Investing in our future
The Global Fund
To Fight AIDS, Tuberculosis and Malaria

**Eighth Board Meeting**
**Geneva, 28 - 30 June 2004**

**GF/B8/9**

# REPORT OF THE PORTFOLIO MANAGEMENT AND PROCUREMENT COMMITTEE

**Outline:** This report covers the deliberations of the Portfolio Management and Procurement Committee, including an update on the work of the Technical Review Panel, several portfolio management issues (particularly around eligibility criteria), and in-kind donations.

**Summary of Decision Points:**

The PMPC recommends that:

1. The Board adopts the decision points related to the Technical Review Panel (decision points 1 – 3 on page 3);

2. The Board adopts the definitions of eligibility criteria (decision point 4 on pages 5 – 6);

3. The Board requests the Secretariat to begin preparations for the Fifth Call for Proposals, to enable a decision at the Ninth Board Meeting on the Fifth Call for Proposals(decision point 5 on page 7);

4. The Board adopts the recommendation on in-kind donations (decision point 6 on page 9).

**Part 1: Introduction**

1. The Portfolio Management and Procurement Committee met on 13 – 14 May 2004 in Geneva. In the afternoon of 14 May, the committee held a joint session on in-kind donations with the Resource Mobilization and Communications Committee. The agenda for the meeting is included as Annex 1.

2. The Chair and Vice-Chair of the meeting were Professor Francis Omaswa (East and Southern Africa) and Dr. Kate Taylor (Private Sector), respectively. The list of attendees is included as Annex 2.

3. The Canada (Germany, Switzerland, and the UK) and the U.S. constituencies expressed their concern at the late distribution of some of the background documents. While acknowledging that this was the result of the overload of work at the Secretariat, they regretted the fact that it made consultation difficult within the constituency and that they would therefore have to reserve the right to later reverse the positions taken in the committee deliberations. After the meeting, the European Commission also expressed similar concerns. All references below to “unanimous” or “consensus” recommendations should therefore be understood to contain this proviso.

**Part 2: TRP Update**

1. The Chair and Vice-Chair of the Technical Review Panel (TRP), Professor Michel Kazatchkine and Dr. Jonathan Broomberg, respectively, presented the committee with an update on the TRP’s work, particularly around the clarifications for approved Round 3 proposal. The TRP review of the Round 4 proposals was still ongoing at the time of the PMPC meeting and its results are discussed separately (see GF/B8/5).

2. Seventy-one components were approved in Round 3, and the TRP clarifications process went smoothly for the large bulk of them. With two proposals – the Angola CCM malaria proposal and the Benin CCM malaria proposal – the unavailability of the TRP reviewers caused the process of completing the TRP clarifications to exceed the deadline originally set by the Board. However, they have now satisfactorily finished the process, and the TRP recommends that the Board exempt these two proposals from the usual deadline. The PMPC unanimously supported this position and made the following recommendation to the Board.

3. Satisfactory responses were not provided for two proposals: the Chad CCM malaria proposal and the Kenya CCM tuberculosis proposal. The TRP Chair and Vice-Chair therefore could not give final approval to these proposals, and they have thus been reclassified from category 2 to category 3. The PMPC noted the reclassification of these two proposals into category 3, in light of the failure of these proposals to satisfactorily address the clarifications requested by the Technical Review Panel.

4. The Chair of the TRP, Professor Michel Kazatchkine, noted that this was his final TRP session and introduced the committee to the current Vice Chair and incoming Chair, Dr. Jonathan Broomberg. Professor Kazatchkine observed that Dr. Broomberg was currently in his third Round, and that if the normal procedures for the rotation of TRP members were to be followed, he would be obliged to leave after Round 5. In order to ensure greater stability in the leadership of the TRP, Professor Kazatchkine urged the Board to exempt Dr. Broomberg from this requirement to allow him to serve two Rounds as Chair of the TRP. The PMPC unanimously agreed and made the following recommendation to the Board.

5. The PMPC praised Professor Kazatchkine for the leadership that he has showed since the first days of the TRP. A number of members remarked that without his vision and commitment, the TRP would not have developed into the strong part of the Global Fund that it is today. The PMPC thus unanimously made the following recommendation to the Board.

***Decision Points 1-3:***

***The PMPC recommends that:***

***1. The Board exempts the Round 3 proposals from the Angola CCM on malaria and from the Benin CCM on malaria from the requirement that all TRP clarifications for proposals in Category 2 should be received within 6 weeks of the applicant's receipt of the initial decision of the Board, and any further clarifications should be completed within 4 months from the receipt of the initial reply from the applicant, in light of the evidence presented by the TRP that this timeframe was impossible to meet due to delays caused by the unavailability of TRP reviewers.***

***There are no material budgetary implications for this decision point.***

***2. The Board exempts the incoming Chair of the TRP, Jonathan Broomberg, from the requirement that TRP members leave the TRP after four Rounds of proposal review, in light of the need for continuity in the leadership of the TRP.***

***There are no material budgetary implications for this decision point.***

***3. The Board commends the Technical Review Panel for its dedicated efforts to ensure that Global Fund financing targets only technically sound proposals. Special recognition is due to the outgoing chair of the Technical Review Panel, Michel Kazatchkine, for his leadership, vision, and dedication to the development of the Technical Review Panel.***

***There are no material budgetary implications for this decision point.***

## Part 3: Definitions of Eligibility Criteria

1. At its Fourth meeting, the Board introduced additional requirements for proposals from countries classified by the World Bank as Upper- and Lower-Middle Income to be deemed eligible. Specifically, these proposals are required to demonstrate:

   a. Co-financing;
   b. Focusing on poor or vulnerable populations;
   c. Moving over time to an increasing reliance on domestic resources. (GF/B5/2 p 22)

2. The Board has not, however, defined any of these three concepts. The PMPC has previously examined the definition of co-financing in some detail but the Board has not been asked to codify definitions of this or either of the other two terms.

3. The absence of these definitions has led to a lack of clarity in the Guidelines for Proposals, with numerous applicants seeking guidance from the Secretariat on, for example,

the necessary level of co-financing required. This first occurred in the Third Round, and has recently recurred in the Fourth Round.

4. The discussion in the committee focused primarily on co-financing, looking at four inter-related dimensions of it:

a. Scope: whether co-financing should encompass an entire disease program (typically national, but potential also either sub-national or regional), or if the scope should be limited to the particular services to be delivered;
b. Source: whether resources for co-financing can be drawn from both domestic and external sources, or exclusively from domestic resources;
c. Type: whether co-financing should be in the form of parallel co-financing (in which the Global Fund would finance distinct goods and services, or different parts of a program from any co-financiers) or joint co-financing (in which the Global Fund would enter into legal agreements with other financiers which would result in an agreed-upon disbursement schedules and proportions);
d. Level: how much co-financing should be required for proposals from Upper-Middle Income countries and from Lower-Middle Income countries, respectively.

5. The committee was ultimately able to reach consensus on the recommendation below. The committee felt that it was appropriate to limit co-financing to domestic resources, in order to highlight the centrality of domestic political commitment in the fight against AIDS, tuberculosis, and malaria. The definition would encompass the entire disease program, in line with the Global Fund's mandate to fill gaps in existing financing efforts and to promote new and innovative programs (which might not be able to demonstrate co-financing, if the definition was restricted to only the services to be delivered).

6. Once it was clarified that parallel co-financing would not inhibit the Global Fund's ability to participate in harmonized financing arrangements (e.g., sector-wide approaches), the committee recommended that co-financing be in the form of parallel co-financing (as joint co-financing would require significant changes to both the approach to performance-based funding and to Secretariat staffing).

7. The committee also agreed upon appropriate levels for co-financing: 12% for proposals from Upper-Middle Income countries and 5% for proposals from Lower-Middle Income countries. A number of committee members felt that it would be more appropriate to initially set higher requirements, citing the fact that these figures were at the lower range of what was typically required by other development institutions. However, guided by the principle that the committee did not want to be overly restrictive and thus exclude applicants inappropriately, the committee agreed to recommend the lower numbers with the proviso that they would regularly be revisited in the light of experience.

8. Once the committee had agreed to limit the source of co-financing to domestic resources, it recognized that the distinction between two of the criteria the Board had previous identified – co-financing and moving over time to an increasing reliance on domestic resources – was no longer appropriate. The committee therefore unanimously recommended that these two criteria be consolidated into a single one, renamed "counterpart financing" to bring it into line with the terminology used by other development partners.

9. The committee discussed whether proposals would be required to demonstrate that the levels of counterpart financing (i.e., the 12% for proposals from Upper-Middle Income countries and 5% for proposals from Lower-Middle Income countries) increased over the course of a program (for example, from 12% to 15% after one year and to 20% after two

years), but ultimately agreed that this should not be a requirement. The committee did, though, agree that such an increase should be encouraged.

10. The committee unanimously agreed that the counterpart financing eligibility criterion should not apply to non-CCM proposals, as this would establish a major additional hurdle to non-CCM proposals. This is consistent with earlier discussions at the Sixth Board Meeting, which had requested the PMPC to review this specific point.

11. The committee discussed the difficulties of defining the term "poor or vulnerable populations" and unanimously recommended that the Board not further define it, but instead allow applicants to use their own definitions. Additionally, the committee requested the Secretariat to work with technical partners, such as the World Health Organization, UNAIDS, and the World Bank, to further develop definitions of this term.

12. The PMPC thus unanimously made the following recommendation to the Board.

***<u>Decision Point 4:</u>***

***The PMPC recommends that:***

***4. The Board replaces the current eligibility criteria of "co-financing" and "moving over time to an increasing reliance on domestic resources" with a single criterion termed "counterpart financing." The Board adopts the following definition of counterpart financing:***

- ***a. Counterpart financing encompasses all domestic resources (including contributions from governments, loans from external sources or private creditors, debt relief proceeds, and private contributions such as from non-governmental organizations, faith-based organizations, other domestic partners, and user fees) dedicated to the disease program;***
- ***b. Counterpart financing is in the form of parallel financing.***

***The Board requests the Secretariat to only deem eligible proposals from Upper-Middle Income countries that demonstrate 12% counterpart financing, and from Lower-Middle Income countries that demonstrate 5% counterpart financing for the first year of proposed Global Fund grant implementation.***

***The Board does not require proposals to demonstrate an increase in counterpart financing over the proposed duration of a Global Fund grant, but such an increase would be encouraged.***

***The Board exempts non-CCM proposals from the counterpart financing requirement.***

***The Board will not further define the eligibility criterion "focusing on poor or vulnerable populations" and instead will allow applicants to use their own definitions of poor or vulnerable populations. The Board requests the Secretariat to work with partners such as the World Health Organization, UNAIDS, and the World Bank to further refine this term in order to provide guidance to applicants.***

***<u>There are no material budgetary implications for this decision point.</u>***

## Part 4: Proposals from Upper-Middle Income Countries Focusing Exclusively on Vulnerable Populations that Do Not Receive Significant Funding from Domestic or External Sources

1. At the Seventh Board Meeting, the Board did not approve two options proposed by the PMPC on "Proposals from Upper-Middle Income countries focusing exclusively on vulnerable populations that do not receive significant funding from domestic or external sources." At that time, the Chair of the Board clarified that this means that the existing (Round 4) eligibility criteria for proposals from Upper-Middle Income countries would apply for Round 5.

2. The committee recognized that the majority of Board members want to keep the current eligibility criteria for proposals from Upper-Middle Income countries (when voted upon at the Seventh Board Meeting, this option narrowly failed to achieve a double majority), but that some constituencies consider changing the current criteria as a matter of utmost importance. Therefore, the committee agreed that those delegations that are particularly keen to change the current criteria should prepare a series of options for the next PMPC meeting. UNAIDS agreed to coordinate this work.

## Part 5: Prioritization of Proposals in a Resource-Constrained Environment

1. At the Seventh Board Meeting, the Board adopted a system for prioritizing proposals in a resource-constrained environment, based on the criteria of poverty and disease burden. It debated including a third criterion that would prioritize proposals that either had not been successfully repeatedly or were from countries that had not previously received funding, but ultimately decided to use only poverty and disease burden for Round 4. The Board asked the PMPC to do further work to address the concerns of those advocating for prioritizing proposals that had repeatedly not been successful or were from countries that had not previously received funding.

2. The PMPC noted that this issue was not urgent and decided to revisit the issue based on the experience in Round 4 with the approach to prioritization approved at the Seventh Board, and based on an assessment of the magnitude of the problem of repeat rejections and/or countries that have not received financing after the TRP review of the Round 4 proposals.

## Part 6: Prioritization of Phase 2 Renewals in a Resource-Constrained Environment

1. Both the PMPC and the Monitoring, Evaluation, Finance and Audit (MEFA) Committee were asked at the Seventh Board Meeting to examine the issue of the prioritization of Phase 2 renewals in the event of resource constraints. As the two committees had done for the first set of recommendations on Phase 2, the MEFA Committee took the lead, and the result of their deliberations was presented to the PMPC.

2. The PMPC agreed with all of the recommendations emanating from the MEFA Committee. The PMPC felt that further attention should be paid to the issue of special considerations for programs with ongoing treatment components and proposed an additional decision point on the topic. As is reflected in the final recommendation (see GF/B8/8 Report of the MEFA Committee), the PMPC felt that the Secretariat should urgently do further work on this topic, both by examining possible internal mechanisms to address the problem and by working with partners (particularly in the context of broader national strategic frameworks).

**Part 7: Preparation for the Fifth Call for Proposals**

1. The committee discussed the timing for the launch of the Fifth Call for Proposals. It was noted that the historical practice has been for the Board to agree upon the timing of the launch of a new Call for Proposals in the same Board meeting at which the TRP recommendations from the preceding Call were considered. However, several committee members expressed reservations at continuing with this practice at the upcoming Eighth Board Meeting, citing the more complicated environment today with advent of Phase 2 renewals. The PMPC did unanimously believe, though, that it was important for the Secretariat to begin preparations for the next Call for Proposals, including taking lessons learned from the Fourth Call for Proposals to commence the revisions of the Guidelines for Proposals.

***Decision Point 5:***

***The PMPC recommends that:***

***5. The Board requests the Secretariat to begin preparations for the Fifth Call for Proposals, to enable a decision at the Ninth Board Meeting on the Fifth Call for Proposals.***

***There are no material budgetary implications for this decision point.***

**Part 8: In-Kind Donations**

1. The PMPC (and its predecessor) has had a series of discussions on in-kind discussions over the past eighteen months. At its May meeting, the committee focused on examining whether the four operational issues that the Board had previously identified (conflicts of interest, legal liability, sustainability, and valuation) could be addressed satisfactorily.

2. The committee both discussed the topic internally and held a joint session with the Resource Mobilization and Communications Committee (in line with the previous Board decision to set up a joint working group). The discussion was facilitated by a Secretariat discussion paper that reviewed the previous work done on the subject, addressed each of the four operational issues, and provided a model for how the four issues could be surmounted (in the context of the Global Fund's broader principles), which is included as Annex 3.

3. The topic of in-kind donations evoked considerable debate among the committee members, with some delegates stating that they had in-principle objections to the Global Fund accepting in-kind donations (in some cases, as with the European Commission, a position based on a pre-existing policy against the use of in-kind donations in a developmental context). In contrast, the Private Sector delegate stated that this was one of – if not the – most important way that it could contribute to the Global Fund.

4. Despite these fundamental differences, the committee was able to reach consensus on many of the operating principles advanced in the Secretariat discussion paper, including that the management of any system should be outsourced, that existing Global Fund procurement and supply management polices would apply to in-kind donations, and that recipients should have the choice of whether or not to accept in-kind donations (without any incentive system). There was consensus that the most appropriate entity at country level to

do this was the CCM, although some members questioned whether CCMs could be expected to have all of the requisite information to make fully informed decisions.

5. The committee was more divided on the question of whether the Global Fund should accept in-kind donations at all, particularly for drugs (although a number of delegates stated that they had less information about non-pharmaceutical products and services, there was considerably less opposition to the idea of the Global Fund accepting donations for non-pharmaceutical products and services).

6. Those opposed to the Global Fund accepting donations of drugs were primarily concerned about the market impact these donations could have (particularly on infant industries in developing countries), the implications for product selection (e.g., they worried that the availability of a product donation might create an incentive to use a product different from what the recipient would have otherwise used), the sustainability of donations, and the difficulty of valuation (particularly for products with unstable and/or rapidly changing market dynamics). There was also a sentiment that the management costs to the Secretariat of setting up the system would be significant (perhaps even exceeding the value of the system) and that it would not be cost-effective compared to other means of expanding the availability of medicines (e.g., using the same resources to negotiate price reductions on health products could yield a bigger and more sustainable benefit to recipients). Those opposed to the Global Fund accepting in-kind donations for pharmaceutical products also cited the negative experiences that a number of recipients had had with drug donation programs.

7. Those in favor of the Global Fund accepting in-kind donations noted that drugs were likely to constitute a significant percentage of in-kind donations, and so ruling them out would mean excluding a large potential value of additional resource for the Global Fund. They also pointed out that a number of recipients already participate in existing donation programs that occur outside the Global Fund context, so it is not clear why they should not be offered the choice within the Global Fund framework, if that assists to mobilize large volumes of additional resources for the organization. They felt that the experience of earlier programs was only partially relevant, because in those programs a recipient was forced to choose between receiving a donation or receiving nothing, whereas in the context of the Global Fund, a recipient would be choosing between a donation and receiving the equivalent value in cash (meaning that there should be no concern about skewing of product selection). Further, they argued that if the Global Fund accepted in-kind donations and applied its procurement and supply management policies, the impact of this would be to force other donations schemes to improve their quality, thus having benefits beyond simply the Global Fund program. Finally, they also noted that the costs of managing such a system could be partially or wholly offset by a donation.

8. Ultimately, the majority of the committee agreed – and then subsequently shared this consensus with the Resource Mobilization and Communications Committee, which concurred – to recommend that the Global Fund accept the in-kind donations of non-pharmaceutical products and services. The committee recommended further work on the issue of the acceptance of drugs.

9. The committees recommended that the Secretariat develop a business plan for the receipt of in-kind donations. This plan would cover both pharmaceutical and non-pharmaceutical products and services, although would recognize that the Board had only approved the latter. The system developed in the plan would be guided by a number of the principles unanimously endorsed, as mentioned above. The recommendation also describes an oversight mechanism for the development of the plan, specific aspects of the topic that should be explored in it, and notes the need for both continuous review and formal evaluation.

***Decision Point 6:***

***The PMPC and RMCC recommend that:***

***6.1. The Board decides to:***

- ***a. Accept in principle in-kind donations of non-pharmaceutical products and services; and***
- ***b. Explore the potential of in-kind donations of pharmaceutical products.***

***6.2. In recognition of the complexities surrounding in-kind donations, the Board requests the Secretariat to develop a business plan for the receipt of in-kind donations by the Ninth Board Meeting. This plan would be based upon the following principles:***

- ***a. The Global Fund is a financial instrument, not an implementing entity;***
- ***b. The Global Fund will base its work on programs that reflect national ownership and respect country-led formulation and implementation processes;***
- ***c. Country Coordinating Mechanisms would choose whether or not they wish to accept in-kind donations, without incentives;***
- ***d. All Global Fund procurement and supply management policies would apply to in-kind donations;***
- ***e. The management of the in-kind donation system would be outsourced.***

***6.3. The Board adopts the following process to develop a business plan:***

- ***a. An on-going working group composed of members of the PMPC and other relevant committees would be charged with oversight of the development of the business plan, and would provide a report to each PMPC meeting;***
- ***b. Guidelines for the use of CCMs for guarding against conflicts of interest, legal liabilities, and meeting Global Fund procurement and supply management quality assurance standards will be prepared by the PMPC (as advised by the Procurement and Supply Management Advisory Panel);***
- ***c. The experience with the system would be reviewed on a continuous basis and would be formally evaluated at the end of the first year of its operations.***

***Budgetary implications of this decision point:***

***The additional cost of implementing this decision in 2004 is estimated in the range of US$300,000 and US$350,000.***

**Part 9: Update on Pre-qualification of Procurement Agents (WHO)**

1. At the Seventh Board Meeting, the Board commended the World Health Organization for its work with partners to develop a system for pre-qualifying procurement agents. In light of the importance of this project for Global Fund recipients, the Board further asked the World Health Organization to report back on progress in establishing the system by the Eighth Board Meeting.

2. This report was not available at the time of the completion of this document, so WHO will provide a separate update either prior to or at the Eighth Board Meeting.

**Annex 1**

**Agenda, May meeting of the Portfolio Management and Procurement Committee**

| | |
|---|---|
| *Meeting* | *Portfolio Management and Procurement* |
| *Date* | 13th – 14th May, 2004 |
| *Time* | *9:00am-6:30pm* |
| *Place* | *Global Fund Secretariat, Ground Floor large conference room (Hope Plaza)* |
| *Chair* | *Francis Omaswa* |
| *Vice Chair* | *Kate Taylor* |

## Agenda

**Thursday, May 13**

| | |
|---|---|
| Welcome Coffee in the Hope Plaza Conference Room | 8:30 |
| 1. Approval of the agenda | 9:00 - 9:05 |
| 2. TRP update | 9:05 - 9:30 |
| 3. Update on PMPC Work Plan May - June 2004 | 9:30 - 10:00 |
| 4. Prioritization: Phase II renewals in a resource constrained environment | 10:00 - 12:30 |
| Lunch (in open space on 5th floor) | 12:30 - 1:30 |
| 5. Eligibility criteria | 1:30 - 4:00 |
| Coffee Break in the Hope Plaza Conference Room | 4:00 - 4:15 |
| 6. Additional work from 7th Board | 4:15 - 6:30 |

- Proposals from Upper-Middle Income countries: vulnerable groups
- Prioritization: inclusion of “previous failure” composite index

**Friday, May 14**

| | |
|---|---|
| Morning Coffee in the Hope Plaza Conference Room | 8:30 |
| 1. Discussion on In-Kind Donations | 9:00 - 11:45 |
| Lunch at the Hotel Movenpick | 12:00 - 1:00 |
| 2. Joint session with RMCC on IKDs (at the Hotel Movenpick) | 1:00 - 3:00 |
| Coffee Break at the Hotel Movenpick | 3:00 - 3:15 |
| 3. Eligibility criteria continued as necessary in Hope Plaza | 3:30 - 4:30 |

**Annex 2**

**Attendance list, May meeting of the Portfolio Management and Procurement Committee**

| Constituency | Name |
|---|---|
| PMPC Members: | |
| Affected Communities | Kim Nichols |
| Canada (Germany, UK & Switzerland) | Thomas Fetz |
| China (Western Pacific Region) | Han Mengjie |
| Developed Country NGOs | Mogha Kamal Smith |
| East & Southern Africa | Francis Omaswa (Chair) |
| European Commission (Austria, Belgium) | Patrick Berckmans |
| France (Luxembourg, Spain) | Frédéric Goyet |
| Italy | Flavio Lovisolo |
| Latin America & Caribbean | Peter Figueroa |
| South-East Asia | Churnrurtai Kanchanachitra |
| World Bank | Jonathan Brown |
| USA | Michele DeKonty |
| WHO | Alex Ross |
| Private Sector | Kate Taylor (Vice-Chair) |
| Observers: | |
| UNAIDS | Catherine Hankins |
| Board Vice-Chair (Developed Country NGOs) | Hélène Rossert-Blavier |
| Technical Review Panel | Michel Kazatchkine |
| Technical Review Panel | Jonathan Broomberg |
| Members not present: | |
| Eastern Europe | Zhanna Tsenilova (unable to attend) |
| Japan | Takeshi Kasai |

Secretariat:
Brad Herbert
Toby Kasper
Hind Khatib Othman
Paul Lalvani
Bartolomeo Migone
Michelle Young
Hans Zweschper

# The Global Fund to Fight AIDS, Tuberculosis and Malaria
## Portfolio Management and Procurement Committee
## May 13 – 14, 2004

## DISCUSSION PAPER ON IN-KIND DONATIONS

### Background

1. At its February 2004 meeting, the Portfolio Management and Procurement Committee asked the Secretariat to prepare a discussion paper on in-kind donations. The committee asked for three specific things:
    a. A synthesis of the existing work on in-kind donations, principally the recent Accenture analysis, the initial McKinsey and Company estimations of the potential value of in-kind donations, and the commentaries on the topic developed by the Procurement and Supply Management Advisory Panel and its predecessor, the PSM Task Force.
    b. A review of the four operational issues singled out in the Sixth Board Meeting decision on in-kind donations (GF/B7/2, p 20):
        i. Guarding against conflicts of interest;
        ii. Potential legal liabilities;
        iii. Long term sustainability;
        iv. Valuation of contribution.
    c. A recommendation from the Secretariat on whether these operational obstacles could be overcome and, if so, a proposal on an operational approach for in-kind donations.

2. This work was requested so that PMPC could agree upon a committee position on the topic, which in turn would facilitate progress in the joint working group with the Resource Mobilization and Communication Committee (as requested by the Sixth Board Meeting; GF/B7/2, p 16).

3. This paper is structured in accordance with the PMPC request, beginning with a synthesis of previous work, continuing with an analysis of the four operational issues, and concluding with a recommendation and operational approach. An Annex presents the potential budgetary implications.

### Synthesis

4. In-kind donations were first discussed in the context of the Global Fund by the Procurement and Supply Management Task Force, the predecessor to the current Procurement and Supply Management Advisory Panel. The Task Force was only able to

recommend further work on the topic (GF/B3/7d, p 15), and even this recommendation was not adopted at the Third Board Meeting.

5. At the Fourth Board Meeting, the Board recognized that two committees needed to be involved in the consideration of in-kind donations. It acknowledged the decision of the Portfolio Management and Procurement Committee to consider "issues related to the related to in-kind contributions, if they are considered eligible by the Board of the Global Fund for resource mobilization, based on advice from the PSM Advisory Panel." (GF/B5/2, p 21)

6. The PMPC Report to that Board Meeting clarified that this work was contingent upon the Board affirming its desire to examine in-kind donations as a resource mobilization strategy: "The PMPC acknowledged that the Resource Mobilization Committee was tasked with recommending whether or not in-kind contributions, through any process, should be eligible for receipt by the Global Fund. The PMPC affirmed that in case in-kind contributions are eligible, critical PSM issues to ensure product quality should be considered." (GF/B4/7, p 10)

7. At the Fourth Board Meeting, the Board also approved terms of reference of the Resource Mobilization and Communications Committee (RMCC), including in these consideration of in-kind donations "in conjunction with other Committees of the Global Fund Board." (GF/B5/2, p 37) The Board also requested this committee to report to the Fifth Board meeting on a private sector resource mobilization strategy.

8. In preparation for the Fifth Board Meeting, the Procurement and Supply Management Advisory Panel twice presented the PMPC with three options on in-kind donations, at its April and May 2003 meetings. The three options were presented for consideration by the PMPC, although the PSM-AP noted that "[i]t is the understanding of the PSM Advisory Panel that the Resource Mobilization Committee will be tasked with recommending whether or not in-kind donations should be eligible for receipt by the Global Fund… The PSM Advisory Panel recommends that the following be considered by the Resource Mobilization Committee prior to taking a decision on the policy for in-kind donations."

9. The three options presented by the PSM-AP were:
    a. "[Global Fund to] accept only [Global Fund]-requested donations in accordance with other relevant [Global Fund] requirements and with the Interagency Guidelines for Drug Donations in case of provision of in-kind pharmaceutical products."
    b. "[Global Fund] to accept only services and non-health products."
    c. "[Global Fund] to accept no in-kind donations (cash only)"

10. The PSM-AP did not rank these three options, although it did note the operational complexity of the acceptance of in-kind donations, highlighting this as the main drawback to accepting in-kind donations.

11. The PMPC did not adopt any of these options, instead choosing to recommend to the Board that it carry out further work on the topic (along with the Resource Mobilization and Communications Committee) on operational aspects of the topic. The Board did not discuss the PMPC recommendation at the Fifth Board Meeting, as it deferred consideration of the entire PMPC Report to the subsequent Board Meeting.

12. The Fifth Board Meeting did consider a discussion paper prepared by the Private Sector Delegation to the Board entitled "Mobilizing Corporate Sector Resources." This

document, prepared with the assistance of a McKinsey team, assessed the possible role of in-kind donations in resource mobilization (as one of three strategies for mobilizing resources from the private sector).

13. By reviewing Round 2 proposals and discussing with potential donors, the McKinsey study estimated that in-kind donations had the potential to cover between 16% and 32% of Round 2 commitments (US$350 – 620 million). The analysis projected that the bulk of this contribution would be in the form of drugs. It also noted that the potential benefits of in-kind donations far exceed likely cash contributions of the private sector, and that models existed in which the handling of in-kind donations occurred at a minimal expense. The Board did not make any decisions based on this document

14. At the Sixth Board Meeting, both the RMCC and the PMPC presented recommendations to the Board that were adopted. The Board approved RMCC's recommendation to establish a "joint working group to develop proposals on the issue of in-kind donations," (GF/B7/2, p 16), while it also endorsed a longer recommendation from PMPC, which "recognize[d] the potential role of in-kind donations in significantly expanding the impact of the [Global Fund] and in making a significant contribution to resource mobilization efforts through providing leverage for cash resources. In-kind donations also constitute a significant means by which the private sector may be involved with the Global Fund and contribute to achieving its goals, thus reflecting the public – private partnership principles upon which the Global Fund is based." (GF/B7/2, p 20)

15. The Board decision then went on to request that the PMPC work further (with other committees, particularly the RMCC) on the four operational issues cited earlier: guarding against conflicts of interest; potential legal liabilities; long term sustainability; valuation of contribution.

16. Prior to the Seventh Board Meeting, the consulting firm Accenture carried out an analysis of the potential operational models for in-kind donations at the request of the Private Sector Delegation. This work identified six potential challenges to the development of a system for in-kind donations:
    a. In-kind donation take-up: Nearly everyone interviewed by Accenture felt that if recipients were offered a choice between donations and cash, recipients would prefer cash;
    b. Market impact: Donations could capture a market as a result of a pricing approach that by definition their competitors could not match, thereby driving the competitors out of the market, lessening competition in the future, and potentially undermining the potential for long-term local solutions;
    c. Scope and scale: Accenture developed a taxonomy of the possible goods and services that could be donated, and noted that it would be possible to restrict donations to only certain areas in order to exclude products (or services) deemed particularly complex. Similarly, a donation system could encompass all in-kind donations a recipient would receive (irrespective of their ties to the Global Fund), or the system could include only donations explicitly being made through the Global Fund (or only donations to the Global Fund of a certain minimum size);
    d. Valuation: Donations could be valued differently by donors and recipients, and there are different possible approaches to calculating the value of a donation to a recipient;
    e. Donor engagement: In order to promote donations as well as to ensure compliance with the Global Fund's requirements, a system could be

established to accredit donors, whether up front before donations were offered, or on a case-by-case basis;

f. Specific issues with drug donations, most of which were not purely related to donations, but rather broader procurement and supply management concerns: These included in-country distribution, sustainability, flexibility, the use of the appropriate drugs, and drug-specific quality assurance issues.

17. The Accenture study presented several case studies of how existing donation programs address these problems, and suggested some operating principles, including that donations should be handled as much like other procurements as possible (including have to adhere to Global Fund procurement and supply management policies), that drug donations should adhere to WHO's "Inter-Agency Guidelines on Drug Donations," and that recipients should have the choice of whether or not to accept a donation.

18. The analysis went on to propose adding three steps to the Global Fund's current resource mobilization and grants management processes, which they described as follows:
    a. In-Kind Donation Resource Mobilization: This step involved identifying donors and managing these relationships, and accrediting them (to ensure their compliance with donation policies and procedures);
    b. In-Kind Donation Matching: Two options were presented for the step of matching donations with recipient needs, which the study characterized as the most complex part of the process:
        i. A fulfillment assessment, in which the Global Fund's current procurement system would be extended to encompass in-kind donations (meaning a high-level of involvement by the Global Fund in the process);
        ii. A marketplace, in which an external electronic system would be developed to enable recipients to "buy" donated goods and services using their grant proceeds;
    c. In-Kind Donation Disbursement: This step involves ensuring the delivery of donated goods and services in such a way that there is no difference between these products and procured goods and services.

19. The Accenture paper concluded by noting that the Global Fund needed to decide whether the potential value of in-kind donations was worth setting up a system to handle them, and, if so, how each of the challenges described above would be addressed.

20. The Procurement and Supply Management Advisory Panel provided a response to the Accenture work. The PSM-AP criticized Accenture's seeming lack of consultation with key bodies involved with donations (some of which had been consulted, although this had not been clearly explained in the original Accenture paper) and review of key documents, such as WHO's "Inter-Agency Guidelines for Drug Donations." In the presentation to the PMPC, the PSM-AP highlighted the managerial challenges of accepting in-kind donations, and strongly recommended that if an in-kind donations system were established, its management should be done by a third party with experience in the field.

21. Both the RMCC and the PMPC discussed the Accenture study prior to the Seventh Board Meeting, although neither made any recommendations to that meeting. While the RMCC nominated representatives for the joint working group established at the Sixth Board Meeting, the PMPC was unable to reach a common position on the topic, and so felt that it would not be able to immediately participate in a joint working group. Instead, it preferred to wait for another discussion at the May PMPC meeting, and asked the

Secretariat to prepare the current discussion paper to facilitate the development of a PMPC position on the issue.

22. The Seventh Board Meeting only discussed the topic briefly, when the Private Sector Delegation proposed a motion that would set as a deadline the Eighth Board Meeting for the presentation of recommendations from the joint working group. This motion was withdrawn when the Chair of the Board and the Chair of the PMPC clarified that it was the intention of both to ensure that recommendations were presented at the Eighth Board Meeting.

23. Finally, virtually all previous discussions of in-kind donations have focused on donations to recipients, rather than donations to the Secretariat, and in keeping with that approach, the current paper will not examine the issue of donations to the Secretariat.

## Operational issues

### I. Guarding against conflicts of interest

24. Conflicts of interest could arise if an in-kind donation allowed a particular supplier to obtain an unfair position in a local market by virtue of its donation. Depending on the nature and length of donation, the economic effect of in-kind donations could be comparable to dumping, with competitors being pushed out of a market and the recipient left facing higher costs over the long-term.

25. Two distinct concerns can be identified and are discussed in turn:
    a. Reduced global or in-country competition;
    b. Increased lifetime program costs and reduced quality.

#### a. Reduced global and in-country competition

26. In-kind donations could be used by a competitor to unfairly capture market share in a product or service by inducing the adoption of or switching to a particular product or service. In this situation, the potential gain to the recipients of the in-kind donation could be more than offset by the negative market impact if the donation is used as a form of predatory pricing to strategically drive out competition, be it local competitors/infant industries or smaller global competitors.

27. This concern is only relevant if certain conditions are met. First, the Global Fund support would have to represent a significant share of the global demand for a particular product or service, a condition that is only likely to be met with regard to certain health products (rather than other goods or services).

28. Second, these health products would have to be made by a limited number of suppliers. Products with small numbers of suppliers are particularly vulnerable because of the heightened risk of creating monopolies (at the global, regional, or local levels) if competitors are pushed out of business. The availability of in-kind donations for these products may also create a disincentive for new entrants, as they are immediately excluded from a percentage of the market. The risk of conflicts of interest with products with limited numbers of suppliers is exacerbated by the fact that for health products there is often a correlation between limited market size and limited number of suppliers (with

larger markets naturally attracting more suppliers), increasing the likelihood that the Global Fund support account for a significant percentage of the market. Examples of products relevant to the Global Fund with limited number of suppliers include antiretrovirals, artemisinin-containing combination therapy, $CD4^+$ T-cell testing machines, HIV RNA (viral load) testing machines, insecticide-treated nets, and second-line tuberculosis drugs.

29. Third, the volume of goods donated would have to be large relative to the global demand. Even if Global Fund support constituted a large percentage of the global market, if only a small volume of goods were donated, it is unlikely that this would be sufficient to drive competitors out of business, as they could target markets not covered by the in-kind donation.

30. There are several options to address these concerns, as described in the table below:

| **Potential Solutions** | **Pros** | **Cons** |
|---|---|---|
| <u>Option A:</u><br>Limit donations could be limited to products for which either a single supplier[1] or a large number of suppliers exist | • Likely to be very effective in limiting the potential for reducing competition | • Limits the resource mobilization potential of in-kind donations<br>• Ignores the fact that recipients may already be accepting donations of limited source products (and so have local methods for ensuring the avoidance of conflicts of interest)<br>• Cost to the Global Fund to determine and monitor which products meet the criteria to be donated |
| <u>Option B:</u><br>Limit the total volume of donated goods to a percentage of the global market | • Likely to be effective in limiting the potential for reducing competition | • Limits the resource mobilization potential of in-kind donations<br>• Significant cost to the Global Fund to determine the appropriate volume above which donated goods should not be accepted, and to monitor market sizes, requiring skills not currently present in the |

[1] If only a single supplier exists, there is no danger of increased market capture as a monopoly already exists. The presence of in-kind donations may deter the entrance of competitors into the field, but without further evidence of the desire of other suppliers to enter the market this is a hypothetical worry that should not be a barrier to in-kind donations.

| | | |
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| | | Secretariat |
| <u>Option C:</u><br>Allow recipients to determine if any market capture issues exist in their country and decide whether or not to accept an in-kind donation | • Allows recipients to use existing systems to determine conflicts of interest<br>• Allows local knowledge of market conditions to inform decision-making on which products to accept as in-kind donations<br>• Preserves primacy of local ownership, in line with the Framework Document | • Despite local knowledge, recipients may not be able to accurately assess the potential for conflicts of interest because of limited knowledge about the global demand and industry structure |

31. Even if these conditions are not met, in-kind donations may nonetheless influence the shape of a local market

32. A special case not covered by the preceding analysis would be the effect on an infant industry that is aimed solely at a domestic market. In this case, the market capture caused by a donation could not be offset by the competitor(s) shifting to another market.

### b. Increased lifetime program costs and/or reduced quality

33. Another potential form of conflict of interest in the use of in-kind donations could stem from the use of a "seeding" strategy in which a donation offer is withdrawn once the product or service has been adopted by a recipient and then replaced by a premium-priced offering, resulting in higher costs for the recipient in the long term.

34. This concern is only relevant for product or service categories that require repeated purchases and have inherently significant barriers to switching, such as treatment regimens that do not allow for substitution or have high staff training costs, which in effect "lock-in" a recipient once a particular product or service is adopted. This would particularly apply to antiretroviral therapy, some diagnostics, and some infrastructure.

35. A related concern is that the cost of service a donated product might exceed that of comparable products that would have otherwise been purchased, or that the servicing necessary to ensure the reliable functioning of a donated good is not readily available in a recipient country, potentially both driving up the total cost of ownership and reducing the impact of the product. This concern is more typically related to infrastructure and non-health products (e.g., automobiles, computers, etc.), although is also applicable to laboratory equipment.

36. The only practicable solution to this potential conflict of interest is to allow recipients to gauge for themselves the likely impact and take a decision on whether or not to accept an in-kind donation in view of it. It is not feasible to imagine the Secretariat assessing and monitoring all of the myriad possible situations in which this form of conflict of interest could occur, as it would require knowledge of local contexts far in excess of what is

imaginable (unless if Local Fund Agents were very extensively involved, at a considerable cost, which would incur a considerable cost).

## II. Potential legal liabilities

### a. Introduction

37. Establishing a system for in-kind donations to recipients of Global Fund grants would increase the Global Fund's exposure to lawsuits and damage awards.

38. Procurement of any kind – whether from cash financing or through in-kind donations – opens the Global Fund up to some liability risks. With regards to in-kind donations, the Global Fund would be exposed to such risk principally because its role in facilitating the donations could be perceived as implying an endorsement of their quality and appropriateness. This might, in turn, lead to responsibility for damages that could result from those donations. For example, a court could hold the Global Fund to be liable for damages caused by a defective donated drug if it were found to have negligently endorsed the quality of the product.

39. As discussed in greater detail below, the degree of risk would depend on the nature of the system that is established and on the extent to which the Global Fund is involved in designing and running it. Generally, the greater the Global Fund's involvement in the in-kind donation system, the greater the liability risk. In addition, liability risk would naturally be affected by the characteristics of what is being donated – if they are defective, antiretroviral drugs are more likely to cause damages than stationery supplies.

40. Liability risk is an important issue because the Global Fund has material cash reserves and other assets that could be attractive to potential claimants. In addition, the Global Fund has not yet been granted immunity from court jurisdiction in the two countries where its principal assets are located, the United States of America and Switzerland. As such, its assets may be vulnerable to damage awards, and the Global Fund does not currently carry liability insurance. In addition, even lawsuits that do not result in an award or settlement can involve significant legal fees and other costs.

41. The benefits of an in-kind donations system must, therefore, be weighed against additional liability exposure in deciding whether – and how – to establish such a system.

42. To this end, the Board and the PMPC have requested that the Secretariat report on the liability implications of establishing a system for in-kind donations. This section of the report illustrates the Global Fund's potential liability exposure and considers how to minimize it.

### b. Scope of research conducted

43. It is likely that, if a system for in-kind donations were established by the Global Fund, donated goods and services would be available to recipients in a large number of countries. As it is not possible to review the relevant legislation of all such countries, we have focused our legal research on two sample jurisdictions: the United States was selected because it is likely to be one of the principal sources of in-kind donations; and

South Africa was chosen as it is an example of a possible recipient country with a sophisticated legal system.

44. Accordingly, the conclusions that follow – reached in consultation with two of the leading law firms in the United States and South Africa – are based on the applicable law of those two countries. Although additional research would need to be carried out in order to achieve greater certainty on legal risk in a particular country, we believe that the conclusions described below are likely to apply in most jurisdictions.

### c. Discussion

45. Establishing and operating an in-kind donation system would increase liability risk where the Global Fund appears to be vouching for the quality and safety of the donations. In addition, a similar increase would occur where the Global Fund provides incentives that lead recipients to procure one product or service over another, or to procure from a particular supplier.

46. These risks are illustrated below with reference to some of the options presented in Accenture's review of possible in-kind donation systems, namely accreditation of donors, incentives to accept in-kind donations, and the different mechanisms for the matching of donors with recipients. Measures that can be taken to minimize or manage such risks are then discussed.

#### i. Donor Accreditation and Donor-Recipient Matching

47. Because of the possibility that the Global Fund will be perceived as endorsing the quality or safety of donations, donor accreditation and the direct brokering of donations by the Global Fund imply a relatively high level of liability risk.

48. Under Accenture's proposal, accreditation would be based on a determination by the Global Fund that a donor is financially sound and that it has certain ethical standards, and by a requirement that it agree to comply with certain standards of behavior when making donations.[2] Presumably, the objective of these requirements would be to enhance the quality and reliability of the in-kind donation system.

49. Recipients might therefore reasonably conclude that, by accrediting donors, the Global Fund is in effect endorsing the quality of their donations. If so, a court might hold the Global Fund responsible for damages resulting from a donation if it found that the relevant donor's accreditation had been negligently granted or maintained, and if the claimant had reasonably relied on the Global Fund's endorsement in deciding whether to accept the in-kind donation.

50. In the same way, any direct role on the part of the Global Fund in brokering an in-kind donation – such as by putting a recipient in touch with a particular donor – could be interpreted by the recipient as an endorsement of the quality and safety of the donation and have the same liability implications as accreditation.

#### ii. Incentives to Accept In-kind Donations

[2] Other than to say that donors might be required to comply with WHO's "Inter-Agency Guidelines for Drug Donations," Accenture provided few details on these prerequisites, so it is not clear what they would entail in practice.

51. One of the assumptions that underlie Accenture's report is that it would not be desirable to compel recipients to accept in-kind donations. However, Accenture concluded that, given a choice between cash and an in-kind donation, most recipients would choose cash unless an incentive to accept the in-kind donation is provided. The possible incentives could be to offer a cash payment on top of the in-kind donation (a "handling fee"), or to allow the recipient to accept the in-kind donation without a corresponding decrease in the amount of cash paid to it under the grant ("additional in-kind donations").

52. Both types of incentives could lead to a significant increase in the Global Fund's liability exposure if they cause a recipient to accept products or services different from the ones that it was otherwise planning to procure. For example, if in order to secure a handling fee or an additional in-kind donation the recipient accepts a donation of Product B instead of the Product A that it normally would have purchased, the Global Fund may be exposed to liability for damages caused by Product B.

53. Additional in-kind donations could give rise to liability under a different theory. If a recipient does not have the absorptive capacity to put both the products that it was planning to purchase with grant funds and additional in-kind donations to proper use, the Global Fund's role in facilitating the donations could cause it to be liable for damages resulting from the recipients' lack of capacity.[3]

### iii. Risk management

54. The Global Fund's exposure to liability can be reduced or managed in several ways.

55. In the case of *donor accreditation*, liability risk could be reduced by enhancing the quality of the accreditation process itself, thereby reducing the scope for claims that the Global Fund negligently endorsed donations (a procedure would also need to be put in place to ensure that accreditation, once granted, is withdrawn where the donor fails to comply with its continuing requirements).

56. Liability exposure resulting from *incentives* to accept in-kind donations over cash could be reduced by not informing recipients of what goods and services are available for donation until after their procurement plans have been completed. If recipients do not know what donations are available, their choices of goods and services would not be influenced by the incentives, and the Global Fund would enjoy a greater degree of insulation from liability.

57. However, there would still be a risk that information on available in-kind donations would reach recipients before they formulate their procurement plans. If such leakage were to occur, a court might still award damages against the Global Fund if the leak had been caused by the Global Fund's negligence, or if it had been reasonably foreseeable that the leakage might occur.

58. In addition, the Global Fund could, in its grant agreements with Principal Recipients, specifically disclaim responsibility for the quality or safety of donations. However, it is not certain that such a provision would be effective if, for example, agents of the Global Fund were found to have made representations that are contrary to the disclaimer. To achieve

[3] Capacity issues should, however, be discovered in the Local Fund Agent's assessments. Therefore, it would be helpful to ensure that the Procurement and Supply Management assessment is extended to cover additional donations as well as procurement to be carried out with grant funds.

further protection, it would be prudent to demand that donors agree to indemnify (i.e., reimburse) the Global Fund for damage awards against it that result from their donations.

59. Liability risk can also be decreased by reducing the Global Fund's involvement in the process of *donor-recipient matching*. Two of the options proposed by Accenture would represent progress toward this objective.

60. The first would be to establish an electronic marketplace, by means of a website, that would allow donors and recipients to transact without direct intermediation by the Global Fund, thereby reducing opportunities for liability exposure to arise from an apparent endorsement of individual donations. However, the Global Fund's role in establishing the website, and in setting the parameters for its use, could still increase its liability exposure. This is because, in this case as well, the Global Fund's involvement might be reasonably interpreted as an endorsement of the quality of the donations carried out through the electronic marketplace.

61. The second option would be to assign responsibility for managing in-kind donations to a third party. For example, donations of drugs for the treatment of tuberculosis could be handled by WHO's Global TB Drug Facility, which could then pass them on to recipients of Global Fund grants. If the Global Fund had neither a role in the designing the third party systems or in running them, its exposure to liability would in most cases be shifted to the third parties (although the choice of an inappropriate third party intermediary could still be problematic). Indeed, a third party system would be the most effective way of reducing the Global Fund's exposure to liability.

62. Needless to say, liability risk could also be reduced by restricting the in-kind system to donations of products and services that are less likely to cause damages. For example, it may be appropriate to exclude products that, if defective, will probably cause significant damages – as would be the case with certain categories of pharmaceutical products.

### d. Conclusions

63. Establishing a system for the facilitation of in-kind donations would entail an increase in the Global Fund's exposure to liability. The magnitude of that increase will ultimately depend on the extent of the Global Fund's involvement in the design and operations of the system, and on the likelihood that the donated goods and services will cause damages to occur.

64. Accordingly, exposure to risk can be decreased by reducing the Global Fund's involvement in the in-kind system. From this perspective, the most favorable system would be one in which a reliable third party performs the role of intermediary between donors and recipients and runs the system. It may therefore be desirable to explore the feasibility of this option.

65. An alternative would be, as discussed above, the establishment of an electronic marketplace that would allow recipients and donors to transact with each other directly, without the intermediation of the Global Fund.

66. Donor accreditation and the direct matching of donors and recipients by the Global Fund create an increased probability that these will result in a perceived endorsement of the underlying donations, which in turn could create responsibility for damages that they may cause.

67. The Global Fund could also consider which categories of products and services would be least likely to cause damages to occur. One option may be to exclude drug donations from the in-kind system on the grounds that they entail a greater exposure to liability risk.

## III. Long term sustainability

68. There are two distinct aspects of "long term sustainability." The first is the impact that in-kind donations might have on the broader market supplying a particular good or service, as in-kind donations have the potential to undermine the availability of affordable supplies by creating monopolies. This question cannot be disentangled from the issue of market capture and so has been addressed above in section I. The second concern about sustainability relates to the impact on end-users if a donation is stopped in the middle of an on-going program.

69. For example, if a recipient is using a donated pharmaceutical product to provide treatment of an on-going nature (e.g., antiretroviral therapy), and had anticipated continuing to receive a donation, the sudden cessation of such a donation could jeopardize the health of patients.

70. There are two options that can address this concern. First, potential donors could be required to make multi-year commitments, so that any recipient would be assured of the continued availability of a donated product for the duration of a grant agreement.

71. Second, donations could be treated as pure substitute for cash, meaning that if a donation was not available, cash would simply replace it. This would involve treating each donation as a one-off event, so recipients would not be placed in a position of expecting a continuous stream of donated products, but would instead be able to switch between donations and cash with the maximum flexibility and interchangeability.

72. Either approach could resolve the concern about long-term sustainability, at least within the parameters of the Global Fund's current architecture (i.e., they would not be any more or less sustainable than the Global Fund's current two year financial commitments to a recipient).

73. The primary advantage of the first option is that it ensures availability of a particular product for the duration of a Global Fund grant. Its main drawback is that it may increase dependence on a particular donated product, thereby exacerbating the market impact concerns described above and leaving a recipient more vulnerable if a particular supplier has a delivery problem. It may also impact the number of donors willing to donate.

74. The principal benefit of the second approach is that it best insulates a recipient from an overdependence on a particular donor. It also provides recipients with the maximal flexibility, leaving them able to move freely between donations and cash contributions as best befits their current situation.

## IV. Valuation of contributions

75. In-kind donations, whether they are of goods or services, need to be assigned a value. This value has several consequences and uses, as discussed in the Accenture paper. As discussed there, it is possible – and indeed established practice with some entities experienced in handling in-kind donations – for an in-kind-donation to have more than one value assigned to it: a recipient can derive a certain value from a donation, whereas the donor can attribute a different value to the donation.

76. For the purposes of the Global Fund, the most important value is that received by a Principal Recipient. This value will:
    a. Define the amount shown as "income" in the income records of the Global Fund;
    b. Be shown as a grant disbursement in the grant disbursement records of the Global Fund; and
    c. Be accounted for as a disbursement, thereby allowing the equivalent amount of cash that had been committed to be utilized for commitment to another grant.

77. An additional important value for the Global Fund is how in-kind donations are factored into resource mobilization tallies. Although this is clear cut for the calculation of resources available for commitment for grant signings, assessing the value for calculation of pledges available for proposal approval[4] is less straightforward and depends integrally on the management approach chosen for handling in-kind donations. As such, consideration of this question has been deferred until the Board decides on whether or not to proceed in principle with in-kind donations, and on the management approach to be used.

78. A donor may set a different value to the donation, for its own accounting, tax, and publicity purposes. This does not present any inherent problems for the development of a system for in-kind donations, so there is no reason why the Global Fund should seek to involve itself in the valuation that donors assign to their contributions. This section thus concerns itself only with the valuation of donations for recipients.

79. The Accenture report presents two potential options for valuation of this in-kind-donation, whereas the PSM-AP recommends a third, drawn from WHO's "Inter-Agency Guidelines for Drug Donations. The advantages and disadvantages of each are described in the table below:

| **Potential Solutions** | **Pros** | **Cons** |
|---|---|---|
| Option A:<br>Value based on an estimate in a Principal Recipient's procurement and supply management (PSM) plan | • No additional work is required by recipients (meaning values are immediately available after approval of PSM plan)<br>• Value should correspond with amount budgeted within grant amount | • Values in PSM plan are only estimates at a point in time<br>• If recipients are aware of donations available to them when they prepare the PSM place, there is an incentive to undervalue the donation<br>• Not an internationally- |

[4] See GF/B7/2, pp 5-7 (The Report of the Sixth Board Meeting) for the Board decision on the Comprehensive Funding Policy, which establishes the approach to approving proposals against funds pledged and signing grant agreements based on assets available for commitment.

| | | |
|---|---|---|
| | | accepted standard |
| Option B:<br>Value based on an assessment by a third party | • Values are more accurate<br>• Values derived on an impartial basis | • Cost of assessment<br>• Likely to cause delays in the process and prove impractical in the in-kind donation chain<br>• Need to establish rules for valuation, even where third party is involved<br>• Not an internationally-accepted standard |
| Option C:<br>Value based on the wholesale price of its generic equivalent in recipient country, or where unavailable, in the world market | • Values are clearly defined – and therefore a transparent process all parties can see<br>• Uses an existing mechanism, avoiding creating new guidelines where an international consensus already exists | • May be difficult for recipients to determine world market wholesale price, if products are not available in the recipient country<br>• May "undervalue" the in-kind donation from perspective of donor, creating a potential disincentive to making a donation |

80. Both the two options developed by Accenture and the approach contained in the "Inter-Agency Guidelines" focus on drug donations, highlighting the complexity of this particular area. For the valuation of other goods and of services, no international consensus has yet been developed. For the purposes of valuing these contributions in the context of Global Fund grants, it is proposed that the figures contained in the recipient's approved budgets be used for the valuation of non-pharmaceutical products and services.

## Recommendation and operational principles

81. The operational challenges discussed above are indisputably significant. However, Secretariat has reviewed these issues carefully and does not believe that they present insurmountable obstacles. The Secretariat has therefore developed an approach to how in-kind donations could be operationalized.

82. This approach provides a framework for operationalizing in-kind donations should the Board agree to proceed with in-kind donations. Should the Board now decide to pursue an in-kind donation system, the details would need to be further developed within the parameters of the approach (or another approach that the Board should decide upon).

83. In developing this approach, the Secretariat had reference to the above analyses, to additional management dimensions of operationalizing a system, and, throughout, to the

Framework Document of the Global Fund. It is this latter document that provides the overarching principles of the approach presented below.

84. First and foremost, the approach proposed by the Secretariat is based on two principles articulated in the Framework Document: “The Fund is a financial instrument, not an implementing entity” and “[t]he Fund will base its work on programs that reflect national ownership and respect country-led formulation and implementation processes.”

85. The approach thus ensures that the Secretariat is not in the position of acting as an implementing entity, instead locating the ownership of the entire process squarely with the recipients of Global Fund financing. Additionally, the system builds on the Global Fund’s existing grants management processes as much as possible, rather than creating a parallel system. Where appropriate, already existing systems for in-kind donations are also used.

86. The approach is described in five sections:
    a. Management;
    b. Uptake (including valuation and sustainability);
    c. Market impact and conflicts of interest;
    d. Scope;
    e. Quality assurance.

## I. Management (including valuation and sustainability)

87. The management of the system would be outsourced to an entity that has experience in the management of in-kind donations. This would simultaneously build upon existing systems, minimize the Global Fund’s legal liabilities, and reduce the management burden for the Secretariat. There are three possible types of entities that could be used:
    a. A multilateral organization, such as UNICEF or the Global TB Drug Facility;
    b. A specialized non-governmental organization, such as AmeriCares; or
    c. A private procurement agent, such as Crown Agents or the International Dispensary Association (IDA).

88. The Secretariat has not entered in discussions with any of these entities, and would recommend that the additional work of identifying the most suitable partner not be carried out until the Board has decided in principle whether or not to pursue the development of an in-kind donations system.

89. The outsourcing partner would be responsible for establishing terms and conditions with donors, developing a system to match donations with recipient needs, and the logistics of handling the donations themselves. There are different possible approaches to several of these stages (as Accenture has examined), but the Secretariat recommends that these aspects would best be fully worked out with the outsourcing partner when this entity is identified. This would ensure the most efficient uses of existing systems, as well as building upon the expertise that has been developed in the field.

90. After the initial start-up phase (when additional work would be needed to identify and negotiate with the partner), Secretariat involvement would be limited to resource mobilization efforts, including the accompanying donor management role.

91. Within the grants management process, existing systems would be used. The current assessments of Principal Recipients – particularly the Financial Management and

Systems, and Procurement and Supply Management (PSM) assessments – would prerequisites for the receipt of donations, exactly as they are the precondition for the receipt of Global Fund monies.

## II. Uptake (including valuation and sustainability)

92. The decision about whether or not to utilize an in-kind donation should be solely the choice of a recipient. No requirements on the acceptance of in-kind donations would be imposed, and no incentives would be offered to promote uptake of donations. As discussed above, this approach minimizes the Global Fund's legal liability.

93. Recipients would thus be presented with a choice between accepting normal Global Fund disbursement practices or (as described below) an equivalently-valued donation. To fully inform the decision, the recipient would be presented the additional information that would impact on the supply management of the donation, such as the timeframe for delivery.

94. To ensure the substitutability of cash and donations, and in keeping with WHO's "Inter-Agency Guidelines on Drug Donations," the value of a donation for a pharmaceutical product would be based on the wholesale price of its generic equivalent in the recipient country, or where unavailable, in the world market. The value of other goods and of services would similarly be based on local equivalents. If a recipient chose to take a donation instead of the cash equivalent, the value of the donation would be deducted from the amount of cash available to the recipient (and would be returned to the pool of funds available for disbursement, thus becoming a contribution of sorts from the recipient to the Global Fund).

95. These deductions would only be made against donations actually available for delivery to a recipient (e.g., rather than against promised future donations). This ensures interchangeably between the donation and cash, meaning that if a donation is suddenly stopped, there are no concerns about sustainability: the recipient is simply entitled to receive the same amount in cash.

96. In light of the fact that the Country Coordinating Mechanism (CCM) originally submitted a proposal seeking exclusively cash financing, and in keeping with the importance that the Framework Document accords to partnership at country-level, it is suggested that any decision to accept in-kind donations would be taken by the CCM, rather than the Principal Recipient in isolation.

## III. Market impact and conflicts of interest

97. As discussed above, in-kind donations can have a significant impact on markets for critical products. However, trying to regulate this from the central level is not in keeping with the Framework Document's emphasis on "national ownership and […] country-led formulation and implementation processes."

98. Stakeholders at the country level are much better positioned to assess the potential market impact that any in-kind donation might have than the Secretariat is (or than any entity to which the management is outsourced is). Similarly, these local stakeholders are best able to identify any other conflicts of interest that might arise from the in-kind donation. Additionally, without considerable changes to the Secretariat structure, it is not

feasible to imagine the Global Fund managing the process of assessing and minimizing conflicts of interests.

99. Therefore, CCMs should have the responsibility to consider market impact and conflicts of interest in the process of deciding whether or not to accept an in-kind donation. In light of the fact that the market impact can be a complicated subject, supplemental information can be provided to CCMs to assist in their decision-making, including the experience of how entities involved in in-kind donations have previously handled this (e.g., the fact that in situations in which it is supplying a large percentage of the total market, UNICEF seeks to provide products from multiple suppliers).

## IV. Scope

100. The scope of in-kind donations should be the decision of individual recipients. Although the Secretariat recognizes that there are considerable additional challenges associated with certain types of donations – particularly pharmaceuticals – some current Global Fund recipients are already participating in drug donations schemes, so there does not appear to be any rationale for the Global Fund to *a priori* exclude these products based on the complexity of their management.

101. In keeping with current Global Fund procurement and supply management practices, any products which a recipient intended to use – including any products for which donations were sought – would have to be included in the Principal Recipient's Procurement and Supply Management Plan. This would be assessed as part of the normal Global Fund assessment process.

102. However, as with the decision on whether or not to receive a donation, the final decision on the scope of goods and services to be accepted would lie with the Country Coordinating Mechanism, rather than the Principal Recipient.

## V. Quality assurance

103. In keeping with the Global Fund's mandate as a financing instrument, the Secretariat would not play any normative role in assessing the quality of in-kind donations. Rather, the Global Fund's existing policies governing quality assurance in procurement and supply management would apply to equally to donations. These policies articulate standards for quality assurance (typically building upon existing national and international systems) and locate the responsibility for adhering to these standards with the recipients of Global Fund financing.

104. As with current practice, a recipient interested in receiving a donation would undergo the same assessment of its capacity to meet the Global Fund's standards before a donation would be made. This assessment would ensure that the recipient has adequate quality assurance mechanisms in place to guarantee the safety and efficacy of all products, including donated goods.

105. This means that the Secretariat would not carry out any form of "accreditation" of donors or otherwise signal to recipients that a particular donation would be exempted from the Global Fund's normal procurement and supply management policies. As described above, this approach minimizes the Global Fund's legal liability.

### Roles and responsibilities

106. The below table summarizes the roles and responsibilities in the proposed approach:

| | CCM | PR | Secretariat | Outsourcing partner |
|---|---|---|---|---|
| **Management** | | ✓ (at country-level) | ✓ (minimal) | ✓ (at global level) |
| **Uptake** | ✓ (decision-making) | ✓ (input) | | |
| **Market impact** | ✓(decision-making) | ✓(input) | | |
| **Scope** | ✓ (decision-making) | ✓(input) | | |
| **Quality assurance** | | ✓ (in line with current approach to procurement and supply management) | | |

### Follow-up

107. Should the Board agree to proceed with such a system for in-kind donations, the Secretariat would recommend that an external assessment be carried out of the system within a year of its initiation, to ensure that the concerns described above are being adequately considered.

## Annex (to original paper): Budgetary implications

1. The development of a system to handle in-kind donations would have significant resource implications for the Global Fund. The most significant impact would hopefully be positive, as the value of in-kind donations projected by the McKinsey study far exceeds any estimate of the costs of establishing such a system.

2. In the short term, however, costs would likely exceed revenues. Costs would be incurred both in the form of Secretariat time and the potential costs associated with contracting a third party to manage the donations.

3. Secretariat staff would be needed to investigate potential third party partners and to establish a contract with the most suitable choice, and to begin the process of contacting potential donors. It is estimated that these functions would require one and a half full-time equivalents (FTE) for the period of six months. On an on-going basis, a minimum of one FTE would be required for resource mobilization purposes and to manage the relationship with the third party.

4. The cost of the contract with the third party is impossible to estimate at the moment, as detailed discussions have not yet been held with the different possibilities entities which could be involved.

5. Should the Board decide to agree to proceed in principle with the development of a system for in-kind donations, the Secretariat would develop detailed budgetary estimates for review by the Board.