GF/B12/7

REPORT OF THE FINANCE AND AUDIT COMMITTEE

Outline: This report from the Finance and Audit Committee (FAC) contains its recommendations on the proposed budget for 2006 and summarizes its review of operating expenses for the first half of 2005, currency risk management and other matters.

Summary of Decision Points:

1. The Board approves the 2006 operating expense budget in the amount of US$83,200,000 as set out in Annex 1 and as recommended by the Finance and Audit Committee (FAC) and proposed by the Secretariat. The Board notes that the budget includes envisaged cost savings and requests FAC to review actual expenditure and budgetary needs after the first half of 2006 and, if necessary, make further recommendations to the Board at that time.

Part 1: Introduction

1. This report reflects the review by FAC of the proposed budget for 2006 conducted through two videoconferences and extensive email communications in October and November 2005. It also summarizes the committee's review of operating expenses for the first half of 2005 and other matters considered at its meeting in London on 7 September 2005.

Part 2: Proposed Budget 2006

2. The proposed operating expense budget for 2006, with indicative numbers for 2007 and 2008 is set out at Annex 1 and is summarized below:

US$ millions	2005	2005	2006	2007	2008
	Budget	Forecast	Proposed	Indicative	
Secretariat Expenses	44.5	44.3	63.6	71.0	74.9
LFA Services	23.4	18.8	22.1	20.4	15.9
Total Operating Expenses (before new Rounds after Round 5)	67.9	63.1	85.7	91.4	90.8
less: Efficiency/savings Target	-1.6		-2.5		
Net of Efficiency/Savings Target	66.3	63.1	**83.2**	91.4	90.8

Staff numbers:	2005	2005	2006	2007	2008
	Budget	Sep '05	Proposed		
Fixed-term (2 year contract)	150	150	198	221	226
Short-term		50	54	45	50
Total Staff (including short-term)		200	252	266	275
(Excluding Office of the Inspector General)					

Note: The indicative numbers for 2007 and 2008 are as estimated by the Secretariat and will be revised prior to discussions of future operating budgets; these numbers have not been reviewed by FAC and are provided for information only.

3. The process for the review by FAC of the proposed budget for 2006 was as follows:

a. A draft of the proposed budget (GF/FAC3/1) was prepared by the Secretariat and circulated to FAC in advance of its videoconference on 19th October 2005. The proposal represented a 43% increase over the 2005 budget.

b. Supplementary information (GF/FAC3/1.1) was provided by the Secretariat in response to queries from FAC members prior to the videoconference.

c. Oral presentations of the budget for each unit of the Secretariat were made by the unit directors at the videoconference who also responded to queries from the committee.

d. FAC requested the Secretariat to analyse the increases proposed for 2006 by priority groupings, to facilitate further consideration of the substantial increase proposed. This was provided (GF/FAC3/1.2)

e. The Secretariat responded to further queries and requests for clarification, including the presentation of scenarios to reduce the budget increase, and the Executive Director furnished a note to FAC explaining the rational for the proposed budget (GF/FAC3/1.3).

f. FAC met by videoconference on 23 November 2005 to consider the further material presented. The magnitude of the proposed budget increase remained of concern to the many members of the committee. In response to suggestions from the committee, the

Secretariat undertook to revisit the budget, having regard to potential savings and presented a revised proposal that reflected a lower increase of 25% (GF/FAC3/1.4).

g. FAC was satisfied to recommend this revised Secretariat proposal in the amount of US$83.2 million. FAC proposes to review actual expenditures after the first half of 2006 and will make further recommendations to the Board at that time, if necessary.

h. FAC noted the assurance of the Executive Director that the allocations of staff across units as proposed in the budget could be adjusted to respond to needs in the light of changing priorities. FAC stressed that priority should be given to enhancing the Operations Unit. The Secretariat acknowledged the concerns of some committee members that the overall total of fixed-term positions proposed was high and undertook to keep this under review when choosing between short-term and fixed-term appointments.

Proposed Decision Point 1

The Board approves the 2006 operating expense budget in the amount of US$83,200,000 as set out in Annex 1 and as recommended by the Finance and Audit Committee (FAC) and proposed by the Secretariat. The Board notes that the budget includes envisaged cost savings and requests FAC to review actual expenditure and budgetary needs after the first half of 2006 and, if necessary, make further recommendations to the Board at that time.

Part 3: Review of Operating Expenses 2005 (first half-year)

4 Operating expenses for the first half of 2005 are set at out at Annex 2 and were reviewed by FAC at its meeting on 7 September 2005.

5 The Secretariat advised FAC that expenditures for the first half of 2005 were 22% less than the budget allocated to the six-months and are anticipated to be within the overall budget for the whole year. Normal Secretariat expenses are expected be close to budget, while significant savings are expected on LFA fees as a result of lower than budgeted cost rates. The office move, which had been budgeted for 2006, will be an exceptional expense in 2005 of US$1.3 million to US$1.8 million. If other savings and use of the contingency are insufficient to cover this, access to part of the savings on LFA fees would be required; the Secretariat will report further to FAC later in 2005.

6 FAC noted that operating expenses for the first half of 2005 were within budget and that progress was on track towards achieving the Board-set targets on key performance indicators for 2005.

7 FAC expressed confidence in operating expenses being under control and commended the Secretariat performance to date. It noted that consent to reallocate anticipated budget savings on LFA fees may be requested by the Secretariat later in the year to cover the exceptional costs of relocating to new office premises in July 2005 (with total expenses contained within the overall budget).

8 FAC, informed by the replenishment discussions, provided guidance to the Secretariat in compiling the draft budget for 2006 (which FAC will review in October) that scenarios should be presented that assume 2 and 3 new rounds in 2006-2007 (in each case separately identifying the costs associated with new rounds). Furthermore, that staffing needs should take account of new activities such as the increased emphasis on harmonization.

Part 4: Other matters considered at FAC meeting on 7 September 2005

Soft Performance Measures

9 FAC noted that the Board had been advised of the discussions of the working group on soft performance measures through the replenishment conference report. It would be for the Board to decide on any further action in this regard, which could be mandated to the committee charged with overseeing the replenishment process.

Currency Risk Management

10 The Secretariat informed FAC that no grants in Euro had yet been signed (two Euro denominated Phase II renewals had been approved by the Board but the related grant amendments had not yet been signed). Accordingly, to date there was minimal currency risk, though some Euro grants were anticipated in Round 5.

11 FAC noted that there was insufficient experience to date on which to base further recommendations to the Board regarding currency risk management at this time (as had been requested by the Tenth Board meeting). FAC will keep the matter under review and make recommendations to the Board when experience is sufficient to do so.

Matters reported to Eleventh Board meeting

12 FAC also reviewed progress towards the appointment of the Inspector General and funding for Round 5, and reported on these matters to the Eleventh Board meeting.

Annexes:

- The 2006 budget proposed by the Secretariat and recommended by FAC is attached as Annex 1.
- The review of operating expenses for the first half of 2005 is attached as Annex 2.
- The other documents considered by FAC at the meetings covered by this report are as listed below and may be consulted on the Global Fund website in the (password protected) section for committee papers.

2nd Finance and Audit Committee Meeting, London, 7 September 2005	
Document No.	**Document Title**
GF/FAC2/01	Draft Agenda
GF/FAC2/02	Recruitment of Inspector General -- interim report of sub-group
GF/FAC2/03	2005 Operating Expenses Review
GF/FAC2/04	Update on the Transition Project
(Replenishment Report)	Soft Performance Measures
	Report of 1st FAC Meeting
	FAC Workplan
	FAC Membership List [Revised]

3rd Finance and Audit Committee Meeting, by videoconferences on 19th October and 23rd November 2005	
Document No.	**Document Title**
GF/FAC3/1	Draft Proposed Budget 2006
GF/FAC3/1.1	Draft Proposed Budget 2006 -- Supplementary Information, 10 October 2005
GF/FAC3/1.2	Analysis of budget increases from 2005 to 2006 by nature of priority
GF/FAC3/1.3	Draft Proposed Budget 2006 -- Supplementary Information, 21 November 2005
GF/FAC3/1.4	Draft Proposed Budget 2006 -- Supplementary Information, 23 November 2006

Annex 1

Proposed Operating Expense Budget 2006

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1 Memorandum from the Executive Director to the members of FAC, 18 November 2005

Dear Colleagues

I am writing to seek your support for the draft budget for the Global Fund Secretariat for 2006 that you are currently reviewing. I acknowledge that we are asking for a substantial increase on the 2005 allocations. I understand that a number of Committee Members have queried these increases and have also asked for my vision of how these increases fit with the future direction of the Global Fund.

Your concerns around the proposed increases focus on a number of areas; possible changes to the business model as a result of the strategy development currently underway, the appropriateness of significant increases in staff in a year when the Secretariat may be transitioning out of the current administrative arrangement with WHO, and how these increases line up with previous growth estimates by MEFA and the Global Fund's strong commitment to a lean and efficient Secretariat.

The work currently underway by the Policy and Strategy Committee to develop a strategy for the Global Fund will not go for final endorsement until the October 2006 Board meeting. Therefore it is very unlikely that there will be any major changes to the basic architecture and the business model of the Global Fund in 2006. On the other hand, there is a significant amount of work that urgently needs to be done to improve implementation and delivery with the current model.

I recently attended the High Level Forum on the Health MDGs in Paris which highlighted, once again, the need for the Global Fund to devote more time and effort to collaboration with partners, both at the country level and globally. Currently, staff simply do not have the time that is required to adequately advance this agenda. Some other areas that need urgent attention and action in 2006 are procurement, review of the current Phase 2 process, the role of LFAs, and what we do when grants come to an end. There is no doubt, in retrospect, that we seriously underestimated the workload involved in Phase 2 renewals and also in responding to the lessons learnt from Phase 2 about implementation issues which now need to be addressed.

In addition, since estimating the indicative 2006 budgetary needs more than a year ago, significant new tasks have been assigned to the Secretariat. These additional tasks include EARS, supporting the expanded role of TERG, continuation of the replenishment process in 2006, helping CCMs and civil society to comply with Board requirements, engagement with new financing mechanisms to strengthen our income, and launching major initiatives with the private sector.

The report of the Deputy Executive Director to the 11th Board meeting (GF/B11/14) stressed the need to commit resources to strengthening, streamlining, simplifying and documenting our internal systems, processes and procedures to ensure that we can move fast and flexibly, innovating as necessary, as the Global Fund strategy and business model evolves. This work has not been adequately pursued to date due to our justifiable focus on "raising it, spending it and proving it", and to scarce resources. But it is now starting to seriously impact on our performance as an organisation and therefore the reputation of the Global Fund. Committee Members have quite rightly queried whether just adding more staff is necessarily the right or only response when more efficient processes might in fact be a better and more appropriate response. I agree and we should not <u>just</u> add more staff. But more staff are indeed required so that we can develop and deliver more efficient and effective processes.

You have expressed concerns about committing to large increases in staff when there are a range of unknowns in the next year. Under the budget as proposed, 21% of staff will be on short term contracts in 2006, and even fixed-term posts are of short duration. In the Global Fund, no-one has a contract longer than 2 years with the result that on average, 50% of fixed-term contracts fall due for renewal each year. This gives us sufficient flexibility to adjust both the numbers and skills mix of staff in a reasonably short time frame.

The current budget request has proposed allocations of staff to individual units based on an analysis of the main areas of increased or strengthened activity. However, I regard these as notional and it is essential to retain the flexibility to respond to staff needs across the units in light of changing priorities and completed pieces of work during the year.

My clear preference, and that of my senior management team, is for FAC to support the budget as submitted by the Secretariat*. This incorporates a "savings target" on the basis that the Secretariat would, as it has previously, strive to make savings but that we would not be penalised if those prove to be impossible. I cannot stress too strongly that the current work load for staff is not sustainable. We currently have a very lean Secretariat, by any benchmark, with operating expenses only 1.4% of the grants under management. We can be more efficient and more effective, but we need an investment now to assure that this can happen. Of utmost importance is the need to avoid burn out and to retain the skills and experience that are critical to the Global Fund.

I thank all members of the FAC for your long hours of dedicated work on behalf of the Global Fund.

With best regards,

Richard

* In the amount of US$83.2 million, per the revised Secretariat proposal

2 Summary of Proposed Budget
(without provision for new rounds)

US$ millions	**2005**	**2005**	**2006**	**2007**	**2008**
	Budget	Forecast	Proposed	Indicative	
Secretariat Expenses	44.5	44.3	63.6	71.0	74.9
LFA Services	23.4	18.8	22.1	20.4	15.9
Total Operating Expenses (before new Rounds after Round 5)	67.9	63.1	85.7	91.4	90.8
less: Efficiency/savings Target	-1.6		-2.5		
Net of Efficiency/Savings Target	66.3	63.1	**83.2**	91.4	90.8

Staff numbers:	**2005**	**2005**	**2006**	**2007**	**2008**
	Budget	Sep '05	Proposed		
Fixed-term (2 year contract)	150	150	198	221	226
Short-term		50	54	45	50
Total Staff (including short-term)		200	252	266	275
(Excluding Office of the Inspector General)					

3 Analysis of increase in 2006, as compared with budget 2005

The proposed budget for 2006 represents an increase of 25% on the 2005 budget and will cater for many key needs of the Secretariat, as outlined in the Executive Director's introductory statement. These are summarised as follows:

		US $'000
1	**Budget 2005, net of efficiency target**	**66,304**
	Less: Round 5 start-up costs in 2005	(1,361)
	Add: Adjustment to reflect 2006 cost of 2005 staff	5,197
	Less: Discontinued activities	(1,956)
2	**2006 cost of 2005 services**	**68,184**
	Cost of additional/expansed services in 2006:	
3	Essential infrastructure *Additional office space (rent and fitting-out), telecommunications, IT, office supplies and services. Further development of information systems for grant management and performance tracking.*	4,675
4	Board mandated activities (related to recent and/or to individual Board decisions) *EARS, support to TERG and TERG-mandated activities, Partnership Forum, TRP renewal, support to CCMs and Civil Society to comply with Board requirements, improvements to recruitment and HR processes, etc.*	4,138
5	Grant management (catering for increased volume and complexity of activity)	
	LFA fees (net saving)	(1,297)
	Secretariat expenses *Reflects increased volume and multi-disciplinary approach (missions with broader skills) to unblock grant issues and accelerate implementation. Provides for better documenting of disbursement decisions. Provides for M&E input to new grants and Phase 2 reviews, and developing M&E frameworks with partners.*	3,963
6	Measures to support grant effectiveness *Regional, CCM and other partner meetings. Reflects cessation of external funding for regional meetings, and increased in-country workshops.*	1,438
7	Resource mobilization initiatives *Development of private sector, IIF, airline and other initiatives. Response to feedback from replenishment. Key conferences, G8, and other events where GF participation and advocacy is required.*	873
8	Measures to increase organisation-wide effectiveness *Staff training and organizational development of Secretariat, to enhance the performance of the Secretariat (as outlined in DED report to 11th Board). Legal support to Board activities, fundraising and other non-grant activities.*	1,130
9	Other key services *Office of the Inspector General (provision for full year of activities) and additional financial management capacity*	1,033
10	Sub-total before increase in savings target	84,136
	Increase in efficiency/savings target	(936)
11	**Budget, after savings target**	**83,200**

4 Staffing

4.1 Amongst the needs accommodated in the budget, is an increase on the current staff numbers from 199 to 252 (including fixed-term and short-term staff) as indicated by the table below. This reflects a strong element of consolidation, helping to key retain skills and experience by transferring some staff to fixed-term (2-year) contracts from short-term/consulting arrangements. The ‘essential infrastructure’ costs ($4.7m) are also closely related to this consolidation, by providing the office space and tools for staff to function efficiently.

	2005			**Increase** (2005 to 2006)				**2006**				**2007**	**2008**
Staff Numbers	Term per Budget '05	add: Short Term (as at Sep 05)	**Total**	Fixed Term	Short Term	**Total**	% of total	Fixed Term	Short Term	**Total**		**Indicative Total**	
Fund Portfolio Operations	77	12	89	15	10	25	47%	92	22	114	45%	125	134
Strategic Information & Evaluation	14	5	19	8	1	9	17%	22	6	28	11%	30	31
External Relations	15	12	27	9	-2	7	13%	24	10	34	13%	35	35
Executive Directors' Office	8	2	10	1		1	2%	9	2	11	4%	11	11
Deputy Executive Director	4	2	6	2	-1	1	2%	6	1	7	3%	8	8
Business Services	25	16	41	11	-4	7	13%	36	12	48	19%	48	47
Finance	7		7	2	1	3	6%	9	1	10	4%	11	11
Total	**150**	49	**199**	**48**	5	**53**	100%	**198**	54	**252**	100%	**268**	**277**
	75%	25%	100%					79%	21%	100%			
Budget			**$22m** *							**$33m**		**$38m**	**$40m**

*Some short term staff were funded from consultancy budgets

4.2 Staff numbers are proposed to increase from 199 (150 fixed-term, 49 short-term) in 2005, to 252 (198 fixed-term, 54 short-term) in 2006. This largely converts the 2005 short-term positions to fixed-term in 2006 (the consolidation aspect), and adds 53 short-term positions in 2006. The posts converted from short-term to fixed term relate to functions where it is clear that the role will continue for the foreseeable future, whereas the ‘new’ short-term posts relate to functions for which the duration of need is not yet clear.

4.3 The 2006 staff numbers retain a significant proportion (21%) of short-term staff to provide flexibility in responding to evolving needs. Short-term appointments are for a maximum duration of11 months. It is also noteworthy that the fixed-term posts are of short duration – no Global Fund staffer has a contract longer than two years, with the result that, on average, 50% of fixed-term contracts fall due for renewal each year. Accordingly, any changes in skills needs that might arise from modifications to the business model or processes whereby some fixed-term posts were no longer needed could be facilitated within a short lead-time.

4.4 A further measure to allow flexibility in catering for 2006 staffing needs would be an understanding that the proposed allocation of staff to individual units could be adjusted in response to changing priorities in the course of the year.

5 Increment for New Rounds (for information)

The budget is presented above without provision for new rounds, in accordance with Board decided practice. The costs associated with each new round will be presented for approval as and when the Board decides to launch the round. The incremental costs of new rounds, if one round was approved each year, would be as follows:

US$ millions	2006	2007	2008
	Estimate	Indicative	
Number of new rounds:	***1***	***1***	***1***
Secretariat Expenses	1.4	1.4	1.5
LFA Services	2.6	11.7	21.3
Total additional costs	**4.0**	**13.1**	**22.7**
Operating Expenses, if cost of new rounds is included	**87.2**	104.5	113.5

(The costs for LFA services in each year include the oversight of new rounds in prior years, as well as the initial assessment costs in the year of grant commencement.)

6 Revisions to original proposal

In consultation with FAC, the Secretariat revised its original proposal for 2006 to take account of potential savings, in order to arrive at a budget that both FAC and the Secretariat were content to recommend to the Board

The revisions made in arriving at the proposed budget reflect envisaged cost savings from service reductions in specific functions and a general savings target that the Secretariat will strive to achieve. FAC intends to review actual expenditure and budgetary needs after the first half of 2006 and will, if necessary, make further recommendations to the Board at that time.

7 Operating Expense Ratios

Based on the foregoing and assuming that one new round is approved each year, the resultant key ratios are:

Key Ratios	**2005**	**2006**	**2007**	**2008**
	Forecast	Proposed	Indicative	
Operating Expenses (including new Rounds) as:				
As % of Disbursements [(a)]	5.3%	4.7%	4.5%	3.8%
As % of Expenditure [(b)]	2.5%	3.0%	3.9%	3.2%
As % of Value of Active Grants [(c)]	1.4%	1.2%	1.1%	1.0%
Operating Expenses per Active Grant [(d)]	$210k	$228k	$221k	$222k

(a) Grant disbursements in the year

(b) New grant commitments (on signing agreements) plus Operating Expenses

(c) Cumulative funds committed to active grants ('funds under management')

(d) Grants (with signed agreements) that have not yet reached completion

The above ratios are based on the following projected grant activity volumes:

Grant Activity Volumes (projected)	**2005**	**2006**	**2007**	**2008**
	Forecast	Proposed	Indicative	
Number of new Rounds approved	1	1	1	1
Number of New Grants signed	86	111	119	130
(d) Number of Active Grants (average)	301	382	473	512
	$m	$m	$m	$m
(a) Value of grant Disbursements in year	1,188	1,850	2,345	2,959
(b) Value of (new) grant Commitments in year	2,471	2,832	2,594	3,382
Operating Expenses (including new rounds)	63	87	105	113
Value of total Expenditure in year	2,534	2,919	2,699	3,495
(c) Value of Active Grants - Commitments	4,363	7,067	9,451	11,060
Value of Active Grants - Disbursements	1,970	3,692	5,827	7,012

8 Changes from 2005 to 2006

Budget 2005		Budget 2005 (US$'000)						
Before new Rounds		TOTAL	Staff	Professional Fees	Travel	Meetings	Office Infrastructure	Communications Materials
Operations	23%	15,419	10,548	1,670	2,314	230	-	656
Strategic Information & Evaluation	6%	3,971	1,724	1,473	378	170	65	160
External Relations	12%	8,166	3,027	970	2,192	966	30	981
Executive Director's Office	2%	1,503	1,046	90	287	70	-	10
Deputy Executive Director	2%	1,018	756	175	58	30	-	-
Business Services	14%	9,595	3,821	1,511	178	8	4,068	10
Finance	5%	3,365	964	2,375	11	-	15	-
Office of the Inspector General	0%	290	137	60	35	-	58	-
Office of the Chair of the Board	0%	191	-	109	32	-	50	-
Sub-total, before Contingency	66%	43,518	22,024	8,434	5,484	1,474	4,285	1,817
Contingency	2%	1,000	33%	13%	8%	2%	6%	3%
Total Secretariat Expenses	67%	**44,518**						
LFA Services	35%	**23,350**						
Efficiency Target	-2%	(1,564)						
Total Operating Expenses	100%	**66,304**	**$66.3m**					

Budget 2006		Budget 2006 (US$'000)						
Before new Rounds		TOTAL	Staff	Professional Fees	Travel	Meetings	Office Infrastructure	Communications Materials
Operations	25%	21,184	14,517	1,728	3,557	1,019	-	363
Strategic Information & Evaluation	6%	5,146	3,507	933	313	270	34	89
External Relations	12%	10,038	4,336	984	2,237	1,492	38	951
Executive Director's Office	3%	2,257	1,543	178	389	118	15	15
Deputy Executive Director	2%	1,692	999	545	99	33	3	13
Business Services	21%	17,394	5,911	3,221	556	80	7,617	10
Finance	5%	3,945	1,317	2,590	11	3	25	-
Office of the Inspector General	1%	797	462	125	150	-	60	-
Office of the Chair of the Board	0%	193	-	109	52	-	32	-
Sub-total, before Contingency	75%	62,647	32,592	10,412	7,363	3,015	7,824	1,441
Contingency	1%	1,000	39%	13%	9%	4%	9%	2%
Total Secretariat Expenses	76%	**63,647**						
LFA Services	27%	**22,053**						
Efficiency Target	-3%	(2,500)						
Total Operating Expenses	100%	**83,200**	**$83.2m**					

Changes from 2005 to 2006		Changes from Budget 2005 to 2006 (US$'000)						
Before new Rounds		TOTAL	Staff	Professional Fees	Travel	Meetings	Office Infrastructure	Communications Materials
Operations	37%	5,765	3,969	57	1,243	789	-	(293)
Strategic Information & Evaluation	30%	1,176	1,783	(540)	(65)	100	(31)	(71)
External Relations	23%	1,872	1,309	14	45	526	8	(30)
Executive Director's Office	50%	755	497	88	101	48	15	5
Deputy Executive Director	66%	674	243	370	42	3	3	13
Business Services	81%	7,798	2,090	1,710	378	72	3,549	-
Finance	17%	580	352	215	-	3	10	-
Office of the Inspector General	175%	507	325	65	115	-	2	-
Office of the Chair of the Board	1%	2	-	-	20	-	(18)	-
Sub-total, before Contingency	44%	19,129	10,568	1,979	1,879	1,541	3,539	(376)
Contingency	0%	-	48%	23%	34%	105%	83%	-21%
Total Secretariat Expenses	43%	**19,129**						
LFA Services	-6%	**(1,297)**						
Efficiency Target		(936)						
Total Operating Expenses	25%	**16,896**	**$16.9m**					

Note: The percentages on this table represent the percentage change over the 2005 budget.

9 LFA Fees

Budget 2006: **LFA Fees**		2005 Budget	2006	2007	2008
	Total	**$23.4m**	**$22.1m**	**$20.4m**	**$15.9m**
	New Rounds approved (assumed)	**1**	**0**	**0**	**0**
	Activity Volumes				
A	Phase 1 grant agreements signed		71	0	0
B	Phase 2 renewals reviewed		126	82	47
	Active grants (at year end)		361	334	213
C	(Av.) No.of Active grants throughout year	334	371	347	256
	LFA Fees for Assessments				
	Unit cost (average per grant)		$53,000	$53,000	$53,000
A	No. of grant assessments		71	0	0
	Total cost of Assessments	$3,009,333	$3,763,000	$0	$0
	LFA Fees for Monitoring				
	Unit cost (per grant-year)		$42,900	$42,900	$42,900
C	(Av.) No.of Active grants throughout year		371	347	256
	Cost	$16,701,087	$15,915,900	$14,878,080	$10,981,850
	LFA Fees for Phase 2 Renewal Reviews				
	Unit cost (per renewal review)		$30,750	$30,750	$30,750
B	Phase 2 renewals reviewed		126	82	47
	Cost	$3,640,000	$3,874,500	$2,534,092	$1,432,658
	LFA Fees for Special Reviews		$2,500,000	$3,000,000	$3,500,000
	Savings target		-$4,000,000		
	LFA Fees - Total	**$23,350,420**	**$22,053,400**	**$20,412,173**	**$15,914,508**
	Change on prior year		-6%	-7%	-22%
	Average LFA fees per active grant	$70k	$59k	$59k	$62k
			(without any new rounds)		

Finance/BG
30 Nov 2005

Annex 2

2005 OPERATING EXPENSES REVIEW – FIRST HALF-YEAR

Outline: The Finance and Audit Committee is mandated to monitor expenditure of the budget in the course of the year and report to the Board thereon after the conclusion of each half-year. This paper reviews operating expenses and performance in the first six months of 2005 and the outlook for the remainder of the year.

Part 1 provides an analysis of Operating Expenses as compared to budget with an explanation of significant variances from budget, and shows the trend in operating expense ratios.

Part 2 presents the outlook for the whole year.

Part 3 reports on progress through mid-year on the Key Performance Indicators set by the Board for 2005.

Part 1: Operating Expenses January–June 2005

Highlights

- Operating Expenses in the first six months of 2005 amounted to $25.5 million, equal to 39% of the $65.9 million budget for the whole year.
- Actual costs ($25.5 million) were 22% less than the $32.8 million budget for the six months.
- Secretariat Expenses and Local Fund Agent (LFA) Services were each less than their respective budgets (16% and 39% less, respectively).

Attachment 1 details the expenditure by each Secretariat unit, summarized as follows:

Operating Expenses	Year 2005 Budget $m	January-June 2005 (6 months) Actual $m	Budget $m	Variance $m	As % of budget	Actual Jan-Jun as % of Year's Budget
Secretariat Expenses (see below)	**44.1**	**18.4**	**21.9**	**3.4**	**16%**	**42%**
LFA Services	**23.4**	**7.1**	**11.7**	**4.6**	**39%**	**30%**
Sub-total	**67.5**	**25.5**	**33.5**	**8.0**	**24%**	**38%**
Efficiency target	(1.6)		(0.8)	(0.8)		
Total Operating Expenses	**65.9**	**25.5**	**32.8**	**7.2**	**22%**	**39%**
Secretariat expenses by function	**44.1**	**18.4**	**21.9**	**3.4**	**16%**	**42%**
Operations	15.0	7.6	7.7	0.1	1%	51%
Strategic Information & Evaluation	4.0	1.1	1.9	0.8	43%	28%
External Relations	8.2	2.5	4.0	1.5	38%	31%
Office of the Executive Director	1.5	0.7	0.8	0.1	14%	45%
Deputy E.D. / Corporate Strategy & Policy	1.0	0.4	0.5	0.1	22%	35%
Business Services	13.0	6.2	6.4	0.2	4%	48%
Office of the Chair of the Board	0.3	0.0	0.0	0.0	0%	0%
Office of the Inspector General	0.2	0.0	0.0			
Contingency	1.0	0.0	0.5	0.5		
Secretariat expenses by type	**44.1**	**18.4**	**21.9**	**3.4**	**16%**	**42%**
Staff	22.1	11.1	11.0	(0.1)	-1%	50%
Professional fees	7.7	2.2	3.8	1.6	41%	29%
Travel & meetings	6.9	2.7	3.4	0.8	22%	39%
Communications materials	1.9	0.5	1.0	0.5	49%	27%
Office expenses and infrastructure	4.2	2.0	2.1	0.1	7%	47%
Office of the Chair of the Board	0.3	0.0	0.0	0.0	0%	0%
Office of the Inspector General	0.2	0.0	0.0			0%
Contingency	1.0	0.0	0.5	0.5	100%	0%

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

Explanation of budget variances (in Jan-June 2005)

Secretariat Expenses ($3.4m less than budget):

The lower-than-budgeted spending on Secretariat Expenses resulted mainly from some activities occurring later in the year than is reflected by the portion of the annual budget attributed to the six-month period. Accordingly, this $3.4 million saving is largely temporary.

LFA Services ($4.6m less than budget):

LFA fees were less than budgeted because fewer Round 4 assessments were undertaken by LFAs in the first six months of 2005 than had been projected, thus deferring those costs to later in the year. The later-than-budgeted start of those grants will produce a saving on LFA monitoring fees for the year. Measures being implemented to optimize the use of LFA services are resulting in lower-than-budgeted LFA pricing, and these efficiency gains are also reflected in the savings.

Operating Expense Ratios

The table below presents the key ratios for the first half of 2005, compared with 2003 and 2004. Operating expenses, expressed relative to each of four measures of activity, show a decline in each case, as compared to prior years.

Key Ratios		2003	2004	**Jan-Jun 2005**
Operating Expenses as % of:				
Total Expenditure		3.0%	4.8%	**2.3%**
Grant Disbursements		14.3%	6.8%	**5.6%**
Grants Under Management		14.2%	2.2%	**0.8%**
Operating Expenses per Active Grant		$489k	$236k	**$191k** (annualized)
Activity data:				
Grants[1]	$m	1,063	861	1,064
Operating expenses	$m	33	43	26
Total Expenditure	$m	1,096	904	1,090
Grant Disbursements	$m	231	628	459
Grants Under Management [2]	$m	232	1,976	3,040
Number of Active Grants[3]		68	183	268

[1] Amount of new grant commitments in the period

[2] Commitments to grants that have not yet reached completion

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

Part 2: Outlook for 2005, whole year

Normal business

With half the year elapsed, expenditure is within budget and is likely to remain so for the remainder of the year. Cost savings are likely on LFA fees as the effects of optimization measures yield efficiencies. There is much less scope for savings on Secretariat expenses, given a tight budget combined with a challenging workload. Overall expenditure, excluding exceptional items, is expected to be within budget for the year.

Office relocation

As previously reported to MEFA and the Board in April 2005, the need to relocate the Secretariat to larger office premises was identified early in 2005 and has taken place during July. Costs in excess of amounts budgeted for 2005 are estimated at approximately $1.3 million (for fitting-out and moving costs) and, potentially, up to $0.5 million in cancellation costs on the current lease. The cancellation costs are disputed and the $0.5 million cost is a worst-case scenario; the outcome may be significantly less than that, or zero. Accordingly, this exceptional item will have a budgetary impact in 2005 in the range of $1.3 – 1.8 million (which, even at the upper end, is lower than the estimate of $1.9 million reported to MEFA and the Board in April).

When compiling the three-year budget estimates presented to the Ninth Board (for approval of the 2005 budget), the office relocation was planned for 2006 and included in the estimates for that year. Subsequently, it became necessary to accelerate the move in order to improve working conditions, and a suitable location which was available for mid-2005 occupation was availed of. Hence, expenditure budgeted for 2006 will now be incurred in 2005. It is planned to cover the additional 2005 costs of $1.3 – 1.8 million by drawing on the $1 million contingency and seeking savings on other Secretariat expenses. If necessary, the Secretariat may seek permission to use part of the anticipated savings on LFA fees (as was allowed in 2004) to cover any remaining part of this exceptional item, so that total costs would still remain within the total budget for 2005. The Secretariat will update FAC on the situation prior to the Twelfth Board meeting so that any required permissions could be sought at that time.

Part 3: Mid-year progress on Key Performance Indicators for 2005

The Board set 14 key performance indicators (KPIs) for 2005. Progress at 30 June 2005 towards the achievement of each KPI is outlined below.

Objective		Metric (KPI)	Target for 2005	Result at 30 June	*% of 2005 target*	Remarks	Units Responsible
Results and Impact							
Finance the rapid scale-up of effective means to prevent and treat the three pandemics	1	% of agreed targets reached by grants in Phase I (based on 18 months performance evaluation) *[Shared responsibility with Board]*	65% across the portfolio	62% to 166%	*ca.100% +*	These figures stem from an analysis of 74 grants that had been recommended to the Board for Phase 2 funding as of 1 August 2005. Results for key services ranged between 62% to 166%.	Operations, SIE
Core Business							
Raise it: Mobilize sufficient resources to implement GF mission and meet country needs	2	% of 2005 funding needs contributed *[Shared responsibility with Board]*	100%	42%	*42%*	2005 contributions by 30 June of $0.6 billion plus $0.2 billion of funds available from 2004, made $0.8 billion available at 30 June. This is 42% of the projected need of $2 billion for 2005. Note: Contributionion of outstanding pledges ($0.8 billion at 30 June) will increase the percentage to approximately 80%.	External Relations
	3	% of 2006 needs for current and next rounds pledged *[Shared responsibility with Board]*	70%	17%	*24%*	Pledges received as of 30 June ($0.5 billion) compared to projected needs ($2.9 billion) before the final replenishment conference	External Relations
Spend it: Scale-up disbursement to well-performing grants through effective grant management	4	Amount disbursed to Rounds 1-4 grants	$1.1 billion (2005 only)	$0.46bn	*42%*	From 1 January to 30 June 2005, $459 million was disbursed. The disbursement rate is expected to rise significantly through the third quarter of 2005 due to disbursements made for newly signed Round 4 grants (grant signing deadline was 30 June 2005).	Operations
	5	Average time between grant approval and first disbursement	<6 months	9 months		The average time between approval and first disbursement for Round 4 grants is 284 days.	Operations
Prove it: Make performance-based funding a reality	6	Second and subsequent disbursements based on evidence of performance and expenditure (including disbursement to sub-recipients)	95%	70%	*78%*	A systematic process to record all information concerning performance and expenditures for second and subsequent disbursements has been designed and will be rolled out during Sept/Oct 2005.	Operations, SIE
Communicate it: Drive consistent external communications	7	All major reports, including periodic grant progress updates, produced and available on website in a timely manner	80% on time	>80%	*100%*	Annual report, replenishment documents (Progress, Resource Needs, Status & Impact of the Diseases, External Assessment, in French and English) produced on time.	External Relations, Operations, SIE, Finance
Development & Innovation							
Develop strategy for sustainable success	8	Completion of a well-defined 3-year strategy, including future rounds, with targets and milestones	Strategy document completed for Board review by July 2005	(Timeframe subject to Board decision)		Strategy process is under way, under PSC and Board direction; timing yet to be set by Board. The output will be a strategy document.	Deputy Executive Director
Organization & Talent							
Facilitate best-practice corporate governance	9	Regular review of quality of Secretariat support to Board and committees	70% rating "satisfactory" or "very satisfactory"	(Not yet measured)		The Board survey will be carried out in the third and fourth quarter and reported at the Twelfth Board meeting.	External Relations
Develop organizational capacity and people to benefit mission	10	Completion of plan for transition to a fully independent entity following signature of headquarters agreement	Complete plan by November 2005	25%	*25%*	Project scoped, first series of staff consultations held, ToRs develped and RFP for consultants launched.	Business Services
	11	% of staff with defined objectives and annual reviews of results, competencies and development	90%	75%	*75%*	Objectives for senior management in place, cascade proceeding, time lags reflect high intake of new recruits.	Business Services, all units
	12	Internal staff survey on professional satisfaction and motivation	70% rating "high" or "very high"	(Not yet measured)		Staff survey to be conducted Q4	Business Services, all units
	13	Operating expenses as % of grants under management and as % of total expenditure	<3%, <10%	0.8%, 2.3%	*100%+*		Business Services, all units

Attachment 1: 2005 Operating Expenses (January–June) – Detail

(in US$)	2005 Budget (Year)	January-June 2005 (6 months) Actual (6 months)	Actual as % of annual budget	Budget (6 months)	Variance (6 months)	Variance as % of 6-month budget
Secretariat expenses	**44,137,769**	**18,442,986**	**42%**	**21,864,235**	**3,421,249**	**16%**
LFA fees	**23,350,421**	**7,094,623**	**30%**	**11,675,211**	**4,580,588**	**39%**
Sub-total	**67,488,190**	**25,537,608**	**38%**	**33,539,445**	**8,001,837**	**24%**
Efficiency target	(1,566,139)	0	**0%**	(783,070)	**(783,070)**	**100%**
Total Operating Expenses	**65,922,051**	**25,537,608**	**39%**	**32,756,375**	**7,218,767**	**22%**
LFA fees	**23,350,421**	**7,094,623**	**30%**	**11,675,211**	**4,580,588**	**39%**
Secretariat expenses by team	**44,137,769**	**18,442,986**	**42%**	**21,864,235**	**3,421,249**	**16%**
Operations	15,038,930	7,603,744	51%	7,662,593	58,849	1%
Strategic Information & Evaluation	3,970,745	1,095,020	28%	1,925,373	830,352	43%
External Relations	8,165,540	2,515,369	31%	4,046,118	1,530,749	38%
Office of the Executive Director	1,502,620	679,866	45%	787,962	108,096	14%
D.E.D. / Corporate Strategy & Policy	1,018,443	360,518	35%	460,443	99,925	22%
Business Services	12,960,491	6,188,469	48%	6,433,995	245,527	4%
Independent Audit / Inspectorate	290,000	0	0%	0	0	0%
Office of the Chair of the Board	191,000	0	0%	47,750	47,750	100%
Contingency	1,000,000	0	0%	500,000	500,000	100%
Secretariat expenses by type	**44,137,769**	**18,442,986**	**42%**	**21,864,235**	**3,421,249**	**16%**
Staff	22,085,839	11,094,703	50%	11,030,891	(63,812)	(1%)
Professional fees	7,655,541	2,212,197	29%	3,765,411	1,553,214	41%
Travel & meetings	6,870,639	2,681,454	39%	3,447,708	766,253	22%
Communications materials	1,867,000	502,359	27%	983,600	481,241	49%
Office expenses and infrastructure	4,177,750	1,952,272	47%	2,088,875	136,603	7%
Independent Audit / Inspectorate	290,000	0	0%	0	0	0%
Office of the Chair of the Board	191,000	0	0%	47,750	47,750	100%
Contingency	1,000,000	0	0%	500,000	500,000	100%

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

Attachment 2 : Transactions on Global Fund bank account January–June 2005

Summary of transactions on Credit Suisse bank accounts

	2005
	USD
Balance at start of year	**1,880,832**
Receipts	
Transfers from Trustee	-
Contributions	1,000,527
Staff reimbursement of personal expenses	16,664
Bank interest	4,899
Total receipts	1,022,090
Payments	
Advertising	3,021
Rent allowance element of ED compensation	45,405
Salary adjustments	25,000
Staff relocation services	155,593
Refundable advances	110,376
Travel expenses	27,533
Meetings	21,080
Audit fees	70,352
BIBC office rent and related charges	428,040
Office catering	12,385
Office sundries	15,204
Recruitment & training	468
Agency staff & consultants	8,556
Communications materials - multimedia	4,000
Transfers to petty cash	8,447
Exchange gain, less bank charges	(1,891)
Total payments	933,569
Balance at 30 June 2005	**1,969,354**
Subsequent transfer to Trustee	1,500,000
Net balance	469,354

Finance/BG
30 Aug 2005