



Investing in our future

The Global Fund

To Fight AIDS, Tuberculosis and Malaria

To: Board members

From: Michel Kazatchkine, Executive Director
John Parsons, Inspector General

Date: 6 December 2010

Re: **Joint communication on Inspector General matters**

1. Background and purpose

Following the October 2010 meeting of the Finance and Audit Committee (FAC), the Inspector General and the Executive Director of the Global Fund have initiated sincere effort towards collaboration to follow up on recent findings by the Inspector General as well as to take steps to permanently strengthen grant oversight.

Since the October 2010 FAC meeting, the Secretariat and OIG have sought new and improved ways of collaboration, and have undertaken joint action on a number of issues described in the sections below.

Importantly, the OIG and Secretariat have reached a closer understanding on a number of key points, including their respective roles and responsibilities, and particular implementation concerns. More specifically:

- The Secretariat has made it clear to the Inspector General that it fully accepts, appreciates and understands the importance of the role of the OIG, and indeed takes very seriously (and acts upon) the OIG's audit and investigation findings and recommendations. The Secretariat is committed to (i) taking immediate and decisive action when fraud or misappropriation is identified, (ii) collaborating with the OIG in achieving restitution and repayment of losses, including from PRs who have a fiduciary relationship with Sub-Recipients who commit fraud, suppliers and Sub-Recipients; (iii) intensifying joint work with the OIG to anticipate and prevent the recurrence of known patterns of fraud; (iv) assisting the OIG in identifying those responsible for instances of fraud or abuse and ensuring their held to account, including through referrals to appropriate national authorities when criminal offenses are committed; (v) sanctioning entities found to have committed fraud or abuse; and (vi) developing and applying a series of changes to improve the Global Fund's efficiency and effectiveness;
- The OIG and the Secretariat are working jointly to review higher-risk expenditure categories across the Global Fund portfolio and to systematically strengthen prevention efforts against fraud;
- The Secretariat and the Inspector General have agreed that it is important that cases of fraud, financial abuse and misappropriation are put in their proper context. Given the large number of countries, and the extreme variations in governance and management capacity across the Global Fund portfolio, the Secretariat and the OIG agree that the OIG's findings in particular cases should not be used to draw general conclusions across all grant-programs about the Global

Fund. OIG findings in particular cases should not be interpreted as calling into question the basic principles underlying the work of the Global Fund, or its general model. The Inspector General supports the actions currently being taken by the Secretariat to deal both with individual issues and to identify structural issues, addressing fraud and financial abuse, and promoting transparency and accountability. The Inspector General commends the Secretariat's commitment to seek to strengthen the Global Fund model, in collaboration with the OIG, and to work with PRs that embrace these principles;

- Many allegations of fraud and financial abuse are being made in connection with Global Fund financed programs, and the OIG's investigation caseload is heavy and increasing. Based on this increase in workload, the Secretariat agrees with the OIG's proposed budget increase for 2011; the OIG will correspondingly do what it can to limit the burden that its operations are having on the Secretariat.

The OIG stresses that fraud it is identifying is not unique to Global Fund grant programs; such problems are a challenge for any donor who supports and makes similar expenditures. The OIG and the Secretariat believe that the Global Fund, in the way it addresses risk and fraud, has the potential to be a leader amongst international organizations - presenting situations with full transparency, taking full responsibility for circumstances on the ground, and putting in place measures to adequately address fraud and financial abuse.

The Secretariat, true to its commitment to transparency, will ensure that its country pages¹ reference OIG findings for each country; references will be agreed to with the OIG and will include (i) the nature and extent of the fraud/misuse/unsupported costs identified, and (ii) the status of actions taken in response to these findings.

2. Current urgent issues

The Inspector General's communications to the FAC highlighted findings which include several significant instances of misuse of funds in Cameroon, Djibouti, Haiti, Mali, Mauritania and Zambia.

The Inspector General's findings were in particular:

a. **In Mali, Mauritania, and Djibouti**, the Inspector General has found "pervasive fraud", mostly concentrated in *training and per-diems*. The OIG looked at significant samples of these activities and found that approximately 70% of the grant expenditure that was examined in Mauritania, 39% in Mali, and 30% in Djibouti were misappropriated²;

b. **In Zambia**, material misuse has been identified in the MOH Principal Recipient (unsupported and ineligible costs of USD 4.36m and USD 2.34m respectively for overall disbursements totalling USD 280m, of which the Inspector General examined USD 112m through its audit);

¹ <http://portfolio.theglobalfund.org/>

² The Inspector General has found that in **Mauritania** 70% of funds (or USD 6.7m) were unsupported/ineligible out of a selected sample of USD 9.6m (total disbursed: USD16.5m); in **Mali**, 39% of funds (or USD 4.3m) were unsupported/ineligible out of a selected sample of USD 11m (total disbursed: USD 57.5m); in **Djibouti**, 30% of funds (or USD 5.2m) were unsupported/ineligible out of a selected sample of USD 17.4m (total disbursed: USD 18.4m).

c. In Haiti the Inspector General found that the Principal Recipient did not have adequate financial and managerial capacity, and identified USD 1.26m in ineligible expenses for overall disbursements of USD 157m, with a total amount of USD 47m examined through the IG's audit.

d. In these and some other countries (Cameroon, Cambodia) Inspector General audits have found varying levels of ineligible costs, and have also provided important findings and recommendations, which the Secretariat and the countries, need to urgently implement;

e. The Inspector General has raised key questions on the role of **Local Fund Agents** (LFAs) in detecting and reporting fraud or risks of fraud, noting that the OIG *“would reasonably have expected the LFAs to have identified many of the challenges raised in the OIG’s country audits and to have identified fraud at much earlier stages in many instances”*. The Secretariat, while pointing out that the LFA’s role has not been to conduct forensic audits and investigations, and noting that the LFA has in some cases alerted the Secretariat to suspicions of misuse of funds agrees that such responsibility is set out in the LFA Manual, and that there needs to be a strengthening of the LFAs’ capacity to look out for misuse as well as clear reference to such responsibility in all Terms of Reference for the LFAs.

The Inspector General’s findings in Djibouti, Mali, Mauritania, and Zambia are of significant concern and in these countries the Global Fund’s grant oversight procedures have not worked inasmuch as misuse of funds took place for a considerable time before it was uncovered. While the eventual discovery and actions to safeguard and recover Global Fund assets show that the Global Fund’s systems against misuse of funds do their job, the organization is taking concrete steps to rectify weaknesses in the grant oversight in these countries as well as applying the lessons learned to strengthen grant oversight in all its program countries.

The Global Fund’s Secretariat and the Office of the Inspector General have a long-standing “zero tolerance of fraud” approach, and have always taken decisive action when fraud or misappropriation is identified and prompt action to recover lost funds. In addition, the Secretariat is responding to the Inspector General’s findings of fraud and misappropriation in two ways, detailed in the following paragraphs:

- i. by intensifying joint work with the Inspector General to anticipate and strengthen prevention measures against the recurrence of known patterns of fraud; and
- ii. by developing and applying a series of improvements to the Global Fund’s operating model.

3. Secretariat’s overall Action Plan for work on high-risk situations

3.1 Immediate Measures

The Secretariat will move to **immediately suspend** two malaria grants in Mali, and to terminate a third grant.

The Secretariat will implement additional safeguards in high-risk countries. Its initial action is to add the following countries to the Additional Safeguard Policy list:

- a. Mali
- b. Mauritania (grants are already suspended)
- c. Djibouti
- d. Cote d'Ivoire
- e. Papua New Guinea

The Secretariat will immediately communicate a two-month freeze on all training activities across the Global Fund portfolio, pending introduction of adequate control measures. (Exceptions to the freeze will be allowed on a case-by-case basis.)

Based on information from the OIG, the Secretariat has identified five countries/PRs where measures to protect Global Fund drug shipments from theft will be prioritized. The measures for these countries are the following:

- a. PRs will be asked by mid-December to submit a plan to secure drug supply (the Plan could include increased security at port/warehouse level, use of procurement agents, etc.);
- b. PRs to work with CCMs and other in-country partners to propose a long-term plan to secure drugs (reception, storage, delivery, distribution, etc.) by March 2011. This plan will be verified by the LFA and approved by the Secretariat. Failure to get the plan approved could result in a suspension of procurement activities.

3.2 Longer term measures

The Secretariat will move to **suspend** further grants when it appears that the level of fraud and the weakness of systems are such that continued disbursements through existing entities would expose the Global Fund to an unacceptable risk.

The Secretariat will review its approach to suspensions and terminations to ensure that suspensions are consistent, effective and constructive, working towards a goal of re-establishing full grant activities as soon as possible once the issues in question have been adequately dealt with, i.e. a PR and Sub-recipient arrangement and grant structure have been found that can be trusted. Upon the identification of fraud or misappropriation in Global Fund programs and the imposition of a suspension by the Global Fund, reinstatement of further funding will be conditioned upon a full commitment to continued cooperation with OIG audits and investigations, and a credible commitment to repay misappropriated sums.

Theft of drugs is a pervasive problem that affects - and drains resources from - all funders of health assistance to countries. The Secretariat and the OIG will jointly invite other multilateral and bilateral agencies funding large procurements of ACTs and other drugs and implementing partners to together address the issues of drug theft through coordinated actions and safeguards.

Recent discussions between the Secretariat and the OIG have focused on the establishment of a Secretariat Action Plan to address fraud and corruption. The Plan will include, *inter alia*:

- A strategy to support national authorities' follow-up of OIG findings;
- Systematic assessment of high-risk activities as identified by the OIG, LFAs, or the Secretariat - e.g. activities involving cash transfers (see below), procurement, payroll, and other activities;

- Further strengthening of the LFAs' role as it relates to the identification of fraud and corruption;
- A number of immediate measures, tailored to specific situations, which Principal Recipients and Local Fund Agents can be asked to implement to reduce further risk of loss; and
- Development of a capacity within the Secretariat for a 'rapid response' to IG findings (this is part of the ongoing restructuring of the Country Programs Cluster).

Addressing fraud in activities involving cash transfers

Based on OIG findings in a number of countries, it has become clear that activities involving cash transfers for training events and associated costs, including per diems, travel, meal and expense payments, are in many cases posing a high risk of misuse. The Secretariat, with strong support from the OIG, is taking immediate action in relation to these high-risk activities.

Across the Global Fund portfolio:

- Principal Recipients will be asked to submit a yearly *Training Program* through the LFA for Secretariat approval, starting with all trainings for the 2011 calendar year (submission by January 15, 2011);
- The Global Fund will only accept to fund training which is included in the Training Program, accompanied by a specific plan/justification, dates, and attendance lists;
- The compliance of each training with the overall program will be reviewed by the LFA and will require CCM approval;
- The Global Fund will strengthen oversight by ensuring that attendants provide proof of identity, PRs and LFAs conduct regular and frequent spot checks of training activities, and cash transactions are avoided whenever possible;
- Training activities will have to be approved in advance, and a number of conditions (firm proof of the event, proof of an individual's attendance, and related expenses) must be met prior to honoring expense vouchers. PRs will be required to reimburse the Global Fund if these conditions are not met and/or if it cannot be demonstrated by credible proof that the expense was properly incurred;
- The Secretariat and OIG have also agreed to develop guidance to Country Teams and LFAs regarding specific 'red flags' (potential high-risk situations) to look for in assessing training programs in approved Round 10 applications (see joint training below);
- The Secretariat will draft a note to the Technical Review Panel highlighting the need for greater scrutiny of (and risks associated with) Round 11 applications containing significant investments in training.

Joint training for LFAs

Following a number of OIG reports on country-level situations, the Secretariat and OIG agree that LFAs are not sufficiently focused on the identification of fraud risks and actual fraud in Global Fund-financed programs, and may not currently have the capacity to address these risks. In response, the Secretariat in partnership with the Office of the Inspector General, is reviewing, clarifying and updating the LFA's role, guidance manual, training, and scope of work to reinforce the LFA role in providing oversight and addressing fraud and financial abuse risks. The OIG has embarked on a training module for LFAs, and the OIG's Director of Investigations & Senior Legal Advisor has presented on this topic at three recent LFA working group sessions.

Changes that have been implemented immediately in response to IG findings include, *inter alia*:

- The OIG is contributing to on-going LFA training on Global Fund requirements, including in relation to fraud. The OIG is focusing the training on best-practice approaches to fraud identification;
- The LFAs scope of work is being revised to include these duties as a priority, and LFAS will be required to support OIG investigations in a number of countries. This collaboration will help demonstrate how LFA work can be adapted to better identify fraud risks and actual fraud;
- As part of OIG-Secretariat cooperation protocols, confirmation will be made that LFAs are required to report to the OIG and Secretariat '*red flags*' related to fraud, which LFAs come across as part of their normal verification work. Some of these referrals trigger OIG investigations;
- In October 2010 the Secretariat rolled-out a new LFA tool ('Country and PR Risk Assessment') to help develop a risk-management plan for critical risks at country-level. The framework includes a specific assessment of fraud and corruption risks;
- In early 2011, the Secretariat will publish the updated LFA Manual, as a comprehensive resource for LFAs. The OIG is contributing sections on fraud and risk management.

Joint work on specific cases

Beyond the activities outlined in this communication, the Secretariat will shortly announce a number of further actions related to specific countries and activities where the organization's assets may be at risk.

The FAC has raised a point on the conditions under which "disbursements are allowed to continue when an OIG investigation takes place". More generally, the question of Secretariat/OIG relations and interactions around *programs under OIG scrutiny* may require further clarifications.

The Secretariat and the OIG both believe that no Protocol can cover the entire variety of situations that may arise; and that only open and constant communication will create an environment in which solid grant-management decision can be made in high-risk situations where there is a credible suspicion or evidence of fraud.

Several recent examples illustrate how the Secretariat and OIG's commitment to work jointly is translated into reality.

- In Papua New Guinea, repeated failures by the LFA have created a situation requiring urgent resolution. The Inspector General provided advice to the Secretariat on the situation itself, which in turn led the Secretariat, within 48 hours, to enact a number of decisions on the termination of the LFA's contract with the Global Fund, new rules for local procurement, and safeguards in relation to activities carried out by one Principal Recipient. These decisions were then checked with the Inspector General for feedback, and only implemented once both the Secretariat and the OIG were comfortable with the way forward;
- In a number of other examples, the Secretariat continues to provide the Inspector General with information on suspected fraud or misappropriation - and to work with the OIG on follow-up.

- The Secretariat understands that disclosure of information on on-going investigations can interfere with and impede the investigation, the central purpose of which is to identify losses, seek recoveries, and identify individuals responsible for the misconduct. Investigations in large grant programs often take substantial amounts of time because of the large volume of transactions, associated records, and often the lack of organization by the PRs. The Secretariat and the OIG are working together to support the needs and requirements of all parties involved in investigations, and to facilitate prompt completion of the work, while also taking into account the sensitivities and requirements of such investigations.

3. Conclusion

The Global Fund, by nature of its mandate, sometimes has to work with entities with weak programmatic and financial capacity, and to operate in environments where there may be a paucity of financial controls and lack of oversight systems. The Global Fund's risk management systems are constantly improving. Recently discovered fraud has made the Secretariat determined to redouble its efforts to improve these systems.

The Secretariat's *risk-approach* consists - in conjunction with the LFA - proactively seeking to identify and address capacity, implementation, and reporting gaps; the OIG's *risk-approach*, in addition to supporting the Secretariat's efforts, consists in focusing its attention on high-risk portfolios and implementers. The Secretariat and the OIG are committed to continue strengthening our actions in dealing with these significant challenges to ensure that the money entrusted to the Global Fund reaches its intended beneficiaries.