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

Tenth Board Meeting
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GF/B10/8

REPORT OF THE MONITORING AND EVALUATION, FINANCE AND AUDIT (MEFA) COMMITTEE

Outline: This report from MEFA and its 10 annexes summarizes the deliberations of the MEFA Committee Meeting on 6-8 March 2005 and offers a number of recommendations for decision by the Board.

Summary of Decision Points:

1. A decision point on the 2004 Audited Financial Statements, Part 2, page 3.
2. A decision point on Euro-denominated Grants and Currency Risk Management, Part 7, page 9.
3. A decision point on action underway and next steps in response to the recent LFA Review, Part 9, page 11.
4. A decision point on Phase 2 Policy, Part 11, page 15 -16.
5. A decision point on the Terms of Reference of the Technical Evaluation Reference Group, Part 12, page 17.

Part 1: Introduction

1. This report summarizes the deliberations of the MEFA Committee at its meeting on 6-8 March 2005 and highlights the decision points which it recommends to the Board for action. The meeting was chaired by Dr Sigrun Mögedal assisted by the vice chair, Ms Rita Arauz Molina. The meeting agenda and participants list are attached as Annexes 9 and 10.

Part 2: Draft Audited Financial Statements 2004

1. The Secretariat's Chief Financial Officer, Mr Barry Greene, introduced the draft 2004 audited financial statements. As explained by the CFO, the draft presented to the meeting reflected the position close to completion of the audit and the final version would be circulated to the Committee for approval once cleared for release by the external auditors. It was agreed that the Committee's approval would be regarded as granted in the absence of any objections by email within seven days. The final version was circulated to the Committee on 18 March, with no material differences from the earlier draft presented to the meeting.

2. The CFO further explained that, as in previous years, the financial statements are prepared in compliance with the International Financial Reporting Standards issued by the International Accounting Standards Board. These standards currently do not contain specific guidelines for non-profit organizations concerning the accounting treatment and presentation of the financial statements. Consequently, in consultation with the external auditors, the Statement of Financial Accounting Standard ("SFAS") 116: "Accounting for Contributions Received and Contributions Made" has been applied in respect of the recognition of contributions and grants. In applying SFAS 116, all contributions governed by a written contribution agreement are recorded as income when the agreement is executed. In previous years, contributions receivable later than one year after the year-end were not recorded as income (whereas from 2004 these contributions are recorded as income). This change in accounting policy has been accounted for retrospectively. Comparative information in the 2004 financial statements has therefore been updated to reflect this change. The cumulative impact of this change is an increase on prior years' Funds of $147 million (2002: $99 million) as detailed in the Statement of Changes in Funds.

3. The Ernst & Young partner in charge of the audit attended the Committee and confirmed that the auditors fully expected to express a "true and fair" opinion, free of any qualification, on the 2004 financial statements; this is reflected in the auditors report accompanying the final version of the financial statements

4. The Ernst & Young partner further answered MEFA members' queries and requests for further explanation on the draft financial statements.

5. A question was raised as to whether the external audit routinely examined the work of Local Fund Agents (LFAs). This is not the case since the LFA reports are on the activities of Principal Recipients and these do not form part of the financial statements of the Global Fund. However, it was confirmed that in the course of 2005 Ernst & Young would work with the Secretariat to review a sample of the external audit reports on Principal Recipients and provide comments as appropriate and that the findings of this analysis would be fed back to the Finance & Audit Committee in due course.

6. A question was also raised as to whether the external audit routinely tested whether policies and procedures safeguarding the expenditure of funds, particularly with respect to the Credit Suisse account, were being correctly implemented and followed. Ernst & Young explained that, given the Secretariat's rapid growth and evolving control environment, the audit team adopted substantive rather than process and control-oriented audit procedures. The audit partner further explained that a substantive audit approach to testing bank accounts includes

obtaining confirmations from each bank relation, sample testing of bank transactions throughout the fiscal year and year-end cut-off testing. Based on these audit procedures, Ernst & Young were satisfied that the Credit Suisse account was correctly maintained and reported in the 2004 financial statements. It was suggested that the auditor should undertake policies and procedures testing as part of future annual audits and Ernst & Young agreed that such procedures would be integrated in a process and control-oriented audit approach.

7. The Secretariat Chief Administrative Officer (CAO), Mr John Burke, described the various initiatives in the area of risk management response, as well as operational procedures review. MEFA Committee took note of this on-going work, including in particular the work of DLA Piper in assessing risk management and risk response across Global Fund activities, the establishment of the Office of the Inspector General (OIG), as well as a number of other related reports (the United States Government Accountability Office report due May 2005, the recent LFA Review, the Bezanson Report prepared for the Replenishment Conference, etc.).

8. The MEFA Committee suggests this work receive an early review by the appropriate body within the revised Board Committee structure, potentially the Finance & Audit Committee (FAC) of the Board.

9. MEFA agreed to recommend that the Board approve the 2004 Audited Financial Statements of the Global Fund as set out in Annex 1, subject to members' e-mail confirmation as described in paragraph 1 above (subsequently received)[1].

Decision Point 1:

> ***The Board approves the 2004 Financial Statements of the Global Fund which have been audited by Ernst & Young.***

Part 3: 2004 Operating Expense Review, Performance against Workplan and 2005 Budget Recap

1. MEFA reviewed the Secretariat's financial report on 2004 Operating Expenses in 2004 as compared to budget, and the report on Performance of Key Deliverables, attached as Annex 2.

2. MEFA advises the Board that:

   a. Almost all deliverables for 2004 were fully achieved, as set out in the Annex:

   b. Secretariat Expenses were $1.0m (3%) below budget. The main areas of savings within Secretariat Expenses were the non-use of the $0.6 million contingency and under-spending of $0.4 million on travel. Staff costs were $1.2 million over budget (due mainly to accruing for untaken vacation), however this was covered by savings on professional fees of $1.4m. MEFA commended the Secretariat for its tight budget management of Secretariat expenses and the efficiencies achieved.

[1] After conclusion of the independent audit and the MEFA Committee's review of the draft financial statements, the Trustee informed the Global Fund of a US$ 1.3 million adjustment for unrealized losses on the investment portfolio. This adjustment to the Trustee's accounts was in order to record at market value the assets held in trust for the Global Fund by the World Bank at 31 December 2004, pursuant to a change of accounting policy by the Trustee. The adjustment, which would reduce the amounts of *Funds Held in Trust* and *Trust Fund Income* per the financial statements, amounts to considerably less than one percent of both total assets and total income. Based on these facts and in consultation with the independent auditors, management determined that the draft financial statements presented for approval should not be adjusted at this late stage but that they continue to present, in all material respects, a true and fair view of the Global Fund's activities for the year ended 31 December 2004.

c. LFA fees for in-country oversight in 2004 were $8.3m (40%) less than budget. This substantial underspend reflects primarily the fact that Round 4 grant signings occurred later than had been provided for in the budget, thus postponing LFA assessments of Principal Recipient capacity in many cases from 2004 to 2005, as well as avoiding some months of implementation monitoring in 2004 for these grants. The 2004 costs were also reduced by savings realized in 2004 on some 2003 LFA contracts.

3. MEFA also reviewed several of the key ratios used by the Secretariat to track its cost base. Specifically:

a. Operating expenses were 4.8% of total expenditure in 2004 (2003: 3.0%). Grant expenditure (the amount of new grant commitments in the year) was less in 2004 than in 2003 and this contributed to the increase in this ratio;

b. Operating expenses were 6.8% of grant disbursements in 2004 (2003: 14.3%). The decrease in this ratio is due to the higher level of grant disbursements in 2004 and the lower level of LFA fees due to later than anticipated Round 4 grant signings;

c. Operating expenses were 2.2% of grants under management in 2004 (2003: 3.0%). The decrease in this ratio is due to the increasing value of grants under management.

4. MEFA discussed the continuing challenge of identifying the best ratios to use to track and benchmark Global Fund operating expense evolution and suggests that the FAC keep this issue under periodic review.

5. Following a sanctioned side discussion regarding the credits and debits to the Credit Suisse account, the US constituency reported back to the Committee the recommendation that the Secretariat ensure that any significant credit balance in excess of annual budgetary needs (estimated to be in the $300-400,000 range) on this account be transferred back to the Trustee or WHO accounts, and the Secretariat agreed. The Secretariat will establish the annual budgetary need and then transfer the amount in excess to the Trustee or WHO accounts.

6. MEFA revisited the approved 2005 budget. The Secretariat flagged that two factors affecting costs since the compilation of the budget in September 2004:

a. The decline by 7% in the value of the US dollar to the Swiss franc (from an exchange rate of 1.25 in September 2004 to 1.16 in February 2005). Almost all the Secretariat Expenses are Swiss franc based. If the decline of the exchange rate were to continue throughout 2005, the USD equivalent of these costs would increase correspondingly;

b. The need to relocate the Secretariat to larger office premises, identified in early 2005 and planned for July 2005. Suitable premises have been procured at a total rent similar to the current rent. Costs associated with fitting-out the new premises and for moving equipment and furniture are estimated at $1.9 million. The issue of financial and/or legal liability for the early termination of the existing lease was reported as under review and negotiation and the target range for settlement flagged as $ 200,000 – $ 300,000.

The Secretariat will strive to accommodate these additional costs within the existing budget and will report further on progress in this regard later in the year.

7. Finally, MEFA discussed the budget process for 2006. The MEFA Committee suggested that, in preparing the 2006 budget, the Secretariat should build on the overall approach developed for MEFA consideration of the 2005 budget, building any proposals for incremental needs in 2006 on a baseline of requirements beyond the level required to continue activities

funded in 2005. This approach should be backed by high level priorities, rather than the current established approach of presenting very detailed workplans. The Secretariat should in particular integrate the process relating to the performance measures for the Executive Director with the budget development process.

8. The MEFA Committee further suggested that the Secretariat engage the Board early in the 2006 budget development process. This might involve an initial orientation to the 2006 budget framework at the September 2005 Board, leading to final approval of the detailed 2006 budget (including an indicative budget outlook for 2007 and 2008), through the FAC, at the December 2005 Board meeting.

Part 4: Briefing on Secretariat Office Space and Proposal to Consider Purchasing a new Headquarters Building

1. MEFA heard a presentation on the evolution of the current Secretariat office space situation and a proposal from the Secretariat to move forward rapidly to negotiate the purchase of a building – yet to be constructed – for an indicative total cost of $50 million (Annex 3).

2. Since July 2004, the steady increase in approved Secretariat headcount has required the Secretariat to rent additional space on an opportunistic basis elsewhere in the current HQ building, as well as in the building next door. From 2 locations in one building mid-2004, the Secretariat now sits in 6 separate locations in 2 buildings. These 6 locations provide “tight” accommodation for up to 150 people, but with no flexible space for temporaries and consultants, extremely limited meeting space and reduced (in fact nearly negligible) social facilities (coffees / kitchen areas, etc).

3. The current environment is already generating some significant associated negatives: reduced staff interaction and communication, limited short-term staff, intern and consultant flexibility, disintegrated teams, risk of isolation, poor quality meeting facilities, unprofessional image, and overall a sub-optimal work environment.

4. MEFA further heard that, as an interim measure, the Secretariat will move from the current Centre Casäi and Alpha buildings to the World Trade Centre 2 (WTC), beside Geneva airport. Reasonable (but still tight) rental space has been secured at in the WTC building for a two year period, to mid-2007, albeit requiring additional annual rental outlay (+ $300,000 per annum) and an installation cost of around $ 1.9 million (under negotiation). The WTC will provide adequate facilities pending a longer-term solution.

5. The Secretariat described and summarized the discussions held with “FIPOI” (la Fondation immobilière pour les organisations internationales), whose primary role is to work with international organizations to help them solve their office space needs. FIPOI provides free or marginal cost consulting and advisory services, and guides and facilitates discussions with lawyers, real estate agents, government departments, etc.

6. FIPOI agreed to work with the Secretariat on defining a long-term solution. A request for proposals was launched across the Geneva region in late 2004. 10 offers were received and analyzed and a short-list of 3 leading options defined. Of these, 2 were construction projects and one rental option. The rental option proposed was a new (shell) building and required an extremely high fitting-out cost to meet Secretariat needs (including IT cabling, etc), estimated by FIPOI at some $10 million. One of the 2 construction projects is close to the airport but has poor access and amenities, limited parking, and is in principle a rental option (sale could be negotiated). The second construction project is in a much better location, has a good all round package of facilities, and is for sale at an indicative price of $50 million. Time from commitment to completion is approximately two years, suggesting a possible entry date of mid-2007.

7. To encourage and support international organizations to locate to and remain in the Geneva area, the Swiss confederation and the canton of Geneva, through FIPOI, have established a mechanism whereby such organizations may apply for favourable terms to finance property acquisition in the region. The usual approach is an interest-free loan (over 50 years) to the organization concerned, with or without possible free land allocation by the canton of Geneva.

8. The Secretariat proposed, based on the discussions and advice from FIPOI and the Swiss authorities, to approach the host country with a request for an interest-free loan of $50 million to fund the purchase of a building, repayable at $ 1 million per year (compares to $1.5 million annual rent in the WTC 2 building). However while recognizing the appropriateness of the overall concept, the Secretariat also reported to MEFA that the Swiss authorities have advised that a) the allocation of funds to FIPOI – the usual vehicle for such loans – is committed for several years to come, and the future levels of replenishment are uncertain at this time; and b) the process for submission and approval of such loans may be quite lengthy and it would be worthwhile considering alternative sources of bridging financing if the Secretariat is to be able to move forward.

9. The Secretariat proposed an alternative option: to use Global Fund assets to purchase the property, pending granting of the loan by the Swiss authorities. FIPOI are ready to assist us in the detailed purchase negotiations and to guide us, in collaboration with the Swiss mission in Geneva, through the loan application process. It was emphasized, however, that if the Swiss loan were eventually not to materialize, then the same allocation would be made annually within the Secretariat budget to reimburse Global Fund cash holdings.

11. MEFA reviewed and explored what the Secretariat presented as significant financial advantages supporting the purchase of a building and discussed the pros and cons of the business. However the discussion indicated that MEFA members shared considerable concern that:

a. MEFA did not have sufficient detailed information in front of it to recommend to the Board that it approves an allocation of $50 million for the purchase of a building;

b. The potential for significant negative public relations and/or media attention was considerable;

c. There had not yet been enough opportunity for wider discussion and consultation within constituencies on the issue.

12. In conclusion, MEFA asked the Secretariat to work with a small sub-group of the Committee in the immediate future. The MEFA Chair requested that this group review the project in more detail and, in consultation with the MEFA Chair and the Chair and Vice Chair of the Board, reach a consensus as to whether it was appropriate to bring the purchase recommendation to the attention of the Tenth or Eleventh Board meeting, through the appropriate Committee.

Part 5: Update on the Global Fund Replenishment Mechanism

1. The Secretariat's Director of External Relations, Dr Christoph Benn, described the process leading up to the 2005 Replenishment Conference. The primary purpose of the voluntary replenishment mechanism is to increase the predictability of the Global Fund's resource mobilization efforts.

2. Greater confidence that the majority of future funding is assured at any given time will have secondary benefits. Liquidity management will be more efficient to the extent that the Fund,

based on synchronized replenishment pledges, may be able to back its commitments with instruments other than cash and thereby reduce to a minimum cash balances. At the same time, the complementary availability of ad hoc resource mobilization channels, especially from non-government donors, will allow the Global Fund to seek further support for additional programs, to tap new constituencies and to respond promptly to unplanned contingencies in between structured replenishment processes.

3. The Secretary General of the United Nations, Mr Kofi Annan will chair the 2005 replenishment process and Mr. Sven Sandström will be vice-chair. The first replenishment cycle will aim to raise funding for two years: calendar years 2006 and 2007. In addition, it will look at anticipated resource shortfalls for 2005.

4. Three meetings are planned in 2005 for the first replenishment cycle. The Swedish government hosted the first meeting in Stockholm and held on 14 -16 March, 2005. A second meeting is planned for June 20 – 22. The British government will host the final meeting, which will take place in London from September 5 - 7, 2005.

5. The Global Fund will provide the Conference with reports on resource needs, goals, impact evaluation and other information needed to help donors determine their contributions. These will include four key documents to be circulated to donors in advance of the first conference, as follows:

1. Status and impact of HIV/AIDS, tuberculosis and malaria, including epidemiological data and social and economic impacts.

2. Funding requirements for fighting the three diseases, including projections from key agencies and partners on global funding needs, and what proportion should be channeled through the Global Fund.

3. Global Fund progress report, including financial, operational and program performance, providing a factual basis for discussion.

4. An independent strategic assessment of the Global Fund based on existing studies and reports, complemented by selected interviews with key stakeholders.

The Stockholm meeting will discuss and review these documents and agree on what further analyses and discussions are required to ensure agreement on the Global Fund's replenishment at the September meeting in the United Kingdom.

6. The main objectives of the first meeting are to review the overall status of the three diseases, assess the performance of the Global Fund, agree on funding needs, and, more broadly, to lay the foundation to enable donors to make decisions on their contributions by the time of the September meeting in the United Kingdom.

7. Following the first meeting, further analyses will be undertaken and discussed in order to ensure agreement on the Global Fund's replenishment at the September meeting. This agreement would cover resource needs for the Fund in 2006 and 2007, and also address any unmet financial needs in 2005.

8. MEFA took note of this background information and complimented the Secretariat on the preparations to date. MEFA also emphasized that the new Board Committee structure should give due attention to the need to link the financial policy aspects of replenishment with the financial forecasting, investment and other related funding policies of the Global Fund.

Part 6: Investment Alternatives for the Global Fund Liquidity Portfolio

1. The World Bank (IBRD), as Global Fund Trustee and in response to a recent request from the Global Fund Board, submitted a paper and made a presentation to MEFA outlining the current investment strategy of the Global Fund's Liquidity Portfolio, and exploring alternative strategies to enhance the future return of the portfolio. The Global Fund Liquidity Portfolio, which amounted to $ 2.2 billion as of December 31, 2004, is currently being managed by the Trustee as a part of the overall $ 9.3 billion Trust Funds Liquidity Portfolio.

2. On January 31st, 2005, IBRD implemented a new investment strategy for trust funds (Tranche 2) in which the Global Fund portfolio is invested. IBRD has informed both the MEFA and Global Fund Board at the 9th Board Meeting of the move to Tranche 2 and confirmed that in their view this was the appropriate choice for the Global Fund portfolio. Tranche 2 is a conservative high-grade fixed income portfolio, where the principal objectives are to protect the value of the donor contributions ("safety"), and to ensure that funds will be available as needed to meet grant disbursement obligations on a timely basis ("liquidity"). The emphasis has been on preserving the nominal funding capacity for the trust fund through its life, with little tolerance for any loss of initial principal.

3. The presentation described the two investment strategies currently available for trust funds managed by IBRD (Tranche 1 and Tranche 2) and then presented other investment alternatives and the associated risk return profiles for these alternatives. Some of the associated requirements that need to be met in order to invest in these alternatives (or some variation on them) were also discussed. The four alternatives are:

- Alternative 1: Tranche 1 (money market instruments and Treasury notes)
- Alternative 2: Tranche 2 (Treasury Notes and Mortgage Backed Securities (MBS))
- Alternative 3: Lehman Aggregate Index (comprised of Treasury notes, MBS, Agency securities,
  ABS and Corporate Bonds)
- Alternative 4: Lehman Aggregate Index and equities

Two other investment strategies were also introduced and briefly explained - hedge funds, and active management through trading and position taking.

4. The subsequent discussion focused on 4 key issues highlighted in the paper:

- The reliability of GF cash flow projections
- The GF's "institutional tolerance" for risk;
- The possible impact of volatile investment returns on the GF income statement; and
- Trustee costs and associated fee implications of different strategies.

The different perspectives of donors and recipients were reviewed and discussed.

5. The Chair reminded MEFA that the Ninth Board meeting had mandated an independent study of both the Comprehensive Funding Policy and the GF investment strategy. The consultants conducting the study, PriceWaterhouseCoopers (PWC) were in attendance at the MEFA discussion and also commented briefly on aspects of the IBRD presentation.

6. MEFA endorsed the selection of the Tranche 2 portfolio as appropriate in current circumstances and further expressed the view that the investment strategy and implications should be the subject of regular review by the future FAC. The Committee also looked forward to receipt of the conclusions of the study by PWC and welcomed the proposal to schedule a briefing session on the results immediately prior to the Tenth Board meeting.

Part 7: Euro-denominated Grants and Currency Risk Management

1. The recent decision of the Global Fund to allow the denomination of grants in Euros as well as US dollars (USD) and the potential increase in the use of Promissory Notes as a mode of contribution (arising from the voluntary replenishment mechanism) increases the Global Fund's exposure to exchange rate movements. Consequently, the Ninth Board Meeting decided that: "*the Secretariat should analyze and quantify the risks of implementing the dual currency decision and the costs associated with those risks. This analysis should result in a set of policies and guidance to the Trustee on how to mitigate and manage those risks. These policies will be referred to the MEFA Committee prior to presentation at the Tenth Board Meeting."*

2. MEFA reviewed a paper (attached as Annex 4) and a presentation outlining the risks, setting out the resultant policy options and operational implications and providing a set of associated recommendations and possible Board decision points for consideration. The World Bank, as Trustee of the Global Fund, provided valuable support to the Secretariat in compiling this paper.

3. The Secretariat presentation highlighted that the Global Fund will be exposed to currency risk if its grant liabilities in a given currency are not fully matched by assets of that same currency. The extent of any mismatch will be determined mainly by the amount of promissory notes held in non-grant currencies and the extent to which the USD/EUR proportions of contributions differ from the USD/EUR proportions of grants.

4. Discussion focused on the two fundamental policy options which exist: whether to hedge or not to hedge the risk. After outlining the pros and cons of each approach, the Secretariat concluded and recommended that the Global Fund should take action to minimize it's exposure to currency risk by a) hedging exposure to currency risk by matching the values of USD assets with USD grant liabilities and Euro assets with Euro grant liabilities to the extent possible using available liquidity, so as to minimize any mismatch within each currency; b) encouraging donors to denominate promissory notes only in the grant currencies (USD and Euro). By excluding (or minimizing) promissory notes in non-grant currencies, a cause of mismatch between assets and liabilities is eliminated or reduced; and c) if a material currency mismatch remains after these measures, maintaining a reserve against commitment authority as a cushion to absorb any potential losses and thus prevent commitments being made in excess of assets available.

5. MEFA considered draft decision points prepared by the Secretariat and felt that further refinement was needed. Instructed by the Chair, a small group reconvened in the margins of the meeting and resubmitted a refined set of proposed decision points, as set out below. The Committee accepted these points and recommended them to the Board.

Decision Point 2:

The Global Fund shall take action to minimize its exposure to currency risk through the following transitional policies that set a framework for currency risk management:

a) hedge exposure to currency risk by matching the values[2] of USD assets with USD grant liabilities and Euro assets with Euro grant liabilities to the extent possible using available liquidity, so as to minimize any mismatch within each currency (excess liquidity after matching shall be held in USD and Euro);

[2] The values of assets and liabilities will generally be computed as the present values of the cash flows associated with those assets and liabilities.

b) ***encourage donors to denominate promissory notes only in the grant currencies (USD and Euro);***

c) ***if a material currency mismatch remains after these measures, maintain a reserve against commitment authority as a cushion to absorb any potential losses and thus minimize commitments being made in excess of assets available; and***

d) ***encourage prospective grant recipients to provide information as to the currency in which they will submit future grant applications.***

The operational implications and practices shall continue to be reviewed by the Secretariat under the guidance of the FAC to present a full recommendation to set the policy and parameters of the currency risk exposure at the Eleventh Board meeting unless insufficient experience warrants extension until the Twelfth Board meeting.

Part 8: Committee Restructuring: Update on Status and Next Steps

1. The Secretariat Board Relations Manager, Ms Dianne Stewart, updated MEFA on the work of the Committee Restructuring Working Group (CRWG). She highlighted four areas in particular for MEFA focus: structure and membership, committee leadership, terms of reference and process improvements.

2. In the general discussion that followed, in particular regarding leadership and representation, the concern was expressed that having the Vice-Chair of the Board lead the PSC might increase this risk of a large PSC being seen as a "shadow" Board entity[3].

3. The Terms of Reference (ToRs) of each Committee were reviewed with special reference to the functions currently within the MEFA mandate. In terms of the F&A functions, it was noted that the role of the future FAC should also include the longer-term resource needs of the Global Fund, and not be limited to the Secretariat operational budget and expenses, although some constituencies felt comfortable with leaving resource mobilization and replenishment to the PSC, It was further noted that the ToRs of the FAC should include a strong linkage between the short and long-term resource needs of the organization. It was suggested that the FAC's ToRs include greater clarity as to the relationship to and the interface with the future Office of an Inspector General (OIG), envisaged for establishment later in 2005.

4. Regarding the M&E functions, MEFA reviewed the recommendations of the Technical Evaluation Review Group (TERG) and considered the adjustments to the TERG ToRs and PSC ToRs proposed by the TERG itself in its meeting immediately preceding MEFA. These proposals were endorsed by MEFA for forwarding to the CWRG and the Board. MEFA confirmed that while the TERG should link in to the work of all future Committees, its primary linkage was appropriately with the PSC. MEFA also endorsed the TERG recommendation that

[3] Subsequent to the meeting the World Bank put forward further written observations concerning the composition of the proposed Portfolio Committee (PC) and the representation of technical advisors on the Committees. Regarding PC, the Bank pointed out that this Committee will be addressing specific and important operational issues involving portfolio performance, proposal guidelines, operational partnerships, grant renewals, procurement and supply management and safeguards. In view of its extensive practical operational in-country and world-wide experience in these areas, especially with regard to the three diseases and health sector strengthening, the Bank believes that it would substantially enhance the work of the Portfolio Committee if it were a member. The Bank has further commented that in proposal 2, each of the technical advisors (non-voting members) should be assigned 2 seats (as are voting members) for all 3 Committees combined - in other words each of the non-voting members should have a seat on 2 of the 3 proposed Committees. Since in the past, Committees have asked WHO, UNAIDS and the Bank to perform tasks on a regular basis, the Bank has stressed that having them on the technical committees has been an effective way of ensuring the work gets done.

the Chair of the TERG delivers updates on issues related to performance of the Global Fund directly to the Board, to safeguard the independent nature of the TERG.

5. In closing, the MEFA Chair encouraged MEFA members to continue consultation within their constituencies on these issues, particularly the two options and the issue of representation and process, and to bring forward further inputs to the Board discussion in April.

Part 9: LFA Review: Status on Response, Action Underway and Next Steps

1. MEFA received a paper (attached as Annex 5) and heard a presentation on the conclusions of the LFA Review, commissioned by the Secretariat in mid-2004, together with an update of actions taken to date, on-going system improvements and next steps in the balance of this year.

2. The LFA Review included 13 in-depth case studies and concluded with an independent overall report on the effectiveness of existing LFA working arrangements. From this review came a number of recommendations, the majority focusing on a well recognized need for more streamlined engagement and working procedures. More substantive recommendations were also explored, including a possible proposed separation of the LFA roles 'by function' (e.g. procurement), as well as the question of better tailoring the role of the LFAs to country context and mechanisms for collaborative donor assessments and pooled support.

3. The LFA Review recommendations are being considered in light of their respective timeframe for implementation and relative appropriateness having regard to the Global Fund's maturing business model. During this process, significant attention is being given towards ensuring Principal Recipients provide robust and transparent reporting on achievements, and that grant management systems adopted by the Global Fund are appropriate to in-country and grant specific risks.

4. Finally the Secretariat highlighted that additional work is also underway to further inform evolution and enhancement of the role of the LFA in the Global Fund's work, including a review by the US General Accountability Office (expected in May 2005), on-going work by DLA Piper on risk management and response, as well as country-level feedback and the real-time learning being acquired via the Phase 2 renewal process. This will also be informed by the work and direction emanating from the Arusha Board consultation and follow up work.

5. The Committee further noted that donor and partner commitments to harmonization of in-country programs should be considered by the Secretariat in any LFA system reform proposals that are recommended for consideration by the Board.

6. Finally, following a wide-ranging discussion, the MEFA Committee took note of the work underway to improve and enhance the effectiveness, cost efficiency, and value added of the LFA model and encouraged the Secretariat to continue with optimizing the current system, as set out and per the timetable in paragraph 27 of the attached paper and guided by MEFA's previous inputs on the direction of LFA development. This includes (under the lead of a new LFA Officer (recruitment pending)) the development of scenarios for in-country piloting of reform proposals, incorporating revised LFA tools and training modules during the pilot phase. The Secretariat will refer these scenarios to the relevant Committee for comment. Over July - December 2005, the Secretariat will aim to conduct these preliminary in-country LFA reform pilots, analyze outcomes to identify key strengths, challenges and relative risks, and report on these to the Board through the relevant Board Committee by the 11th or 12th Boards.

Decision Point 3:

> ***The Board is satisfied with the workplan and next steps relating to working with LFAs set out in Part 4 of Annex 5 to this report and developed in consequence of the findings of the recent LFA Review commissioned by the Secretariat, informed also by other work underway to inform and enhance the efficiency and effectiveness of the LFA role in Global Fund activities.***[4]

Part 10: Timelines for Grant Signings: Update on Experience to Date

1. The Secretariat provided an update to the Committee on the implementation of the Eighth Board Meeting decision on timeframes for the signing of grant agreements. This decision established a target that a proposal would result in a grant agreement within six month of Board approval, and a deadline for grant signing of twelve months from Board approval (extendable by up to a further three months).

2. The target has not been systematically met, but the Secretariat nonetheless feels that it is an appropriate target and that in future Rounds it will be attained. Reasons why the target could not be attained included the fact that the portfolio management clusters are still building experience and have only recently reached full staffing, an emphasis on ensuring that grants are ready to be disbursed at the time of signing (rather than having considerable delays between grant signing and first disbursement), and the commencement of Phase 2 activities (which, as described below, have taken considerably more time than had been anticipated).

3. The deadlines for grant signing were first applied in Round 3 (despite the fact that the Board decision occurred six months after the Board approved Round 3). Nearly all Round 3 proposals resulted in signed grant agreements within the deadline, although the Secretariat did request extensions for seven proposals (five of which were from countries in which the Additional Safeguards Policy is used). The Board approved all of these extensions, and six of the seven resulted in signed grant agreements within the additional three months. The Secretariat concluded that the twelve month deadline is appropriate.

4. The Secretariat called the Committee's attention to the distinction between grant signing and first disbursement. A lag of a few weeks typically occurs between grant signing and first disbursement (for purely administrative reasons) and in some cases there have been much more considerable delays. As noted above, considerable efforts have gone into reducing the gap between grant signing and first disbursement, such that the interval has been reduced from 58 days in Round 1 to 27 in Round 4. However, the implication of any gap at all is that some grants that have been signed within the 12 month window may not disburse until after it. It also noted that a program's official "Start Date" is normally adjusted based on the first disbursement, rather than remaining fixed, even if there is a considerable gap between signing and first disbursement.

5. The Committee agreed with the Secretariat's assessment of the appropriateness of the current timeframes. It discussed the potential that grants may not receive their first disbursement until after the twelve month period has elapsed, and one Committee member proposed setting a deadline for first disbursement, on the basis that allowing a further indefinite delay in grant start-up after the 12 month target undermines the meaningfulness of that target. The Committee did not adopt this proposal, feeling instead that the current approach is sufficiently robust and that adding new requirements at the moment without a clearer sense that there is actually a problem to be addressed is unnecessary.

[4] The U.S. constituency notes that the language of this Decision Point was not specifically considered or discussed at the MEFA meeting, but was added to the MEFA report between the first and final draft and therefore does not support bringing this Decision Point to the Board

6. Instead, the Committee again encouraged the Secretariat to avoid delays caused by internal inefficiencies and asked the Secretariat to continue to monitor the implementation of the Eighth Board Meeting decision and to report back as necessary to the appropriate Committee in the next structure of Board Committees.

Part 11: Phase 2 Operational Review

1. The Secretariat provided an update on Phase 2. Twenty-nine proposals had been reviewed by the Secretariat:

a. The Secretariat had recommended committing additional financing for 23 proposals:
   i. The Board agreed for 21 of these, and committed US$119 million;
   ii. At the time of the Committee meeting, two recommendations were pending before the Board. These two have subsequently been approved, committing a further US$29 million.

b. The Secretariat recommended not committing additional funding for 4 proposals:
   i. The Board agreed for 1 proposal;
   ii. The Board disagreed for 2 proposals (in line with the Ninth Board Meeting decision, the Secretariat will provide its recommendation again on 1 April);
   iii. At the time of the MEFA Committee meeting, one recommendation was pending before the Board. The Board disagreed with this recommendation and the Secretariat will provide its recommendation again on 1 April.

c. The Secretariat deferred making recommendations for two proposals.

2. First, the Secretariat described the approach that it was taking in developing its recommendation which focuses on performance and a “holistic” view, considering how a Global Fund financed program, in line with the originally agreed proposal, would impact at least one of the three diseases, rather than picking and choosing elements within a proposal. In some cases, this approach would result (and indeed has already resulted) in the Secretariat recommending that the Board not commit additional resources despite the fact that performance may have been demonstrated in some parts of a proposal.

3. Second, the Secretariat noted that the Phase 2 decision process may be occurring early in the life of a proposal. In order to provide a recommendation to the Board in month 20 and in line with current Board policy, the Secretariat needed to receive information from CCMs and PRs by month 18. Consequently, cases, performance data through only the first 15 months of a program is available at the time of the Phase 2 renewal process (and in some cases, only 12 months of data is available). Additionally, the compressed timeframe for both applicants and the Secretariat may not be conducive to thorough preparation and review of the Request for Continued Funding. However, within the framework of an initial two-year financial commitment (as set out in the Comprehensive Funding Policy), it will not be possible to push back or extend the process

4. Third, the Secretariat amplified comments that it had already provided to the full Board on its approach to reviewing the Phase 2 budgets. In the first set of proposals sent to the Board, the Secretariat had not been able to complete as rigorous a review of the Phase 2 budgets as it would have liked. It has therefore initiated a strategy to improve the thoroughness of the budget review, including requesting more information, including information on actual disbursements to subrecipients, in the Request for Continued Funding, developing more detailed guidance for Local Fund Agents and establishing a process for proactive follow up and a more intensive in-house review of budget requests.

5. Fourth, the Secretariat noted that the Phase 2 process had taken considerably more time than previously estimated, both on the part of recipients and on the part of the Secretariat. The

Secretariat is examining ways to streamline the process, but noted that a rigorous approach to performance-based funding will invariably require a considerable investment of time. The Secretariat also noted that the suite of tools for transparent and rigorous performance tracking of grant progress is now well developed. A focus of the Secretariat will be to fully embed these tools for all grants well before Phase 2 maturity will be reached. This will ensure that grant performance information is well documented and accessible to all stakeholders throughout the grant life cycle building up towards the Phase 2 decision (and beyond). With these tools fully in place, the process for Phase 2 decision making will be easier. This will also allow building and strengthening the focus on early warning, rather than waiting for the final phase two review at month 18 to 20.

6. Fifth, the Secretariat observed that in some situations, it was necessary to undertake additional efforts to either collect more data or fully understand the complexities being faced on the ground and other contextual considerations before a final recommendation can be made for Board decision. The Secretariat has twice used the flexibilities built into the process agreed at the Ninth Board Meeting to exercise its discretion to delay sending a recommendation to the Board for proposals where it determined that it could not make a satisfactory recommendation based on the information available at the time. In exceptional cases this will require an extension of the terms of Phase 1 grant agreements of up to 6 months, in line with existing Board policies.

7. Sixth, the Chair of the TRP, the chair of TERG and the Secretariat discussed the role of the TRP in the process. The Seventh Board Meeting decision (at which point the Secretariat rather than the Board was making Phase 2 funding decisions) set out a role for the TRP in reviewing all “No-Go” recommendations. The formal requirement that the TRP be involved in reviewing “No-Go” recommendations was revoked in the Ninth Board Meeting decision, but the Secretariat had voluntarily sent its “No-Go” recommendations to the TRP prior to submitting them to the Board. Both the TRP and Secretariat recommendations were then sent to the Board, although the Board voted on the Secretariat recommendation.

8. The lesson learned from the experience of the first four “No-Go” recommendations was that this process was not appropriate. The Secretariat has the benefit of having twenty months of experience handling a grant when it makes its recommendation. The process also provides for a multi-layered review in the Secretariat, which is possible because it has two months to develop its recommendation. The TRP, in contrast, has much more limited resources, does not have a perspective on what is actually happening on the ground (except through Secretariat and CCM/PR documentation), and has a much shorter timeframe within which to develop its recommendation.

9. From this experience, both the TRP Chair and the Secretariat recommended that the TRP not play a role in reviewing “No-Go” recommendations. Instead, both recommended that the TRP systematically review “Revised Go” recommendations. These are recommendations that emerge from the Secretariat when issues of material reprogramming have arisen. The TRP’s role in these cases would focus on judging the technical merit of the new approach and making recommendations to the Board (directly, rather than through the Secretariat) about whether or not to commit additional resources for the new approach. This role is much more in keeping with the approach taken by the TRP in its initial review of proposals and takes better advantage of the TRP’s strength in assessing technical merit. These recommendations are also confirmed by the TERG which reviewed the phase two processes in more detail during its second meeting directly preceding the MEFA meeting.

10. Finally, the Secretariat concluded by highlighting the results seen in the progress report prepared for the first Replenishment Conference, which demonstrated that performance-based funding is starting to work, with well-performing PRs receiving more financing than poor-performers.

11. Moving on from the process itself to the Board voting, the Secretariat flagged for the Committee that some discordant positions had been seen in the first several sets of votes. First, some Board constituencies seemed to indicate that Round 1 proposals should be treated differently than later proposals, in light of the fact that systems were still being set up. While the Secretariat had taken the lack of clarity in the early days of the Global Fund in its review of a program's performance, it was still applying the principles of performance evaluation in its review of Round 1 proposals, rather than systematically giving Round 1 unconditional support.

12. Second, a number of Board constituencies had, in their objections to Secretariat "No-Go" recommendations, indicated that the need faced by a country should factor into the Phase 2 funding decision. Other Board constituencies have articulated a very different position, one based on the primacy of performance-based funding. As need was not something that had been included as part of the previous Board-approved processes (except in the context of resource constraints), it is not something that the Secretariat has systematically included in the process.

13. The Committee discussion focused on the role of the TRP and the importance of flexibility in the system. On the former, the Committee noted and agreed with the recommendations from the Chair of the TRP and the Secretariat and supported by the TERG that the TRP no longer be involved in reviewing "No-Go" recommendations. This is in line with existing Board policy, so the Committee saw no need to make a recommendation for decision to the Board on the matter.

14. On the other hand, the Committee, with the exception of the US, does recommend that the Board amend the existing Phase 2 policy (as approved at the Ninth Board Meeting) to formalize the role of the TRP in reviewing "Revised Go" recommendations. It would thus be the recommendation of the TRP – rather than the Secretariat – on which the Board would vote.

15. The Committee, again with the exception of the US, also agreed with the need to ensure that country realities are accommodated in the Phase 2 process, by providing the Secretariat with the flexibility to extend Phase 1 grant agreement and commit additional resources up to the amount of half of the first year budget in the Request for Continued Funding.

16. The Committee noted that while the previous discussions on Board "no objection" procedures for Phase 2 renewals had dealt with the implications of a blocking vote on "Go" recommendations from the Secretariat, the implications of a blocking vote on the "No Go" recommendations have not yet been considered. Furthermore, the procedure for a full Board vote on blocked Phase 2 applications has not been worked out. This needs to receive further attention in the revised Committee structure. The possibility for having a simple Board procedure that either confirms the block or unblocks it (whether a blocked go or a blocked no go) was discussed in a preliminary way. (Such a procedure is indicated in the bracketed text of Annex 6 – Point 9 - not for Board decision at this stage).[5]

17. The Committee supported the emphasis that the TERG put on strengthening the early warning system to ensure that all stakeholders were apprised early in the life of a grant if performance was off-track and that therefore Phase 2 funding was potentially in jeopardy.

18. Finally, the Committee took note of the review and positive assessment presented by the chair of the TERG on the overall process of Phase 2 and the work undertaken by the Secretariat in operationalizing the Phase 2 decision process. The Committee asked the Secretariat to report back again on lessons learned.

[5] The US constituency notes that this annex was neither presented nor discussed at the MEFA meeting, but was added subsequent to the meeting to this report. The US constituency therefore does not support the inclusion of this annex in this report.

19. Subsequent to the MEFA Committee meeting, the PMPC met and discussed the recommendations from the MEFA Committee. The PMPC agreed with the recommendations, suggesting an amendment to the second bullet below to emphasize the exceptional nature of the Secretariat committing additional resources. This was accepted by MEFA – with the exception of the US constituency – based on adjustments to and circulation of the draft minutes of the meeting.

Decision Point 4:

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The Board decides that "Revised Go" recommendations shall be provided to the Board by the TRP and not by the Secretariat, and amends the Phase 2 Policy as set out in Annex 6 to Board Document GF/B10/8 to provide for this process.

The Board acknowledges that, in line with the existing Phase 2 policy, the Secretariat may need to take more than 20 months to provide a Phase 2 recommendation to the Board. It therefore decides that in exceptional circumstances the Secretariat may extend the terms of Phase 1 grant agreements by up to six months and to commit additional funds up to a maximum of one-half of the first year budget contained in the Request for Continued Funding. The Secretariat shall inform the Board accordingly.[6]

The Board asks the Secretariat to report back on further lessons learned in the Phase 2 process through the appropriate Board Committee at the 12th Board Meeting and to work further through that Committee to address the issue of a possible simple Board procedure for blocked Phase 2 applications.

Part 12: Global Fund Performance: Report of the Technical Evaluation Reference Group

1. The Committee was provided with a report from the Chair of the Technical Evaluation Reference Group (TERG) summarizing the TERG deliberations during its second meeting 1-3 March 2005. The TERG discussions focused on issues around: Phase 2 progress; Target setting for performance management; Early Warning System; Revision and Reprogramming of underperforming Grants; Quality Assurance; CCM assessment; phasing of overall evaluations; role of TERG within the revised committee structure. The summary report of the meeting with a series of concrete recommendations was provided to MEFA and is attached in Annex 7.

[6] The U.S. wishes to note what it considers to be substantial procedural irregularities in the formulation of this and two other Decision Points (Decision Points 3 and 5). With respect to Decision Point 4, the U.S. constituency points out that the Secretariat asked the Committee to consider decision points to change the existing Phase 2 policy (related to the extension of Phase 1 grant agreements beyond 20 months and to allow the Secretariat to commit additional funds) in an oral request at the very end of the MEFA meeting. In contrast, the meeting agenda called only for a Secretariat update on initial experience on Phase 2 operations, the Secretariat had not circulated any paper prior to the Committee on proposals to change the process, nor offered any draft decision points at any point in advance of the session. Nor was this change, unlike changes to the role of the TRP, recommended by the TERG. Furthermore, there was insufficient time to discuss or modify the decision points the Secretariat drafted and distributed only in the waning moments of the Committee meeting, which adjourned earlier than scheduled. The result may be the forwarding of an insufficiently vetted Decision Point, not based on a consensus of the Committee. In particular, the U.S. constituency notes that even with the addition from the PMPC of the words"in exceptional circumstances", there is still no understanding of what circumstances would allow the Secretariat to invoke this procedure. Furthermore, the U.S. believes that the current system of the Board's approving such extensions is the only legally defensible position, since only the Board can commit funds. Allowing the Secretariat to commit funds will require a specific delegation of authority from the Board to the Secretariat. Lastly, the Decision Point sets forward no criteria on which to base a recommendation of additional funding, such as whether there is, in fact, a need for additional funds. Consequently, the U.S. Constituency considers this Decision Point to be brought forward prematurely, and on the basis of limited Phase 2 experience, and objects to forwarding this Decision Point to this Board meeting on these grounds

2. The Committee welcomed the report and TERG's positive evaluation of progress made by the Secretariat in Strategic Information and Evaluation and the priorities set for 2005 in its work plan.

3. The Committee agreed with the recommendations made by the TERG and urged the Secretariat to incorporate those recommendations into it's on-going operations, in particular the scope and timing of major external evaluations of the Global Fund. As described above, the Committee specifically discussed recommendations related to the role of the TRP in "no-go" decisions and the importance of "early warning" for under-performing grants.

4. The Committee also endorsed the proposed change in the role of the TERG vis-à-vis the Board's new committee structure summarized in the revised TOR for the TERG (Annex 8). In particular the Committee suggested that the TERG Chair shall be invited to meetings of the PS Committee and the Global Fund Board and shall at each meeting of the Board present brief independent assessments on performance and status of the M&E system to the Board, based in the TERG mandate. Recommendations from the TERG are advisory, but not binding, to the board of the Global Fund and the GFATM Secretariat. Board Committees dealing with recommendations from the TERG can not revise the recommendations or block them from reaching the Board, but will give their comments and prepare Board actions to accompany such recommendations, following regular procedures.

Decision Point 5:

The Board approves a revision to the Technical Evaluation Review Group (TERG) Terms of Reference (ToRs) to respond to the proposed changes in the Board Committee structure. The proposed revised ToRs are attached as Annex 8 to this report. The Board also requests that the TERG Chair present brief independent assessments on performance and status of the Global Fund M&E system to each meeting of the PSC and the Board.

Annexes:

Annex 1: 2004 Financial Statements
Annex 2: Review of 2004 Operating Expenses, Performance against Workplan and 2005 Budget Recap
Annex 3: Purchase of Headquarters Premises – The Business Case
Annex 4: Dual Currency Grants and Currency Risk
Annex 5: Discussion Paper on a Review of the Roles, Functions and Performance of Local Fund Agents
Annex 6: Proposed Amendment to Phase 2 Policy
Annex 7: Summary Report of the Technical Evaluation Review Group (TERG)
Annex 8: Revised Terms of Reference for the TERG
Annex 9: MEFA Meeting Agenda
Annex 10: MEFA Participants List

Updated version 18 March 2005

Financial statements of

The Global Fund to Fight AIDS, Tuberculosis and Malaria

as of 31 December 2004

prepared in accordance with International Financial Reporting Standards

together with the Report of the independent auditors

ERNST & YOUNG

ERNST & YOUNG

Ernst & Young Ltd
Assurance & Advisory
Business Services Industries
Route de Chancy 59
P.O. Box
CH-1213 Geneva

Phone +41 58 286 56 56
Fax +41 58 286 56 57

www.ey.com/ch

To the general meeting of the Board of

The Global Fund to Fight AIDS, Tuberculosis and Malaria, Geneva

Geneva, xx April, 2005

Report of the independent auditors

We have audited the accompanying statement of financial position of The Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Global Fund") as of 31 December 2004, and the related statements of activities, changes in funds, and cash flows and notes for the year then ended. These financial statements are the responsibility of the Global Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as of 31 December 2004, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards and specifically with Statement of Financial Accounting Standard 116 Accounting for Contributions Received and Contributions Made with respect to the recognition of contributions and grants.

Ernst & Young Ltd

Mark Hawkins	Mélanie Denéchère
Chartered Accountant	Chartered Accountant
(Auditor in charge)	

Enclosures

- Financial statements (statement of financial position, statement of activities, statement of changes in funds, statement of cash flows and notes)

Financial Statements

Statement of Financial Position at 31 December 2004

In thousands of US dollars	Notes	2004	Restated 2003
ASSETS			
Cash and bank balances	2.4, 3.1	1’881	225
Funds held in trust	2.4, 2.5, 3.1, 3.2	2’205’078	1'741'968
Promissory notes	2.6, 3.3	237’449	62’460
Contributions receivable within one year	2.6, 3.4	93’239	104’182
Prepayments and miscellaneous receivables		5’706	2'699
		2’543’353	1’911’534
Contributions receivable after one year	2.6, 3.4	129’204	146’837
Total ASSETS		**2’672’557**	**2’058’371**
LIABILITIES and FUNDS			
Liabilities			
Undisbursed grants payable within one year	2.7, 3.6	919’047	610'885
Accrued expenses		4’235	303
		923’282	611’188
Undisbursed grants payable after one year	2.7, 3.6	191’040	272'340
Total LIABILITIES		**1’114’322**	**883'528**
FUNDS		**1’558’235**	**1’174’843**
Total LIABILITIES and FUNDS		**2’672’557**	**2’058’371**

The notes represent an integral part of the Statement of Financial Position

Financial Statements

Statement of Activities
for the year ended 31 December 2004

In thousands of US dollars	Notes	2004	Restated 2003
INCOME			
Contributions	2.6, 3.5	1’254’688	1’416’650
Bank and trust fund income	2.9	33’819	28'235
Total INCOME		**1’288’507**	**1’444’885**
EXPENDITURE			
Grants	2.7, 3.7	854’368	1'063'304
Operating expenses	3.8	50’747	32'555
Total EXPENDITURE		**905’115**	**1'095'859**
INCREASE IN FUNDS for the year		**383’392**	**349’026**

The notes represent an integral part of the Statement of Activities

Statement of Cash Flows
for the year ended 31 December 2004

In thousands of US dollars	Notes	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES			
Contributions received	3.5	1'101'008	1'330'862
Bank and trust fund income		34'329	28'930
		1'135'337	1'359'792
Grants disbursed	3.7	(627'506)	(231,200)
Payments to suppliers and personnel		(43'065)	(36,889)
		(670'571)	(268,089)
CASH FLOWS FROM OPERATING ACTIVITIES being the net increase in cash and cash equivalents		**464'766**	**1'091'703**
CASH AND CASH EQUIVALENTS at beginning of the year	2.4, 3.1	**1'742'193**	**650'490**
CASH AND CASH EQUIVALENTS at end of the year	2.4, 3.1	**2'206'959**	**1'742'193**

The notes represent an integral part of the Statement of Cash Flows

Statement of Changes in Funds
at 31 December 2004

In thousands of US dollars	Notes	2004	Restated 2003
FUNDS at the beginning of the year as previously reported			**727'108**
Prior periods' effect of change in accounting policy	2.2, 2.6, 3.5		98'709
FUNDS at the beginning of the year, restated		**1'174'843**	**825'817**
INCREASE IN FUNDS for the year as previously reported		383'392	300'898
Change in accounting policy	2.2, 2.6, 3.5	-	48'128
INCREASE IN FUNDS for the year		**383'392**	**349'026**
FUNDS at the end of the year		**1'558'235**	**1'174'843**
Attributed as follows:			
Foundation capital		50	50
General Funds		1'558'185	1'174'793
		1'558'235	**1'174'843**

The notes represent an integral part of the Statement of Changes in Funds

Financial Statements

1. Activities and Organization

The Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Global Fund") is an independent, non-profit foundation that was incorporated in Geneva, Switzerland on 22 January 2002. The purpose of the Global Fund is to attract and disburse additional resources to prevent and treat AIDS, tuberculosis and malaria. The Fund provides grants to locally-developed programs, working in close collaboration with governments, non-governmental organizations, the private sector, development agencies and the communities affected by these diseases.

The Global Fund has been founded on the following principles:

- Rely on local experts to implement programs directly;
- Make available and leverage additional financial resources to combat the three diseases;
- Support programs that reflect national ownership and respect country-led formulation and implementation processes;
- Operate in a balanced manner in terms of different regions, diseases and interventions;
- Pursue an integrated and balanced approach covering prevention, treatment and care, and support in dealing with the three diseases;
- Evaluate proposals through independent review processes based on the most appropriate scientific and technical standards that take into account local realities and priorities;
- Seek to establish a simplified, rapid, innovative grant-making process and operate in a transparent and accountable manner based on clearly defined responsibilities. One accountability mechanism is the use of Local Fund Agents to assess local capacity to administer and manage the implementation of funded programs.

Financial contributions to the Global Fund are held in the Trust Fund for the Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Trust Fund") until disbursed as grants or for operating expenses. The Trust Fund is administered by the International Bank for Reconstruction and Development (the "World Bank"), as Trustee. The responsibilities of the Trustee include management of contributions and investment of resources according to its own investment strategy. The Trustee makes disbursements from the Trust Fund only upon written instruction of the Global Fund.

Most contributions are received directly in the Trust Fund. Some contributions for the benefit of Global Fund are also received by the United Nations Foundation and are held in trust for the Global Fund until subsequently transferred to the Trust Fund.

Personnel and administrative services to support the operations of the Global Fund are provided by the World Health Organization ("WHO") under an agreement between WHO and the Global Fund. The Global Fund bears in full the cost of these personnel and services. Funds remitted to WHO for this purpose are treated as funds held in trust by WHO for the benefit of the Global Fund until an expenditure obligation is incurred.

These financial statements were authorized for issuance by the Board on xx April 2005.

Financial Statements

2. Significant Accounting Policies

2.1 Statement of Compliance

The financial statements have been prepared in accordance with and comply with the International Financial Reporting Standards issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

These standards currently do not contain specific guidelines for non-profit organizations concerning the accounting treatment and presentation of the financial statements. Consequently Statement of Financial Accounting Standard ("SFAS") 116: "Accounting for Contributions Received and Contributions Made" has been applied in respect of the recognition of contributions and grants.

2.2 Basis of Presentation

The financial statements are presented in US dollars, the Global Fund's operating currency, rounded to the nearest thousand. Management elected not to operate and report in Swiss Francs, the domestic currency, as its cash flows are primarily in US dollars.

The financial statements are prepared under the historical cost convention. The fair value of non-current contributions receivable, promissory notes and undisbursed grants has been determined as indicated in Notes 2.6 and 2.7.

The preparation of the financial statements requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of the financial statements, and reported amounts of income and expenses during the reporting period. If in the future such estimates and assumptions, which are based on management's best judgment at the date of the financial statements, deviate from actual circumstances, the original estimates and assumptions will be modified through the statement of activities as appropriate in the year in which the circumstances change.

In 2004, the Global Fund has changed its accounting policy for the recognition of contributions receivable, as further described in Note 2.6. This change in accounting policy has been accounted for retrospectively. Comparative information in these financial statements has been updated to reflect this change. The cumulative impact of this change is an increase on prior years' Funds of USD 147 million (2002 : 99 million) as detailed in the Statement of Changes in Funds.

2.3 Foreign Currency

All transactions in other currencies are translated into US dollars at the exchange rate prevailing at the time of the transaction. Monetary assets and liabilities in other currencies are translated into US dollars at the year-end rate.

Financial Statements

2. Significant Accounting Policies (continued)

2.4 Cash and cash equivalents

The Global Fund considers that cash and cash equivalents include cash and bank balances and funds held in trust that are readily convertible to cash within three months.

2.5 Funds held in Trust

The financial statements include funds that are held in trust solely for the benefit of the Global Fund by the World Bank, the World Health Organization and the United Nations Foundation.

Assets held in trust by the World Bank are maintained in a commingled investment portfolio for all of the trust funds administered by the World Bank. These investments are actively managed and invested in high-grade instruments according to the risk management strategy adopted by the World Bank. The objectives of the investment portfolio strategy are to maintain adequate liquidity to meet foreseeable cash flow needs, preserve capital (low probability of negative total returns over the course of a fiscal year) and maximize investment returns.

The returns on funds held in trust are accounted for on an accruals basis.

2.6 Contributions

In accordance with SFAS 116 contributions governed by a written contribution agreement are recorded as income when the agreement is executed. Other contributions are recorded as income upon receipt of cash or cash equivalents, at the amount received.

Contributions are considered received when remitted in cash or cash equivalent, or deposited by a sovereign state as a promissory note, letter of credit or similar financial instrument.

Contributions receivable under written contribution agreements executed on or before the date of the statement of financial position but which have not been received at that date are recorded as an asset and as income. Contributions and promissory notes receivable later than one year after the date of the statement of financial position are discounted to estimate their present value at this same date. In previous years, contributions receivable later than one year after the date of the statement of financial position were not recorded as an asset or income; in the light of favourable collection experience and to better reflect the Global Fund’s financial position, such contributions are recorded as an asset and as income in 2004, as mentioned in Note 2.2.

Foreign currency exchange gains and losses realized between the date of the written contribution agreement and the date of the actual receipt of cash and those unrealized at the date of the statement of financial position are recorded as part of Contribution income.

2. Significant Accounting Policies (continued)

2.6 Contributions (continued)

Non-cash contributions donated in the form of goods or services (in-kind contributions) are recognized at the time of receipt and reported as equal contributions and expenses in the Statement of Activities, at their estimated economic value to the Global Fund.

2.7 Grants

All grants are governed by a written grant agreement and, in accordance with SFAS 116, are expensed in full when the agreement is executed.

Grants or portions of grants that have not been disbursed at the date of the statement of financial position are recorded as liabilities. The long-term portion of such liabilities represents amounts that are due to be disbursed later than one year after the date of the statement of financial position, discounted to estimate its present value at this same date.

2.8 Local Fund Agent Fees

Fees to Local Fund Agents to assess local capacity prior to and during grant negotiation, and to manage and monitor implementation of funded programs as grants are disbursed, are expensed as the work is completed.

2.9 Bank and Trust Fund Income

Bank and trust fund income includes deposit interest on bank balances and realized gains and losses on investments and currencies on funds held in trust.

2.10 Employee Benefits

All personnel and related costs, including current and post employment benefits, are managed by the WHO and charged in full to the Global Fund, apart from insignificant incidental costs borne directly by the Global Fund. There are no unfulfilled obligations for employee benefits outside of the Global Fund's obligations to the WHO.

Financial Statements

3. Details relating to the financial statements

In thousands of US dollars

3.1 Cash and Cash Equivalents

	2004	2003
Cash and bank balances	1’881	225
Funds held in Trust	2’205’078	1’741’968
	2’206’959	**1’742’193**

3.2 Funds held in Trust

	2004		2003
World Bank	2’192’288		1’729’149
World Health Organization	12’154		12’567
United Nations Foundation	636		252
	2’205’078		**1’741’968**

3.3 Promissory Notes

	2004	2003
Promissory notes to be encashed	216’201	52’773
Unrealized gains on foreign currency promissory notes to be encashed	21’248	9’687
	237’449	**62’460**
Maturing in 2004	-	62’460
Maturing in 2005	237’449	-
	237’449	**62’460**

3.4 Contributions receivable

	2004	Restated 2003
Contributions receivable*	201’516	236’420
Unrealized gains on foreign currency contributions receivable	20’927	14’599
Total contributions receivable	**222’443**	**251’019**

Receivable within one year	93’239	104’182
Receivable after one year	129’204	146’837
	222’443	**251’019**

* Comprises amounts receivable under written contribution agreements executed on or before 31 December 2004 and 2003 respectively that had not been received at that date.

Financial Statements

3. Details relating to the financial statements (continued)
In thousands of US dollars

3.5 Contributions

	2004	Restated 2003
Governments	1’195’170	1’314’795
Private sector	59’518	101’855
Total contributions	**1’254’688**	**1’416’650**

	2004	Restated 2003
Cash received including encashed promissory notes	1’101’008	1’330’862
Increase in promissory notes to be encashed	174’989	10’620
Increase / (decrease) in contributions receivable	(28’575)	75’168
Contributions in kind	7’266	-
Total contributions	**1’254’688**	**1’416’650**

The effect of the change in accounting policy for contributions, as referred to in notes 2.2 and 2.6, is an

increase in contributions of USD 48 million for the year ended 31 December 2003 (2002: USD 99 million).

3.6 Undisbursed grants payable

	2004	2003
Payable within one year	919’047	610'885
Payable after one year	191’040	272'340
	1’110’087	**883’225**

3.7 Grants

	2004	2003
Disbursed in the year	627’506	231’200
Movement in undisbursed grants	226’862	832’104
Grant expense	**854’368**	**1’063’304**

Financial Statements

3. Details relating to the financial statements (continued)
In thousands of US dollars

3.8 Operating expenses

	2004	2003
Secretariat expenses		
Personnel	16’854	9’793
Trustee fee	2’150	1’870
Administrative services fee	982	900
Other professional services	3’521	2’078
Travel and meetings	4’673	3’750
Communication materials	7’728	966
Office rental	754	509
Office infrastructure costs	1’376	998
Other	533	1’572
	38’571	22’436
Local Fund Agent fees	12’176	10’119
	50’747	**32’555**

Included in Operating expenses above are contributions in kind amounting to USD 7.3 million which have been attributed to Other professional services for USD 0.7 million and to Communication materials for USD 6.6 million. In 2003, contributions in kind were not included in the financial statements as they were not material.

3.9 Personnel

As described in Note 1, personnel to support the operations of the Global Fund are provided by the WHO under an agreement between the WHO and the Global Fund. At 31 December 2004, there were 127 personnel assigned to the Global Fund (2003:96). Of these, 74 (2003: 55) are assigned under fixed-term contracts, typically of two years duration. All other personnel are assigned under contracts of shorter duration.

3.10 Taxation

The Global Fund is exempt from tax on its activities in Switzerland.

3.11 Commitments

At 31 December 2004, the Global Fund has the following outstanding operating lease commitments:

Financial Statements

Year	Office space	Office equipment	Vehicle
2005	988	19	1
2006	677	19	-
2007	677	19	-
2008	677	15	-
2009	677	7	-
Beyond 2009	1’635	-	-
	5’331	**79**	**1**

Financial Statements

4. Financial Instruments

As described in Note 2.5, those funds held in trust by the World Bank, acting as Trustee for the Global Fund, are actively managed and invested in a commingled investment portfolio in accordance with the investment strategy established for all trust funds administered by the World Bank.

Other than those funds held in trust by the World Bank, as mentioned above, the Global Fund employs the following risk management policies to financial instruments:

Currency risk: The risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Global Fund does not hedge its exposure risk on foreign exchange as it operates primarily in US dollars.

Interest rate risk: The risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Global Fund does not use derivative financial instruments to reduce its exposure risk on interest from variable rate bank balances and funds held in trust.

Market risk: The risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Global Fund has assigned the management of market risk primarily to the Trustee, and does not use derivative financial instruments to reduce its market risk exposure on other financial instruments.

Credit risk exposures: Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. The Global Fund does not use derivative financial instruments to reduce its credit risk exposure.

The Global Fund's maximum exposure to credit risk in relation to cash and bank balances, funds held in trust, promissory notes and contributions receivable is the carrying amount of those assets as indicated in the statement of financial position. The Global Fund places its available funds with high quality financial institutions to mitigate the risk of material loss in this regard. With respect to the Global Fund's contributions receivable, management believes these will be collected as they result from mutually signed contribution agreements primarily with governments.

5. Comparative financial information

Certain comparative balances have been itemized for compliance with the current year presentation. Except for the effect of change in accounting policy as identified under Notes 2.2 and 2.6, there is no other impact on the Statement of Changes in Funds.

REVIEW OF 2004 OPERATING EXPENSES and 2005 BUDGET RE-CAP

Outline: This paper outlines the Secretariat performance in 2004 against budget and work plan and recapitulates the 2005 budget.

Part 1 provides analysis of Operating Expenses in 2004 as compared to budget with an explanation of significant variances from budget.

Part 2 summarises performance on key deliverables of the 2004 work plan.

Part 3 recapitulates the Board-approved budget for 2005 (for information).

Part 1: Operating Expenses in 2004

1. Operating expenses in 2004 totaled $43.5 million, which was 18% less than the budget for the year of $52.8 million. Fees for Local Fund Agent (LFA) services were 40% less than budgeted, while Secretariat Expenses (which include Board and Technical Review Panel expenses) were 3% under budget. The reasons for these variances are outlined at 2 and 3 below.

Annex 1 details the expenditure by each functional unit of the Secretariat, summarized as follows:

Operating Expenses 2004	Actual		Budget	Variance	
	$m	As % of Budget	$m	$m	As % of Budget
Secretariat Expenses	31.3	97%	32.3	1.0	3%
LFA Services	12.2	60%	20.5	8.3	40%
Total Operating Expenses	**43.5**	**82%**	**52.8**	**9.3**	**18%**
Secretariat expenses by function	**31.3**	**97%**	**32.3**	**1.0**	**3%**
Operations	10.6	99%	10.7	0.1	1%
Strategic Information & Evaluation	2.8	93%	3.0	0.2	7%
External Relations	6.1	97%	6.3	0.3	5%
Office of the Executive Director	1.8	86%	2.1	0.3	14%
Business Services	10.1	104%	9.7	(0.3)	(3%)
Contingency	0.0	0%	0.6	0.6	100%
Secretariat expenses by type	**31.3**	**97%**	**32.3**	**1.0**	**3%**
Staff	16.9	108%	15.7	(1.2)	(8%)
Professional fees	5.9	81%	7.3	1.4	19%
Travel & meetings	4.7	92%	5.1	0.4	8%
Office infrastructure	2.7	104%	2.6	0.0	0%
Communications materials	1.2	109%	1.1	0.0	0%
Contingency	0.0	0%	0.6	0.6	100%

Variances are computed as budget minus actual expenditure. Hence, positive amounts are favourable, since expenditure is less than budgeted.

2. Secretariat Expenses: $1.0m (3%) less than budget

The main areas of savings within Secretariat Expenses were the non-use of the $0.6 million contingency and under-spending of $0.4 million on travel. Staff costs were $1.2 million over budget (due mainly to accruing for untaken vacation), however this was covered by savings on professional fees of $1.4m. The variances on staff costs and professional fees are inter-related, because budgets for consultants were in some cases spent on hiring short-term staff.

3. Local Fund Agent (LFA) fees for in-country oversight: $8.3m (40%) less than budget

LFA fees were 40% less than budget mainly because of Round 4 grant signings occurring later that had been provided for in the budget, thus postponing LFA assessments of Principal Recipient capacity in many cases to from 2004 to 2005, as well as avoiding some months of implementation monitoring in 2004 for these grants. This reduction in actual activity as compared to the activity volumes assumed when formulating the budget is reflected in the budget savings. The 2004 costs are also reduced by savings realized in 2004 on some 2003 LFA contracts.

$m	Budget	Actual	Saving	Actual/ Budget Costs	Actual/ Budget Activity	Budgeted activity	Actual activity	
PR assessments	9.1	5.8	3.3	64%	73%	143	104	No. of new grants signed
Grant monitoring	10.8	7.5	3.3	69%	77%	310	239	No. of active grants
Phase II renewals	0.6	0.6	0.1					
Saving on 2003 contracts		-1.7	1.7					
Total	20.5	12.2	**8.3**					

a) The costs for PR assessments were 64% of the budget for assessments. The budget assumed that 143 grants would be signed in 2004, whereas the actual number was 104 grants (73% of the assumed activity). The average cost of LFA assessments was $56,000 per new grant signed, whereas the budget had allowed for a cost of $64,000 each.

b) The costs for grant monitoring were 69% of the budget for monitoring. The budget assumed that 310 grants would be active in 2004, whereas the actual number was 239 grants (77% of the assumed activity). The average cost of LFA implementation monitoring was $31,000 per active grant, whereas the budget had allowed for a cost of $35,000 each.

4. **Key Ratios**

Operating expenses were 4.8% of total expenditure in 2004 (2003: 3.0%). Grant expenditure (the amount of new grant commitments in the year) was less in 2004 than in 2003 and this contributed to the increase in this ratio.

Operating expenses were 6.8% of grant disbursements in 2004 (2003: 14.3%). The decrease in this ratio is due to the higher level of grant disbursements in 2004.

Operating expenses were 2.2% of grants under management in 2004 (2003: 3.0%). The decrease in this ratio is due to the increasing value of grants under management.

Statement of Activities (Summary)	2003		**2004**	
	$m		**$m**	
Income				
Contributions	1,369	98%	1,393	98%
Financial income	28	2%	34	2%
	1,397	100%	1,427	100%
Expenditure				
Grants[1]	1,063	97%	861	95%
Operating expenses	33	3%	43	5%
	1,096	100%	904	100%
Excess of Income over Expenditure	**301**		**523**	
Uncommitted funds:				
At start of period	727		1,028	
Excess of income over expenditure	301		523	
At end of period	1,028		1,551	

[1] Amount of new grant commitments in the year

Key Ratios		2003	**2004**
Operating Expenses as % of:			
Total Expenditure		3.0%	**4.8%**
Grant Disbursements		14.3%	**6.8%**
Grants Under Management		3.0%	**2.2%**
Operating Expenses per Active Grant		$489k	**$230k**
Activity data:			
Total Expenditure	$m	1,096	904
Grant Disbursements	$m	231	628
Grants Under Management [2]	$m	1,115	1,976
Number of Active Grants[3]		68	187

[2] Commitments through year-end to grants that have not yet reached completion

[3] Average number grants that are active during the year

Part 2: Performance on Key Deliverables for 2004

5. The table below indicates the degree of achievement by the end of 2004 of key deliverables in respect of each of the five corporate objectives for 2004:

Achievement of Key Deliverables per 2004 Work Plan (as at 31 December 2004)

	Key Deliverable	Target Date (per Work Plan)	Percentage complete by 31 Dec 2004	Remarks
	Corporate Objective 1: **Achieving Results**			
1.1	Signing of Round 2 grants completed	Dec-04	96%	
1.2	Signing of Round 3 grants completed	Dec-04	88%	(97% signed by 21 Feb 05)
1.3	Proposal guidelines updated, TRP review of Round 4 proposals supported and submitted to Board, TRP clarifications for Rounds 3 & 4 completed.	Jun-04	100%	
1.4	Considerable progress made towards signing of Round 4 grants	Dec-04	75% (Est.)	Grant negotiations well under way and 18% signed (34% signed by 21 Feb 05, 80% expected by 31 Mar)
1.5	$850 million disbursed (cumulative)	Dec-04	100%	$860m disbursed
1.6	Deal brokered with Clinton Foundation on ARV prices	Apr-04	100%	
1.7	Phase II policy options developed for MEFA consideration and policy paper presented to March Board meeting	Mar-04	100%	
1.8	Operational policies developed and codified in an Operational Policies Manual.	Jun-04	100%	
1.9	CCM guidelines shared, interpreted and understood	Dec-04	100%	
1.10	CCM toolkit developed and disseminated, outlining the CCM principles, roles and responsibilities	Jun-04	n/a	Postponed to 2005 (Board decision)
1.11	First requests for phase two funding evaluated and decisions made	Dec-04	n/a	Postponed to 2005 (Board decision)
	Corporate Objective 2: **Documenting Results**			
2.1	Criteria and guidelines for Phase II funding decisions developed	Jun-04	100%	
2.2	Appropriate coverage indicators selected by PRs for annual reporting	Dec-04	100%	
2.3	TERG members recruited and operational, TOR developed and two meetings held in 2004	Dec-04	75%	
2.4	Information platform for monitoring progress established and priority modules operational for country profiles and Phase II	Dec-04	100%	
2.5	Evaluation study on functioning of LFAs implemented and results disseminated.	Sep-04	100%	
2.6	Working group on additionality established (sub-group of TERG); studies and evaluations designed and completed.	Dec-04	100%	
2.7	Consensus reached on key performance indicators fot the Global Fund; monitored regularly and reported to MEFA and	Jun-04	100%	
2.8	2003 Annual Report published	Apr-04	100%	
2.9	Performance report published for Partnership Forum and Bangkok AIDS Conference	Jun-04	100%	

Corporate Objective 3: Mobilizing Support				
3.1	Strategic relationships maintained with donors and 90% of pledges for 2004 turned into contributions	Dec-04	100%	91% of pledges converted
3.2	Preparations under way for implementation of a voluntary replenishment mechanism, including by securing a Chairperson	Dec-04	100%	
3.3	Establishment of Friends of the Fund network supported; offices open in USA, Japan, France and Italy	Sep-04	60%	Friends offices operational in US and Japan, France to be launched in April 2005
3.4	Awareness raising campaign: creative content finalized and first phase of campaign launced in 5 priority countries	Dec-04	50%	Campaign successfully launched in France, negotiations ongoing in UK, Japan and Germany
3.5	In-depth information sessions held and profile of Global Fund raised at key events, including World Economic Forum, EU Dublin Conference, World Health Assembly and Bangkok AIDS Conference	Dec-04	100%	
3.6	Meetings held with missions of 25 potential donor countries and contributions secured from 10 new countries	Dec-04	65%	Meetings were held with 18 potential donor countries. Contributions were received from six new donor countries.
3.7	Recipient country support for Global Fund activities harnessed through meetings with 15 recipient countries	Dec-04	100%	Meetings were held with 15 recipient countries
3.8	Phase 2 of website launched with enhanced features and monthly progress documents uploaded	Jun-04	100%	
Corporate Objective 4: Managing the Secretariat				
4.1	Headquarters Agreement (with Switzerland) executed.	Dec-04	100%	
4.2	2003 Financial Statements approved by Board	Mar-04	100%	
4.3	2005 Budget and Work Plan approved by Board	Nov-04	100%	
4.4	Additional office accommodation procured and equipped for use	Jun-04	100%	
4.5	Induction course designed and operational for new staff	Sep-04	100%	
4.6	Performance management system operational, with all staff assessments up-to-date	Dec-04	61%	Performance management system operational, 61% of assessments up-to-date; others being updated in 2005
4.7	Updating of Administrative Services Agreement agreed with WHO	Sep-04	100%	
4.8	Statutory filings maintained up-to-date	Jul-04	100%	
4.9	Global Fund intranet operational	Apr-04	100%	
4.10	Secretariat job responsibilities externally reviewed and re-defined where appropriate	Jul-04	100%	
Corporate Objective 5: Facilitating Governance				
5.1	Three Board meetings, Partnership Forum and twenty-nine Committee meetings organized and supported with logistics, briefing papers and reports	Nov-04	100%	
5.2	TRP renewal facilitated with PMPC	Mar-05	100%	
5.3	PMPC/RMCC recommendations on in-kind donations facilitated	Jun-04	100%	
5.4	Comprehensive policy proposed on use of Global Fund logo	Jun-04	100%	
5.5	New Board members inducted successfully	Mar-04	100%	
5.6	Recommendations developed for Board action on CCM performance	Nov-04	100%	
5.7	Analysis provided to Board on Committee functioning to improve operation	May-04	100%	

Part 3: Re-cap of Budget 2005

6. The Board-approved budget for 2005 totals $65.5 million, comprised as follows:

Approved Budget 2005 ($m)	Before new Rounds	Round 5 incremenral costs	**Total**
Secretariat Expenses	42.4	1.3	**43.7**
LFA Services	20.2	3.2	**23.4**
Total			**67.1**
less: Efficiency Target			-1.6
Net of Efficiency Target			**65.5**

7. Significant factors affecting costs since the compilation of the budget in September 2004 include:

a) The decline by 7% in the value of the US dollar to the Swiss franc (from an exchange rate of 1.25 in September 2004 to 1.16 in February 2005). Almost all the Secretariat Expenses are Swiss franc based. If the decline of the exchange rate were to continue throughout 2005, the USD equivalent of these costs would increase correspondingly.

b) The need to relocate the Secretariat to larger office premises, planned for July 2005 was identified early in 2005. Suitable premises have been procured at a total rent similar to the current rent. Costs associated with fitting-out the new premises and for moving equipment and furniture are estimated at $1.9 million.

The Secretariat will strive to accommodate these additional costs within the existing budget and will report further on progress in this regard later in the year.

Attachment 1: 2004 Operating Expenses

2004 Actual US$'000	LFA Fees	Staff	Travel & Meetings	Communicat. materials	Professional services	Office infrastructure	Contingency	**Total**	As % of budget
In-country Oversight (LFA fees)	**12,176**							**12,176**	**59%**
Secretariat Expenses		**16,854**	**4,673**	**1,169**	**5,948**	**2,662**		**31,306**	**97%**
Fund Portfolio Operations		7,802	1,815	386	526	28		10,558	99%
Strategic Information and Evaluation		1,351	248	82	1,111			2,792	94%
External Relations		2,629	2,247	643	519	44		6,083	96%
Office of Executive Director		1,233	259	56	249			1,797	87%
Business Services		3,838	104	2	3,543	2,590		10,076	103%
Contingency									
Total	12,176	16,854	4,673	1,169	5,948	2,662		**43,482**	**82%**
As % of budget:	59%	108%	92%	102%	81%	103%		**82%**	

2004 Budget US$'000	LFA Fees	Staff	Travel	Communicat. materials	Professional services	Office infrastructure	Contingency	**Total**
In-country Oversight (LFA fees)	**20,478**							**20,478**
Secretariat Expenses		**15,666**	**5,065**	**1,143**	**7,343**	**2,572**		**32,338**
Fund Portfolio Operations		7,942	1,592	205	912			10,651
Strategic Information and Evaluation		766	521		1,681			2,968
External Relations		2,037	2,494	908	910			6,349
Office of Executive Director		1,242	322		510			2,074
Business Services		3,678	136	30	3,330	2,572		9,746
Contingency							550	550
Total	20,478	15,666	5,065	1,143	7,343	2,572	550	**52,816**

2004 Variances US$'000	LFA Fees	Staff	Travel	Communicat. materials	Professional services	Office infrastructure	Contingency	**Total**	As % of budget
In-country Oversight (LFA fees)	**8,302**							**8,302**	**41%**
Secretariat Expenses		**(1,188)**	**392**	**(26)**	**1,395**	**(90)**		**1,032**	**3%**
Fund Portfolio Operations		140	(223)	(181)	386	(28)		93	1%
Strategic Information and Evaluation		(586)	273	(82)	571			176	6%
External Relations		(592)	247	265	390	(44)		266	4%
Office of Executive Director		9	63	(56)	261			277	13%
Business Services		(159)	32	28	(213)	(18)		(330)	(3%)
Contingency							550	550	
Total	8,302	(1,188)	392	(26)	1,395	(90)	550	**9,335**	**18%**
As % of budget:	41%	(8%)	8%	(2%)	19%	(3%)		**18%**	

Notes
(a) Variances are calculated as budget minus actual expenditure. Hence negative amounts (shown in partentheses) indicate unfavourable variances, since actual expenditure was greater than had been budgeted. Conversely, positive amounts indicate favourable variances, where actual expenditure was less than budgeted.
(b) 'Business Services' comprises Finance, Administration, Human Resources, Legal, Contracts and IT services.

Attachment 2: Transactions on Global Fund bank account in 2004

	USD
Balance at start of year	**224,736**
Receipts	
Transfers from Trustee	200,000
Contributions	1,873,524
Staff reimbursement of personal expenses	27,079
Bank interest	1,679
Total receipts	2,102,282
Payments	
Advertising	122,749
Rent allowance element of ED compensation	103,316
Salary adjustments & rent subsidy	58,500
Travel expenses	39,761
Refundable advances	35,208
Meetings	20,611
Audit fees	25,790
Relocation services	26,963
Office catering	4,053
Office sundries	15,849
Recruitment & training	15,117
Agency staff & consultants	863
Office rent adjustment	(4,623)
Exchange gain, less bank charges	(17,971)
Total payments	446,186
Balance at end of year	**1,880,832**

Attachment 3:

Reconciliation of the Audited Financial Statements with the Review of Operating expenses

Statement of Activities US$ million	**Per the Review of Operating Expenses**	Attributed to prior years (change in revenue recognition policy)	Contributions in-kind (pro bono)	Discounting of long-term assets & liabilities to present value	Adjustment to unrealized gains on long-term assets	Late posting of Sweden contribution	**Per the IFRS Audited Financial Statements**
Income							
Contributions	1,393	(147)	7	(6)	1	7	1,255
Financial income	34						34
	1,427						1,289
Expenditure							
Grants	861			(7)			854
Operating expenses	43		7				50
	904						904
Increase in Funds for the year	523						385
Funds:							
At start of year	1,028	147					1,175
Increase in Funds for the year	523						385
At end of year	1,551						1,560

Annex 3

PURCHASE OF HEADQUARTERS PREMISES

THE BUSINESS CASE

Outline: This paper sets out the business case for the Global Fund to purchase a building to serve as the longer-term headquarters (HQ) for the Global Fund Secretariat, rather than continuing to rent premises. It sets out options to finance such a purchase, and examines the pros and cons of acquiring real estate in Switzerland. Objective is to finalize a Committee recommendation to take forward to the Tenth Board Meeting in April 2005.

Annexed to this overview is material relating to one specific project on which – given Board approval in principle to the approach – the Secretariat would plan to enter into negotiations.

<u>Annex</u>

1. "Fleur d'eau" – information folder / key data – will be provided at MEFA meeting.

Part 1: Background

1. To cope with accelerating workload, the Global Fund Secretariat is expanding steadily. From around 90 staff in mid-2004, headcount reached some 120 by year-end. The 2005 approved budget authorizes a rise to 150 staff, which, if temporaries, short-term staff, interns and consultants are included, implies a potential space need for 170 – 180 work stations at any time. The 2005 budget provisional projections envisage headcount leveling off at close to 200 in 2006 – 07.

2. Since July 2004, this steady increase has required the Secretariat to rent additional space on an opportunistic basis elsewhere in the current HQ building, as well as in the building next door. From 2 locations in one building mid-2004, the Secretariat now sits in 6 separate locations in 2 buildings.

3. Based on current floor planning, these 6 locations provide “tight” accommodation for up to 150 people, but with no flexible space for temporaries and consultants, extremely limited meeting space and reduced, now nearly negligible facilities (coffees / kitchen areas, etc).

4. The current environment is already generating some significant associated negatives: reduced staff interaction and communication, limited short-term staff, intern and consultant flexibility, disintegrated teams, risk of isolation, poor quality meeting facilities, unprofessional image, and overall a sub-optimal work environment. In a recent staff meeting, several staff have already questioned whether we are close to - or in breach of - established office hygiene/health norms.

Part 2: Steps taken to date

1. In parallel with finding, fitting out and furnishing “emergency” rental space prior to budget approval, a range of alternate options have been researched to establish the optimum long-term solution. In September 2004, the Secretariat contacted “FIPOI” (la Fondation immobilière pour les organisations internationales), whose primary role is to work with international organizations to help them solve their office space needs. Inter alia, FIPOI provides free or marginal cost consulting and advisory services, and guides and facilitates discussions with lawyers, real estate agents, government departments, etc.

2. Given (at that time) the imminent signature of the Headquarters Agreement, FIPOI agreed to work with the Secretariat on defining a long-term solution. A request for proposals was launched across the Geneva region. 10 offers were received and analyzed and a short-list of 3 leading options defined. Of these, 2 were construction projects and one rental option. The rental option proposed was a new (shell) building and required an extremely high fitting-out cost to meet our needs (including IT cabling, etc), estimated by FIPOI at some $10 million. One of the 2 construction projects is close to the airport but has poor access and amenities, limited parking, and is in principle a rental option (sale could be negotiated). The second construction project (Annex 1) is in an excellent location, has a good all round package of facilities, and is for sale at an indicative price of $50 million. Time from commitment to completion is approximately two years, suggesting a possible entry date of mid-2007.

Meanwhile, steady recruiting has already brought us beyond the acceptable limits of our current “emergency” space expansion and as an interim measure, the Secretariat will move from the current Centre Casäi and Alpha buildings to the World Trade Centre 2 (WTC), conveniently located beside Geneva airport. Reasonable (but still tight) rental space has been secured at in the WTC building for a two year period, to mid-2007, albeit requiring additional annual rental outlay (+ $300,000 per annum) and an installation cost in the range of $2.4 - $2.8 million (under negotiation). The WTC which will provide adequate facilities pending a longer-term solution.

Part 3: Possible mechanism for HQ purchase

1. To encourage and support international organizations to locate to and remain in the Geneva area, the Swiss confederation and the canton of Geneva, through FIPOI, have established a mechanism whereby such organizations may apply for favourable terms to finance property acquisition in the region. The usual approach is an interest-free loan (over 50 years) to the organization concerned, with or without possible free land allocation by the canton of Geneva.

2. Following discussions with FIPOI and the Swiss authorities, we would plan to approach our hosts with a request for an interest-free loan of $ 50 million to fund the purchase of a building, repayable at $ 1 million per year (compares to $1.5 million annual rent in the WTC 2 building). However while recognizing the appropriateness of the overall concept, the Swiss authorities have advised that a) the allocation of funds to FIPOI – the usual vehicle for such loans – is committed for several years to come, and the future levels of replenishment are uncertain at this time; and b) the process for submission and approval of such loans may be quite lengthy and it would be worthwhile considering alternative sources of bridging financing if the Secretariat is to be able to move forward.

3. An alternative option would be to use Global Fund assets to purchase the property, pending granting of the loan by the Swiss authorities. FIPOI are ready to assist us in the detailed purchase negotiations and to guide us, in collaboration with the Swiss mission in Geneva, through the loan application process.

4. If the Swiss loan were eventually not to materialize, then the same allocation would be made annually within the Secretariat budget to reimburse Global Fund cash holdings.

Part 4: The business case for purchasing a building

1. **Purchasing represents the best "value for money" scenario for the Global Fund.** With annual rental charges reaching $1.5 million in 2005, this rental cost will likely further increase as our space needs reach their eventual level and we allow for an acceptable office environment. The FIPOI study suggested that if we would a) expand space to reach established FIPOI per capita space allowance, and b) move to any of the available premises, then our annual rental outlay at an overall headcount of 200, would move into the range $2.3 – $3.0 million (or even higher) depending on options selected.

This annual rental outlay would be "lost" spending. It contrasts with an annual outlay of $1 million under the preferred interest-free loan option, fully directed to the acquisition of a long-term asset for the Fund. On the basis of 2005 projected WTC 2 rent of $ 1.5 million p.a., the interest free loan option represents an extremely attractive 42% NPV comparison:

$ Million	Rent ** @ $1.6m p.a.	Interest-free loan	Loan at 2.5%
Year 50 Cash Flows	129.4	50.0	88.1
Net Present Value*	75.0	31.4	55.4
	100%	42%	74%

* NPV at discount rate of 2% per annum
**Rental inflation assumed at 2% per annum (Swiss norm)

2. **The Geneva real estate market represents an attractive long-term investment.** The Secretariat recently commissioned an external study on the "buy versus rent" question and the study concluded that real estate purchase currently represents an extremely solid proposition. This reflects Swiss real estate's long-term steady growth record (averaging 4 – 5% per annum), the steadiness of the Swiss economy and the likely sustained long-term appreciation of the Swiss franc.

3. **Purchase will send an extremely positive message to the Swiss federal and cantonal authorities.** The Swiss have been supportive and cooperative in establishing the recently-signed Headquarters Agreement. Both FIPOI and the Swiss mission in Geneva have been extremely helpful in guiding us through our accommodation challenges and options. Purchase of a building will confirm the Fund's commitment to Geneva and help ensure sustained warm relations with the Swiss host country.

Part 5: The case <u>against</u> purchasing a building

1. **There is a risk that the Global Fund may be seen as "grand-standing", using donors' money to acquire real estate in a high cost, glamorous location.** While this view is in contrast to the financial reality (use of Global Fund assets in this way will actually <u>reduce</u> the net administrative overhead cost of running the Secretariat) it is possible that perceptions may generate some negative comment of this type.

2. **Using Global Fund cash to purchase a building will tie up money that should be directed to fighting the 3 diseases.** In fact, with $2.2 billion cash on hand in early 2005, $50 million represents 2% of assets. The outstanding balance will decrease annually, and when set against the annual savings compared to the significantly higher cash outlays otherwise required for rental premises, the "real" cost of the purchase option is substantially lower (see NPV comparison above).

3. **The Global Fund should not speculate in property.** As indicated above, Swiss real estate has shown substantial long-term appreciation with negligible risk. An appreciating asset, valued in Swiss francs, may also generate significantly greater long term returns when both property values and currency effect is taken into account. In the event that the Fund is wound up in the foreseeable future, the likely significant capital gain realized would of course be available for return to the Global Fund liquidation asset pool.

4. **Purchasing a building represents a major management distraction, when the Secretariat should be focussing on getting performance-based funding right**. The Business Services team which will manage the project is staffed to cope with the project from April 2005, when the Administrative Services Unit reaches full complement. Most of the work will be managed through the developer and architects involved, whose management fees will be included within the overall purchase package. The Operations and M&E teams will not be involved in project management.

Part 6: Proposed draft decision point

"The Board authorizes the Secretariat to use up to $50 million of Global Fund assets for the purchase of a new headquarters building in Switzerland."

Annex 4

DUAL CURRENCY GRANTS AND CURRENCY RISK

1. Introduction

The decision of the Global Fund to allow the denomination of grants in Euros as well as US dollars (USD) and the potential increase in the use of Promissory Notes as a mode of contribution (arising from the voluntary replenishment mechanism) will increase the Global Fund's exposure to exchange rate movements. This paper outlines the risks, sets out the resultant policy options and operational implications and makes recommendations for consideration by the MEFA Committee.

The paper addresses the decision of the Ninth Board Meeting that:
"*the Secretariat should analyze and quantify the risks of implementing the dual currency decision and the costs associated with those risks. This analysis should result in a set of policies and guidance to the Trustee on how to mitigate and manage those risks. These policies will be referred to the MEFA Committee prior to presentation at the Tenth Board Meeting."*

The World Bank, as Trustee of the Global Fund, has provided valuable support to the Secretariat in compiling this paper.

Summary of Proposed Decision Points

The Fund should take action to minimize it's exposure to currency risk by adopting the following transitional policies that set a framework for currency risk management:

a) Hedge exposure to currency risk by matching the values[7] of USD assets with USD grant liabilities and Euro assets with Euro grant liabilities to the extent possible using available liquidity, so as to minimize any mismatch within each currency. Any excess liquidity after matching shall be held in USD and Euro.

b) Encourage donors to denominate promissory notes only in the grant currencies (USD and Euro).

c) If a material currency mismatch remains after these measures, maintain a reserve against commitment authority as a cushion to absorb any potential losses and thus minimize commitments being made in excess of assets available.

d) The operational implications and practices should continue to be reviewed by the Secretariat under the guidance of the FAC to present a full recommendation to set the policy and parameters of the currency risk exposure at the 11th Board meeting unless insufficient experience warrants extension until the 12th Board meeting.

e) Encourage prospective grant recipients to provide information as to the currency in which they will submit future grant applications.

[7] The values of assets and liabilities will generally be computed as the present values of the cash flows associated with those assets and liabilities.

2. Currency Risk Exposure in the Global Fund

The Global Fund will be exposed to currency risk if its grant liabilities in a given currency are not fully matched by assets of that same currency.

Background

2.1 At present, the Global Fund has minimal foreign exchange risk exposure because all its grant liabilities are in USD and all contributions to the Fund are converted to USD on receipt and held in USD until disbursed to grantees.

2.2 The Fund considers both cash and demand public promissory notes as assets available to fund grant commitments. A relatively small element of contributions (approximately 10%) is received in the form of Euro promissory notes; when these notes are encashed, the proceeds are immediately converted to USD. Hence, the Fund's exposure to currency risk is limited to any fluctuation in the USD value of those promissory notes prior to encashment. This provides considerable certainty over the value of the assets that are available to meet grant commitments, enabling the Fund to manage its commitment authority[8] and avoid the risk of over-committing assets.

Cause of Currency Risk Exposure

2.3 In the future, an increase in the Fund's exposure to currency risk will arise from two sources: grants in Euro and an increased use of promissory notes.

2.4 **Grants in Euro**: The denomination of some grants in Euros would, if all the Fund's assets continued to be held in USD, create the risk that the amount of USD set aside ('committed') for the grant at the time of signing the grant agreement could be insufficient to fund the disbursements (in Euros) in the subsequent years. This could happen if the value of the Euro appreciated against USD in the years between grant signing and completion of disbursement.

2.5 **Promissory Notes**: Typically, promissory notes are contributed in the donor's national currency and are encashed over a number of years after the date of contribution (usually aligned with the grant disbursement period). Therefore, the USD value of a non-USD promissory note depends on the exchange rate on the day it is encashed and the proceeds converted into USD. Any estimate of the note's USD-equivalent value prior to encashment will fluctuate as the exchange rate changes. (The same is true for the Euro-equivalent value of a non-Euro promissory note.) Accordingly, when a promissory note is valued for the purpose of calculating commitment authority in another currency, that valuation is subject to fluctuation until the note is finally encashed.

2.6 To date, only 10% of contributions have been made in the form of promissory notes and therefore the Fund's exposure to exchange rate risk has been small. However, it is probable that the Fund's replenishment process may result in an increased use of promissory notes as a mode of contribution, creating greater exposure to the risk of exchange rate fluctuations.

2.7 **Mismatch is the issue**: Currency risk arises when there is a mismatch between assets and liabilities in a given currency. Currency risk would not exist if the value of the Fund's assets held in USD was sufficient to cover its USD grant commitments, and the value of its Euro assets was

[8] 'Commitment authority' means the value of assets available to fund new grant commitments.

sufficient to cover its Euro grant commitments. In a scenario where the values of assets and liabilities were matched in each currency, the impact of any exchange rate movements would be neutralized – naturally hedged – by affecting assets and liabilities similarly.

2.8 If all assets were held as cash, conversions between currencies could be made as grants were signed, thus ensuring that assets matched liabilities in each currency. However, the proceeds of a promissory note cannot be converted to another currency until encashed, which may result in potential mismatches.

2.9 **Extent of potential mismatch**: The extent of any mismatch will be determined mainly by the amount of promissory notes held in non-grant currencies and the extent to which the USD/EUR proportions of contributions differ from the USD/EUR proportions of grants. For example, if 40% of contributions were in Euro[9] (and mainly contributed in promissory notes), and if less than 40% of grants were denominated in Euro, a mismatch would arise that could not be corrected (by converting Euro to USD) until the promissory notes were encashed.

3. Managing the Currency Risk

The Fund shall act to reduce its exposure to currency risk through measures designed to match the value of grant liabilities in a given currency with assets of the same currency.

Policy options

3.1 Two fundamental policy options exist: whether or not to hedge the risk.

3.2 **Option 1: (Not recommended)**

Do not hedge the risk

3.2.1 If no measures were taken to mitigate the Fund's exposure to currency risk, any currency losses would be eliminated by drawing on uncommitted assets on hand, or if no uncommitted assets existed, the next inflow of contributions. This approach makes no effort to avoid losses, relying on current or future availability of uncommitted assets to make good any deficiency.

3.2.2 If future contributions were not sufficient to rectify a shortfall, the Fund would not have sufficient assets to meet its obligations. Hence it would be necessary to create a commitment authority reserve to absorb any potential currency losses. Such a reserve would set aside assets for this contingency, preventing their use for funding new or renewed grants. Depending on the magnitude of potential exchange rate movements that the reserve was intended to cover, a substantial amount of assets could be tied-up for this contingency, which could well exceed any actual currency losses. This is not the recommended approach.

[9] The currency composition of contributions to the Global Fund from inception through 2004 was: 51% USD; 38% EUR; 11% other currencies. If countries had contributed in their national currencies, the composition would have been approximately: 40% USD; 40% EUR; 20% other currencies. (Note: the USD amounts include private sector contributions.)

3.3 Option 2: (recommended)

<u>The Fund should take action to minimize it's exposure to currency risk</u> by adopting the following policies that set a framework for currency risk management:

3.3.1 **Hedge exposure to currency risk by matching the values of USD assets with USD grant liabilities and Euro assets with Euro grant liabilities** to the extent possible using available liquidity, so as to minimize any mismatch within each currency[10]. Any excess liquidity after matching shall be held in USD and Euro. (This option is suited to the Fund, since it receives contributions in both USD and Euro. This is referred to as the 'proportional holding and re-balancing approach' and is the method adopted by the International Development Association. (See example at Annex 1.))

3.3.2 **Encourage donors to denominate promissory notes only in the grant currencies** (USD and Euro). (By excluding (or minimizing) promissory notes in non-grant currencies, a cause of mismatch between assets and liabilities is eliminated (or reduced)).

3.3.3 If a material currency mismatch remains after these measures, **maintain a reserve against commitment authority** as a cushion to absorb any potential losses and thus prevent commitments being made in excess of assets available. (The amount of such a reserve is considered at 4.7)

3.4 Based on the Fund's projected cash flows through 2007, the approach proposed would result in approximately 77% to 96% of grant liabilities being matched by assets of the same currency, depending on the assumed rates of Euro grant take-up and promissory note usage modelled (see Annex 2). It is proposed to maintain a reserve against commitment authority to absorb any potential losses (see 4.7).

3.5 The use of market-based hedging instruments was also considered, in consultation with the Trustee. Currency swaps would normally be considered appropriate for hedging multi-year cash flows. However, such instruments are unlikely to be available to the Global Fund because of its lack of credit rating. Another alternative would be the use of short-term forward foreign exchange contracts on a rolling basis. However, the Trustee is currently not in a position to undertake this form of hedging for the Fund. This could only be implemented by the Trustee in the long-term and would be subject to an evaluation of the cost and timing of implementation.

3.4 The operational implications of the proposed policy are considered in Section 4.

4. Operational Implications

5.1 The implications of putting the proposed currency risk management policy into operation during a transitional period are as follows:

5.2 **Scope:** Currency re-balancing measures will be adopted at the time of entering into grant commitments (i.e. on signing the grant agreement). Re-balancing calculations will take account of grant liabilities and the assets funding those grants.

[10] It may be impossible to <u>fully</u> cover liabilities with assets of the same currency if some of the Fund's assets are held in promissory notes of another currency (because these notes cannot be immediately encashed and converted to the desired currency). To the extent that liabilities are covered by assets of another currency, a risk of currency loss will remain. This residual risk can be reduced through periodic review and re-balancing of assets and liabilities by switching assets between currencies to maintain coverage of the liabilities.

(To the extent feasible having regard to the level of certainty of grant signing timings and the conversion of pledges to contributions, measures should be undertaken to manage the currency composition of assets from the time of approval of new grant rounds, in order to facilitate asset-liability matching by currency when the grants are subsequently signed. Such measures would include the selection of currency for holding excess liquidity, as mentioned in 3.3.1).

5.3 **Need for liquidity in USD and Euro**: Currency re-balancing will require the holding by the Trustee of cash and investments in Euro as well as USD. Currently, this is not provided for by the Trustee Agreement[11], which will need to be amended accordingly.

5.4 **Responsibility:** The Secretariat shall be responsible for the day-to-day management of the currency risk management framework including currency re-balancing calculations. The approach will require a periodic review of all assets and liabilities to quantify any mismatches. Mismatches would then be negated by conversion of liquid assets in one currency to another (within the limits of available liquidity). The Secretariat will advise the Trustee of required currency conversions after each re-balancing calculation and of the currency (Euro or USD) into which cash contributions in other currencies should be converted and held.

5.5 **Frequency of review**: Assets and liabilities shall be reviewed by the Secretariat at least each quarter to assess whether re-balancing is required.

5.6 **Threshold**: Re-balancing should be undertaken if there is a mismatch between the values of assets and liabilities in either grant currency in order to minimize exposure.

5.7 **Commitment authority reserve**: As outlined in 3.4, an element of currency mismatch may remain after re-balancing. To provide for such a contingency, assets could be reserved (i.e. not used as commitment authority for new grants). The amount of any desired commitment authority reserve would depend on the size of the potential currency movement and the extent of the currency mismatch to be provided for. The Secretariat shall, following each re-balancing calculation, compute the amount of the reserve to be maintained and inform the Trustee accordingly.

5.8 **Promissory Notes**: The Global Fund treats demand public promissory notes as assets eligible to fund grant liabilities. To facilitate re-balancing with predictability of the amount and timing of cash inflows, promissory notes should be encashed according to a schedule agreed in advance. In the event of an unforeseen liquidity shortage, encashment would be requested on an earlier date. To limit currency mismatches, promissory notes should be requested in either USD or Euro.

5.9 **Oversight and guidance**: The Secretariat shall monitor the effectiveness of currency hedging and review the asset-liability management strategy periodically and report thereon to the Finance and Audit Committee. After each rebalancing exercise, the Secretariat shall report by e-mail to the FAC on the status of the extent of the currency exposure and any recommended associated reserve required. The Secretariat may seek guidance from the Committee on operational aspects of the currency risk management policy.

[11] Agreement by and between the Global Fund to Fight AIDS, Tuberculosis and Malaria and the International Bank for Reconstruction and Development, as Trustee of the Trust Fund, dated May 31, 2002: “The Trust Fund shall be maintained in United States Dollars. If a Donor makes a contribution in a currency other than United States Dollars, the World Bank shall convert the contribution into United States Dollars promptly following receipt of the contribution by the World Bank.”

5. Cost Implications

5.1 Secretariat costs

To manage the ongoing monitoring of exposure to currency risk and consequent currency re-balancing and associated activities, the Secretariat would require the partial use of an additional finance professional at an approximate cost of $100,000 per year (including office overheads).

5.2 Trustee costs

The Trustee advises that a dual currency investment portfolio with proportional holding/currency rebalancing will result in higher Trustee fees and that the exact fees will need to be assessed based on the policy and strategy implemented.

Attachment 1: Example of Currency Re-balancing

Prior to currency re-balancing

$ billions	Position before re-balancing: Cash	Prom. Notes	Total Assets		Grant Liabilities		Mismatch	If adverse currency movement of 20%: Total Assets	Grant Liabilities	Subsequent Mismatch
USD	0.0	2.2	2.2	48%	4.2	91%	-2.0	2.2	4.2	-2.0
EUR, at USD equivalent	1.0	0.9	1.9	41%	0.4	9%	1.5	1.5	0.3	1.2
Other currencies, at USD equivalent	0.0	0.5	0.5	11%		0%	0.5	0.4		0.4
Total	1.0	3.6	4.6	100%	4.6	100%	**0.0**	4.1	4.5	**-0.4**
							Matched, overall	Mis-matched		**Shortfall**

- While assets and liabilities are matched overall, $2bn of USD liabilities is covered by non-USD assets.
- If those non-USD currencies were subsequently to decline against the USD, the liabilities would no longer be fully covered.
- For example, a 20% currency movement would create a shortfall of $0.4bn.

Shortfall is reduced

After currency re-balancing

EUR liquidity converted to USD

$ billions	Position after re-balancing: Cash	Prom. Notes	Total Assets		Grant Liabilities		Mismatch	If adverse currency movement of 20%: Total Assets	Grant Liabilities	Subsequent Mismatch
USD	**1.0**	2.2	3.2	70%	4.2	91%	-1.0	3.2	4.2	-1.0
EUR, at USD equivalent	**0.0**	0.9	0.9	20%	0.4	9%	0.5	0.7	0.3	0.4
Other currencies, at USD equivalent	0.0	0.5	0.5	11%		0%	0.5	0.4		0.4
Total	1.0	3.6	4.6	100%	4.6	100%	**0.0**	4.3	4.5	**-0.2**
							Matched, overall	Mis-matched		**Shortfall**

- Conversion of the EUR cash to USD reduces the mismatch from $2bn to $1bn.
- Full balancing is not possible because of having promissory notes in non-grant currencies and EUR promissory notes in excess of EUR liabilities.
- With a mismatch of $1bn, a 20% currency movement would create a shortfall of $0.2bn, halving the previous exposure.

Impact of the re-balancing:

- Prior to re-balancing, USD grant liabilities exceeded USD assets by $1.9bn. If the non-USD currencies were to decline in value by 20%, total assets would no longer match total liabilities, leaving a shortfall of $0.4bn.
- The re-balancing reduces the mismatch to from $2.0bn to $1.0bn. If the non-USD currencies were now to decline in value by 20%, the resultant shortfall would be $0.2bn, half the $0.4bn shortfall prior to re-balancing.

Commitment authority reserve

- To provide for such a contingency, assets of $0.2bn could be reserved (i.e. not used as commitment authority for new grants). The amount of any desired commitment authority reserve would be influenced by the size of a potential currency mismatch (in this case $1bn) and the potential currency movement to be provided for (in this case 20%).

Attachment 2: Effectiveness of Currency Re-balancing - Examples

(A) EUR grants 15% of new grants; promissory notes accepted in non-grant currencies

In $ billion, with non-USD amounts expressed at USD equivalents. Assumes that grants are signed in year of approval and that all assets are fully committed.

$ billion	2004		2005							2006							2007						
	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year	
LIABILITIES																							
USD Liabilities	2.3	96%	2.3	2.1		-1.1		3.3	96%	3.3	3.0		-2.1		4.2	90%	4.2	3.1		-2.4		4.8	90%
EUR Liabilities		0%		0.2		-0.1		0.1	4%	0.1	0.5		-0.2		0.4	10%	0.4	0.5		-0.5		0.5	10%
Surplus	0.1	4%	0.1	-0.1				0.0	0%	0.0					0.0		0.0					0.0	
	2.4	100%	2.4	2.2		-1.2		3.4	100%	3.4	3.5		-2.3		4.6	100%	4.6	3.6		-2.9		5.3	100%
ASSETS																							
USD Cash	2.2		2.2	0.4	0.2	-1.1	1.0	2.7		2.7	0.0	0.7	-2.1	0.9	2.3		2.3	0.0	1.2	-2.4	1.4	2.4	
USD Prom. Notes				0.4	-0.2			0.3		0.3	1.4	-0.7			0.9		0.9	1.4	-1.2			1.1	
EUR Cash				0.4	0.4	-0.1	-0.7	0.0		0.0	0.0	0.7	-0.2	-0.5	0.0		0.0	0.0	1.2	-0.5	-0.8	0.0	
EUR Prom. Notes	0.2		0.2	0.4	-0.4			0.3		0.3	1.4	-0.7			0.9		0.9	1.4	-1.2			1.1	
Other Cash				0.2	0.1		-0.3	0.0		0.0	0.0	0.4		-0.4	0.0		0.0	0.0	0.6		-0.6	0.0	
Other Prom. Notes				0.2	-0.1			0.1		0.1	0.7	-0.4			0.5		0.5	0.7	-0.6			0.6	
	2.4		2.4	2.2	0.0	-1.2	0.0	3.4		3.4	3.5	0.0	-2.3	0.0	4.6		4.6	3.6	0.0	-2.9	0.0	5.3	
Assets, by Currency																							
USD Assets	2.2	92%						3.0	88%						3.2	70%						3.6	68%
EUR Assets	0.2	8%						0.3	8%						0.9	20%						1.1	22%
Other Assets	0.0	0%						0.1	4%						0.5	10%						0.6	11%
	2.4	100%						3.4	100%						4.6	100%						5.3	100%
Assets-Liabilities																							
Mismatch USD	**-0.1**							**-0.3**	-8%						**-0.9**	-21%						**-1.2**	-23%
Mismatch EUR	0.2							0.1							0.5							0.6	
Mismatch Other								0.1							0.5							0.6	
Mismatch Total	0.1							0.0							0.0							0.0	

Potential currency mismatch of 23%
77% matched

Assumptions		2005	2006	2007
New contributions	$bn	2.2	3.5	3.6
New grants approved	$bn	2.3	3.5	3.6
Disbursements	$bn	1.2	2.3	2.9
% Prom Notes		50%	100%	100%
%EUR Grants		10%	15%	15%
%USD Contribs		40%	40%	40%
%EUR Contribs		40%	40%	40%
%Other Contribs		20%	20%	20%
Encashment of Notes		Year 1	Year 2	Year 3
		40%	40%	20%

(B) EUR grants 30% of new grants; no promissory notes in non-grant currencies

In $ billion, with non-USD amounts expressed at USD equivalents. Assumes that grants are signed in year of approval and that all assets are fully committed.

$ billion	2004		2005							2006							2007						
	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year		At Start of Year	New Grants & Contribs	Encash. Of Notes	Grant Disb.	Curr. Re-Bal.	At End of Year	
LIABILITIES																							
USD Liabilities	2.3	96%	2.3	2.1		-1.1		3.3	96%	3.3	2.5		-1.9		3.8	84%	3.8	2.5		-2.0		4.4	82%
EUR Liabilities		0%		0.2		-0.1		0.1	4%	0.1	1.1		-0.4		0.8	16%	0.8	1.1		-0.9		0.9	18%
Surplus	0.1	4%	0.1	-0.1				0.0	0%	0.0					0.0		0.0					0.0	
	2.4	100%	2.4	2.2		-1.2		3.4	100%	3.4	3.5		-2.3		4.6	100%	4.6	3.6		-2.9		5.3	100%
ASSETS																							
USD Cash	2.2		2.2	0.7	0.3	-1.1	0.7	2.7		2.7	0.0	1.1	-1.9	0.3	2.3		2.3	0.0	1.8	-2.0	0.3	2.4	
USD Prom. Notes				0.7	-0.3			0.4		0.4	2.1	-1.1			1.4		1.4	2.2	-1.8			1.7	
EUR Cash				0.4	0.4	-0.1	-0.7	0.0		0.0	0.0	0.7	-0.4	-0.3	0.0		0.0	0.0	1.2	-0.9	-0.3	0.0	
EUR Prom. Notes	0.2		0.2	0.4	-0.4			0.3		0.3	1.4	-0.7			0.9		0.9	1.4	-1.2			1.1	
Other Cash				0.0	0.0		0.0	0.0		0.0	0.0	0.0		0.0	0.0		0.0	0.0	0.0		0.0	0.0	
Other Prom. Notes				0.0	0.0			0.0		0.0	0.0	0.0			0.0		0.0	0.0	0.0			0.0	
	2.4		2.4	2.2	0.0	-1.2	0.0	3.4		3.4	3.5	0.0	-2.3	0.0	4.6		4.6	3.6	0.0	-2.9	0.0	5.3	
Assets, by Currency																							
USD Assets	2.2	92%						3.1	92%						3.7	80%						4.2	78%
EUR Assets	0.2	8%						0.3	8%						0.9	20%						1.1	22%
Other Assets	0.0	0%						0.0	0%						0.0	0%						0.0	0%
	2.4	100%						3.4	100%						4.6	100%						5.3	100%
Assets-Liabilities																							
Mismatch USD	**-0.1**							**-0.1**	-4%						**-0.2**	-4%						**-0.2**	-4%
Mismatch EUR	0.2							0.1							0.2							0.2	
Mismatch Other								0.0							0.0							0.0	
Mismatch Total	0.1							0.0							0.0							0.0	

Assumptions		2005	2006	2007
New contributions	$bn	2.2	3.5	3.6
New grants approved	$bn	2.3	3.5	3.6
Disbursements	$bn	1.2	2.3	2.9
% Prom Notes		50%	100%	100%
%EUR Grants		10%	30%	30%
%USD Contribs		60%	60%	60%
%EUR Contribs		40%	40%	40%
%Other Contribs		0%	0%	0%
Encashment of Notes		Year 1	Year 2	Year 3
		40%	40%	20%

Potential currency mismatch of 4%
96% matched

DISCUSSION PAPER ON A REVIEW OF THE ROLES, FUNCTIONS AND PERFORMANCE OF LOCAL FUND AGENTS

Outline:

The decision not to have a Global Fund presence outside Geneva, and instead secure the services of in-country Local Fund Agents (LFAs), is amongst the most innovative elements of the Global Fund's grant management structure.

LFAs are contracted to assess the capacity of nominated Principal Recipients (PRs) to administer grant funds and, beyond grant signature, to report on financial and programmatic progress and challenges to program success. During grant implementation, LFAs also ascertain whether PRs are undertaking product and other procurement consistent with the Global Fund's guidelines. In addition, LFAs verify a PR's periodic disbursement requests, progress updates and annual audit reports. From late 2004, the scope of LFA services has expanded to provide critical, objective input into the Phase 2 grant renewal process.

The crucial role of LFAs in the Global Fund's grant governance cycle necessitates an on-going review of the system and its relative strengths. *The Review of Roles, Functions, and Performance of Local Fund Agents* (LFA Review) conducted in August 2004[12] is part of a much broader pool of information under review by the Global Fund to assess methods to optimize the LFA model. This paper comments on key discussion topics arising from the LFA Review, the LFA model, and areas requiring further development and/or consideration.

[12] The document titled *'Review of the Roles, Functions and Performance of Local Fund Agents'*, Final Report, August 2004, Stein-Erik Kruse (HeSo) and Jens Claussen (Nordic Consulting Group) – is annexed to this Discussion Paper at Annex 1. Section 8 of the LFA Review report sets out a detailed list of findings and proposed strategies for improved risk assurance within the Global Fund's grant management model.

Part 1: Introduction

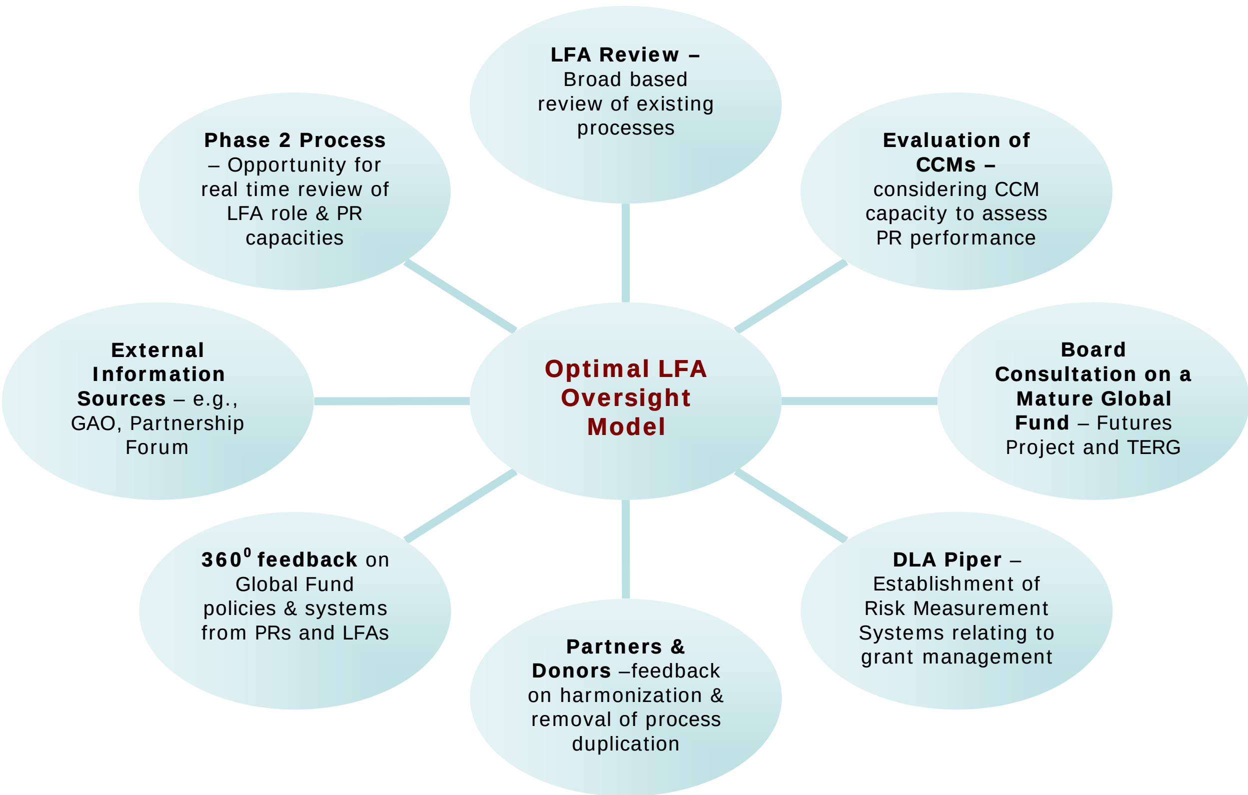
1. Although the idea behind the LFA model is not unique, no other major development finance mechanism has so far made use of outside assessment and verification of the type and scale of the Global Fund's LFA system. With 18 months of LFA assessment services and 12 months of LFA grant verification services having been provided to the Global Fund, June 2004 comprised an opportune time for the Global Fund to commence a targeted review of the effectiveness, and relative benefits and challenges of the LFA model.

2. The LFA Review included 13 in-depth case studies and concluded with an independent overall report on the effectiveness of existing LFA working arrangements. From this review came a number of recommendations, the majority focusing on a well recognized need for more streamlined engagement and working procedures. More substantive recommendations include a proposed separation of the LFA role 'by function' and this is discussed in Part 2 below.

3. The LFA Review recommendations are being considered in light of their respective timeframe for implementation and relative appropriateness having regard to the Global Fund's maturing business model. During this process, significant attention is being given towards ensuring PRs provide robust and transparent reporting on achievements, and that grant management systems adopted by the Global Fund are appropriate to in-country and grant specific risks.

4. Additional sources of information contributing to the Global Fund's assessment of the relative appropriateness and effectiveness of the recommendations arising from the LFA Review are shown in Figure 1 below.

Figure 1



Part 2: LFA Review – Summary of Recommendations & Key Themes

1. A key finding of the LFA Review is that the LFA concept is not contested in the sense that the Global Fund secures the services of independent companies at the country level to provide assessment and verification services for grants under management. It is also stated that for the LFAs themselves, the mandate and role is well understood, and the tools provided by the Global Fund provide a satisfactory basis upon which the LFA undertakes its role.

2. However, for a majority of CCMs and PRs, the existing model has a number of key challenges. For the purposes of this discussion paper, these are summarized according to four functional areas:

a. *LFA mandate and role* – despite broad acceptance of a risk assurance model involving some form of "LFA", there remains much uncertainty of the current scope of the LFA role across all stakeholders. This creates an environment of reduced confidence , negatively impacting on the Global Fund's risk and governance model;
b. *Cost effectiveness of LFAs* – without optimizing contractual arrangements, the cost/benefit equation is substantially unbalanced. However, the Global Fund's overall budget for LFA services is relatively low compared to fees incurred for program assurance and oversight of grant/loan funds by other donor agencies, and there is scope to reform the cost model to deliver greater benefits with increased cost efficiencies;
c. *Selection and management of LFAs* – the existing "one size fits all" engagement model results in a cumbersome, non-flexible LFA system. A more strategic approach to management of LFAs, adjusting work streams to situational needs, is perceived to be capable of delivering significant administrative advantage; and
d. *Relevance and quality of service* – LFAs are not necessarily perceived by all stakeholders as the key partner that the Global Fund states they are in grant management, and wide variations in LFA competency and service delivery are key features of the existing system.

3. Broadly speaking, reform strategies set out in the LFA Review comprise either:

a. functional and more quickly implemented system improvements; or

b. more substantive structural alterations, the practical impact of which may have significant impact on the Global Fund's operations and risk management model.

4. Specific suggestions for improved grant management set out in the report are:

c. Operating within the current framework

i. Adjust the current approach to contracting services from LFAs and introduce greater differentiation in grant management practices between countries and grants.

ii. Introduce increased competency into the LFA system by including other partners to better match skills and experience to the various LFA tasks (e.g., procurement and supply management specific "LFAs" to undertake these assessments in addition to other LFA assessment services now provided).

d. Beyond existing arrangements - substantive structural reform

i. Applying systems used by other bilateral and multilateral donor agencies, and potentially moving towards a Global Fund in-country presence.
ii. Exploit opportunities for more joint arrangements and harmonization, including adopting systems of other donors to, potentially, obviate the need for a "Global Fund specific" LFA.

5. During consideration of improvements to the LFA system, the Global Fund continues to be guided by the key principles of ensuring efficiency and cost effectiveness in its processes and, most importantly, delivering demonstrable benefit to the people and communities living with and affected by the three diseases. The outcome of the LFA Review should therefore combine timely implementation of recommendations that bring early and appropriate reform, with more systemic changes which may result after informed analysis of the relative strengths and challenges of more extensive reform proposals.

A. Early System Improvements

6. Those LFA Review recommendations that refine the existing framework and are more quickly addressed are illustrated in Table 1 (*Annex 2*), grouped into three broad subject headings.

7. In this context, the Phase 2 grant renewal process presents an ideal opportunity to complete a full cycle of grant management and renewal whilst these initial system improvements are implemented. Global Fund personnel and other key stakeholders are providing real time feedback on process improvement initiatives. Refinements continue to be made on a concurrent basis, with more transparent decision making and communication patterns featuring in those reform initiatives (including, publicly available information memorandums).

8. Lessons learned during more recent implementation of the Global Fund's decision from the 8th Board Meeting regarding *Timeframes for Grant Agreements* have also provided valuable feedback on LFA management initiatives. In particular, the Global Fund has streamlined the manner in which LFAs are instructed to undertake PR assessments, in order to facilitate grant signature as swiftly as possible.

B. Moving Beyond Early Interventions

9. A number of the suggested reforms imply more systemic and structural changes to the Global Fund's grant management and risk assurance processes. The LFA Review concludes that many key stakeholders perceive the existing LFA arrangements to be less than optimal.

10. In that context, there are two particularly distinct stages of Global Fund grant management where highly competent and effective LFA services are required.

e. First, a timely and highly targeted assessment process prior to the grant negotiation phase to readily identify PR capabilities and essential capacity building needs.

f. Second, during program implementation, to provide real time verification on the ongoing capacity of PRs to implement the program, and to verify disbursement requests via monitoring and evaluating programmatic performance according to agreed targets and indicators.

11. It is evident from the LFA Review (and other primary information sources[13]), that the perceived ability of LFAs to provide high quality services during both stages is challenged on the basis that LFAs, generally, are not considered to hold sufficient capacity in several critical program areas. The most significant questions surround the relative capacity of LFAs to competently assess, and thereafter oversee, PR capacity in the core areas of procurement and supply management (PSM), and monitoring and evaluation (M+E).

12. At the same time, the number and complexity of grants under management continue to grow. In the circumstances, a radical departure from the LFA system before recent enhancements are evaluated is not considered appropriate. Thus, those LFA Review recommendations that propose a very different system of risk assurance for the Global Fund and will not be pursued at the current time are set out in Table 2 (*Annex 3*).

Part 3: Opportunities for Preliminary Structural Enhancements

13. Key requirements of an enhanced LFA model include:

    a. Highly trained and capable service providers focused on supporting the Global Fund's *performance based funding* model throughout the grant management cycle;

    b. Regionally proximate PSM experts to alleviate bottlenecks during the LFA assessment phase;

    c. Greater definition of the level of M+E expertise required of LFAs ; in the context of a need to more systematically link capacity constraints of PRs identified during the assessment process, with external agencies able to provide necessary technical support throughout grant implementation; and

    d. Greater coordination and consistency between LFAs across regions and disease components.

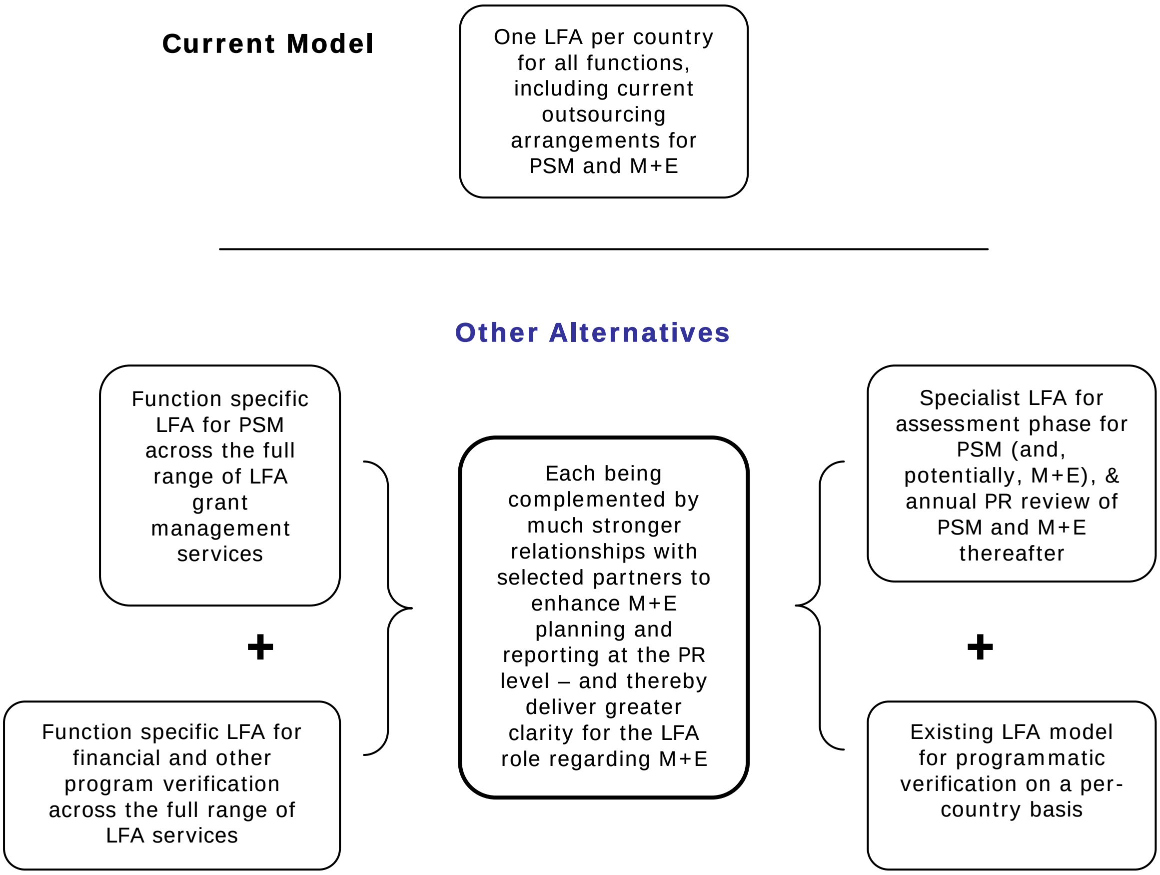
14. As proposed in the LFA Review, one possible means of reinforcing these characteristics within the LFA system is to re-structure the delivery of LFA services according to function. Clearly, it is also possible to strengthen the LFA model in a manner which facilitates different approaches depending on whether it is the assessment phase or verification role that is under consideration.

15. Paramount is the need to ensure that resulting reforms meaningfully streamline the LFA engagement model, to bring enhancements and not simply greater administrative and financial burden for each of the key stakeholders.

16. Diagrammatically, a number of the potential ways in which to strengthen the current LFA system include those set out as Other Alternatives in Figure 2 below:

[13] These primary information sources include those described in Figure 1.

Figure 2



17. In each of the above (including in the current model), there exists the possibility to consider moving towards more regionally located "central LFA coordination" teams, to enhance LFA responsiveness, competence and quality control, at the same time maintaining a common management and training team.

18. After further assessment of options, LFA enhancement models will be considered for piloting at the FPM Team Leader level within the Global Fund. One evolution for LFA management over 2005 is that Team Leaders will hold both budget accountability for grants under their management, and responsibility for the most effective means of engaging the high quality LFA services mandated by the Global Fund grant management model. This is intended to strengthen the Global Fund's grant management processes at the most appropriate level, simultaneously providing much needed clarity in communication channels.

19. Inevitably, there are risks and limitations that will require detailed consideration before any systemic enhancements may be introduced. Issues for particular consideration include:

g. Integrated LFA assessments and verification of programmatic performance may no longer be available in the event of a separation of LFA services on a functional basis (e.g., a "PSM expert LFA" to supplement the existing arrangements for strengthened LFA services may lead to the submission of separate reports, with separate lines of accountability);

h. A likelihood of increased complexity in LFA relationships at the country and Global Fund interaction level, perhaps also necessitating a decision on which "LFA" would be the primary contractor in a multi-LFA setting;

i. Potentially, a greater level of uncertainty regarding the primary role of the LFA and reporting channels to the Global Fund (e.g., CCMs and PRs may be uncertain as to which "LFA" provides particular services to the Global Fund, with a potential for communications to be either lost or misunderstood between the various players);

j. More highly dispersed responsibility for risk during both the assessment and verification phases, perhaps diluting what would otherwise be perceived an appropriate level of accountability and legal recourse in the event of poor performance;

k. Responding appropriately to the requirement for a larger sub-set of PSM and/or M+E experts and/or partners, to more fully cover geographic, language and personnel availability issues, through differing cost structures that those which apply under the current LFA arrangements; and

l. Determining what may comprise an appropriate LFA performance evaluation framework should the Global Fund move away from the standard "one size fits all" approach to LFA appointments.

20. A more complete assessment of the relative benefits of potential LFA system enhancements will be available to the Global Fund upon completion of a number of external assessments that are of equal importance to the LFA Review material. Two such sources comprise:

m. The United States Government General Accountability Office report on the Global Fund's operations to 31 December 2004 (expected by 31 May 2005); and

n. DLA Piper feedback on enhancing the Global Fund's grant management processes through the introduction of a number of risk mitigation strategies, including a risk measurement system which, once adopted, would link differing measures of risk with different systems (expected by 30 April 2005).

Part 4: Next Steps

21. The Global Fund is committed to implementing lessons learned from the LFA Review and from the other broad sources of information becoming available during 2005.

22. Already, the reforms targeting enhanced "communication" and "coordination" in Table 1 of this discussion paper are being implemented according to identified timeframes. These will be implemented, reviewed for effectiveness, fine-tuned and updated on an ongoing basis.

23. For reasons set out within this paper, other more medium term reform initiatives will be explored according to the following planned schedule:

o. 7-8 March 2005 - Obtain input from MEFA on key LFA system reform recommendations arising from the LFA Review;

p. By 30 April 2005 - Analyze DLA Piper feedback on an appropriate risk measurement system enabling movement away from the "one size fits all" model;

q. By 15 June 2005 – Review GAO Report findings and recommendations referencing the LFA system;

r. By 15 July 2005 – under the lead of the newly recruited LFA Officer, develop scenarios for in-country piloting of reform proposals based on the potential models set out in Figure 2 above, incorporating revised LFA tools and training modules during the pilot phase;

s. The LFA Officer shall then refer these scenarios to the relevant Board Committee for comment;

t. July to December 2005 – conduct preliminary in-country LFA reform pilots, analyze outcomes to identify key strengths, challenges and relative risks, and report on pilot outcomes to the appropriate board committee for review and, where relevant, preparation of decision points for Board consideration.

Attachment 1

Review of the Roles, Functions and Performance of Local Fund Agents*

Final Report, August 2004

Stein-Erik Kruse (HeSo) &
Jens Claussen (Nordic Consulting Group)

** Circulated as a separate document*

Attachment 2

Table 1: LFA Review – Early System Improvements

Proposed subject area of Reform	General Issue	Initial Responses already underway
Enhanced & Clearer Communication	Despite the mandate of the LFA being very different to this notion, the LFA is seen as an "agent" of the Global Fund in the strictly legal sense by many in-country stakeholders. There is uncertainty and frustration about the role of the LFA, including whether the LFA is an appropriate source of Technical Assistance for PRs. Some believe that Global Fund processes are only explained after relevant decisions or actions have been taken.	• Development of clear LFA Terms of Reference (TORs) – March 2005. • Clarity of processes and roles to external stakeholders (e.g., Phase 2 information on website[14]) - ongoing. • Participation in external "Lessons Learned" studies to enhance processes and clarity of roles[15] - Ukraine study to be completed by July 2005. • Provision of more "tools" for PRs to enhance capacity to complete LFA assessment phase with less delay - ongoing.
More appropriate Coordination	Although individual LFAs work closely with Fund Portfolio Managers (FPMs), the increasing complexity of in-country grant management (including expanding internal and external human resources) brings added complexity to the management of LFAs. A key failing is the absence of consistency and quality across LFAs, the central coordination teams of LFAs, and FPMs within the Global Fund.	• The position "Officer, LFAs" is being actively recruited – expected by 1 June 2005. • Internal FPM trainings to bring consistency amongst regions are operational – ongoing. • External LFA training sessions supported by the Global Fund – ongoing. • LFA work order arrangements are being optimized to reduce delays and focus on outputs rather than level of effort – ongoing.
Incorporating Risk and Diversity Factors into the Grant Management Process	The historical "one size fits all" model implemented by the Global Fund, in practice, may operate as a disincentive towards the appropriate utilization of LFA services and other Global Fund resources. The relative capacity of PRs to develop and operationalize both procurement & supply management, and monitoring & evaluation systems is not sufficiently understood and evaluated by all LFAs.	• Grant and in-country risk assessment models are actively being developed with external expertise (e.g., DLA Piper), and will be implemented into the FPM and LFA working relationship to ensure appropriate identification and management of risk and grant performance. The Operations Policy Manual and PR assessment tools are also under review, to identify best practices according to grant and in-country risks, and guidance sections will be strengthened. • Early intervention systems – including a Crisis Response Plan – are being implemented across 2005 to ensure earlier and better PR, LFA and FPM interactions for appropriate grants.

[14] Clarity regarding the role of the LFA in the Phase 2 Decision Process is provided externally at: http://www.theglobalfund.org/en/files/funds_raised/performance/phase2_qa_050208.pdf

[15] An example is the USAID funded "Synergy TA" - *Global Fund grant to Ukraine – Real Time Analysis of Lessons Learned from the Appointment of a Grant Steward* which the Global Fund is actively participating in: http://www.aidsalliance.kiev.ua/ru/gfund/pdf/briefing_trip_2_final.pdf

Attachment 3

Table 2: LFA Review – Recommendations not currently pursued

Proposed subject area of Reform	**Basis of Recommendation**	**Key Challenge(s) with Reform Proposal**
Establish Global Fund In-country Presence	As proposed by a number of CCMs and PRs, establishment of a full time Global Fund presence for priority countries and regions, to permit a greater participation in donor harmonization and coordination.	• Substantial alteration to the Global Fund's risk model. • Ignores substantial number of pre-existing in-country representative offices who are equally able/more legitimately placed to provide the desired level of coordination (e.g., UNAIDS, STOP TB, Roll-Back Malaria). • Significant cost-benefit analysis would have to be undertaken before a realistic proposal could be contemplated.
Move to more local based LFA offices	There are a number of stakeholders that perceive that nationally incorporated LFA offices (e.g., KPMG Croatia, in Zagreb) are not sufficiently "national or local" to fully appreciate in-country circumstances and capably fulfill the role of LFA. There is also a perception that perceived "global contracts" result in higher fees for service.	• Without first determining whether LFA services should be provided by a sole LFA, or some other joint/expert working arrangement, it would be premature to re-tender for LFA services on an altered model. • As a preliminary phase, revised contracting processes are anticipated to result in increased assurance and efficiencies, through "ownership" of the LFA engagement at the team leader level.
Move away from a "Global Fund specific" LFA model	By reason that Global Fund grants are, typically, only part of a wider program supported by other donors, common systems for disbursement, assessment and overall program verification could be agreed. This would permit, in some cases, for other donor verification models to be used in the place of a LFA.	• In countries where "Sector Wide Approaches" (SWAps) operate, the Global Fund fully supports shared reporting and minimal incremental assessment of potential PRs. However, it is premature to equate shared reporting with shared verification. Movement towards a model which accepts other donors' reports as satisfying the Global Fund's verification requirements necessitates greater initial clarity on what it is that the Global Fund is seeking to measure, and what is the agreed role of the LFA. This latter aspect is being reviewed as noted above.

Phase 2 Decision-Making Policies and Procedures

1. The Board may commit funds for Phase 2 renewals (up to the full duration of a proposal) up to the cumulative uncommitted amount pledged through the calendar year of the Board decision.

2. The Board makes funding decisions for Phase 2 renewals based on its review of Secretariat or Technical Review Panel (TRP) recommendations, according to procedures agreed by the Board.

3. The Secretariat or TRP will present the Board with its recommendations on the first of every month (notice to Board constituencies of a recommendation shall be effective upon the posting of the recommendation on the Global Fund website; the Secretariat will inform Board constituencies via e-mail when recommendations have been posted). The Board will vote by email on each recommendation on a no-objection basis. Votes must be received by the Secretariat no later than the tenth of the same month.

4. A Board decision in favor of a Secretariat or TRP recommendation either:

- Commits additional resources in the amount proposed in the recommendation (in the case of recommendations of "Go," "Conditional Go," and "Revised Go"); or
- Does not commit any additional resources (in the case of recommendations of "No Go"), thereby discontinuing the proposal after Phase 1.

5. If the Board does not decide in favor of a Secretariat or TRP recommendation, this would serve to request further clarification on the recommendation and ask the Secretariat or TRP to reassess its recommendation. To facilitate the clarifications process, those Board constituencies that are not ready to decide in favor of a Secretariat or TRP recommendation would provide a written explanation that is made publicly available. The Secretariat or TRP will review its recommendation in light of the questions and comments of those Board constituencies and will then present a second recommendation on the first day of the subsequent month (unless time-constraints make it necessary to wait to the month thereafter). The Board then votes again, on the second Secretariat or TRP recommendation, using the procedures described above.

6. A Board decision in favor of the second Secretariat or TRP recommendation either:

- Commits additional resources in the amount proposed in the recommendation (in the case of recommendations of "Go," "Conditional Go," and "Revised Go"); or
- Does not commit any additional resources (in the case of recommendations of "No Go"), thereby discontinuing the proposal after Phase 1.

7. If the Board does not decide in favor of the second recommendation, the matter is deferred to the next Board Meeting [as a "blocked Go" or a blocked "No Go"] for a final decision on making a funding commitment.

8. [The Board may in a full meeting decide that a "blocked No Go" recommendation be unblocked, thereby discontinuing the proposal after Phase 1. Alternatively the Board can decide to turn the application back to the Secretariat for further dialogue with the PR and the CCM, with the purpose of repeated submission to the Board, along with a specific commitment of bridge funding.

9. The Board may in a full meeting decide that a “blocked Go” recommendation be unblocked, thereby committing additional resources in the amount proposed in the recommendation. Alternatively the Board can decide to turn the application back to the Secretariat for further dialogue with the PR and the CCM, with the purpose of repeated submission to the Board, along with specific commitment of bridge funding.]

10. In circumstances in which insufficient resources remain in Phase 1 to cover financing needs until any Board decision in the Phase procedure can be operationalized, the Board authorizes the Secretariat to extend the terms of the grants by up to six months, and to provide bridge funding for such grants as appropriate. The Board authorizes the Secretariat to commit up to a maximum of one-half of the first year budget contained in the Request for Continued Funding in question for these purposes, which would be financed by utilizing the Phase 2 renewal funding of the proposal. The actual amount committed by the Secretariat would be based primarily on the performance and disbursement patterns in Phase 1.

11. For proposals for which the Board commits Phase 2 funds, a sufficient amount of assets to cover the full costs of the extension of the Grant Agreement must be deposited with the Trustee or readily available on demand prior to the Secretariat extending a Grant Agreement.

12. The Technical Evaluation Reference Group (TERG) will regularly review and report on the soundness of the Phase 2 review and decision process to the Board through the MEFA Committee.

13. The Phase 2 decisions will typically be taken based on recommendations that are made 20 months after the Program Starting Date (exceptions could include for situations of *force majeur*). The decision may be taken earlier in cases of (i) accelerated implementation; or (ii) severe exchange rate fluctuations.

14. These procedures for the Board commitment of funds for Phase 2 are subject to a time-limited trial period. The Board asks the MEFA Committee to review these procedures and prepare recommendations on whether the Board should continue with these procedures or should adopt an alternative set of procedures. Based on these recommendations the Board will reconsider the procedures at the Thirteenth Board Meeting.

Summary Report of the Technical Evaluation Reference Group (TERG) of the Global Fund Second Meeting

Glion, Switzerland, 1-3 March 2005
(Draft 7 March 2005)

1 Update by the GF Secretariat on major achievements since the last meeting

This document reports on the second TERG meeting, which took place from 1 to 3 March 2005 in Glion, Switzerland. It provides a summary of key issues discussed and the TERG's recommendations.

The TERG welcomed progress made by the Global Fund Secretariat regarding the overall Measurement Framework, with its implementation at four levels:

1) Operational performance: Core indicators have been implemented; Executive Dashboard is functional.

2) Grant management**:** Standard indicators agreed with partners, and included in the M&E toolkit. Suite of tools for grant performance management developed and rolled out. Portfolio results are already available for ARVs, DOTS, and insecticide-treated bednets (ITNs), and will be extended in 2005. Phase Two management systems and tools developed and applied to the first batches of Phase Two grants.

3) System effects**:** The measurement framework and indicators have been agreed and baseline implementation has been initiated with results for core indicators to be reported in 2005.

4) Impact**:** Impact indicators are defined in the M&E toolkit. Tools have been implemented to capture targets for all grants entering Phase Two. The contribution to Millennium Development Goals will be assessed in 2005.

The TERG also welcomed the launch of the TERG website and the website Evaluation Library containing the major studies on GF activities, and the mechanisms to facilitate communication between members in between meetings.

The TERG welcomed the progress made by the Secretariat and the priorities set for 2005, while providing detailed recommendations for improvements relating to the major agenda items.

2 Review of Phase Two progress

2.1 Background

The TERG reviewed the process of Phase Two renewals and the overview of the first 27 grants evaluated. Both Operations and Strategic information and evaluation units within the Secretariat presented preliminary results. The TERG discussed the overall process, individual scorecards and results, contextual issues of performance and the final score assigned by the Secretariat. They strongly supported the implementation of performance-based funding as presented by the Secretariat. The TERG underlined the importance of the performance-based strategy in sustaining the Fund's credibility. The TERG recognizes the desire to continue funding to countries under difficult circumstances. The TERG suggests that early recognition of grant problems and necessary remedial action should be strengthened including an early warning system while the principles of performance based funding in Phase Two be maintained.

TERG recognized the following major strengths of the Phase Two process to date:

- The transparent and well documented process
- The well structured scorecard and clear guidance on its use
- The inclusion of both quantitative performance evaluation and consideration of contextual factors that influence that performance

- The dual system for review inside the secretariat with parallel independent review by both Operations and SIE units at all levels and the forwarding of both reviews to the decision panel, which formulates the recommendation to the Board. Such a system is vital to ensuring the integrity and credibility of the review process.

The TERG identified several areas in which the review process could be strengthened, or for which additional information was required in order to judge the robustness of the evaluation process.

2.2 Target setting for performance measurement

Grant performance, in part, is based on measurement of progress using agreed indicators defined in the multi partner M&E toolkit. PRs are requested to report on progress in these indicators against set targets. Specific targets are developed as part of the yearly workplans and relate to the overall targets documented in the proposals approved by the Board. TERG discussed a number of issues around target setting which are relevant to the performance measurement system of the Global Fund. There may be a negative incentive to set targets at low levels to ensure that performance measures are met, and thus funding may continue. A question was also raised to what extent requested budgets are consistent among the portfolio with specific targets, or with other words, does the same amount of resources “buy” the same or at least a similar, plausible level of services in different grants.

2.2.1 Recommendations

I. The TERG recommends that the Secretariat performs an analysis to compare targets and requested resources across grants

II. The TERG recommends that the Secretariat initiates an evaluation of the proposal review process of Round 5 applications, including the review of the appropriateness of targets in proposals for funding as well as the corresponding appropriateness of funding solicited. The TERG welcomes the revised procedures for Round 5 to include budget estimates by service delivery area.

2.3 Early Warning System

TERG emphasizes that performance based funding (PBF) does not start with the Phase Two decision process as such. PBF starts with proposal decision and grant signing and builds on periodic progress updates linked to disbursement requests. TERG discussed the importance of using all information available on grant performance, in particular the regular progress updates and LFA verification reports to identify early on areas of weaknesses. Strengthening grant performance management in early phases of the grant cycle will help to maximize performance during phase one of the grant and to protect and strengthen the phase two funding decision based on performance during the first 18 months of the grant.

2.3.1 Recommendations

I. TERG recommends to accelerate and strengthen the development of the early warning system with the goal of identifying under-performing grants as soon as possible, providing maximum opportunity to both the CCM and its partners to take corrective action and/or initiate project redesign. Such a system should utilize existing quarterly/semiannual progress updates & disbursement requests. At 6 and 12 months the Secretariat, with LFA input, should assess the performance of the CCM and the Principal Recipient, in addition to general progress against indicators. The results of these assessments should be shared with both CCMs and with the Fund’s partners to enable all parties to identify remedial actions. These reviews should provide positive incentives for self assessment by CCMs and Principal Recipients. This mechanism may contribute to program improvement and improve the likelihood of continuing funding.

II. Consistent with the Fund's transparency policies, Grant Performance Reports should be published on the web from grant signing and when updated to facilitate peer review process within and between countries and partners.

III. Acceptance of the request for Phase 2 funding should be conditional on the submission of an annual review provided by the CCM.

2.4 Revision and Reprogramming of underperforming Grants

The TERG discussed the role of the PR, CCM, Secretariat and the TRP in phase two funding decisions, in particular the review of no-go decisions and the role of the different partners in proposing revision and reprogramming of (underperforming) grants. TERG emphasized existing GF policies which put the countries at the centre of the development of proposals and workplans, through the CCM.

2.4.1 Recommendations

I. In the event of a Phase Two review identifying a seriously under-performing ("No Go") grant, responsibility for requesting a revised/reprogrammed grant lies with the CCM/PR rather than the Secretariat or the TRP.

II. The TRP focus in the Phase Two process should be on evaluating grants that request substantial revision/reprogramming of their activities. TERG recommends that TRP should not have a function in the review of recommended No-Go grants. Instead TRP should be provided with performance reports as a feedback for their own initial decision process.

2.5 Quality Assurance of Data Quality and Decision Processes

The TERG discussed the importance of data verification and quality assurance of data submitted to the Secretariat as the basis for performance based funding decisions. As discussed during the first meeting of the TERG, systems for quality assurance need to be developed as a priority including both, systems of data verification and quality assurance of processes designed under performance based funding policies. Appropriate inclusion and recognition of national systems and technical partners needs to be ensured.

2.5.1 Recommendations

I. TERG recommends that the Quality Assurance mechanism recommended in the first meeting be prioritized. There is urgent need for systems of quality assurance. Such systems should include both tools that PRs can use to improve their internal quality assurance procedures as well as external assessments by the LFAs and sample quality audits. They should also capitalize on the activities and data collected by partners such as Health Metrics Network, RBM, Stop TB etc.

II. While the TERG recognizes the enormous advance in consistency and utility of indicators in response to the development of the M&E toolkit, the usefulness of the data would be further enhanced by technical calibration of indicators in collaboration with the respective technical agencies.

III. Experience has been gained with the first round of Phase Two decisions. Processes and lessons learned should be documented with external support to clearly define business processes and performance standards for inclusion and further refinement as experience is accumulating.

3 CCM assessment: results of pilot study

3.1.1 Background

The first TERG meeting identified transparency of governance of Country Coordination Mechanisms (CCMs) as a key issue, and proposed a checklist for CCM self-assessment. An instrument was pilot tested in five countries by the Futures Group and results were presented to the TERG. The presentation of findings gave rise to a number of issues that required clarification by the TERG.

The TERG reconfirmed the principle of self assessment for the CCMs. In addition, the TERG reemphasized transparency as a guiding principle, with the GF seeking to have self assessment results posted on the website.

The TERG reviewed the checklist and made a number of suggestions to improve the instrument and processes to be used in its application. These specific comments were provided to the consultant for the instrument's revision prior to any wide scale application.

3.1.2 Recommendations

I. It should be made clear to CCMs that completion of the checklist is mandatory at least once per year.

II. The satisfaction elements of the checklist require the development of a separate sub-tool.

III. The self-assessments shall be validated by sample audits in 10 to 20 countries. Some proportion of the sample will be selected on the basis of a purposive sample. The TERG agreed that these in-depth sample audits should include views of selected external stakeholders at the country level.

IV. A user guide should be developed to accompany the self assessment checklist. The users guide should clearly describe the criteria that would qualify as a "yes" or "no" response to each item.

V. When implementing the checklist focus should be given to the principle of self assessment. The consultants should rather support the self assessment process than doing the assessment as such.

4 Discussion on Role of the TERG within the revised committee structure

4.1 Background

The TERG was informed about the proposed new committee structure. One of its aims is to simplify decisional processes, in line with the requirements of the current developments of the Global Fund. Four Committees will be created: Policy and Strategy Committee, Finance & Audit Committee, Portfolio Committee and Ethics Committee.

TERG discussed the possible implication of this reorganization for its relationships with the Board and the Committees. TERG expressed concern that with the proposed TOR for the committees TERG may be required to relate to several Board Committees without a clear communication line towards the Board.

4.1.1 Recommendations

I. While the TERG will work with all Board committees, it recommends that a main entry point would facilitate its input and recommendations to the Board. The TERG recommends that the Policy and Strategy Committee should serve as the main entry point for this purpose.

II. The TERG suggests that there be a focal point for monitoring and evaluation within the Policy and Strategy Committee. It is recommended that the focal point should have expertise in the area of monitoring and evaluation and serve as an ex-officio member of the TERG.

III. The TERG suggests that the TERG Chair be invited to meetings of the GFATM Board and the Policy and Strategy Committee. The TERG also suggests that the Chair of the TERG reports to the Board regularly on progress related to performance measurement of the Global Fund as regular agenda item.

IV. TERG recognized that the change in committee structure requires adjustments in the terms of Reference for the TERG. The revised Terms of Reference are attached (See Annex).

5 Preparing for the 5-year evaluation of the Global Fund

5.1 Phasing of evaluations

TERG reconfirmed the need to commence work on "a first major evaluation of the Fund's overall performance against its goals and principles after at least one full grant funding cycle has been completed (five years)" (M&E strategy, approved by the Board). In accordance with this recommendation the evaluation would be due in 2007/08. This decision was taken in view of the relevance of outcome and impact data as an important element of this overall evaluation. In view of the complexity of the Global Fund system, and the need to learn as early as possible about strengths and weaknesses, TERG recommends to shift from a one-off evaluation to a phased incremental approach. This approach would enable the Global Fund to take early remedial action where appropriate.

The Global Fund has already established a number of verifiable evaluation systems and tools that contribute to the overall performance assessment. In addition, the innovative nature of the Global Fund attracts a substantial number of studies on the Fund's performance. The Global Fund's own mechanism of continued learning plus the results of external studies should be included in overall assessments.

5.1.1 Recommendations

I. TERG recommends to initiate an in depth review of Global Fund performance in 2006 on the basis of accumulated knowledge covering the first three levels (operational performance, grant performance, systems effects) of the four level measurement framework for the Global Fund. The emphasis of the 2006 in depth review will be on:

- GF policies,
- institutional strategies,
- partnerships, and
- effects on health systems

II. The second phase of the first overall evaluation will be conducted in 2008 and will concentrate on the forth level of the Global Fund's measurement framework (impact) with a focus on

- health outcomes,
- impact, and
- factors influencing outcomes and impact.

III. The TERG recommends that the Secretariat continues its efforts to synthesize the key results of relevant evaluations and studies.

5.2 Data needs for health outcome and impact evaluation

TERG recognizes the substantial gaps in existing health information systems to generate information on health outcomes and impact. TERG further recognizes that without information on health outcomes and impact overall evaluation of major health initiatives, including but not limited to the Global Fund, will not be possible. Systems and mechanisms for the generation of crucial health information need to be built now. TERG acknowledges the concept paper prepared on "Evaluation of impact and the Global Fund" by TERG members which outlines modes to address these issues, including the role of relevant partners, in particular the Health Metrics Network.

5.2.1 Recommendations:

I. TERG recommends that the Global Fund Secretariat, together with relevant partners (WB, PEPFAR, WHO, HMN UNAIDS), convenes a meeting in May 2005 to discuss measurement procedures around the common interests and understanding in the area of health outcome measurement. An outcome of this meeting should be to define concrete steps to ensure that national partners make use of the full range of the opportunities that existing mechanisms offer (including a refinement of incentives and disincentives within existing funding frameworks).

II. In preparation of such a meeting the Global Fund should prepare an analysis about which of its grants currently include necessary baseline data. Ideally this analysis will include similar information of other major funding partners and existing plans to fill such gaps (e.g. DHS, MICS, World Health Surveys, SAM, etc.). The TERG recognizes the need of an analysis on cost of the appropriate systems and tools for impact measurement and urges the Secretariat to explore with partners the timely preparation of such an analysis.

5.3 Operations/implementation research to build knowledge base

TERG re-emphasized the need to strengthen operations/implementation research in developing countries.

5.3.1 Recommendations

I. TERG recommends that the Global Fund, together with relevant partners, organizes a high level meeting with relevant stakeholders in 2005. The objective of this meeting will be to discuss a framework on how operations/implementation research will effectively be implemented as an integral part of Global Fund funded programmes, and how the results of such studies will contribute to learning processes across programmes and countries. TERG welcomed the agreement between the Global Fund and the International AIDS Society (IAS) to use the IAS conference in Rio, July 2005, as a platform to a wider audience, in particular researches from developing countries.

II. TERG welcomes the Global Fund's involvement in the preparation of a Wilton Park conference (part of a series of high level conference in UK) in June 05 around performance based investments in health and recommends that a focus will be given to discuss the importance to build the evidence base.

5.4 Attribution

TERG discussed the question of attribution of results to specific donors and intervention mechanisms. The objective of impact evaluations is to evaluate the effects of large scale collective efforts, including efforts of a range of national and international partners. The TERG supports the approach of attribution through collective effectiveness taken by the Secretariat in its results reporting.

5.4.1 Recommendations

I. TERG recommends that the Global Fund not attempt to evaluate impact of its efforts alone but to recognize the contributions of all relevant partners.

6 Replenishment Conference

TERG expressed concern that the "Independent Review" document prepared by an external consultant for the first Replenishment Conference included a statement on whether the Global Fund is "measuring the right things". TERG questions the basis of such a statement which is at best anecdotal. TERG confirmed that the Global Fund is making a substantial effort to produce evidence to manage the Fund effectively and to measure its performance.

6.1 Recommendation

I. TERG recommends that the Replenishment Conference make full use of the documented evidence generated through the Global Funds monitoring and evaluation systems.

Technical Evaluation Reference Group for the Global Fund to fight AIDS, Tuberculosis and Malaria

Terms of reference, membership and procedures

March 2005

I. Background

Issues:

1. As recommended in the Evaluation strategy for The Global Fund to Fight AIDS, Tuberculosis & Malaria (GFATM) (REF) and agreed by the Board in its meeting in October 2003, the GFATM will establish a Technical Evaluation Reference Group (TERG). The Evaluation strategy spells out the broad areas of work to be addressed in Monitoring and Evaluation of the Global Fund. The diversity of issues, as well as the number and type of relevant partners and linkages, requires solid technical advice and coordination in the operationalization and execution of the strategy. The TERG shall provide independent advice, assessment and oversight for the Fund's work on Monitoring and Evaluation (M&E).

II. Terms of reference

2. The TERG shall provide independent assessment and advice to the Board of The Global Fund to Fight AIDS, Tuberculosis & Malaria on issues which it determines require board attention. The Board may also direct the TERG to examine specific programmatic aspects of the Fund, as appropriate. The TERG shall provide advice to the Global Fund Secretariat on evaluation approaches and practices, independence, reporting procedures and other technical and managerial aspects of monitoring and evaluation at all levels. Specifically, the TERG shall provide input and conduct regular reviews of progress towards the implementation and refinement of the M&E Strategy of the GFATM, and provide a link to broader discussion of monitoring and evaluation of HIV/AIDS, TB, and Malaria in general. This includes reviewing monitoring and evaluation activities in relation to:

- The programme level: performance based funding.
- The country level: linking performance with disease impact, and key processes related to disease impact including the principle of additionality, and the institutional architecture of the fund as it relates to country level performance.
- The global level: added value of the Global Fund, including the Global Fund's Grant portfolio, and monitoring of key performance indicators for the Fund as an organization; health system-wide effects of the Global Fund, including the principle of additionality and harmonization of efforts with existing national and international M&E systems.

3. The scope of work for TERG shall include:

- providing technical review and advice on the processes and the products of the monitoring and evaluation activities of the Global Fund;
- identifying priorities and gaps in the Monitoring and Evaluation Plan and outlining an

agenda to address them;

- advising on harmonization of monitoring and evaluation approaches of the Global Fund, and on dissemination of best practices, including through appropriate partnership arrangements
- critically assessing the quality and usefulness of selected reports of internal and external evaluations, assessments, qualitative and quantitative research of relevance to the Global Funds monitoring and evaluation efforts;
- regularly reviewing the total product of the M&E system established and reporting on its quality, timeliness, relevance and use to the Board through MEFA
- In addition, the TERG may provide support as needed to the Board of the Global Fund as well as to the Global Fund Secretariat, including:
- providing input to the further development and implementation of the Global Fund's functional evaluation frameworks;
- providing guidance in technical resource networking related to monitoring and evaluation of the Global Fund;
- advising on the dissemination of findings and lessons learned from evaluation activities; and,
- strengthening inter-organizational networking, in particular coordinating with and building on established M&E reference mechanisms such as the UNAIDS and Roll Back Malaria Monitoring and Evaluation Reference Groups (MERG), or the Stop TB Evaluation advisory panel.

5. The TERG shall serve all the three Board Committees, but have the Policy and Strategy Committee as its main entry point for recommendations to the Board committee structure. Among the PS Committee members there should be a person that can serve as a Monitoring and Evaluation focal point in the Committee structure and be an Ex officio member of the TERG.

III. Membership

5. The TERG shall have 9 appointed plus 4 ex officio members representing the broad range of disciplines required for Monitoring and Evaluation of the Global Fund.

Selection of TERG Members

6. Each Board member of the Global Fund may nominate candidates who match the profile and qualifications defined in paragraph 7 (up to 4 candidates per board member). The names of candidates will be submitted to the Policy and Strategy Committee with the appropriate information and documentation through the Secretariat. The PS Committee with the support of the Fund Secretariat, will recommend a proposed list of appointees to the selection committee which is comprised of the Chair or Vice Chair of the PS Committee, the Committee M&E focal point and the Executive Director of the Global Fund. The final proposed list will be forwarded to the Board of the Global Fund for decision. The confirmed appointees will be invited to become members of the TERG by the Executive Director of the Global Fund. The M&E focal point member of the PS committee as well as the chairs of the monitoring and evaluation reference panels of UNAIDS, Roll back Malaria, and StopTB shall be ex-officio members of the TERG. In addition to the regular TERG membership, additional experts may be invited to participate as the need arises.

7. Membership of the TERG shall be drawn from a range of stakeholders, including practitioners, research institutions, academics, donor and recipient countries, and non-governmental organizations and shall be guided by the following criteria:

- credibility and independence
- expertise and experience in monitoring and/or evaluation,
- country experience in data collection and quality assurance
- knowledge of HIV/AIDS, tuberculosis and malaria issues;
- knowledge of the Global Fund and its activities;
- commitment and availability to participate in meetings;
- absence of conflict of interest;
- geographical representation; and,
- Gender balance.

8. The disciplines considered essential for the TERG include evaluation, monitoring, public health (including epidemiology/biostatistics), HIV/AIDS, Tuberculosis and Malaria, social sciences (including behavioural sciences, demography, operations research etc.), programme management including health management information systems (HMIS), and issues related to development, such as sector wide approaches and harmonization. The members shall act fully independent from the Board and Secretariat of the Fund.

9. Members of the TERG shall normally serve for a period of three years, and shall be eligible to serve not more than two consecutive terms.

10. After the first full term of a member, the rotation of members shall be such that approximately one third of the membership is changed every year.

11. In the event that a TERG member is unable to attend a meeting, he/she will be exceptionally able to designate a replacement subject to prior approval of the TERG Chair.

12. TERG members may receive a honorarium for their service as TERG members, as approved by the Fund Secretariat, in addition to travel expenses and per diems.

IV. Chair

13. The TERG Chair and Vice-Chair shall be elected by the TERG members from among its membership. The ex-officio members of the TERG cannot hold the position of chair or vice chair. The rules regarding the length of appointment set out in 9 and 10 above apply equally to the Chair and Vice-Chair. In their identification, appropriate consideration shall be given to geographic representation, discipline, skills and expertise, and gender.

V. Meetings

14. The TERG will have at least one formal meeting each year, scheduled at a time convenient to at least half plus 1of the members. Additional meetings may be scheduled if the need arises. Sub-groups of the full TERG may be convened by the Chair in consultation with the M&E focal point member of the PS Committee and the Secretariat on an *ad hoc* basis to consider specific issues. In addition, other means of communication (e.g. electronic discussion groups, video conferencing) will be used to facilitate exchange of views between formal meetings and arrangements will be made for regular access to relevant information from internal and external M&E activities related to the Global Fund as specified by the TERG.

15. TERG members will normally be notified two months in advance of meetings and will be sent relevant documentation one month prior to the meeting.

VI. Reporting

16. A summary of the meetings shall be issued within one month of the close of each TERG meeting by the chair of the TERG. This summary shall be distributed to all TERG members and made available to GFATM board members, all members of the Three Board Committees and the Fund Secretariat.

17. The TERG Chair shall be invited to meetings of the PS Committee and the GFATM Board and shall at each meeting of the Board present brief independent assessments on performance and status of the M&E system to the Board, based in the TERG mandate. Recommendations from the TERG are advisory, but not binding, to the board of the Global Fund and the GFATM Secretariat. Board Committees dealing with recommendations from the TERG can not revise the recommendations or block them from reaching the Board, but will prepare Board actions to accompany such recommendations, following regular procedures

18. A summary of TERG activities and main recommendations shall be included in the annual evaluation report prepared by the Global Fund Secretariat, which shall be prepared in consultation with the TERG. The chair of the TERG shall give an independent report to the board of the Global Fund through its MEFA Committee. This report shall include comments on, the annual M&E report of the Global Fund Secretariat.

VII. Secretariat

19. The Global Fund Secretariat will serve as the secretariat to the TERG, in particular with regard to the arrangements for TERG meetings, sending of invitations and providing logistic support. In addition, the Global Fund Secretariat may be supported by an external institution which will also make additional arrangements as required to support specific functions of the TERG such as the creation and servicing of electronic discussions groups, the preparation of reviews or analytical summaries of existing work and experience in support of the work of the TERG. The supporting institution will be selected through an independent search based on expertise, logistical and cost considerations by the Secretariat of the Fund. The work carried out to support the TERG will be under the oversight of the chair of the TERG.

Annex 9

12th MEFA Committee Meeting
6 – 8 March 2005, Hotel Victoria, Glion, Switzerland

Final Agenda

Sunday 6 March 2005

19.30 Working Dinner – Hotel Victoria, Glion

Monday 7 March 2005

Item o.	Subject	Presenter
1	Welcome, introductions, review & approval of agenda	Chair
2	2004 External audit – presentation from auditors, draft decision pproval of 2004 Financial Statements) for Board	Barry Greene
3	2004 Operating expense review & 2005 budget recap	Barry Greene
4	Briefing on Secretariat office space, options, next steps, possible points	John Burke
5	Update on Replenishment Conference	Christoph Benn
6	Trustee presentation on investment options (information & possible ndation) & discussion, update on fiscal management structure and s study	World Bank tative(s)
7	Euro-denominated grants / currency risk management – further on risks & cost	Barry Greene
8	Committee re-structuring: update on status & next steps, transition	Chair

Tuesday 8 March 2005

Item No.	Subject	Presenter
9	LFA review: status on response, action underway and next steps	Karmen Bennett
10	Timelines for grant signings. Update on experience to date (Operations verbal report)	Brad Herbert
11	Phase 2 Operational review – Secretariat update on initial experience (Ops & SIE verbal reports) TERG report (Phase 2) & TRP Chair feedback	Brad Herbert Bernhard Schwartländer Prof. Rolf Korte,TERG Chair Dr J. Bloomberg, TRP Chair
12	Global Fund Performance: TERG presentations & discussion – with Rolf Korte (including summary of second TERG meeting)	TERG Chair, Prof Rolf Korte

Annex 10

List of Participants
12th MEFA Committee Meeting, 6-8 March 2005

12th MEFA Attendance List - 6-8 March, Glion		
Name		Constituency
Sigrun	Mogedal	Point Seven (Chair)
Ashleigh	Roberts	Developed NGO
Paul	Avontroodt	European Commission
Madeleine	Leloup	France
Guglielmo	Riva	Italy
Mitsuji	Suzuka	Japan (Observer)
Rita	Molina	NGO Developing Country (Vice Chair)
Jerry	O'Dwyer	Support to the Chair
Carole	Presern	Canada Delegation
Nick	Banatvala	Canada Delegation
Rolf	Korte	TERG (Invited Guest)
Jonathan	Broomberg	TRP (Invited Guest)
Robert	Greener	UNAIDS
Eddy	Haarman	UNAIDS
Jim	Kulikowski	US Delegation
Maurice	Fezeu	W. Africa
Xia	Gang	Western Pacific
Deborah	Schermerhorn	World Bank - Trustee
Kyung Hee	Kim	World Bank - Trustee
John	Gandolfo	World Bank - Trustee
Krishnan	Chandresekhar	World Bank - Trustee
Global Fund Secretariat		
John	Burke	Chief Administrative Officer
Barry	Greene	Chief Financial Officer
Brad	Herbert	Chief of Operations
Bernhard	Schwartlander	Director, Strategic Information & Evaluation
Christoph	Benn	Director, External Relations
Dianne	Stewart	Board Relations Manager
Karmen	Bennett	Fund Portfolio Mgr, Eastern Europe
David	Sullivan	Senior Legal Officer
David	Ball	Senior Finance Officer
Philippa	Dobrée-Carey	MEFA Logistics Coordinator