived to meet an evolving context to better support countries and the people we serve. The Secretariat has leveraged robust financial planning discipline to activate cost efficiencies and optimization strategies to remain within the US\$ 900M 3-year envelope, while continuously investing in strategic capabilities, organizational maturity, and delivering financial performance. At the same time, donor commitments (Global Fund pledges) to the fight against HIV, TB, malaria and strengthening health and community systems has increased close to 40% over the past 10 years, which has enabled ambitious country programmatic targets to be achieved.

In millions of USD, at budget rates



- An analytical view of the evolution of the OPEX cost base since 2015 is provided with a focus on the delivery model. The analysis establishes clear linkages between structural changes in OPEX evolution with strategic orientations and trade-offs discussed with the AFC and Board. Departmental/ Divisional budgets have been re-categorized into five operational areas:
 - Secretariat operational capabilities:** resource mobilization, grant operations, support functions and infrastructure
 - Secretariat programmatic capabilities:** disease experts, human rights and gender, health financing and supply operations
 - organizational risk and assurance:** risk, ethics, OIG
 - digitalization and IT security:** introduction and enhancements of business systems, IT infrastructure and security investments

- **in-country and external assurance:** CCM, LFA, and TERG. Among peer organizations, these activities are either not undertaken or not integrated in the OPEX Budget.
3. Excluding funding for annual priorities, the structural baseline for the budget has increased by a net US\$ 14M since 2015 – in line with the budget level increase approved for 2021—with the following strategic shifts:
- **building in-house capabilities** through reallocating efficiencies achieved through various initiatives on non-staff cost optimization (- **US\$ 30.2M** through zero-based budgeting (ZBB), LFA services optimization, annual efficiency targets embedded in the budgeting process...) **to address strategic competency gaps identified through workforce planning**
 - **gradual rebalancing between organizational risk and assurance (+ US\$ 2.5M), and in-country and external assurance (- US\$ 3.4M)** through strengthening of the Risk and Ethics functions and optimization of the LFA scope of services
 - **optimizing Secretariat operational capabilities (- US\$ 12.4M) through increased effort on digitalization and IT security (+ US\$ 14.4M)**, and continuous scaling up in resourcing of more strategic and differentiated resource mobilization efforts
 - **significantly enhancing (+US\$ 12.8 M) programmatic capabilities** (disease advisors, human rights, community strengthening, AGYW, Health Financing) and enablers (Supply Operations with the establishment of the wambo.org and Supply Chain teams)



4. As a result of these structural investments in organizational maturity and acquisition of strategic capabilities, KPI results have remained relatively strong and stable thus far despite the impact of Covid-19. Current KPI results on Global Fund core operations reflect the progress of Global Fund-funded programs and initiatives since the beginning of the 2017-2022 strategy cycle but are

underpinned by improvements within the Secretariat itself. Increasing organizational maturity, for instance, around process definition, stronger controls and streamlined systems, positions the Global Fund well to continue successfully supporting the fight against the three diseases, while mitigating the impact of Covid-19. The link between KPI results and investments at the Secretariat is evident considering that performance of KPIs measuring areas with a strong level of Secretariat influence is currently at / above target.

A continuous focus on value for money and efficiency has been at the core of OPEX Evolution. Benchmarking with peer organizations on operational efficiency strengthens the OPEX Evolution 'case for change'. It clearly positions the Global Fund as having a very lean cost structure. Sampled peer organizations have operational efficiency ratios ranging from 7% to 37%, while the Global Fund's current ratio is 5.4%. Adding the current high level of OPEX budget execution, opportunities for further optimization become much more limited.

5. Considering change across replenishment cycles, unlike other organizations, the Global Fund is in a unique situation where the level of pledges has significantly outgrown changes in available funding for OPEX.
6. With respect to operational efficiency, in-country and external assurance costs (LFA CCM and TERG) are specific to the Global Fund model and are currently integrated in the Secretariat OPEX budget. Adjusting the OPEX framework enables a 'like for like' comparison with other organizations on the level of management fees (represented by Secretariat OPEX) vis-a-vis the overall level of pledges. The Global Fund is the only organization with an operational efficiency ratio at 5%, even under a revised 3-year budget ceiling scenario, in comparison with sampled peers who are within the 7% to 37% range⁴. This underscores the financial discipline that has been maintained on Secretariat costs. Aligning the Secretariat OPEX level with an operational efficiency level of 7% would require a 3-year OPEX envelope of US\$ 1,160M.

What do we propose to do and why?

7. Despite the significant level of disruption on Secretariat operations experienced in 2020 due to COVID-19, OPEX budget execution remained at a historically high level of 98% (US\$ 299M or + US\$ 2M above latest forecasts presented to the AFC in October 2020). Savings emerging from COVID-19 related disruptions (e.g. travel) have been proactively reinvested to fund adaptation activities, prioritizing funding request reviews, resource mobilization, IT enablers / security reinforcements and business continuity activities.
8. While the Secretariat has undertaken a number of actions to support and protect staff well-being during the COVID-19 pandemic, during 2020 employee wellbeing has been adversely impacted due to the increased workload, resulting in a significant increase in medical leave compared to the previous year. In the most recent staff survey (Fall 2020), well-being received the lowest favorable score (45%) among measured dimensions of the employee experience.
9. For 2021, budget execution is also expected to remain at a high level (US\$ 312 million), with only residual underspend to be carried over. If this does materialize, a balance of US\$ 289M of the originally forecasted aggregate operating expenses for the 2020-2022 allocation period of US\$ 900M would be available to finance recurrent and priority activities for 2022. Recruitment for 2021 budgeted positions has been accelerated and contingent workforce has been extended to address the increased workload. This has resulted in a higher level of staff costs in January 2021 relative

⁴Organizations sampled include Gavi, IFAD, Stop TB and Unitaid, Analysis was based on publicly available information.

to previous years. Savings related to delays in hiring are unlikely to materialize as they have in the past.

10. C19RM is a temporary urgent response mechanism that will not be a permanent part of the Global Fund operating model, The Secretariat has proposed to cover incremental management and operating costs through any additional funds made available for C19RM. Resourcing needs for C19RM will thus be funded from a distinct source of funds and excluded from the OPEX budget funding request.

What options did we consider?

11. The Secretariat considers that in order to maintain existing investments in strategic capabilities and ensure that there is sufficient funding for priority initiatives in 2022, an increase in the 2020-2022 OPEX cap is required. Continuing under the 900M cap would jeopardize investments made to date and would require a potential scaling back of Secretariat capabilities during a year when the Secretariat will need to be focused on preparing for the implementation of the next strategy. Therefore, the Secretariat is proposing that a revised cap of US\$ 930M for the 2020-2022 period be recommended to the Board for approval. The rationale for this is that 2022 marks the end of the current strategy cycle and the transition to the next, which will require significant preparation, including for the 2023-2025 allocation cycle. All this will be occurring in a context where COVID-19 is projected to continue to impact and disrupt programs and operations. For 2022, the Secretariat aims to continue investing in strategic areas already prioritized in 2021:
 - strategic capabilities (e.g. Health Finance, Human Rights, AGYW, RSSH, Supply Operations ...)
 - reinforcing financial performance (e.g. absorption, pledge conversion...)
 - digital transformation and IT infrastructure and security
 - effective responses to challenges related to COVID-19 in terms of emergency preparedness and business continuity
 - organizational maturity, risk and assurance management, overall business process improvement initiatives to facilitate simplification and agile approaches
12. Additional priority initiatives related to the business/strategic cycle, such as the 7th replenishment or preparations for implementation of the new strategy, will need to be integrated into the Secretariat 2022 workplan. As part of the preparation for transitioning to the new strategy, organizational focus will shift to emerging work areas, including but not limited to, scaling up Health Financing efforts, rolling out the new M&E and KPI frameworks, implementing the Market Shaping Strategy as well as the Supply Chain Roadmap, and advancing on Global Health Security and incorporating climate and environmental considerations.
13. Through thematic deep dives with MEC members, a detailed mapping of emerging priority themes for 2022 has been developed ahead of the annual budgeting / prioritization process. This provides a more granular view of prioritized initiatives by operational area and highlights likely trade-offs required in case the 3-year OPEX Budget cap for 2020-2022 is maintained. Full delivery of the ambition would require an increase of the 3-year OPEX envelope from US\$ 900M to US\$ 930M.

US\$ 930M

2020-2022 ambitions

<p>Secretariat Operational Capabilities</p>	<p>US\$ 490.8M</p>	<ul style="list-style-type: none"> • Resource Mobilization: 7th replenishment, advocacy, positioning and pledge conversion - NEW • Next GF strategy & KPI development and operationalization • Maintain COVID disruption adaptation to enable effective grant implementation at country-level • Mainstream operational oversight interventions to enhance financial (in-country absorption) and programmatic performance • Continue adaptation of ways of working as part of the “Future of Work” • Continue transformation of financial processes and systems with increased capabilities (reporting, planning, analytics, controls)
<p>Programmatic Capabilities</p>	<p>US\$ 84.4M</p>	<ul style="list-style-type: none"> • Maintain tactical investment in strategic capabilities to accelerate program quality and better health outcomes <ul style="list-style-type: none"> ◦ Disease Advisor capacity to support in-country operations ◦ RSSH capabilities and oversight model ◦ Human Rights and AGYW ◦ Market shaping strategy, supply chain and quality assurance- NEW ◦ Procurement systems and processes to address gaps identified during Covid-19 ◦ Health Financing Department - NEW • Develop and fund the implementation of the new M&E framework – NEW • Expand support to countries on domestic health financing
<p>Organizational Risk & Assurance</p>	<p>US\$ 56.9M</p>	<ul style="list-style-type: none"> • Reinforce in-country code of conduct and due diligence on key hiring/appointments • Increase the maturity and application of the Ethics & Integrity Framework to our grant-funded activities • Manage specific ethics risks within the ‘in-country conduct and ethics’ risk framework - NEW • Adapt Risk Appetite and Management Frameworks to the new COVID-19 context • Effectively manage emerging and significantly increased risks
<p>Digitalization & IT Security</p>	<p>US\$ 117.4M</p>	<ul style="list-style-type: none"> • Ensure IT resilience for emergency preparedness and security, roll-out a new operating model (“future of work”) - NEW • Efficient and effective data integration and data analytics, improved data frequency and availability • Provide in-country technology and digital services - NEW • Strengthen IT Governance to foster IT efficiency and effectiveness
<p>In-country & External Assurance</p>	<p>US\$ 180.6M</p>	<ul style="list-style-type: none"> • Adapt and adjust LFA model as part of ‘Future of Work’ • Increase LFA’s focus on implementation effectiveness and programmatic assurance to support implementation oversight and highlight bottlenecks - NEW • Strengthen CCM in-country oversight of grants • Potential increase in TERG’s role as part of the new M&E framework - NEW

14. Under a US\$ 900M scenario beyond the risk of backsliding on achieved gains, trade-offs and re-prioritization will be required in 2022 as there will be US\$ 289M available. Under this scenario, the Secretariat would need to scale back on the level of ambition agreed with the Board by postponing implementation of prioritized activities or decreasing baseline resources in some areas of the organization to reallocate resources elsewhere. This would likely negatively impact financial and programmatic performance, portfolio risk as well as staff well-being. Key deliverables for 2022 such as deliverables related to the 7th replenishment and operationalization of the new Global Fund strategy will continue to be prioritized within the available level of OPEX resourcing but would likely require de-prioritization of other areas. Potential trade-offs and negative impact are detailed in the table below.

US\$ 900M		Fiscal Gap / Trade-offs
Secretariat Operational Capabilities	US\$ 479.0M	<ul style="list-style-type: none"> Maintain appropriate resourcing on critical 2022 deliverables (7th replenishment, strategy and KPI operationalization) Reduce support for Covid-19 adaptation to enable grant implementation at country level Scale back 2022 ambition for financial and programmatic performance oversight Delay adaptation in ways of working Potentially reduce current resourcing baseline for enabling functions (Financial Management, Legal & Governance, HR and Communications)
Programmatic Capabilities	US\$ 82.0M	<ul style="list-style-type: none"> Scale back implementation of the next five-year Market Shaping Strategy and postpone implementation of the Supply Chain Roadmap and Quality Assurance Strategy Significantly scale back on supply operations-related critical systems / tools upgrades Scale back 2022 ambitions on: <ul style="list-style-type: none"> Implementation of enhanced Health Financing strategic approach Implementation of M&E framework RSSH improvement and oversight model Achievement of KPI targets for CRG
Organizational Risk & Assurance	US\$ 56.1M	<ul style="list-style-type: none"> Reduce current resourcing baseline on Secretariat Risk and Assurance Postpone mainstreaming of the Ethics Code of Conduct Revert to more limited and reactive advice provision in relation to Ethics matters
Digitalization & IT Security	US\$ 106.9M	<ul style="list-style-type: none"> Scale down on innovative technology and security investments, which would result in vulnerabilities including emergency preparedness Postpone implementation of in-country technology and digital services Postpone implementation of adaptation to ways of working ("future of work") Eliminate capacity to further integrate country data, support data interoperability and other integration needs
In-country & External Assurance	US\$ 176.0M	<ul style="list-style-type: none"> Reduce current resourcing baseline of external assurance (LFA, CCM) setup and related costs

What do we need to do next to progress?

15. As the Secretariat will commence the internal integrated organizational planning process (prioritization/budgeting/workforce planning) in May 2021, a decision by the Board on whether or not to accept an increase in the US\$900M cap for 2020-2022, is requested during this 45th Board Meeting. A decision by the Board in May 2021 would facilitate the organizational planning process which is aligned to the governance timelines relating to annual OPEX budget approval. A delay in a decision would provide uncertainty for the organizational planning process and in a US\$ 900M scenario, would create a challenging operational context where the Secretariat would need to cost and rapidly scale-down or even halt implementation of budgeted 2021 activities to ensure sufficient budgetary resources remained available for a small set of prioritized activities in 2022.

Recommendation

The Audit and Finance Committee recommends the Decision Point presented on page 2 of this Paper to the Board.

Annexes

The following items can be found in Annex:

- Annex 1: Relevant AFC Decision
- Annex 2: Detailed Presentation of the proposed revision of OPEX ceiling (GF/B45/02_Annex 2)

ANNEX 1 – RELEVANT AFC DECISION

Decision Point GF/AFC15/DP02: Recommendation on Operating Expenses for the 2020-2022 Allocation Period

1. The Audit and Finance Committee (the “AFC”):
 - a. Recalls its review and discussion of the 2021 Work Plan and Budget Narrative at its 14th meeting and its request to the Secretariat to submit a revised 3-year budget ceiling for 2020-2022 no later than the AFC’s 15th meeting;
 - b. Acknowledges constraints in the projected remaining funds available for the 2022 operating expenses budget based on the originally forecasted aggregate operating expenses of US\$900 million for the 2020-2022 allocation period;
 - c. Notes its assessment of the constraints on the implementation of critical activities in 2022 posed by such forecasted amount and the availability of additional funds which could be used to supplement the amount set aside for operating expenses for the 2020-2022 allocation period;
 - d. Underlines that the additional US\$ 30 million discussed in subsection e below, if approved by the Board, does not address the additional management and operational costs needed for the implementation of C19RM mechanism; and
 - e. Decides to recommend to the Board at its 45th meeting a US\$30 million increase to the forecasted aggregate operating expenses available for the 2020-2022 allocation period to help facilitate organizational budgetary planning for 2022.
2. Accordingly, the AFC recommends the following decision point to the Board for approval at its 45th meeting:

Decision Point: GF/B45/DPXX: Operating Expenses for the 2020-2022 Allocation Period

Based on the recommendation of the Audit and Finance Committee, the Board approves the increase of forecasted aggregate operating expenses available for the 2020-2022 allocation period by US\$ 30 million, in order to facilitate the implementation of critical activities in 2022; such that the amount made available for operating expenses for the 2020-2022 allocation cycle shall be US\$ 930 million.