

Thirty-Third Board Meeting

Report of the Audit and Ethics Committee

GF/B33/17

Board Information

PURPOSE: This report serves to inform the Board of the decisions taken by the Audit and Ethics Committee since the Thirty-Second Board Meeting in accordance with its Charter.

I. Introduction

1. This report covers the following:
 - a. A summary of Audit and Ethics Committee (“AEC”) reflections covering 2014 for the functions and activities for which the AEC holds oversight responsibility; and
 - b. A summary of decisions recommended to the Board by the AEC at this Thirty-Third Board Meeting, decisions taken by the committee pursuant to its delegated authority, decisions recommended to the Board for electronic decision between the Thirty-Second and the Thirty-Third Board Meetings, and an overview of key items discussed under the committee’s oversight since the last Board meeting.
2. Since the Thirty-Second Board meeting in November 2014, the AEC held one virtual meeting (part I of the 11th AEC Meeting), and assembled once in person (part II of the 11th AEC Meeting), in accordance with its Charter. Graham Joscelyne and Claude Rubinowicz serve as Chair and Vice-Chair of the committee respectively. The Chair and Vice-Chair of the Finance and Operational Performance Committee (“FOPC”) and Strategy, Investment and Impact Committee (“SIIC”) were invited to participate in both the virtual and in-person meeting, so as to facilitate committee collaboration on cross-cutting issues including financial matters and risk management.
3. The meetings took place as follows:
 - a. 11th AEC Meeting Part I: virtual meeting held via video conference on 2 March 2015.
 - b. 11th AEC Meeting Part II: in-person meeting held at the Global Fund Secretariat in Geneva on 17-18 March 2015.
4. The Committee’s agendas follow the AEC work plan, available on the *BoardEffect* platform, and are structured around the following key oversight responsibilities:
 - a. External Audit and Financial Reporting Matters
 - b. Office of the Inspector General
 - c. Risk Management
 - d. Recoveries
 - e. Ethics, including confidential ethics matters discussed in executive session
 - f. Privileges and Immunities
 - g. Sanctions Panel
5. This report is divided as follows:
 - a. AEC Reflections
 - b. Decisions recommended to the Board
 - c. Decisions taken by AEC pursuant to its delegated authority
 - d. Matters addressed by AEC as part of its oversight and advisory functions in accordance with its Charter
 - e. Decisions recommended to the Board and approved electronically between Board Meetings

II. AEC Reflections

6. The AEC hereby submits to the Board a summary of the committee’s observations and reflections, in light of oversight activities that cover 2014, but which necessarily can only be completed in early 2015.

7. Collaboration with Board and standing committee leaders. The AEC sought – and succeeded – to engage regularly with the Board and other standing committees. As a step towards improved collaboration at the committee and Coordinating Group level, the AEC leadership has appreciated the opportunity to participate as observers in meetings of the Finance and Operational Performance Committee (“FOPC”), and the Strategy, Investment and Impact Committee (“SIIC”), and, likewise, has welcomed the regular participation of the FOPC leadership at AEC meetings, and regular interaction with the leadership of the SIIC. From an AEC perspective, this interaction enriched the committee’s work. The AEC notes, however, that this greater level of collaboration increases the level of effort now required of its leadership. This reality must be taken into consideration, in particular when the Board appoints independent members to the AEC.

8. Assurance. The AEC notes that the Global Fund uses the COSO¹ Framework as its internal risk management and control model. The AEC views itself as having a duty to provide the Board with assurance as to whether the key risk and control elements in this Framework work as intended. To this end, each of the functions over which the AEC has oversight responsibility, or interacts with, feeds information that allows the AEC to obtain a view as to the Framework’s effectiveness.

9. We are pleased to inform the Board that, at its 11th meeting, the AEC reviewed comprehensive assurances from EY (the external auditor), the Office of the Inspector General, and the Ethics Official, covering 2014. The committee also reviewed representations made by the Chief Financial Officer on the state of internal controls over financial reporting. These assurances cover key aspects of the COSO Framework. The AEC looks forward to receiving the Chief Risk Officer’s annual assurance report in late-2015 to enable the committee to reflect on the effectiveness of the assurance providers under the AEC’s mandated oversight. In addition, the AEC views the Chief Risk Officer’s annual assurance report as key to enabling the Board to consider the key risks faced by the organization, the Global Fund’s risk profile and risk trends.

10. Financial Reporting. 2014 marks the first year that both Condensed Consolidated Interim Financial Statements, and Annual Consolidated Financial Statements and Statutory Financial Statements were produced. The AEC commends the Secretariat for the improved quality of the Global Fund’s financial information and reporting, as well as for succeeding to introduce more stringent reporting deadlines, in line with good practice. The effect is improved accountability for and clarity with respect to Global Fund finances. The AEC welcomes management’s plan to review the style of the presentation of its financial reporting in 2015.

11. 2014 External Audit. The AEC confirms its confidence as to the quality and credibility of the financial information that is being produced and shared with the Board. The AEC based its opinion on the following inputs:

- a. The Secretariat’s representations in relation to the quality of internal controls around financial reporting;
- b. The quality of the financial information reviewed by the committee and management responses to questions raised by the AEC;
- c. The commentary received from the external auditor on the robustness and effectiveness of the financial audit closing process, and that they are in a position to sign an unqualified audit opinion for both the 2014 Consolidated Financial Statements and 2014 Statutory Financial Statements;
- d. The AEC notes the external auditor’s reliance, for the first time, on work completed by the OIG that is useful also for external audit purposes, and considers this an improvement in the quality of the audit process;
- e. The OIG’s first Annual Opinion on Governance, Risk Management and Internal Controls; and

¹ Committee of Sponsoring Organizations of the Treadway Commission (COSO) Enterprise Risk Management Framework

- f. The FOPC's role in overseeing financial performance, the FOPC's inputs into the review of the Interim and Annual Financial Reports for 2014, and the SIIC leadership's comfort with the narrative of the Annual Financial Report.

12. Office of the Inspector General. The AEC notes with appreciation the leadership provided by Martin O'Malley (former Inspector General), Katie Hodson (Head of Investigations), and Elmar Vinh-Thomas (Audit Director). Under their leadership, OIG focused its efforts on strategic matters, including governance-related work. The OIG also brought forward, by one year, the production of its first Annual Opinion on Governance, Risk Management and Internal Controls of the Global Fund (the "Opinion"). The provision of such an Opinion sets the OIG ahead of most of its peers and provides useful insight for Management and the Board as to where best to prioritize attention. The AEC notes, with appreciation, the Executive Director's response to the Opinion and looks forward to receiving updates during the course of 2015.

13. The committee commends the OIG for externally validated conformance with the Standards and Guidelines for its internal auditing and investigations work. It notes too that all legacy investigation cases have been dealt with.

14. With regard to the staffing challenges faced in the Audit Unit, the committee recognizes that these issues are close to resolution. Furthermore, the AEC recognizes efforts to make operational improvements that will enhance OIG maturity, and expects the OIG to submit a realistic 2016 operating budget later this year. The committee appreciates the transparency afforded by the Stakeholder Engagement Model, and looks forward to a review of the model's effectiveness.

15. Finally, regarding the just-ended Inspector General transition period, the committee confirms to the Board that the transition period and interim leadership arrangements were overseen closely by the AEC Chair, and have been effective. The committee formally reiterates its appreciation for the work of Martin O'Malley and Katie Hodson as Interim Inspector General, and wishes Mouhamadou Diagne a successful tenure.

16. Ethics. The AEC continues to interact closely and effectively with the Ethics Official on ethics matters, and has observed increased activity, improved compliance and proactive follow-up in relation to the annual Declaration of Interest process.

17. The committee endorses the work of the Ethics Steering Committee, led by the AEC Vice-Chair, which guides the Ethics and Integrity Initiative. Following approval by the Board of an Ethics and Integrity Framework and endorsement of the proposal to create a dedicated ethics function for the Global Fund,² the AEC fully supports the proposals presented to the Thirty-Third Board Meeting to adopt a Code of Ethical Conduct for Governance Officials, and to approve the Terms of Reference for a dedicated Ethics Officer. The AEC looks forward to the next stage of the initiative, to engaging with the FOPC to determine the resourcing requirements for the ethics function, and to the development of a set of policies under the umbrella of the Ethics and Integrity Framework.

18. Finally, the AEC notes its view that the Ethics Official's work can provide useful input into assessment of the degree of ethics-related risk and the quality of ethics-related controls. The committee expects that the development of a holistic assessment of ethical risk to ensure that ethics-related considerations are fully embedded in Global Fund internal controls will take place in due course.

19. Risk Management. Throughout 2014, the AEC engaged regularly with the Chief Risk Officer and, jointly with the other standing committees, oversaw the development of both the Risk

² GF/B32/DP09: Ethics and Integrity First Stage Policy Proposals.

Management Policy and risk differentiation approach approved by the Board at its Thirty-Second Meeting in November 2014.³ Under the model for oversight of risk management, implemented following Board approval of the Governance Plan for Impact,⁴ the AEC continues its interaction with the Risk Management Department. Under the model for oversight of cross-cutting matters, the AEC will liaise with the FOPC and SIIC to review the semi-annual Risk Management Reports from the AEC perspective. The AEC, with its colleagues on the FOPC, SIIC and Board, expects to review how Management addresses the risks faced by the Global Fund: external and internal; from strategy through to the operational level; risk trends and Management's responses; the quality of mitigation measures; and the level of compliance. This information, together with the assurances that will be provided in the Chief Risk Officer's first annual assurance report, will help the AEC to assess how the functions under the AEC's oversight take this information into account in their work.

20. Recoveries. The committee continues to review the Recoveries Report on a semi-annual basis. The AEC looks forward to the Secretariat's implementation of the expanded scope of reporting, to also include reporting on recoverable amounts identified in the due course of grant management, beginning the period ending 31 December 2015. The AEC has requested that the OIG conduct a review of the recoveries process in due course as noted in paragraph 27 below.

21. Privileges and Immunities. The AEC acknowledges its joint role in the oversight of progress in the acquisition of privileges and immunities ("P&I") by the Global Fund as decided by the Board at its Thirty-Second Meeting⁵ and looks forward to liaising with the P&I Advisory Group in 2015. The committee acknowledges the role of AEC member Christopher Kassami in facilitating the signing of the P&I Agreement with Uganda in 2014. Finally, the committee reminds the Board that tax exemptions are granted to the Global Fund through P&I by the United States and Switzerland only, and looks forward to progress in executing and ratifying the P&I Agreement in other countries.

22. Sanctions Panel. Ahead of the 10th AEC Meeting in October 2014, the Chair of the Sanctions Panel submitted a formal and confidential report to the AEC. The committee noted to the Board at that time that the appointment of Sanctions Panel members for a two-year term may prove restrictive in terms of maintaining institutional memory and continuity, particularly in the context of the onboarding requirements for members not familiar with the Global Fund.

III. Decisions Recommended to the Board

01 Annual Financial Report 2014

23. At the 11th AEC Meeting on 17-18 March 2015, the committee undertook a thorough review of the Annual Financial Report 2014, which includes the audited 2014 Consolidated Financial Statements, and of the audited 2014 Statutory Financial Statements. Having listened to the representations of management and the external auditor, and following satisfactory responses to AEC questions by both the Secretariat and the external auditor in both open and executive session, the committee took a decision to recommend the Annual Financial Report 2014, which includes the 2014 Consolidated Financial Statements, and the 2014 Statutory Financial Statements, to the Board for approval and publication, as presented to the Board under separate cover in document GF/B33/03 – Revision 1. AEC reflections on the 2014 external audit process are outlined in paragraph 11 above.

³ GF/B32/DP11: Approval of the Risk Management Policy; GF/B32/DP12: Risk Differentiation Approach.

⁴ GF/B32/08 – Revision 2. GF/B32/DP05: Approving the Governance Plan for Impact.

⁵ GF/B32/DP06: Privileges and Immunities.

02 Appointment of the External Auditor

24. At its 11th meeting, the AEC recommended to the Board the appointment of Ernst & Young SA as external auditor for the 2015 fiscal period, as set forth in document GF/B33/23. The committee considered the need for rotation of the external auditor, noting that in Switzerland, there are no requirements to rotate audit firms, and recognizing both the value of maintaining the current external auditor's knowledge and experience with the organization and the opportunity to periodically examine proposals from a set of firms. Looking ahead to the 2016 external audit, the AEC called for the Secretariat to launch a competitive bidding process in late-2015 with a view to presenting a set of proposals to the AEC for consideration in quarter one 2016.

03 Ethics and Integrity Initiative: Second Stage Policy Proposals

25. Following the decision of the Board at its Thirty-Second Meeting, the AEC has been closely involved in the ongoing work of the Ethics and Integrity Initiative through the committee Vice-Chair, who chairs the Ethics Steering Committee. At its 11th meeting, the committee reviewed and provided input to the Code of Conduct for Governance Officials, and the terms of reference for the Ethics Officer. The AEC notes the consultation process undertaken with Board constituencies to inform the proposals. Of particular note, the terms of reference for the Ethics Officer reflect an overarching goal of fully embedding ethics and integrity into operations. The committee has paid particular attention to the clarity of distribution of responsibility between the OIG, the Executive Director and the Ethics Officer, and notes the importance of clear referral and decision-making processes on ethics matters. The AEC's recommendation to the Board is presented in document GF/B33/15.

IV. Decisions Taken by AEC Pursuant to its Delegated Authority

26. At its 11th meeting, the AEC deliberated and took one decision under its delegated authority, on the following matter.

01 Methodology for reporting on recoveries identified in the due course of grant management

27. Pursuant to Board decision GF/B32/DP04, the Secretariat presented a proposed methodology for reporting on recoveries identified in the due course of grant management, for AEC approval. The Secretariat informed the AEC that recoverable amounts identified in the due course of grant management represent comparatively minor amounts, and reassured the committee that any suspected fraud or corruption is referred to the OIG. The AEC approved the following decision point, and, in addition, called on the OIG to undertake further independent review of the recoveries process.

Decision Point GF/AEC11/DP05: Secretariat Reporting on Recoveries Identified in the Normal Course of Grant Management

- 1. In accordance with GF/B32/DP04, the AEC acknowledges the authority delegated to it by the Board to approve a methodology and format for future reporting by the Secretariat on recoverable amounts identified in the due course of grant management operations.***
- 2. Based on the recommendation of the Secretariat, the AEC approves the methodology and format proposed by the Secretariat, as set forth in GF/AEC11/10.***

V. Matters Addressed by the AEC as part of its Oversight and Advisory Functions in accordance with its Charter

28. In addition to the matters discussed in parts III, and IV of this report, at its 11th meeting, and through inter-sessional activities, the AEC deliberated and received updates from the Secretariat and the Office of the Inspector General on the following issues:

02 Office of the Inspector General Matters

29. 2014 Annual Report. The OIG presented its standing update on operational and management matters to the committee at the 11th AEC Meeting. Discussions focused on the OIG's self-evaluation and achievements against approved 2014 KPIs and work plans for the Audit and Investigations Units, the successful close-out of investigations legacy cases, staffing matters and challenges, and expenditure against the approved 2015 operating expenses budget. The committee provided input to inform the OIG's 2014 Annual Report, presented to the Board at this Thirty-Third Board Meeting, which can be referred to in document GF/B33/06.

30. Annual Opinion on Governance, Risk Management and Internal Controls. The AEC reviewed and welcomed the OIG's first Opinion, presented to the Board under separate cover (document GF/B33/07), which provides an assessment of the organization's maturity. The Opinion represented a key deliverable for the OIG and resulted from the multi-year audit plan approach approved by the AEC in 2012. Committee discussion recognized the Global Fund's noteworthy movement along the organizational maturity scale as compared to the pre-2013 situation. Moreover, the committee emphasized the importance of cost-benefit analysis in decisions around investment in controls in a resource-constrained environment. It was noted that successful and well-established organizations may choose not to aim for the highest rating on the maturity scale.

31. Stakeholder Engagement Model. In accordance with the OIG's Stakeholder Engagement Model, the AEC plays a key role in reviewing all audit and investigation reports prior to their release to the Board and publication on the OIG web site.

03 Status Update on OIG Agreed Management Actions

32. Following the commitment to the Board at the Thirty-First Board Meeting, the AEC has provided regular guidance to the OIG and the Secretariat to guide formal reporting on the status of implementation by the Secretariat of OIG agreed management actions, with the first such report submitted to the Board at its Thirty-Second Board Meeting. A report is once again submitted to the Board ahead of the Thirty-Third Meeting to this effect (GF/B33/08), presenting a status update on progress made in closing out audit and investigations agreed actions. The AEC was encouraged to learn that the progress made by the Secretariat is viewed by the OIG as being on the right trajectory.

04 Risk Management

33. The Chief Risk Officer reports to the AEC twice per year under the risk management oversight model implemented following Board approval of the Governance Plan for Impact, and submits a consolidated Risk Management Report to the AEC, FOPC and SIIC. At its 11th meeting, the AEC reviewed the first edition of the Risk Management Report with particular emphasis on the risks associated with the work of the other functions the AEC oversees. This report is submitted to the Board under separate cover (GF/B33/05).

05 Ethics

34. 2014 Annual Report. At its 11th meeting, the AEC reviewed and provided input to the Ethics Official 2014 Annual Report, submitted to the Board at this Thirty-Third Meeting (document GF/B33/14). The AEC expressed appreciation for the work of the Ethics Official and supporting Legal Officer, noting the improvements in compliance in submission of declarations of interest under the Ethics Policy, and recognizing efforts to ensure maximum compliance. The committee emphasized the importance of “tone from the top” with regard to ethics procedures.

35. Declaration of Interest Review. The AEC regularly reviews confidential ethics matters in executive session. In addition, the AEC participated in the Declaration of Interest review process for the Board Leadership nominees, and other governance official appointments upon request from the Ethics Official.

06 Recoveries

36. The AEC reviewed and endorsed the fourth Recoveries Report to the Board at its 11th Meeting. This document is submitted for Board information under separate cover (GF/B33/21). The Board may expect to receive such reports, reviewed by the AEC, twice per year, pursuant to the decision taken at the Thirty-Second Board Meeting.⁶ With effect from the financial period ending 31 December 2015, the Recoveries Reports will include reporting on recoverable amounts identified in the due course of grant management, as noted in paragraph 27 above.

09. Committee Matters

10. Declaration of Interest. At the beginning of every meeting of the AEC, members consider the Agenda and are required to state whether or not they have any conflicts of interest with their work on the AEC in general, or the Agenda specifically. When such real or perceived conflicts arise, AEC members recuse themselves for any discussion or voting on these topics.

11. Self-assessment. The AEC intends to complete an annual self-assessment in or around June 2015, covering the first year of the current membership’s term. As in the past, the committee will report to the Board Leadership on the findings of this self-assessment. The plan for the AEC self-assessment will be subject to change upon the conclusions of the ongoing work of the Transitional Governance Committee regarding the Board and committee performance assessment framework, and may be adjusted accordingly and as required. In addition, the committee routinely reviews its ways of working, performance and progress through informal self-evaluation at the end of every scheduled meeting.

VI. Decisions Recommended to the Board and Approved Electronically Between Board Meetings

12. In the period between the close of the Thirty-Second Board Meeting and the opening of the Thirty-Third Board Meeting, the AEC did not submit any recommendations to the Board for approval via electronic decision point.

This document is part of an internal deliberative process of the Global Fund and as such cannot be made public until after the Board meeting.

⁶ GF/B32/DP04: Communication on Status of Recoveries