GF/B17/6
Attachments

ATTACHMENTS

TO THE REPORT OF THE FINANCE AND AUDIT COMMITTEE

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

GF/B17/6
Attachment 1

2007 AUDITED FINANCIAL STATEMENTS

Financial statements of

The Global Fund to Fight AIDS, Tuberculosis and Malaria

as of 31 December 2007

prepared in accordance with International Financial Reporting Standards

together with the Report of the independent auditors

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To the general meeting of the Board of

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

Geneva, xx April, 2008

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 2007, and the related statements of activities, cash flows and changes in funds, and notes for the year then ended, published on pages xxx to yyy of the Annual Report.

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 confirm that we meet the requirements concerning professional qualification and independence.

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 Global Fund as of 31 December 2007, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Ltd

Mark Hawkins
(Auditor in charge)

Thomas Madoery

Statement of Financial Position
at 31 December 2007

In thousands of US dollars	Notes	2007	2006
ASSETS			
Cash and bank balances	2.4, 3.1	279	616
Funds held in trust	2.4, 2.5, 3.1, 3.2	4'337'357	3'135'762
Promissory notes maturing within one year	2.6, 3.3	356'102	240'568
Contributions receivable within one year	2.6, 3.4	270'209	283'383
Prepayments and miscellaneous receivables		108	899
		4'964'055	3'661'228
Promissory notes maturing after one year	2.6, 3.3	140'039	178'838
Contributions receivable after one year	2.6, 3.4	404'234	359'008
		544'273	537'846
Total ASSETS		**5'508'328**	**4'199'074**
LIABILITIES and FUNDS			
Liabilities			
Undisbursed grants payable within one year	2.7, 3.6	2'053'863	1'684'163
Accrued expenses		3'808	6'329
		2'057'671	1'690'492
Undisbursed grants payable after one year	2.7, 3.6	893'288	391'325
Total LIABILITIES		**2'950'959**	**2'081'817**
FUNDS at the end of the year		**2'557'369**	**2'117'257**
Total LIABILITIES and FUNDS		**5'508'328**	**4'199'074**

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

Statement of Activities
for the year ended 31 December 2007

In thousands of US dollars	Notes	2007	2006
INCOME			
Contributions	2.6, 3.5	2'912'881	2'429'635
Trust fund income	2.5	240'502	126'483
Bank interest		-	15
Total INCOME		**3'153'383**	**2'556'133**
EXPENDITURE			
Grants	2.7, 3.7	2'596'029	1'817'424
Operating expenses	3.8	117'242	85'846
Total EXPENDITURE		**2'713'271**	**1'903'270**
INCREASE IN FUNDS for the year		**440'112**	**652'863**

The notes represent an integral part of the Statement of Activities

Statement of Cash Flows
for the year ended 31 December 2007

In thousands of US dollars	Notes	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES			
Contributions received	3.5	2'802'496	1'652'780
Trust fund income	2.5	240'502	126'483
Bank interest		-	15
		3'042'998	**1'779'278**
Grants disbursed in the year	3.7	(1'724'365)	(1'306'969)
Payments to suppliers and personnel		(117'375)	(68'163)
		(1'841'740)	**(1'375'132)**
CASH FLOWS FROM OPERATING ACTIVITIES being the net increase in cash and cash equivalents		**1'201'258**	**404'146**
CASH AND CASH EQUIVALENTS at beginning of the year	2.4	**3'136'378**	**2'732'232**
CASH AND CASH EQUIVALENTS at end of the year	2.4, 3.1	**4'337'636**	**3'136'378**

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

Statement of Changes in Funds
at 31 December 2007

In thousands of US dollars	Notes	2007	2006
FUNDS at the beginning of the year		**2'117'257**	**1'464'394**
INCREASE IN FUNDS for the year		**440'112**	**652'863**
FUNDS at the end of the year		**2'557'369**	**2'117'257**
Attributed as follows:			
Foundation capital		50	50
Temporarily restricted funds	2.6	12'452	1'302
Unrestricted funds		2'544'867	2'115'905
		2'557'369	**2'117'257**

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 Global 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 2008.

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, and SFAS 117: "Financial Statements of Not-for-Profit Organizations" has been applied in respect of temporarily restricted contributions and funds balance.

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, except for the following assets and liabilities which are measured at fair value:

- funds held in trust as indicated in Note 2.5;
- non-current contributions receivable and promissory notes as indicated in Note 2.6; and
- non-current undisbursed grants as indicated in Note 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.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date and that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Fair Value of long-term portions of Assets and Liabilities : Valued based on the expected cash flows discounted using the rates of investment returns on funds held in trust respectively in US dollars and Euros and applied to long-term assets and liabilities denominated in those currencies. Long-term assets and liabilities are not held in any other currencies. This valuation requires the Global Fund to make estimates about expected future cash flows and discount rates, and hence they are subject to uncertainty.

2. Significant Accounting Policies (continued)

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. Financial assets and liabilities in other currencies are translated into US dollars at the year-end rate.

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 held in a pooled cash and investments portfolio established by the Trustee for all trust funds administered by the World Bank Group. 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 optimize investment returns.

The movement of fair value of funds held in trust is recognised in the Statement of Activities.

2.6 Contributions

In accordance with SFAS 116 contributions governed by a written contribution agreement are recorded as income when the agreement is signed. 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 signed 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. Promissory notes maturing and contributions 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. The movement of fair value of promissory notes and contributions receivable is recognised in the Statement of Activities. The carrying value of promissory notes and contributions receivable approximates their fair value.

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 contributions income.

In accordance with SFAS 117 contributions received whose use is limited by donor-imposed purpose or time restrictions have been classified as temporarily restricted contributions. Comparative information in the financial statements has been reclassified where needed.

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 signed.

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. The movement of fair value of undisbursed grants is recognised in the Statement of Activities. The carrying value of undisbursed grants payable approximates their fair value.

Foreign currency exchange gains and losses realized between the date of the written grant agreement and the date of the actual disbursement of cash and those unrealized at the date of the statement of financial position are recorded as part of Grants expenditure.

2.8 Impairment of financial assets

The Global Fund assesses at the date of statement of financial position whether a financial asset or group of financial assets is impaired. This assessment identified no impaired financial assets, but the following policy would apply in the event of impairment:

Assets carried at amortised cost: If there were objective evidence that an impairment loss on assets carried at amortised cost had been incurred, the amount of the loss would be measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that had not been incurred) discounted at the financial asset's original effective rate of investment return (i.e. the effective rate of investment return computed at initial recognition). The carrying amount of the asset would be reduced through use of an allowance account and the loss would be recognised in the Statement of Activities.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease could be related objectively to an event occurring after the impairment had been recognised, the previously recognised impairment loss would be reversed, to the extent that the carrying value of the asset would not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss would be recognised in the Statement of Activities.

In relation to promissory notes and contributions receivable, a provision for impairment would be made if there were objective evidence (such as the probability of insolvency or significant financial difficulties of the donor or debtor) that the Global Fund would not be able to collect all of the amounts due under the terms of the written contribution agreement or the invoice. The carrying amount of the promissory note or contribution receivable would be reduced through use of an allowance account. Impaired debts are derecognised if they were assessed as uncollectible.

2. Significant Accounting Policies (continued)

2.8 Impairment of financial assets (continued)

Available-for-sale financial investments: The Global Fund has no available-for-sale financial instruments at the reporting date.

2.9 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.

2.10 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. There are no additional obligations for employee benefits outside of the Global Fund's obligations to the WHO.

2.11 Future Changes in Accounting and Reporting

The IASB and IFRIC issued a number of new and amended standards and interpretations through February 2008 as follows, none of which will impact the Global Fund's financial statements when implemented:

- IFRS 8 *Operating Segments* issued in November 2006 for implementation on 1 January 2009.
- IAS 23 *Borrowing costs* revised in March 2007 for implementation on 1 January 2009.
- IAS 1 *Presentation of Financial Statements* revised in September 2007 for implementation on 1 January 2009.
- IFRS 2 *Share-based Payments – Vesting Conditions and Cancellations* amended in January 2008 for implementation on 1 January 2009.
- IFRS 3R *Business Combinations* revised and issued IAS 27R *Consolidated and Separate Financial Statements* in January 2008 for implementation on 1 January 2009.
- IAS 32 and IAS 1 *Puttable Financial Instruments* amended in February 2008 for implementation on 1 January 2009.
- IFRIC 12 *Service Concession Arrangements* issued in November 2006 and becomes effective for financial years beginning on or after 1 January 2008.
- IFRIC 13 *Customer Loyalty Programmes* issued in June 2007 and becomes effective for financial years beginning on or after 1 July 2008.
- IFRIC 14/IAS 19 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* issued in July 2007 and becomes effective for financial years beginning on or after 1 January 2008.

3. Details relating to the financial statements

In thousands of US dollars unless otherwise stipulated

3.1 Cash and Cash Equivalents

	2007	2006
Cash and bank balances	279	616
Funds held in trust	4'337'357	3'135'762
	4'337'636	**3'136'378**

3.2 Funds held in trust

	2007	2006
World Bank	4'301'895	3'119'244
World Health Organization	32'612	14'014
United Nations Foundation	2'850	2'504
	4'337'357	**3'135'762**

3.3 Promissory Notes

	2007	2006
Promissory notes to be encashed	463'517	400'006
Unrealized gains on foreign currency promissory notes to be encashed	32'624	19'400
	496'141	**419'406**
Maturing in 2007	-	240'568
Maturing in 2008	356'102	178'838
Maturing in 2009	140'039	-
	496'141	**419'406**

3.4 Contributions receivable

	2007	2006
Contributions receivable*	661'221	635'609
Unrealized gains on foreign currency contributions receivable	13'222	6'782
	674'443	**642'391**
Receivable within one year	270'209	283'383
Receivable after one year	404'234	359'008
	674'443	**642'391**

* Comprises amounts receivable under written contribution agreements signed on or before 31 December 2007 and 2006 respectively that had not been received at that date.

3. Details relating to the financial statements (continued)

In thousands of US dollars unless otherwise stipulated

3.5 Contributions

	2007	2006
Governments	2'816'433	1'916'808
Private sector	49'224	500'388
Temporarily restricted	47'224	12'439
	2'912'881	**2'429'635**

	2007	2006
Contributions received including encashed promissory notes	2'802'496	1'652'780
Increase in promissory notes to be encashed	76'735	350'437
Increases in contributions receivable	32'053	417'306
Contributions in kind	1'597	9'112
	2'912'881	**2'429'635**

3.6 Undisbursed grants payable

	2007	2006
Undisbursed grants payable	2'934'640	2'080'853
Unrealized losses / (gains) on foreign currency undisbursed grants payable	12'511	(5'365)
Total undisbursed grants payable	**2'947'151**	**2'075'488**
Payable within one year	2'053'863	1'684'163
Payable after one year	893'288	391'325
	2'947'151	**2'075'488**

In addition to the grant agreements entered into as outlined above, the Board has approved US$ 2.3 billion (2006: US$ 1.6 billion) of new grants which will become liabilities upon signature of the grant agreements.

3.7 Grants expenditure

	2007	2006
Grants disbursed in the year	1'724'365	1'306'969
Movement in undisbursed grants	871'664	510'455
	2'596'029	**1'817'424**

3. Details relating to the financial statements (continued)

In thousands of US dollars unless otherwise stipulated

3.8 Operating expenses

	2007	2006
Secretariat expenses		
Personnel	41'054	30'632
Trustee fee	2'250	2'400
Administrative services fee	1'971	2'090
Other professional services	15'002	12'183
Travel and meetings	10'932	8'186
Communication materials	2'570	1'223
Office rental	4'683	2'195
Office infrastructure costs	5'036	2'113
Other	871	930
	84'369	61'952
Local Fund Agent fees	32'873	23'894
	117'242	**85'846**

Included in Operating expenses above are contributions in kind attributed as follows:

	2007	2006
Contributions in kind		
Other professional services	1'422	8'921
Travel and meetings	34	191
Communication materials	141	-
	1'597	**9'112**

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 2007 there were 337 personnel assigned to the Global Fund (2006: 251). Of these, 228 (2006: 155) are assigned under fixed-term contracts, typically of two years duration. All other personnel are assigned under contracts of shorter duration.

3.10 Remuneration of key management

Key management, in common with all personnel assigned to the Global Fund, are remunerated according to the WHO salary scale. Remuneration consists of salary, allowances and employer contributions towards pension and benefit schemes. Remuneration of key management, comprising the Executive Director, the Deputy-Executive Director, heads of the Global Fund's six business units, and the Inspector General, amounted to US$ 2.1 million in 2007 (2006: US$ 1.9 million).

The Global Fund does not remunerate its Board members.

3.11 Taxation

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

3. Details relating to the financial statements (continued)

In thousands of US dollars unless otherwise stipulated

3.12 Lease Commitments

At 31 December 2007, the Global Fund has the following outstanding operating lease commitments:

Year	Office space	Office equipment	Vehicle
2008	6'321	68	8
2009	6'321	68	7
2010	6'321	68	-
2011	6'321	68	-
2012	6'321	68	-
Beyond 2012	527	5	-
	32'132	**345**	**15**

4. Financial Instruments

The Global Fund employs the following risk management policies to financial instruments:

Market risk: The risk that the value of a financial instrument will fluctuate as a result of changes in market prices, in interest rates or in currency rates 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.

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.

Currency risk: The risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Global Fund hedges its exposure to currency risk by matching grant liabilities in Euros with assets in the same currency to the extent possible.

Credit risk: 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 promissory notes and contributions receivable, management believes these will be collected as they result from mutually signed contribution agreements primarily with governments.

As described in Note 2.5, those funds held in trust by the World Bank, acting as Trustee for the Global Fund, are held together with other trust fund assets administered by the World Bank in a pooled cash and investments portfolio ("the Pool"). The Pool is actively managed and invested in accordance with the investment strategy established by the Trustee for all trust funds administered by the World Bank Group. The objectives of the investment strategy are foremost to maintain adequate liquidity to meet foreseeable cash flow needs and preserve capital and then to optimize investment returns. The Pool is exposed to market, credit and liquidity risks. Promissory notes and contributions receivable are exposed to credit, currency and liquidity risks. There has been no significant change during the financial year or since to the types of financial risks faced by the Trust Fund or the Trustee's approach to the management of those risks. The exposure and the risk management policies employed by the Trustee to manage these risks are:

Market risk: The risk that the value of a financial instrument will fluctuate as a result of changes in market prices, in interest rates or in currency rates. The Trust Fund is exposed to market risk primarily related to foreign exchange rates and interest rates. The Trustee actively manages the Pool so that the probability of incurring negative returns is no more than 1% over the applicable investment horizon. The asset allocation of the Pool is managed so as to optimize the Pool's total returns within the specified risk tolerance.

4. Financial Instruments (continued)

Interest rate risk: The Trustee uses a value at risk (VAR) computation to estimate the potential loss in the fair value of the Pool's financial instruments with respect to unfavourable movements in interest rate and credit spreads. The VAR is measured using a parametric/ analytical approach. It assumes that the movements in the market risk factors are normally distributed. In constructing the covariance matrix of market risk factors, a time decay factor is applied to weekly market data for the past three years. This approach takes into account three years' historical market observations while giving more weight to recent market volatility. The absolute VAR of the Trust Fund's share in the Pool over a twelve month horizon at a 95% confidence level is estimated to be $107.3 million or 249 basis points (2006: $59.3 million or 190 basis points). The computation does not purport to represent actual losses in fair value of the Trust Fund's share in the Pool. The Trustee cannot predict actual future movements in such market rates and does not claim that these VAR results are indicative of future movements in such market rates or to be representative of the actual impact that future changes in market rates may have on the Trust Fund's future results or financial position.

Currency risk: The risk that the value of a financial instrument will fluctuate because of changes in currency exchange rates when there is a mismatch between assets and liabilities denominated in any one currency. In accordance with the Trustee Agreement between and/or instructions from the Global Fund, the Trustee maintains the Trust Fund's share in the Pool in U.S. dollars and Euros. Cash contributions received are converted into U.S. dollars on receipt, except when the Global Fund instructs the Trustee to hold selected cash contributions received in Euro. Commitments for administrative budgets, trustee fee and majority of the grants are denominated in U.S. dollars.

The following table details the sensitivity of the Statement of Activities to a strengthening or weakening of the major currencies in which the Trust Fund holds financial instruments. The percentage change applied to each currency is based on the average currency rate changes over each of the previous three reporting periods. The average currency rate changes are based on the beginning and ending exchange rates for each of those periods.

	2007		2006	
Currency	Change %	Amount US$ millions	Change %	Amount US$ millions
Euro	11%	(+/-) 78	11%	(+/-) 71
Pound Sterling	8%	(+/-) 19	10%	(+/-) 24

4. Financial Instruments (continued)

Credit risk: The risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Trust Fund's maximum exposure to credit risk at the reporting date is $5,507.9m (2006: $4,197.6m). The Trustee does not hold any collateral or credit enhancements except for securities pledged under repurchase agreements with other counterparties. The Trust Fund's proportionate share of the fair value of those securities is $951.0 million (2006: $786.1 million). The Trust Fund's porportinate share of collateral that the Trustee has accepted and is permitted to sell or re-pledge in the event of default is $50.6 million (2006: $144.2 million). The Trustee has not sold or re-pledged any collateral during the period. The terms and conditions associated with collateral have no significant unusual requirements from the usual practice of recourse when a default occurs.

The Trustee invests in liquid instruments such as money market deposits, government and agency obligations, and mortgage-backed securities. The Trustee is limited to investments with minimum credit ratings as follows:

- <u>Money market deposits</u>: issued or guaranteed by financial institutions whose senior debt securities are rated at least A-.
- <u>Government and agency obligations</u>: issued or unconditionally guaranteed by government agencies rated at least AA- if denominated in a currency other than the home currency of the issuer, otherwise no rating is required. Obligations issued by an agency or instrumentality of a government, a multilateral organization or any other official entity require a minimum credit rating of AA-.
- <u>Mortgage-backed securities and corporate securities</u>: minimum rating must be AAA.

At the reporting date, approximately 97% of the Trust Fund's share in the Pool is held in securities rated AAA, and approximately 3% is held in securities rated AA-.

The concentration of credit risk with respect to the Pool is limited because the Trustee has policies that limit the amount of credit exposure to any individual issuer.

Notes and Contributions Receivable result from mutually signed contribution agreements.

No financial assets are past due or impaired. Further, there was no renegotiation of terms to financial assets that would otherwise be past due or impaired.

Liquidity risk: The risk that an entity will encounter difficulty in raising liquid funds to meet its commitments as and when they fall due. As a policy, the Global Fund makes commitments for administrative budgets, trustee fees and grants only if there are sufficient underlying assets. The Trustee maintains a significant portion of the Pool in short-term money market deposits to meet disbursement requirements.

THE PRIORITIES FOR THE OFFICE OF THE INSPECTOR GENERAL

SUMMARY

1. The Sixteenth Board meeting requested the incoming Inspector General (IG) to develop a list of priorities for inclusion in the 2008 work plan of the Office of the Inspector General (OIG). These priorities should be based on key risks that the Global Fund faces. In the absence of a corporate risk profile, the Inspector General undertook a scoping study to identify such risk areas, reflected on the actions being taken by the Secretariat to manage those risks and proposed issues that need to be addressed by the IG in specific pieces of work or by management with support from the OIG.

2. Based on this, a strategy is proposed which gives a strong focus to country based work as well as work in the Secretariat. The strategy also calls for the IG to provide reasonable assurance over time on all key business processes, to add value by supporting key managerial and governance initiatives in an advisory capacity and to investigate when allegations of irregularities arise.

3. The OIG will balance the need to move ahead with a substantive work program against the imperative of building its staff and capacity. The paper also reflects on the resources required for the OIG.

4. Whilst the paper first relates priorities for inclusion in the short-term 2008 work plan it also identifies medium-term priorities in the period up to the autumn session of the Board in 2009, and considers the long-term coverage planned in the period up to 2011.

APPROACH

5. The IG took up post in mid-January 2008. He carried out a scoping study to analyse Global Fund processes and identify risks that could threaten achievement of Global Fund objectives and risks that could threaten its reputation and credibility. This involved:

- A review of internal and external studies, including work to date on the Five Year Evaluation; results of five preliminary country audits carried out by OIG; and the report on the organizational management review etc.
- Meeting Secretariat staff representing a range of operations and business support functions, to discuss (informally and on an unattributable basis) their views of risks and challenges.
- Short visits to three recipient countries namely Morocco, Nigeria and Ukraine, to meet representatives of CCMs, PRs and LFAs.
- Seeking informal input from several Board members, including some represented on the FAC.
- Obtaining input from two independent advisers with experience on oversight in international development organizations.

GLOBAL FUND ACHIEVEMENTS, CHALLENGES AND RISKS

6. The Global Fund's achievements include:

- Its growth over the past five years to its present cumulative total of 496 grant agreements signed with 136 countries worth $10.1 billion which is impressive[1]

[1] Information as at 22 February, 2008

- The international confidence placed in the Global Fund, first as an innovative concept and subsequently as it has performed with notable success as a financial instrument. The donor base is slowly starting to broaden, and the Global Fund is beginning to use its leverage to secure funds outside traditional official development assistance sources.
- The way it continuously comes up with innovative approaches e.g. RED Campaign and Debt2Health and embraces other new programs such as Affordable Medicines Facility for Malaria and Voluntary Pooled Procurement.
- The high standards of openness and transparency it has displayed since its inception.
- When problems have arisen it has acted swiftly to suspend grants.

7. However, the Global Fund's achievements have resulted in challenges and/or risks which include:

- The speed of growth and scale of operations make the Global Fund vulnerable to risks. Further growth involving disbursements rising to $6 billion annually, perhaps more, is forecast. During this period of rapid growth the Global Fund has continued to rely on often cumbersome procedures which have tended to adopt a "one size fits all" approach. Although the restructuring of the Secretariat is intended to simplify reporting lines, the management response needs to "scale up" to address this other than by increasing the number of staff.
- The organizational restructuring and/or new processes set in train by management in response to this growth present their own challenges and risks. For example, the impact of restructuring on the Global Fund's increasing human resources could be challenging, particularly since this year also sees the transition away from the Administrative Services Agreement (ASA) between the Global Fund and the WHO, with important implications for the organization: its staff, controls and processes. Its well qualified staff is a key asset of the Global Fund: effective management of the restructuring and the transition from the ASA is therefore a key challenge that carries significant risks. An important aspect of the restructuring is the current review of senior management posts, many of which are being opened to competition.
- There is an inherent risk in the countries that the Global Fund operates in i.e. countries often need to strengthen the structures, systems and processes to receive, manage, effectively utilize/absorb, procure, account for and show results for the funds they receive.
- The innovative business model followed by the Global Fund is only tested when applied e.g. reliance on LFAs. As would be expected innovative models have challenges and risks associated with them. Management's response has been to test some innovations with pilots and to commission various studies and reviews of the innovative processes involved e.g. the ongoing Five Year Evaluation and the LFA retendering exercise.
- Confusion about roles and responsibilities regarding the provision and financing of technical assistance and what depending on partners at country level means in practice emerges as a key risk in the initial findings of the Five Year Evaluation.
- The Global Fund is being pressed to consider doing even more as it becomes a more significant player in global health. There is a risk of "mission creep". Absolute clarity about the Global Fund's own role and its interaction with other global partners is crucial. The Five Year Evaluation reporting on partnerships will stimulate further thinking on the way the Global Fund interacts – or should interact – not only with partners in country, but also with other major partners such as the World Bank and other members of the UN family; and on where the Global Fund fits in to the global health debate at the intergovernmental level. Questions are also being asked about the role of the likes of the Global Fund in health system strengthening and whether the balance of resource allocation is right.

GOALS AND STRATEGY

8. The OIG's goal is to give independent and objective assurance that effective controls are in place to manage the key risks referred to above, thereby assisting the Global Fund in achieving its mission and in maintaining donor and public confidence in the operations, competence, values and integrity of the Fund. This will be secured by means of the following strategy:

(i). Reviewing all the Global Fund's main process areas (see Annex 1) in both recipient countries and the Secretariat between 2008 and 2011 to identify strengths, good practices as well as gaps and shortcomings that need to be addressed. (Current work on the Global Fund's "funding architecture" will be critical, and the OIG would expect to contribute to this, building on OIG's work in country)

(ii) Providing catalytic support to key managerial and governance initiatives in the Secretariat, recognizing that the responsibility for such initiatives rests with management.

(iii) Investigating cases of alleged irregularities in both grant programs and the Secretariat to strengthen the culture of accountability and to preserve donor and international confidence in the Global Fund.

(iv) Strengthening OIG resources and capacity, given the extreme under-resourcing at present and developing protocols to govern the work of OIG in all its interactions with the Secretariat and the Board.

9. This strategy will be implemented by applying the following priorities:

Priority 1: providing assurance on grant processes

10. In relation to point (i) of the strategy, the scoping study identified grant processes, starting with the initial capacity assessments of potential partners , to be high risk. Therefore, the OIG will review these processes by undertaking a body of work involving various "actors" in these processes i.e. the Secretariat and its main implementation partners in the countries, the CCMs, PRs, SRs, LFAs and technical partners. This assessment is based on a number of factors, for example:

- Procurement by grant recipients represents about 60% of total grant expenditure. Improper procurement procedures can lead to excessive costs, poor quality products, and potential irregularities (concern that the Global Fund's procurement oversight standards lack rigor is raised in the initial Five year Evaluation findings);
- A high volume of procurement by grant recipients leads to a high volume of inventory. Poor inventory systems and inefficiencies in the supply chain after procurement can lead to loss, damage, waste of inventory, and delays that put at risk the continuity of treatment;
- Lack of transparency in the sub-recipient selection process can lead to partners without adequate capacity being chosen, and difficulties in securing accountability;
- Proper planning, implementation and evaluation processes require adequate, reliable and accessible data and information. Shortcomings can lead to poor decision making and inaccurate public reporting.

11. The risks in grant implementation emerging would be validated and refined based on an analysis in the Secretariat of problems that have arisen in particular grants in the past and an assessment of the extent to which the risks have been addressed by the Secretariat. This would enable the OIG to plan a program of country audits. Assurance would be provided on the economy, efficiency and effectiveness of the grant processes covering the following:

- Selection of principal and sub-recipients
- Procurement and supply management
- Monitoring and evaluation of program delivery

- LFA performance
- Reliance that can be placed on grant annual audits and other audits
- Accuracy of publicly disclosed grant information
- Grant oversight by Global Fund staff

12. The OIG audit activities on grant processes and accountability mechanisms will be undertaken based on a sample of grants selected by refining a country risk analysis already drafted by OIG. In auditing a country grant program OIG will audit both well performing grants and problem cases, learning lessons from both. But at least initially OIG will select primarily risky environments to audit as these offer the greatest scope to reduce risks.

13. By the end of 2009, and with adequate resources being made available, the OIG would expect to carry out eight country audits with teams of four to five specialists in programmatic, procurement, monitoring and evaluation, and financial matters. This will start at a modest level with two audits in 2008 as the OIG function is staffed up, and accelerate to 6 audits in 2009. Procurement will be a particular area of focus. By then the IG aims to have completed recruitment of a full staff with the appropriate skills mix. The aim would be to draw on this country based work, and combine it with the outcome of work in the Secretariat, to provide reasonable assurance on all key grant implementation processes.

14. The proposed scope of this OIG work on providing assurance on grant processes and accountability mechanisms, and an outline for an approach to these, are explained in more detail in Annex 3. OIG reports consolidating the findings from a number of country audits will also contribute to the ability of both the Board and the Secretariat to benefit from lessons learned. Initiatives will also be taken to capitalize on the partnerships that are being forged between development actors to help secure better accountability by sharing audit findings and undertaking joint audits (for example, in the case of SWAPS).

Priority 2: Providing assurance on other main business processes

15. Management and governance processes (see Annex 1) in particular should be subject to systematic review so that the OIG can provide reasonable assurance that they are sound.

16. Ongoing administrative changes call for the IG to provide assurance on a timely basis, for example on the transition from the ASA with WHO, and the LFA retendering.

17. The arrangements with WHO cover only a small percentage of Global Fund business in financial terms, but the areas of business covered – particularly compensation and pensions – have a high profile among staff. Staff will need to be encouraged to fully accept the need for change, and to be convinced that they will benefit from it. Within the tight timetable for phasing out the ASA arrangements by 31 December 2008, there is still time to assess and address any associated risks.

18. The OIG will deliver to the autumn 2008 Board a “process audit” on the transition from the ASA. The objective would be to assess whether there is a reasonable level of assurance that appropriate steps are being taken to plan and manage the process.

19. The decision taken in 2007 to re-tender for LFA services provided an opportunity to reflect on the detail of the services required of LFAs. Under a timetable which has already suffered slippage, the Global Fund is committed to LFA arrangements being in place by August 2008, after completion of re-tendering and contracting. In view of the cost to the Global Fund of LFA services, and the importance of a smooth transition to arrangements under new contracts – with minimal disruption to Global Fund business as a further round of grant proposals comes on stream alongside current grants – the OIG has put in hand a review of the re-tendering exercise. This will prepare the way for a more comprehensive audit of contracting for professional and other services in the Secretariat.

Priority 3: Supporting key managerial and governance initiatives

20. The OIG expects to play a role in providing catalytic support to a number of management initiatives, all of which have linkages with the risks identified above. These are the necessary pre-conditions to establishing a strong control environment for the Global Fund and provide a foundation for future OIG work. They will enable the Global Fund to detect and manage reputational risk. It needs to be clear that the responsibility for such initiatives rests with management with OIG providing catalytic support as necessary in line with its mandate.

- Accountability

21. Lack of clarity on authority and accountability emerged as one of the major risks. Although some limited work has been done in defining authorities, an overall accountability framework is yet to be developed.

22. There is a particular need to clarify the role of the Fund Portfolio Manager (FPM). Working arrangements for FPMs have been addressed to some extent by the restructuring exercise, which proposes a team approach to grant management from the earliest stages of the grant process. The FPM, however, will remain central to Global Fund business, and the function needs sharper definition, and clear guidance on accountability. The function was not given enough attention in the management review.

23. The model for business in country raises further questions about accountability, in relation, for example, to the roles of the CCM and the LFA.

24. The development of a table of authorities and accountabilities should be a high priority for the Global Fund's management. The OIG would assist in developing this table. In the view of the IG, development of such a table needs to take place before an assurance framework can be finalized. A draft framework was developed in some preliminary work by the interim inspection function, on which the FAC asked for more work to be done (at the Sixteenth Board meeting).

- Risk management

25. Senior managers at the Global Fund agree that strategic thinking on risk is a priority, indeed it is overdue.

26. Staff assess and manage risk every day as part of their work, and risk assessment procedures are incorporated into grant management: for example, into the disbursements and Phase 2 approval procedures. A preliminary attempt has been made to establish an early warning system for particularly difficult problems associated with grant disbursement.

27. But a comprehensive approach to risk management has not been formalized and systematized. A corporate risk profile identifying the key corporate risks that the Global Fund faces has not been developed, nor has the approach to managing risk in relation to individual work processes. Development of such processes will be a major exercise, involving staff at headquarters and Global Fund partners in country.

28. The OIG will offer catalytic support to the Secretariat's efforts to develop a corporate approach to risk management and an action plan to take this forward. The OIG's country audit missions would provide material for continuous revision and updating of the corporate risk profile.

- Values and integrity

29. Unethical conduct can result in considerable reputational damage. Global organizations must deliver against extremely high standards. Everyone must conduct themselves as moral actors-responsible agents who do their work within an ethical framework. The IG has proposed that management take forward a Values and Integrity Initiative for the Global Fund to identify and define the core values that should drive behaviour and articulate an organizational culture as one committed to ethical conduct. The initiative will demonstrate that both results and principles-what we achieve and how we achieve it-truly matter.

30. The Values and Integrity Framework provides the underpinning for (i) a Code of Conduct that is unique to the Global Fund; (ii) education and training for all stakeholders to help them recognize, appreciate and resolve ethical dilemmas; (iii) a commitment entered into by suppliers used by grant recipients that they will follow ethical principles; (iv) whistleblower arrangements (including whistleblower protection) for reporting possible irregular or unethical conduct; (v) an investigation and sanction process that has due regard to human rights and due process; and (vi) a confidential advisory resource for management and staff. Under the oversight of the Ethics Committee, with input from the Finance and Audit Committee, OIG suggest that management should launch the Values and Integrity Initiative in 2008. Such an initiative would bring the Global Fund into line with similar ones in other international organizations.

Priority 4: Strengthening the Office of the Inspector General

31. Reinforcing the OIG function is a priority. The long term work plan for the OIG entails building a stable function for the future, with an increased number of permanent professional staff. This will take time: the IG aims for a fully staffed function by the end of 2009. In order to make progress with priority work, and to put in hand a planned extensive programme of country and Secretariat based audit work, the OIG will need to contract temporary staff and interim professional services.

32. The strategy for the OIG entails:

- recruiting permanent staff to provide a core capacity and continuity, while identifying temporary staff and specialised professional services to be contracted to support the OIG, both ad interim while the OIG is building to strength, and in the medium term to supplement OIG skills in areas where specialist knowledge is needed;
- developing protocols to govern the work of OIG in all its interactions with the Secretariat and the Board;
- developing and seeking agreement by both Board and management on a reporting strategy that will encourage early implementation of IG recommendations, and also meet the disclosure policy approved by the Board.

33. The charter and terms of reference for the OIG, approved by the Sixteenth Board meeting, emphasize its independence, and its reporting relationship with the Board (through the FAC). The OIG notes the potential interest of other key Board committees, and would welcome discussion with the Board on how to take account of this, without adding to the Board's workload or obscuring reporting lines. The IG might copy his reports to the chairs of other committees, and invite them to communicate any views to the FAC.

34. The planned structure of the OIG would involve two main units each led at a senior level. The first unit will be responsible for developing and implementing the program of country audits in the field, headquarters audits and studies, and developing tools and protocols governing audit work (including, for example, a protocol to track the implementation of OIG recommendations) and carrying out special studies and assistance to the Secretariat in developing, for example, accountability and assurance frameworks. The second unit will be responsible for investigations, promoting corporate values and integrity, and maintaining the hotline. Both units would have permanent posts and be multi-disciplinary, supported by specialized consultants when needed. The staff level is expected to be 13 by the end of 2008 (11 professionals and two support), but it is too soon to determine whether this is adequate to provide the required core staffing for the OIG.

Budget and Staff

35. Using this approach and the assumptions about the staff and organization of the Office, the IG proposes to carry out 18 separate audits, studies and supporting assignments before the end of 2009. They are listed in Annex 2. Ten of these projects are based at headquarters and 8 in the field, with the country audits representing about 60% of the total staff effort and a higher share of the budget because of travel and support costs in the field. An important feature of headquarters based work will be providing assurance on the management of country level risk.

36. The resources required for 2008 is expected to be contained within the budget allocated of $3.1 million. However, the IG has only been able to do so because it will realistically take until July to significantly increase the size of the core OIG team through recruitment. For 2009, the IG has identified the need for a budget of close to $5 million based on a core staffing of 13 but as noted above it is too soon to tell whether this is adequate. The aim is to have full core staffing in OIG by the end of 2009 and the budget and staffing will need to be reviewed again in autumn 2008. Moreover, the budget contains only a limited provision for investigations which are by nature unplanned. If further investigations arise in 2008, there will be a need for supplementary resources.

Annex 1 - Main Processes & Activities of the Global Fund

Main Processes	**Component Activities**
Management and Governance Processes	Supporting the Board & Board Committees
	Evaluating the Fund's Impact and Performance
	Managing the Secretariat
	Maintaining an appropriate organizational structure with defined authorities and accountabilities
	Governance Reporting & Strategic Information
	Developing Organizational Strategy, Policy, Plans
	Managing External Relations
	Establishing & Monitoring a Risk Management Framework
	Promoting Ethical Standards & Conduct, Encouraging & Protecting Whistleblowers, Reducing Risk of Fraud.
	Planning for Business Continuity/Disaster Recovery
Resource Mobilization Processes	Mobilizing resources
	Fostering Appropriate Global Partnerships, Private Sector Partnerships & Co-investments
	Tracking pledges & contributions
	Resource needs forecasting
	Replenishment
Grant Approval Processes	Proposal process
	Negotiating & processing grants
	Negotiating & processing grant renewals
Grant Delivery Processes	Managing Grant Disbursements
	Managing Relationships with CCMs, LFAs, PRs, SRs,
	Monitoring Procurement
	Leveraging Technical Assistance
	Developing Monitoring Tools
Legal, Financial, HR & Administrative Processes	Regulatory Reporting/compliance
	Litigation
	Managing the Contracting Process

	Knowledge Management
	Performance Evaluation Recruitment Learning & Development Leadership Development Compensation
	IS strategy, operations, security
	Public & Internal Communications
	Operational planning/budgeting, Managing Expenditures, Accounting and financial reporting
	Providing office facilities
	Managing Structural projects – ASA & GSM transition
	Responding to OIG matters
	Regional & other in-country meetings
	Global health initiatives e.g. health system strengthening

Annex 2: Priorities for the Office of the Inspector General and the Subject and Timing of Work on each before the end of 2009

1. Developing a body of country work to provide reasonable assurance on grant processes
   - Overview risk analysis study at HQ-learning lessons from past problem cases (Quarters 1 & 2, 2008)
   - 8 country audits of main risk areas: procurement, data systems and quality, responsibilities of FPM, CCM, PR, SRs, LFAs. (ongoing from Quarter 2, 2008)
   - Any necessary investigations. (ongoing from Quarter 1, 2008)
2. Beginning and expanding audit coverage of the main managerial processes in the Secretariat, to provide reasonable assurance on each of them to the Board by 2011.
   - LFA retendering (leads into contracting processes) (Quarter 2, 2008)
   - ASA transition from WHO (leads into HR and Financial processes) (Quarters 2 & 3, 2008)
3. Supporting key managerial and governance initiatives in the Secretariat, to provide useful tools for management.
   - Accountability framework (ongoing from Quarter 2, 2008)
   - Risk management framework (ongoing from Quarter 1, 2008)
   - Values and Integrity Initiative (ongoing from Quarter 1, 2008)
4. Developing appropriate capacity and operating protocols for the OIG to enable it to provide reasonable assurance to the Board.
   - Organization structure (Quarter 1, 2008)
   - Staffing & training (ongoing from Quarter 1, 2008)
   - Work and reporting protocols (Quarter 2, 2008)

DEVELOPMENT OF A BUDGET FRAMEWORK
(GF/FAC10/06, revised)

Outline: This paper responds to the requests of the FAC and the Board for the development of a Budget Framework to guide the formulation of annual budgets for Operating Expenses of the Global Fund. It outlines the matters to be considered in developing such a framework, and proposes a Budget Framework.

Part 1: Current budgetary context

1 The Global Fund will continue to in the years through 2011 and beyond. This growth will be driven by increasing grant volumes, evolution of grant management needs and additional mechanisms for channeling finance to fight the three diseases. The Fund will also play an expanding role in the global health architecture, necessitating involvement in matters beyond the core grant-making orientation of the Fund.

2 It is the Fund's grant recipients that chiefly determine the success of its grant investments. However, the selection, management, oversight, renewal and nurturing of those investments are also crucial factors in this success. In setting a budgetary framework for the Global Fund, the challenge is in determining what level of investment in these operating activities is right in order to optimize the impact of the Fund's grant investments.

3 In a more mature business model with predictable activity trends and stable processes that are no longer subject to significant change, it could make sense to link current workload measurements to future staffing needs. However, as noted in the Organizational and Management Review[2], "*the Global Fund is at a critical inflection point in its trajectory, an inflection point of exponential financial growth that will be amplified by several major modifications to the nature and balance of its operations*". The danger, in such circumstances, of attempting to link current workload measurements to future staffing needs was emphasised by a former World Bank Head of HR. He cautioned that *"while workload measurements can be reasonably reliable for routine and predictable tasks, they are notoriously unreliable in complex settings with complex tasks";* this is the situation for the Global Fund.

4 Many factors will affect the Global Fund's future staffing needs. Foremost amongst those factors currently anticipated, and their likely impact on staffing needs, are:

Factor	*Impact on staffing needs*
Major scale-up of financing activity	Increase (volume)
Dual-track financing	Increase (volume)
Grant consolidation	Decrease (volume) & Increase (complexity)
Rolling-Continuation Channel	Increase (complexity)
Funding of national health strategies	Increase (complexity)
AMFm	Increase (volume & complexity)
Simplification of grant architecture	Decrease (complexity), after initial increase
Role in the global health architecture and aid effectiveness	Increase (activity scope)
Increased emphasis on partnerships	Increase (complexity), prior to potential decrease
Streamlining processes	Decrease (efficiency)
Discontinuation of ASA	Increase initially

[2] Organizational & Management Review of the Global Fund, Booz Allen Hamilton, December 2007

5 The Organizational & Management Review makes it clear that the Global Fund is not a steady state organization. Because the organization is experiencing not just steep financial growth, but also embarking into new areas and evolving processes, the staffing needs over the next five years have a high degree of unpredictability, both quantitatively and qualitatively.

6 The factors that drive staffing needs also drive almost all the other elements of operating expenses, such as the office space, utilities and infrastructure that support staff, and the in-country oversight services of LFAs.

Part 2: Approach to budget sizing

1 Because of the dangers inherent in attempting to link current workload measurements to future staffing needs in the near-term context of the Global Fund (as outlined above), the Organizational & Management (O&M) Review instead gave indications of future staffing needs relative to a high-level measure of activity, annual grant commitments.

2 That methodology provides a useful indication of overall workforce trends, on the premise that the right level of effort required of the Global Fund to responsibly manage its grant portfolio bears a relationship to the financial value of the portfolio. An extension of that approach would set the level of operating expenditure as a percentage of grant expenditure, since the factors that drive staffing needs in the Global Fund context also drive most of the other operating costs.

3 It is also clear that given the high degree of unpredictability of the factors that will determine the nature and extent of Secretariat effort in the near-term, any formulaic approach to rigidly defining staff numbers would not serve the Global Fund well. The skills mix, as well as the number of staff will require attention, as flagged in the O&M Review: *"… in addition to financial growth, its staff will need to meet the challenges of continuous change and accommodate high levels of ambiguity*".

4 The O&M Review cautioned that even if the most optimistic efficiency gains were achieved, "… *increases in staff size may be essential not only to cope with growth in financial size, but also to ensure the Fund is able to manage its risk and ensure good stewardship of funds*".

5 Hence in the near-term context of the Global Fund, a useful approach to judging the 'right' budget size could be to set a limit -- **as a percentage of total annual expenditure** -- within which the proposed budget for operating expenses should normally fit. Within that budget limit, the reasonableness of staff numbers could be assessed relative to grant expenditure (e.g. the number of FTE per $ billion), recognising this as an indicative, rather than definitive, number. These two metrics could define the limits for a '***normally acceptable budget size***' and act as KPIs for budgetary performance.

6 This approach could simplify, but not obviate the need for a 'bottom-up' construction of the budget, whereby management estimates at Unit level the resources it needs for the year ahead, based on (imperfect) predictions of grant volumes and complexity, and other tasks to be undertaken by the Secretariat. The approach would provide a framework for assessing at a macro level the appropriateness of the budget size suggested by the bottom-up estimation.

7 Importantly, as recommended by both the TERG (Five-Year Evaluation) [3] and the Organizational & Management Review[4], such an approach could provide the Executive Director

[3] TERG (Five-Year Evaluation), p.15: "Based on the projections for growth of the Global Fund, the Board should set new budgetary ceilings for the Secretariat and allow the Executive Director to staff within those ceilings according to a well-defined workforce plan."

[4] Organizational & Management Review, p.17: "Given unpredictability as to which new initiatives the Global Fund will implement and the level of involvement in each one, the Fund will also need to be far more agile, flexible and efficient in aligning staffing to program needs. Rather than having to approach the Board to justify individual positions or annual shifts, the Executive Director should be given the authority to function with such agility and to staff the organization quickly as needs are clarified and the requirements for specific challenges become better known."

with the flexibility to quickly respond to needs as unpredictable requirements become better known, after the budget had been approved.

Part 3: Proposed Budget Framework

1. For each of the key stages in the budget cycle, the current process and the modifications proposed to form a budget framework for the future are outlined below. The key stages are:

(a) Budget formulation process and its review by FAC to inform Board approval
(b) Budgetary adjustments during the year
(c) Monitoring of outcomes by the FAC

(a) *Budget Formulation and Review for Board approval* *(in preceding year)*

Current	**Proposed**
Formulation of annual workplan and budget • The Secretariat prepares detailed workplans and budgets at team and sub-team level, specifying individual staff positions and individual events/activities that require resources. These are then consolidated into an organization-wide budget. • The process involves many staff throughout the Secretariat over a four-month period each year. Much of the detailed input is required to facilitate response to FAC queries and is not used further once the budget has been approved. • The factors taken into account when the budget is being compiled in May-August may differ significantly from what will actually be required of the Secretariat in the following year.	• The Secretariat prepares a brief workplan and budget for each Cluster, focused on the major activities foreseen for the organization in the coming year. • The workplan identifies and explains major shifts in anticipated resource needs from year-to-year. It does not focus on individual staff positions, but highlights strategic aspects and options in a simplified manner that better enables consideration of the 'big issues'. • If the proposed budget is greater than the '*normally acceptable budget size*' (see Part 2) further justification and review is required. • In addition to the budget proposed for the coming year, indicative budgetary estimates are provided for the following two years.

Review by the FAC to inform Board approval • Detailed workplan and budget data is initially shared with FAC. • Further analysis is undertaken to respond to high-level and detailed queries from FAC member delegations (ranging from assumptions underlying new activities to position lists and grades).	• Review focuses on major shifts in activities and their budgetary consequences. • Information provided to FAC outlines with regard to each Cluster its strategic role, factors impacting its resource needs, comparison of budget and staffing with prior year and explanations of major changes (similar to 2008 Budget information per GF/B16/8 Attachment 2). • Additional attention is triggered if the proposed budget total is outside the parameters set for the *normally acceptable budget size*.

(b) Budgetary adjustments during the year

Current	Proposed
• The annual budget contains a contingency ($1 million) to cater for unforeseen needs that may arise in the course of the year, subsequent to approval of the budget. It also sets an efficiency target ($3 million), intended to encourage cost saving during the year. However, the efficiency target exceeds the contingency, leaving no net provision for unforeseen eventualities. • Adjustment is made to the budget for decisions taken by the Board in the course of the year with budgetary implications which were not anticipated in the annual budget (as approved in the previous year). Such decisions may also arise through committee processes in parallel with those of FAC in the lead-up to the Board meeting that approves the annual budget, causing late additions to the budget considered by FAC.	• When approving the annual budget, a more substantial net contingency of **10%** of the budget will be added. This will better enable the Secretariat to both absorb the cost of unforeseen needs, and cater for the budgetary implications of new Board decisions without having to go back to the Board for approval on a piecemeal basis. • Only in exceptional circumstances (e.g. approval by the Board of a major new initiative) will it be necessary to consider an increase beyond the originally approved budget. [This approach is consistent with the recommendations of the TERG and the O&M Review for providing appropriate budgetary flexibility to the Executive Director.]

(c) Monitoring of outcomes by the FAC

Current	Proposed
• The FAC reviews budgetary performance, in terms of expenditure on operating expenses and the achievement of the set of Board-approved KPIs for the Secretariat, each half-year.	• As currently, with an enhanced set of KPIs for the Secretariat (as recommended by the PSC for Board approval).

(d) Other elements of the Framework

Current	Proposed
‘Ring-fencing’ of certain budgets • The portions of the overall approved budget that relate to the functions listed below are specific to those functions individually and cannot be used to supplement the budget of other functions without the approval of the FAC: (a) In-country Oversight (b) Office of the Inspector General (c) Funding of CCMs	• As currently, with the possibility for the Executive Director to supplement the ‘ring-fenced’ budgets by drawing on the (enhanced) contingency.
Carry-over of unused budget at year-end • No carry-over is provided for. Where it is foreseen at the time of budget compilation (i.e. mid-year) that an activity will be postponed to the following year, then this can be taken into account in the budget proposed for that year. However, if the postponement becomes apparent later in the year, such that it is not included in the budget for the following year, there is no mechanism for adjusting that budget post approval.	• Unused budget for specific activities which were postponed to the following year may be added to the approved budget for that following year, subject to the approval of the FAC. • The aggregate amount of such transfers shall not exceed the overall amount of unused budget for the prior year (as ‘ring-fenced’ where applicable) and shall not increase the budget for the subsequent year beyond the *normally acceptable budget size.*

Part 4: The *‘Normally Acceptable Budget Size’*

1. As outlined in Part 2, in the near-term context of the Global Fund, a useful approach to judging the ‘right’ budget size could be to set a limit -- as a percentage of total annual expenditure -- within which the proposed budget for operating expenses should normally fit. Within that budget limit, the reasonableness of staff numbers could be assessed relative to grant expenditure (e.g. the number of FTE per $ billion), while recognising this to be an indicative, rather than definitive, number. These two metrics could collectively define the limits for a *‘normally acceptable budget size*’.

Metric 1: Operating Expenses as percentage of Total Expenditure

2. Over the past three years, Operating Expenses have, on average, represented 4% of total annual expenditure; in 2008 this will increase to 6%. The growth in the ratio in 2008 reflects a budget increase that begins to address previous under-capacity and build a more scalable organizational structure for the activity growth expected through 2010 and beyond.

3. Operating expense ratios of the other organizations listed in Table 1 range from 6% to 15% (excluding outliers). At 6%, the Global Fund operating expense ratio for 2008 would be at the bottom of its peer group. A ratio less than 6% would suggest that the Global Fund is either more efficient or is taking more risk than any of its peers, unless their businesses are sufficiently different from that of the Global Fund to explain such a divergence.

4. It is proposed that for the purpose of indicating *normally acceptable budget size*, an operating expense ratio in excess of 6% should be used for the Global Fund. This is because in a period of

continuing growth, resources should be scaled-up before, rather than after, the growth occurs if effectiveness and risk are to be managed properly. Hence **a ratio of 6% is proposed**, which should be kept under review as growth stabilizes. This could replace the corresponding KPI which is currently set at 10%.

Table 1: Operating Expense Ratios

			A	B	C (=A+B)	B/C
Organization	Year		Grant/ Program Expenditure	Operating Expenses	Total Expenditure	**Operating / Total Expend.**
<u>> US$ 1 billion</u>						
USAID	2007	USD m	7,159	621	7,780	8%
Gates Foundation	2006	USD m	2,964	182	3,146	6%
Global Fund	2007	USD m	2,681	115	2,796	**4%**
<u>< US$ 1 billion</u>						
Ford Foundation	2007	USD m	685	118	803	15%
Kellogg Foundation	2007	USD m	384	48	432	11%
RW Johnson Foundation	2006	USD m	334	88	422	21%
McArthur Foundation	2006	USD m	207	28	235	12%
Packard Foundation	2005	USD m	175	24	199	12%

<u>Metric 2: Staffing relative to grant expenditure</u>

5. Global Fund annual grant commitments averaged $8.8 million per employee over the past three years (equivalent to 114 staff per $ billion committed). Other organisations listed in the Organizational & Management Review had grant commitments (or expenditure) ranging from $0.52m to $3.55m per employee (per Table 2 below). At $8.8 million per employee, the current ratio for the Global Fund is more than twice that of any other organization listed. As with the operating expense ratio, this would suggest that the Global Fund is either more efficient or is taking more risk than any of its peers, unless their businesses are sufficiently different from that of the Global Fund to explain such a divergence.

6. Accordingly, for the purpose of assessing the staffing levels proposed within the Secretariat budget, it is proposed that a ratio not greater than the current level of staff relative to grant commitments ($8.8 million per FTE) be applied. This should be kept under review as efficiencies emerge following the enhancement of grant management systems, streamlining of processes and the implementation of a risk management framework, and as processes for managing new activities become stable.

7. Table 3 below provides the projection of staff numbers that was provided in the Organizational & Management Review (at Figure 7 on page 11 of the Review), based on assumptions of annual grant commitment amounts. In response to requests from FAC members, staff numbers have also been projected for a lower level of annual grant commitments as an additional scenario in Table 3. Assuming current levels of staff to grant commitments, the Table projects a staff in the range of 650 to 700 FTE by 2011, under the original and alternative scenarios, respectively.

Table 2: Grant Expenditure per Employee – other organizations *(O&M Review, p.6)*

Organization	Total Staff	Grants/Expenditure (US$m)	Funds per Staff (US$m)
Asian Development Bank	2,163	$5,300	$2.45
Bank of America	133,944	$365,447	$2.73
Citigroup	250,000	$436,447	$1.75
David and Lucille Packard Foundation	78	$224	$2.87
Department of Homeland Security (FEMA)	2,600	$1,700	$0.65
DFID	2,257	$3,310	$1.44
Ford Foundation	600	$931	$1.55
The Gates Foundation	440	$1,560	$3.55
International Fund for Agricultural Development	315	$450	$1.43
Inter-American Development Bank	1,852	$6,400	$3.45
International Financial Corporation (IFC)	3,100	$2,820	$0.91
Kellogg Foundation	205	$223	$1.09
MacArthur Foundation	171	$225	$1.32
National Science Foundation	1,350	$5,920	$4.39
The Pew Charitable Trusts	124	$147	$1.19
The Open Society Institute (SOROS Foundation)	500	$261	$0.52
Robert Wood Johnson Foundation	254	$403	$1.58
Turner Foundation	7	$10	$1.42
USAID	6,910	$8,800	$1.27
World Bank	10,000	$19,500	$1.95
Global Fund	326	$2,812	$8.63

Table 3: Workforce projection, based on grant commitments

Year	**Annual Grant Commitments ($USm)**	Lowest efficiency since inception	**Current efficiency (average 2004-7)**	Highest efficiency since inception	Highest+15% efficiency (=current +43%)	
		6.2	**8.6**	**10.7**	**12.4**	$m per FTE
		160	**116**	**93**	**81**	FTE per $bn
Per Organisational & Management Review:						
2009	4,711	755	**546**	439	381	
2010	5,290	848	**613**	493	428	
2011	6,100	978	**707**	568	494	
Lower scenario:						
2009	4,000	641	**463**	372	324	
2010	4,800	769	**556**	447	389	
2011	5,600	897	**649**	521	453	