



Investing in our future

The Global Fund

To Fight AIDS, Tuberculosis and Malaria

The Global Fund Voluntary Replenishment 2005

A Technical Note on Financial Management of the Global Fund

Contents

1	Financing to Date	3
1.1	Utilization of Funds	3
1.2	Liquidity and Funding Policy	3
1.3	Fundraising Mechanism	4
2	Financing the Needs Through 2007	5
2.1	The Needs	5
2.2	Financing Options	6
2.3	Currency and Translation Rates for Replenishment Calculations	8
2.4	Level of Contribution and Board Representation	8
	Annexes	10
1	Contributions Through 2004	10
2	Grants Approved & Disbursed	11
3	Pledges Not Yet Fulfilled	11
4	Scope of Fiscal Management Study	12
5	Impact of Promissory Notes on Cash Balance	13

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1 Financing to Date

1.1 Utilization of Funds to Date

From inception through 31 December 2004, US\$ 3.3 billion had been contributed to the Global Fund. Of this, US\$ 3.2 billion had been allocated to Board-approved proposals from four rounds of grant proposals, leaving US\$ 0.1 billion available for grants to be approved in 2005.

US\$ 0.9 billion had been disbursed to grant recipients, leaving assets on hand of US\$ 2.4 billion at the end of 2004, comprised of US\$ 0.2 billion in promissory notes and US\$ 2.2 billion in liquid assets invested by the Trustee.

Table 1: Utilization of funds from inception through 31 December 2004

	\$ billion	
Contributions & Grant Approvals:		
Contributed	3.3	(Annex1)
Grants approved	<u>3.2</u>	(Annex 2)
Available for approvals in 2005	<u>0.1</u>	
Disbursement of Approved Grants:		
Grants agreements signed	2.0	
Approved but not yet signed	<u>1.2</u>	
Total grants approved	3.2	
Grant disbursements	<u>-0.9</u>	
Not yet disbursed	<u>2.3</u>	Projected to be disbursed:
		1.0 in 2005
		1.2 in 2006
		0.1 in 2007
Assets held by the Trustee:		
For disbursements to approved grants	2.3	
Available for approvals in 2005	<u>0.1</u>	
	<u>2.4</u>	Comprised:
		2.2 Cash & investments
		0.2 Promissory notes
Note: Operating Expenses, less Investment Income were \$20m		

1.2 Liquidity and Funding Policy

As indicated above, the Fund held liquid assets of US\$ 2.2 billion at end 2004. This large amount of liquidity results from the Fund's Comprehensive Funding Policy that requires that assets, in the form of cash or promissory notes, sufficient to cover the entire amount of a grant, be deposited with the Trustee prior to the signing of the grant agreement, combined with the relatively low use of promissory notes as a contribution mode.

Of the US\$ 2.4 billion assets on hand (US\$ 2.2 billion cash and US\$ 0.2 billion in promissory notes), US\$ 2.3 billion is required for disbursements to approved grants; these 39 disbursements will occur over 2005-2007. In accordance with the Comprehensive Funding Policy, these grants could not be signed unless a corresponding amount of assets (US\$ 2.3 billion) had been deposited with the Trustee.

The Policy considers both cash and demand public promissory notes as assets, however to date only 10% of contributions (from one donor) have been in the form of promissory notes. Hence, promissory notes account for only US\$ 0.2 billion of total assets, with the remaining US\$ 2.2 billion held as liquid assets invested by the Trustee.

The Policy ensures that the Fund can honor its grant commitments regardless of the amount of future contributions to the Fund; also, the substantial funds on hand generate investment income which has covered the vast majority of the Fund's administrative expenses to date. However, some observers question whether this is the most effective use of the amounts contributed to the Fund to fight the three pandemics; others have difficulty reconciling the Fund's appeals for additional funding to finance new rounds of grants with the holding of such a large amount of liquid assets.

At its November 2004 meeting, the Board called for a study of the Policy, the findings of which will be available in the course of the replenishment process. The intended scope of the study is outlined in Annex 4. The study is being undertaken by PriceWaterhouseCoopers and findings are expected to be reported in April 2005.

Apart from any changes to the Policy that might result from Board consideration of the study, the amount of liquidity would be reduced if more donors made their contributions in promissory notes that were encashed on a timetable suited to the disbursement needs of the Fund.

1.3 Fundraising Mechanism

Donors have until now made their contributions to the Fund, totaling US\$ 3.4 billion by the end of 2004, on an ad-hoc basis and timing, pledging for one or more years at a time. Throughout the three-year history of the fund, donors have contributed in full almost all the amounts they pledged, in the year for which pledged or shortly after.

While this approach has fully met the financial needs of the Fund to date, it gives only limited certainty of future income, since the majority of donors pledge for a single year at a time. The voluntary replenishment mechanism is expected to provide greater predictability of contribution income, through multi-year pledges.

2 Financing the Needs Through 2007

2.1 The Needs

2.1.1 The needs of the Global Fund, as described in the paper *Addressing HIV/AIDS, Malaria and Tuberculosis: the Resource Needs of the Global Fund, 2005 – 2007*, are summarized as follows:

Estimated grant approvals: (US\$ billion)	2005	2006	2007	
New grant rounds (Phase I) ⁽¹⁾	1.0	1.1	2.6	
Renewal of grants (Phase II) ⁽²⁾	1.3	2.4	1.0	
Total approval capacity needed	\$bn 2.3	3.5	3.6	
Funding shortfall: (US\$ billion)	2005	2006	2007	
Total grant approval capacity needed (per above)	2.3	3.5	3.6	
Operating Expenses, less Interest ⁽³⁾		0.1	0.1	
Less: Funds available from prior year	-0.1			
Total contributions needed	2.2	3.6	3.7	
Less: Pledged ⁽⁴⁾ to date (23 Feb 2005)	-1.3	-0.7	-0.4	Annex 3
Additional pledges needed	\$bn 0.9	2.9	3.3	

⁽¹⁾ It is assumed that Round 5 grants will be approved in 2005, Round 6 in 2006 and Rounds 7 & 8 in 2007. The total value of grants approved for Phase I of each round (the initial two years) is assumed to be \$1 billion for Round 5, \$1.1 billion for Round 6 and \$1.3 billion for each of Rounds 7 & 8.

⁽²⁾ It is assumed that 85% by value of grants will be renewed for Phase II (usually years 3 to 5) and that renewal is approved twenty months after the first disbursement. Renewal of grants in 2007 is lower than in 2006 because the approval of new grants in 2005 (Round 5) is planned for the end of the year. Accordingly only a relatively small proportion of Round 5 grants will be reaching the end of their initial two years, and hence be due for renewal, in 2007.

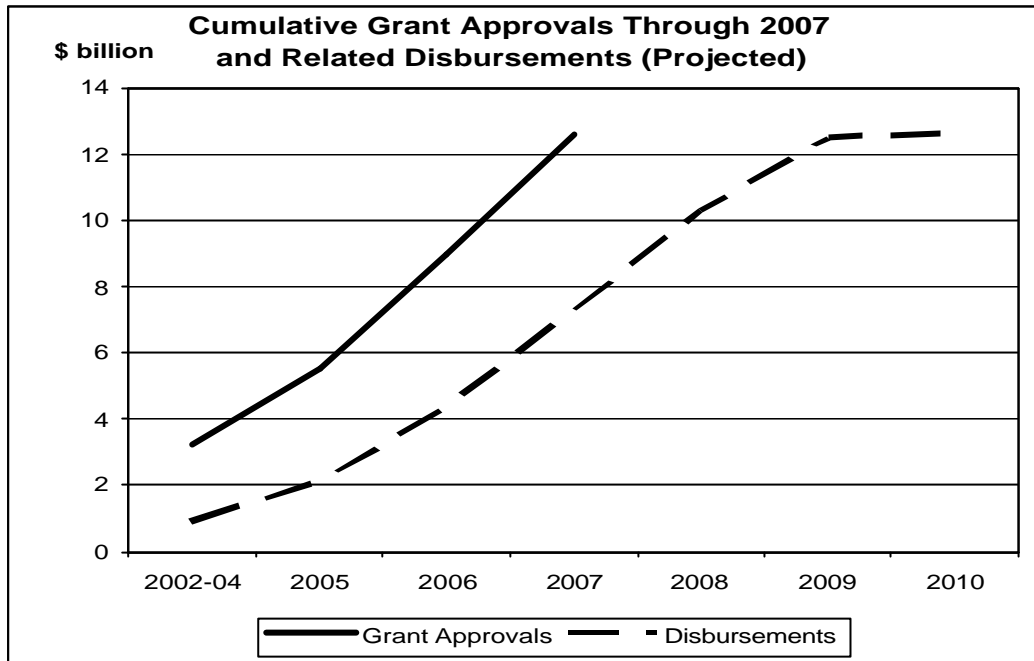
⁽³⁾ Operating Expenses, less Interest Income: Projected at \$30m to \$70m per year, depending on usage of promissory notes (increased usage would reduce the cash balance and hence reduce interest income). The 2005 amount rounds down to zero; the 2006 & 2007 amounts, assuming an increasing usage of promissory notes, round up to \$0.1bn. Operating Expenses comprise Local Fund Agent fees and Board, Technical Review Panel and Secretariat expenses.

⁽⁴⁾ The 2005 pledge amount includes \$0.1bn of 2004 pledges expected to be contributed in 2005.

2.1.2 Disbursement of the grant amount commences after grant approval by the Board and subsequent negotiation of the grant agreement, and is made in installments at intervals throughout the duration of the grant agreement. Hence, grants approved through 2007 will be disbursed through 2010, based on projected disbursement timings.

\$ billion	2002-04	2005	2006	2007	2008	2009	2010	Total
Approved	3.2	2.3	3.5	3.6				12.6
Disbursed	0.9	1.2	2.3	2.9	3.0	2.2	0.1	12.6

The inherent time lag between approval of grants and completion of disbursement is illustrated by the following graph:



2.2 Financing Options

2.2.1 Cash As explained at 1.2, Fund policy allows for contributions to be made in the form of promissory notes that are encashed on a timescale suited to the Fund's needs. To date, only 10% of contributions have been made in promissory notes. If the Fund's increasing grant approval needs continued to be financed by (mainly) cash contributions, then it is inevitable that the Fund's cash balance will grow, given the inherent time lag between approval and disbursement. The table below shows at (A) that by the end of 2007, the cash balance would be approximately US\$ 5 billion assuming contributions will match projected resource needs.

2.2.2 Promissory Notes Alternatively, if contributions were made by promissory notes that were encashed in installments over two-and-a-half years, this would be adequate to meet the Fund's projected disbursement needs. Financing the needs in this manner would reduce the Fund's cash balance to approximately US\$ 1.7 billion by the end of 2007, as shown at (B) below. This is 66% less than would be the case if 90% of contributions continued to be made in cash. (However, contribution by promissory note may not be a feasible or preferred option for all donors.)

Impact of Promissory Notes on Cash Balance

\$ billion	2002-04	2005	2006	2007	2008	2009	2010	Total
Grant Approvals	3.2	2.3	3.5	3.6				12.6
Contributions (in cash or notes)	3.3	2.2	3.6	3.7				12.8
A Cash Flows, if 10% of contributions were paid by promissory note:								
Contributions Encashed	3.1	2.3	3.4	3.6	0.2	0.1		12.8
Grant Disbursements	-0.9	-1.2	-2.3	-2.9	-3.0	-2.0	-0.3	-12.6
Operating Exps. less Int.								
Cash at start of year		2.2	3.3	4.4	5.0	2.3	0.4	
Cash at end of year	2.2	3.3	4.4	5.0	2.3	0.4	0.2	0.2
Unencashed Notes	0.2	0.1	0.3	0.4	0.1			
B Cash Flows, if 100% of contributions were paid by promissory note:								
Contributions Encashed	3.1	1.0	1.9	3.2	2.4	1.2		12.8
Grant Disbursements	-0.9	-1.2	-2.3	-2.9	-3.0	-2.0	-0.3	-12.6
Operating Exps. less Int.			-0.1	-0.1				-0.2
Cash at start of year		2.2	1.9	1.5	1.7	1.1	0.3	
Cash at end of year	2.2	1.9	1.5	1.7	1.1	0.3		0.0
Unencashed Notes	0.2	1.5	3.1	3.6	1.2			
(Notes: Includes Operating Expenses to 2007. Assumes interest of 1.5% per annum. Totals may appear not to add because of rounding.)								

(See Annex 5 for further details of the above cash flows.)

2.2.3 Possible encashment schedule Fund policy allows for promissory notes to be encashed according to an agreed schedule¹. The required timing of cash inflows could be achieved if promissory notes were encashed in six equal installments according to a schedule such as:

Contribution for 2006:

- First installment: 31 March 2006
- Second installment: 30 September 2006
- Third installment: 31 March 2007
- Fourth installment: 30 September 2007
- Fifth installment: 31 March 2008
- Sixth installment: 30 September 2008

¹ The Global Fund shall consider as assets for the purposes of entering into grant agreements, promissory notes or similar obligations issued by the government of a sovereign state (or its designated depository) which shall be non-negotiable, non-interest bearing and payable at par value to the account of the Fund in the designated depository on demand or in accordance with an encashment schedule agreed between the contributor and the Secretariat. (Decision of Seventh Board Meeting, 18-19 March 2004.)

It is proposed that promissory notes be payable on demand, although the planned calling for encashment would be according to the agreed encashment schedule. This would allow, in exceptional circumstances, the calling of notes in advance of the envisaged date in order to meet any unforeseen need for liquidity.

It is assumed that a contribution would be made by deposit of the promissory note (or in cash) in the first quarter of the year for which contributed. This contrasts with experience of the Fund to date where contributions have been made (in cash) throughout the year.

The making of the contribution in this manner would also facilitate matching requirements for the United States contribution, which takes account of contributions made (including contributions made by deposit of a promissory note) by 31 July each year for matching calculations.

- 2.2.4 Currency of Promissory Notes In order to limit the Fund's exposure to currency losses, it is proposed that contributors be encouraged to denominate their promissory notes in one of the "grant currencies": US dollar or Euro.

2.3 Currency and Translation Rates for Replenishment Calculations

To date, all grants made by the Fund are denominated in US dollars. From 2005, applicants may apply for grants (new grants or Phase II renewals) in Euros, as well as US dollars. No application has yet been made for a Euro denominated grant and it will only be in June 2005 when Round 5 proposals are received that a view of demand will begin to emerge. Accordingly, it is envisaged that the major portion of the Fund's grant liabilities will continue to be in US dollars through 2007. The financial reporting currency of the Fund is also US dollars.

For these reasons, it is proposed that the reporting currency of the voluntary replenishment be US dollars. For replenishment calculation purposes (only), contributions to be made in other currencies would be translated to a US dollar equivalent using an agreed rate of exchange for each currency. It is proposed that the agreed rate be the simple average of the rates on the first day of January, February, March, April, May and June 2005 as published by the United Nations.

2.4 Level of Contribution and Board Representation

The Board of the Global Fund is structured to ensure a balance between donor seats and recipient seats. The voting mechanism reinforces this balance with two equal voting blocks of nine seats each: a recipient block and a donor block. Two thirds of each "voting block" is required to make decisions, in cases where full consensus cannot be reached. The donor structure therefore originally allowed for nine voting seats for donors, with two of those being reserved for the Private Sector and Private Foundations constituencies, thus leaving seven donor seats to be allocated to public sector donor representatives.

These seven public sector donor seats were then allocated amongst donor groups based informally on a "share" principle with each seat being merited by contributions of approximately US\$ 100 million (or more) per year. Donors either provided finance that allowed them to maintain their own seat, or grouped themselves appropriately to

ensure the group total contribution met the indicative threshold. The seven seats have one vote each, regardless of whether they are held by one country or shared between several.

The addition of another voting member to the recipient group in June 2004 (the NGO representing Communities living with the diseases wished to become a voting member) raised the possibility of an additional donor seat – thus opening the door for either a reorganization of the donor group based on revised shares, or the addition of an entirely new donor or donor group to the Board while maintaining the current “cost” of a seat.

The Board expressed a strong wish for the additional donor seat to be used by a new donor – or a new and substantial contribution from an existing donor. In other words, the Board wanted to use the new seat to increase the “cost of a seat”, and to attract new money. Initial donor consultations on the issue indicate that the “cost” of the original seven public sector seats has increased to the region of US\$ 140 million per year as a minimum, and that there is still optimism that the possible eighth donor seat could be used to attract additional money from new donors. In addition, several individual country donors significantly exceed the threshold and we anticipate that this generosity will continue.

It should be noted that these arrangements are informal and that donors rely on consultations and consensus in establishing the parameters for engagement in this regard, rather than any fixed rules or codes.

Annex 1: Contributions Through 2004 (US\$)

DONOR	2001-2002	2003	2004	TOTAL	% of Total
Governments					
United States	300,000,000	322,725,000	458,881,279	1,081,606,279	32.5%
European Commission	137,064,385	50,360,226	264,413,350	451,837,961	13.6%
France	59,005,000	63,679,739	196,078,431	318,763,170	9.6%
Japan	80,400,337	79,993,443	104,726,233	265,120,013	8.0%
Italy	108,618,673	106,541,600		215,160,273	6.5%
United Kingdom	78,215,278	40,032,750	60,333,210	178,581,238	5.4%
Netherlands	8,087,400	43,590,360	54,344,679	106,022,439	3.2%
Canada	25,000,000	25,000,000	50,005,530	100,005,530	3.0%
Germany	11,995,200	37,427,325	45,944,850	95,367,375	2.9%
Sweden	22,369,965	11,488,363	47,811,683	81,670,011	2.5%
Norway	17,962,003	17,709,581	17,864,799	53,536,383	1.6%
Spain		35,000,000	15,000,000	50,000,000	1.5%
Denmark	14,816,511	13,790,866	16,188,433	44,795,810	1.3%
Ireland	9,835,000	11,161,430	12,299,000	33,295,430	1.0%
Belgium	12,207,409	7,229,938	10,270,518	29,707,866	0.89%
Australia			13,827,500	13,827,500	0.42%
Switzerland	5,594,133	4,405,973	2,343,384	12,343,490	0.37%
Russia	1,000,000	4,000,000	5,000,000	10,000,000	0.30%
Nigeria	9,080,914			9,080,914	0.27%
Luxembourg	1,037,500	1,094,820	3,410,752	5,543,072	0.17%
Saudi Arabia		2,500,000	2,500,000	5,000,000	0.15%
China		2,000,000	2,000,000	4,000,000	0.12%
South Africa		2,000,000		2,000,000	0.06%
Thailand		1,000,000	1,000,000	2,000,000	0.06%
New Zealand		734,000	625,200	1,359,200	0.04%
Austria	1,075,900			1,075,900	0.03%
Kuwait		1,000,000		1,000,000	0.03%
Portugal		400,000	600,000	1,000,000	0.03%
Korea (Republic of)			500,000	500,000	0.02%
Uganda			500,000	500,000	0.02%
Iceland			206,299	206,299	0.01%
Singapore			200,000	200,000	0.01%
Liechtenstein	100,000		77,190	177,190	0.01%
Zimbabwe		158,462		158,462	0.005%
Monaco	44,000	44,000	44,000	132,000	0.004%
Andorra	100,000			100,000	0.003%
Barbados		100,000		100,000	0.003%
Burkina Faso	75,000			75,000	0.002%
Brazil		50,000		50,000	0.002%
Poland		20,000	10,000	30,000	0.001%
Zambia	25,000			25,000	0.001%
Hungary			10,000	10,000	0.000%
Kenya	8,273			8,273	0.000%
Slovenia			5,479	5,479	0.000%
Total - Governments	903,717,881	885,237,875	1,387,021,799	3,175,977,556	95.4%
Private Sector	53,236,804	50,165,113	50,867,359	154,269,276	4.6%
Total	956,954,685	935,402,988	1,437,889,158	3,330,246,831	100%

Annex 2: Grants Approved & Disbursed

Grants approved through 2004

US\$ millions	Grant Agreements Signed	Agreements Not Yet Signed	Total Approved by Board	Disbursed	Not Yet Disbursed
Round 1	545	10	555	370	185
Round 2	807	52	859	336	523
Round 3	543	92	635	135	500
Round 4	72	966	1,038	19	1,019
Accelerated access to Phase II funding	3	117	120	0	120
Totals	1,970	1,237	3,207	860	2,347
	\$2.0bn	\$1.2bn	\$3.2bn	\$0.9bn	\$2.3bn

Annex 3: Pledges Not Yet Fulfilled (at 23 February 2005)

DONOR	PLEDGES by YEAR DUE (in USD)						TOTAL
	2004	2005	2006	2007	2008	Period to be Confirmed	
Australia		3,878,976					3,878,976
Belgium		6,601,307	6,601,307	6,601,307			19,803,922
Brazil	50,000						50,000
Canada		56,451,613					56,451,613
China		2,000,000	2,000,000	2,000,000			6,000,000
Denmark		24,604,569					24,604,569
European Commission		56,209,150	56,209,150				112,418,301
France		196,078,431	196,078,431				392,156,863
Germany		107,189,542	94,117,647	96,078,431			297,385,621
Greece						326,797	326,797
Hungary		12,000					12,000
Italy	130,718,954	130,718,954					261,437,908
Liberia						25,000	25,000
Netherlands		60,130,719					60,130,719
Niger						50,000	50,000
Russia		5,000,000	5,000,000				10,000,000
Rwanda						1,000,000	1,000,000
Saudi Arabia		2,500,000	2,500,000				5,000,000
Singapore		200,000	200,000	200,000	200,000		800,000
Spain		15,000,000	35,000,000				50,000,000
Thailand		1,000,000	1,000,000	1,000,000			3,000,000
Uganda		500,000	500,000	500,000			1,500,000
United Kingdom		91,194,969	96,855,346	96,855,346			284,905,660
United States		435,000,000	200,000,000	200,000,000	200,000,000		1,035,000,000
Health Authorities of Taiwan	1,000,000						1,000,000
Total	131,768,954	1,194,270,231	696,061,882	403,235,084	200,200,000	1,401,797	2,626,937,949
	\$0.1bn	\$1.2bn	\$0.7bn	\$0.4bn	\$0.2bn	\$0.0bn	\$2.6bn

Annex 4: Scope of Fiscal Management Study

Terms of Reference for Study of the Global Fund's Fiscal Management Structure and Processes (Extract)

Scope: The matters addressed by the study should include the following:

(A) Policy regarding asset cover for grants

- Consider the appropriate degree of asset cover for grant commitments, having regard to:
 - Best practices;
 - The interests of donors and recipients;
 - The Fund's legal obligations (including in Switzerland); and
 - The nature and timing of the Fund's cash flows
- Identify and assess alternatives to the Fund's current policy of requiring sufficient cash or promissory notes to be on hand to cover the entire amount of each grant at the time of signing the grant agreement, taking account of:
 - The multi-year disbursement profile of the Fund's grants;
 - The replenishment mechanism to be introduced in 2005;
 - The cash-flow impact of the increased use of promissory note as a contribution mode that could result from the replenishment mechanism; and
 - The consequences for investment income.

(B) Investment Strategy

- Identify the investment strategies best suited to the needs of the Fund, having regard to:
 - Risk profile/capital preservation requirements;
 - Liquidity needs
 - Currency mix of assets and grant commitments; and
 - Proportions of contributions in cash and promissory notes.
- Consider the range of investment mechanisms available via the Trustee and their fit with the investment strategies identified as best suiting the needs of the Fund.
- Analyse the comparative strengths of the Trustee and commercial banks, including:
 - The suitability to the Fund of the investment mechanisms available; and
 - The security of the Fund's assets, having regard to the stability and prudential regulation of each category of institution and the applicability of legal immunities to assets held by either category of institution.
- Based on the foregoing, make recommendations to the Monitoring, Evaluation, Finance and Audit Committee that the Global Fund might wish to discuss with the Trustee.

Annex 5: Impact of Promissory Notes on Cash Balance

This considers two scenarios: (A) where the level of promissory note usage remains at 10% of contributions and (B) where all contributions are paid by promissory note.

It is assumed that promissory notes are encashed in six equal installments at six-month intervals commencing on 31 March of the year of contribution.

Under scenario A (10% promissory note usage), the Fund's cash balance is projected to grow from US\$ 2.2 billion at end of 2004 to US\$ 5 billion by end of 2007, whereas under scenario B (100% promissory note usage) the cash balance would reduce to US\$ 1.7 billion.

Scenario (A)

If 10% of contributions were paid by promissory note:

\$ million	2002-04	2005	2006	2007	2008	2009	2010	Total
Grants								
Approved	3,207	2,311	3,503	3,612				12,633
Disbursed	860	1,229	2,279	2,931	3,040	2,002	292	12,633
Contributions								
Total contributed	3,308	2,240	3,561	3,665				12,774
Contributed in Cash	2,980	2,016	3,205	3,299				11,499
Contributed by note	328	224	356	367				1,275
Encashment of notes	90	313	193	316	241	122		1,275
Cash Flows								
Contributed in Cash	2,980	2,016	3,205	3,299				11,499
Encashment of Notes	90	313	193	316	241	122		1,275
Total Encashed	3,070	2,329	3,398	3,614	241	122		12,774
Grant Disbursements	-860	-1,229	-2,279	-2,931	-3,040	-2,002	-292	-12,633
Operating Expenses	-84	-65	-70	-80				-299
Interest	72	38	55	69	58	20	1	314
Net Cash Flow	2,198	1,073	1,104	672	-2,741	-1,860	-291	156
Cash at Start		2,198	3,271	4,375	5,048	2,307	447	
Cash at End	2,198	3,271	4,375	5,048	2,307	447	156	156
Unencashed Prom. Notes		238	149	312	363	122		

(Notes: Includes Operating Expenses to 2007. Assumes interest of 1.5% per annum.)

Cash Balance \$5.0bn

Scenario (B)

If 100% of contributions were paid by promissory note:

\$ million	2002-04	2005	2006	2007	2008	2009	2010	Total
Grants								
Approved	3,207	2,311	3,503	3,612				12,633
Disbursed	860	1,229	2,279	2,931	3,040	2,002	292	12,633
Contributions								
Total contributed	3,308	2,240	3,561	3,665				12,774
Contributed in Cash	2,980							2,980
Contributed by note	328	2,240	3,561	3,665				9,794
Encashment of notes	90	985	1,934	3,155	2,409	1,222		9,794
Cash Flows								
Contributed in Cash	2,980							2,980
Encashment of Notes	90	985	1,934	3,155	2,409	1,222		9,794
Total Encashed	3,070	985	1,934	3,155	2,409	1,222		12,774
Grant Disbursements	-860	-1,229	-2,279	-2,931	-3,040	-2,002	-292	-12,633
Operating Expenses	-84	-65	-70	-80				-299
Interest	72	31	25	20	16	6	1	170
Net Cash Flow	2,198	-279	-391	164	-615	-774	-291	13
Cash at Start		2,198	1,920	1,529	1,693	1,078	304	
Cash at End	2,198	1,920	1,529	1,693	1,078	304	13	13
Unencashed Promissory Notes	238	1,493	3,121	3,630	1,222			

(Notes: Includes Operating Expenses to 2007. Assumes interest of 1.5% per annum.)

Cash Balance \$1.7bn