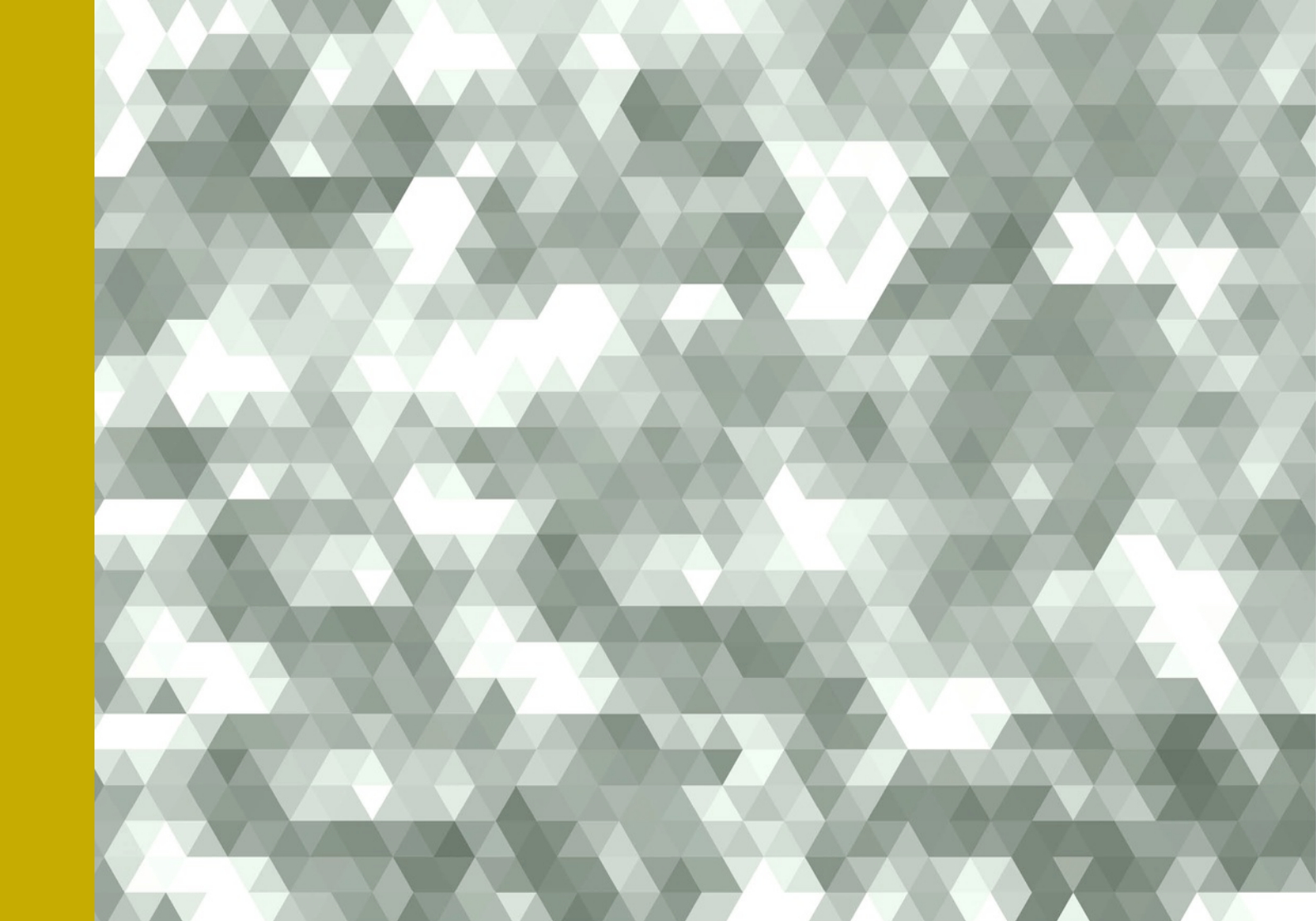




Audit Report

Procurement and Supply Chain Management at the Global Fund

GF-OIG-15-008
22 May 2015
Geneva, Switzerland

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I. Background.

Efficient and effective Procurement and Supply Chain Management (PSM)¹ is fundamental to the Global Fund's fight against the three diseases and the achievement of its strategy. This is because the Global Fund's biggest investments at country level concern health product procurement (estimated at 40% but as high as 90% for some grants). In 2013, the Global Fund spent USD 3.6 billion, of which USD 3.3 billion was grant-related. An estimated 67% grant disbursements (USD 2.2 billion) was related to procurement and supply chain management related activities broken down as follows:

- USD 1.32 billion (40% of annual grant disbursements) for health products. Health products include (i) pharmaceutical products; (ii) durable and non-durable in vitro diagnostic products, microscopes and imaging equipment; (iii) mosquito nets; and (iv) consumable/single-use health products (including condoms, insecticides, therapeutic nutritional support, general laboratory items and injection syringes); and
- USD 890 million (27% of annual grant disbursements) for non-health products. Non health products are all products and services other than health products that are procured to support activities related to the procurement, distribution and use of health products, including but not restricted to vehicles, computers, construction materials and technical assistance.

In addition to these grant-related disbursements, approximately 50% of the Secretariat's 2013 operational budget (USD 275 million) was also spent on purchasing goods and services. This included the Local Fund Agent costs amounting to approximately USD 59 million.

Oversight

Board level oversight of the Secretariat's activities related to procurement and supply chain management of health products was done primarily through the Market Dynamics Advisory Group, a subcommittee of the Strategy, Impact and Investment Committee. This Group's focus was limited to market dynamics issues primarily for anti-retrovirals (ARVs). In November 2014, the Global Fund Board approved a wholesale reform of procurement related oversight.² This reform terminated the Market Dynamics Advisory Group and delegated oversight of sourcing and procurement initiatives to two committees of the Board i.e. the Finance and Operational Performance Committee to oversee financial and operational matters, and the Strategy, Investment and Impact Committee to oversee the strategies for enhancing investment impact and value for money, including market-shaping interventions.

Operations

Principal Recipients are responsible for the implementation of all procurement and supply chain management activities in accordance with grant agreements for health and non-health products. In order to ensure access to effective and quality-assured health products, the Global Fund has developed a set of policies and principles on procurement and supply management that aim to:

- support the timely procurement of quality-assured health products in adequate quantities;
- attain cost efficiencies in procurement and supply management activities;
- ensure the reliability and security of distribution systems;
- encourage appropriate use of health products; and
- enable the monitoring of all procurement and supply management activities.

A "Voluntary Pooled Procurement" mechanism, now called the Pooled Procurement Mechanism, was approved by the Global Fund Board in April 2007. This gave the Secretariat a wider mandate

¹ Procurement and supply chain management are all procurement, supply and distribution activities required to ensure the continuous and reliable availability of sufficient quantities of quality-assured, effective products to end-users, procured at the lowest possible prices in accordance with national and international laws.

² Board decision GF/B32/DP08

to facilitate the procurement of health products for Principal Recipients through the services of Procurement Services Agents, and the ability to enter into contracts with providers of procurement capacity-building services and supply-chain-management assistance. These arrangements are intended to support and improve the capacities of Principal Recipients and to leverage the Global Fund's purchasing power in a more strategic manner.³ The Pooled Procurement Mechanism is in principle voluntary with ten countries accounting for 75% of its purchases.⁴ The Secretariat can, however, require a Principal Recipient (PR) to use this mechanism as a risk-mitigating measure or if the PR or the designated procurement entity has not demonstrated adequate capacity to procure health products effectively and efficiently. Furthermore, specifically for drug resistant tuberculosis, second line drugs may only be procured through the Green Light Committee's Procurement Agent, the Global Drug Facility.^{5,6}

An additional procurement activity managed by the Global Fund is the Affordable Medicines Facility-malaria (renamed the Private Sector Co-payment Mechanism), a financing model created in 2009. Under the oversight of a partner steering committee, its purpose is to expand access to affordable artemisinin-based combination therapies (ACTs) in the private sector i.e. the not-for-profit (e.g. non-governmental organizations) and private for-profit sectors. By increasing access to ACTs and displacing artemisinin monotherapies from the market, the co-payment mechanism contributes to delaying resistance to the active pharmaceutical ingredient, artemisinin. The Global Fund disbursed USD 112 million in 2013 under the co-payment mechanism.

The Secretariat's roles and responsibilities for procurement and supply chain management have been split between two divisions - Grant Management and Finance:

- The Grant Management division has health product management specialists that are responsible for working with countries to define country-level procurement and supply chain management implementation arrangements and risk mitigation measures. These are designed to ensure that health products, of acceptable quality, reach beneficiaries in-line with programmatic needs and that the Global Fund's policies on procurement and supply management are adequately implemented.
- The Sourcing Department, within the Finance Division, is responsible for procurement carried out by the Secretariat, which includes both Secretariat operational expenditures as well as the Pooled Procurement Mechanism and the Private Sector Co-payment Mechanism. The department is also responsible for supply chain management activities for the Pooled Procurement Mechanism up to the designated delivery point.
- The two divisions engage in relation to specific countries that procure their health products through the Pooled Procurement Mechanism.

A Chief Procurement Officer was appointed at the Global Fund in 2013 and a Sourcing Department created to optimize costs, improve purchasing capabilities and ultimately deliver more products at the right time and place to more people in countries - using the Pooled Procurement Mechanism. The department has defined its vision, objectives and key performance indicators, reengineered the Global Fund's procurement operating model for pooled procurement and operational expenditure and reorganized its team. The *Procurement for Impact* (P4i) initiative was launched in 2013 to minimize waste, build collaborative supplier relationships and deliver considerable cost-savings.

Under this initiative, the Sourcing Department has developed and implemented individual product procurement strategies for core health products procured through the Pooled Procurement Mechanism by specific countries. The biggest expenditures concern long lasting insecticide-treated

³ Board decision GF/B15/DP15

⁴ At the time of the audit, 56 countries were procuring products through the PPM.

⁵ Board decision GF/B13/DP26

⁶ The Green Light Committee Initiative was set up by the World Health Organization and the Stop TB Partnership to support countries in the management of multidrug-resistant tuberculosis. This is by (i) ensuring access to quality assured second line drugs at affordable prices (ii) monitoring and evaluation of second-line drug use in approved projects; and (iii) promotion of technical assistance for MDR-TB projects.

nets, artemisinin-based combination therapies and anti-retrovirals. At the time of the audit, a number of initiatives were underway including:

- The Rapid Response Mechanism which aims to quickly respond to potential stock shortages and mitigate the risks of treatment disruptions.
- An “e-marketplace”, which is a single technology platform that will give buyers at country level direct access to suppliers.

II. Scope and Rating

Scope

This audit is part of the OIG's risk-based audit plan for 2014, and aims to assess the governance, risk management and internal controls related to procurement and supply chain management activities and processes undertaken by the Global Fund Secretariat. The audit seeks to give the Board reasonable assurance on whether controls over procurement and supply chain management activities are adequate in supporting the Global Fund's achievement of its strategy and objectives.

Specifically, the audit sought to answer three questions:

1. How effectively the Global Fund's procurement and supply chain management strategy is aligned to and support the strategic objectives.
2. The effectiveness of controls in supporting the implementation of strategies i.e.:
 - whether the Global Fund is organized and managed in a manner that enables it to deliver on its mandates related to procurement and supply chain activities;
 - whether controls over the Global Fund's Pooled Procurement Mechanism activities are adequate and effective in ensuring procurements result in the best value for money; and
 - whether the Secretariat's Sourcing Department has the capability and capacity to lead procurement in the organization.
3. Whether assurance mechanisms over procurement and supply chain management are adequate and effective in mitigating identified risks.

The audit did not include internal controls over procurement and supply chain management processes undertaken by Principal Recipients which are typically the subject of country audits and for which the oversight is provided by Health Products Management Hub in the Grant Management Division. This means, for example, that Secretariat's processes and controls related to approval of funded health products' type and quantification, its assessment of implementer's supply chain and related strengthening activities, or the effectiveness of quality assurance measures, were not included in the scope.

Rating⁷

Operational risk	Rating	Reference to findings
1. Effectiveness of strategies in place in supporting the Global Fund achieve its strategic objectives:		
(i) Secretariat's undertaking of procurement related activities	Generally effective	4.1
(ii) Secretariat's oversight of supply chain management related activities	Partial plan to become effective	4.1
2. Effectiveness of controls in supporting implementation of procurement and supply chain management strategies	Partial plan to become effective	4.2, 4.3, 4.4
3. Adequacy and effectiveness of procurement and supply chain management assurance mechanisms	Full plan to become effective	4.5

⁷ See Annex A for the rating definitions.

III. Executive Summary

The Global Fund's biggest investments relate to health commodity procurement and account for an estimated 40% of annual disbursements. Procurement and supply chain management of health products are, therefore, critical to the Global Fund's fight against the three diseases. This OIG audit seeks to provide reasonable assurance on whether internal controls over procurement and supply chain management of health and non-health products at the country level and the Secretariat's operational expenditure are adequate to support the achievement of the Global Fund's strategic objectives.

Adequacy and effectiveness of the Global Fund's procurement and supply chain management strategy in meeting the Global Fund's vision and strategic objectives

Over the past 18 months, the Secretariat has transformed its approach to the procurement of core health products through the Procurement for Impact initiative by implementing a market shaping strategy that aims to deliver on its 2012-2016 strategy targets. Following the appointment of a Chief Procurement Officer in 2013, the Secretariat has prioritized the development of procurement strategies for core HIV and malaria health products with the biggest spend.

The procurement strategies employed by the Secretariat have increased the procurement spend under its direct control from USD 200 million in 2012 to USD 1.2 billion in 2013⁸ (USD 665 million in 2014). This has contributed to a reduction in lead times, cost reductions for long lasting insecticide-treated nets and artemisinin-based combination therapy as well as overall savings.⁹ These strategies have also lowered agency costs, increased ownership of supplier relationships, improved funds flow to procurement agents and stabilized supply levels.

Strategies in place focus on the procurement of core health products at Secretariat level but do not yet cover other products or supply chain management processes at either Secretariat or country level, which are considered as "high risk" according to the Secretariat and previous OIG country audits. This is because oversight at the Board and the Secretariat level has prioritized procurement over supply chain management and the Secretariat does not have a function that is responsible for supply chain management. The Secretariat's recently developed steering committee on procurement and supply chain management strategic matters has prioritized the development of an in-country supply chain strategy. This strategy is expected to guide the Secretariat's approach and role in supply chain system investments in different country contexts.

Although strategies in place do not yet cover all key products, procurement and supply chain management processes, this area is rated as **generally effective**. This is because the Secretariat has prioritized core products with the highest spend and the noted weaknesses do not materially affect the achievement of its strategic objectives. The Secretariat has prioritized the development of outstanding procurement strategies for key health products for 2015, including tuberculosis drugs and diagnostics. On the other hand, the Secretariat has a **partial plan to become effective** with regard to the development of a supply chain management strategy, with a committee in place to oversee its development. However, limited progress had been made in this regard at the time of the audit.

Effectiveness of controls to support the implementation of procurement and supply chain management strategies

The Sourcing Department has built its strategic capability over the past two years and the Secretariat has re-engineered its procurement operating model and reorganized the team to deliver

⁸ The USD 1.2 billion procurement spend is not exclusive to the purchase of only products related to 2013 disbursements but covers products for 2013 and beyond.

⁹ Executive Director's November 2014 Report to the Board. Please see section IV.3. The anti-retroviral tender was concluded subsequent to the audit.

on its new vision and objectives. However, the Secretariat's procurement strategies need to be supported by a strong internal control framework, which includes resources, policies and procedures, tools and systems to support the effective implementation of its activities. The development of internal controls and operations that would underpin the effective implementation of the procurement strategies has not been prioritized at the time of the audit.¹⁰ This has compromised the control environment within which strategies are implemented. In particular:

Grant related procurement and supply chain management (approximately USD 1.3 billion)

- The Secretariat's current organizational structure does not support the effective execution of its procurement and supply chain management related activities, especially the Pooled Procurement Mechanism activities. This is due to a lack of effective collaboration between the procurement-related teams in the Grant Management and Finance divisions. The priorities and roles between the two teams are not currently defined and harmonized, and effective linkages have not been built to facilitate their respective work. This has affected the Secretariat's ability to plan effectively and deliver products in a timely manner to countries using Pooled Procurement Mechanism. The Secretariat is aware of this weakness and has initiated processes to address the structural challenges. However, this process is not complete.
- The Secretariat's financial controls over the Pooled Procurement Mechanism processes were inadequate at the time of the audit. This included an absence of reconciliations of funds transferred to Procurement Service Agents, a lack of comprehensive review over forecasts that form the basis for the Secretariat's cash transfers to Procurement Agents, and slow reconciliation and closure of final invoices issued by Procurement Agents. At the time of the audit, a staff member had been identified to resolve the financial issues noted by the OIG.
- While the Secretariat had established processes for measuring Pooled Procurement Mechanism related performance, it had not formalized the methodologies, terminologies and cut off dates for calculating and interpreting the key pooled procurement mechanism related performance indicators. As a result, the OIG was unable to validate the accuracy of the reported performance results.

Procurement of Secretariat operational goods and services (approximately 275m)

- OIG testing found that 74% of eligible non-health product related purchase transactions sampled¹¹ (excluding Pooled Procurement Mechanism related purchases) were effected through non-competitive means. Although some exceptions can be expected, this level of non-compliance points to either inappropriate policies, or a lack of understanding of policies and/or a lack of compliance monitoring by the Secretariat. Compensatory controls were not in place to ensure that best value was obtained in the absence of competition. During the audit, the Secretariat embarked on a process to update its internal procurement policies and regulations.
- The Secretariat does not have an internal management information system in place that provides procurement-related data for its decision-making processes. The Sourcing Department's requests during the past 18 months for systems to be built have not been prioritized. The development of the department's information system is included in the Secretariat's Information Technology work plan for 2015.

¹⁰ At the time of the audit, procurement policies and an operations policy note related to pooled procurement were under development.

¹¹ USD 70 million and 49% in value

An audit of the Global Fund by the European Commission in late 2014 concluded that “there were material weaknesses/deficiencies in its procurement-related systems, controls, rules and procedures”.¹² The OIG audit confirms this. Prior to the audit, the Secretariat had a **partial plan to become effective** in this area, having initiated a number of actions to address the issues identified. These corrective actions are at different stages of implementation.

The Secretariat has put in place measures that are expected to address the issues noted in the audit for example updating the procurement policy, implementation of a pooled disbursement mechanism for procurement agents and updating the Pooled Procurement Mechanism operational policy.

Adequacy and effectiveness of assurance mechanisms over procurement and supply chain management in mitigating identified risks

In terms of assurance, current human resource and financial resources are not commensurate with the function’s strategic importance in achieving organizational objectives.¹³ The Secretariat’s risk assessment, using the Qualitative Risk Assessment, Action Planning and Tracking Tool, has identified procurement and supply chain management -related risks at country level as a key priority. However, the Secretariat has not allocated sufficient resources to gaining assurance over procurement and supply chain management activities. For example, while an estimated 67% of grant disbursements is spent on procurement of health and non-health products, only 5% of the Local Fund Agent budget has been allocated to procurement and supply chain management related assurance.

Prior to the audit, the Secretariat had already developed a **full plan to become effective** in this area. A high-level Risk and Assurance Working Group has been constituted to better articulate and formalize the assurance framework around grant funds. The group will consider, among other things, the level of assurance and how the Secretariat will obtain the required assurance over procurement and supply chain management related risks.

¹² A follow up audit undertaken subsequently to the OIG audit found the department to be in compliance with the EC requirements.

¹³ In particular, objectives related to treatment disruptions, substandard products quality and theft or diversion of non-financial assets.

IV. Findings and agreed actions.

IV.1	Global Fund's procurement and supply chain management strategy	Executive Level
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The Secretariat has implemented a number of initiatives to support a sustainable supply of core health products and to provide cost effective and quality assured products to Principal Recipients. Under the Procurement for Impact initiative, the Secretariat has prioritized the development and implementation of procurement strategies for core health products with the biggest spend (long lasting insecticide-treated nets, artemisinin-based combination therapy drugs and antiretroviral drugs). Through these strategies, the Secretariat has secured quality assured products, better pricing, delivery conditions and reduced procurement lead times for Pooled Procurement Mechanism countries.

The Secretariat has also developed strategies related to rapid supply management, improved supply management and the development of an “e-marketplace”. Once implemented, these arrangements are expected to provide a quick response to potential stock shortages and a single technology platform that gives buyers at country level direct access to competitive pricing and suppliers.

However, strategies in place do not yet cover all key procurement and supply chain management processes that are necessary in supporting the Global Fund's achievement of its strategic objectives:

- The Secretariat's plan to develop strategies for key products by the close of 2013 has fallen behind schedule¹⁴ with regard to:
 - a. Tuberculosis drugs and diagnostics (estimated annual spend of USD 60m and USD 45m respectively): Challenges with the current arrangements remain unaddressed, for example, fragmented demand, high prices and long lead times.¹⁵
 - b. Operational expenditure related to non-health products (estimated at 27% of annual disbursements and 50% of total Secretariat costs): This includes Local Fund Agent services,¹⁶ vehicles, information technology, etc. and non-core health products such as condoms, laboratory supplies. Purchases remain spread thinly across multiple categories, supplier bases and geographical regions and are not optimized to reduce costs and maximize best value at the country level and globally.
- The Secretariat does not yet have in place a supply chain management function nor strategy that covers in-country processes such as quantification and forecasting, logistics management and distribution. These all play an important role in delivering quality products to intended beneficiaries in a timely manner. Supply chain management initiatives are currently undertaken by different departments within the Secretariat without a framework in place to ensure that their work is aligned and that they create the desired impact.¹⁷

¹⁴ The Sourcing Department Roadmap committed to the development of strategies for all key products by the end of 2013 but strategies were only developed for prioritized core health products

¹⁵ Procurement of second line drugs by the Global Drug Facility “Assessment of GDF supply chain for MDR Tb drugs” by Ron Kapicki

¹⁶ The Board's decision [BD 15/50] to retender Local Fund Agent services every four years has not been implemented, with the last tender having taken place over six years ago. At the time of the audit, the Secretariat did not have a strategy to address the Board's concerns around the need to diversify its supplier base from the one dominant supplier of services.

¹⁷ Divisions included Grant Management, Finance, External Relations, and Strategy Investment and Impact

The Board and Management Executive Committee levels have not provided strategic direction and comprehensive oversight to procurement and supply chain management-related activities. In particular:

- Board oversight, previously undertaken through the Market Dynamics Advisory Group has not prioritized supply chain management. Instead, it was largely focused on global procurement through market shaping activities for health products. In order to address this, the Board in November 2014 delegated the procurement and supply chain management role to the Strategy, Investment, and Impact Committee and the Finance and Operational Performance Committee.
- The 2007 Board decision to establish the Capacity Building Services and Supply Chain Management Assistance mechanism to strengthen procurement and supply chain systems at country level has not been implemented by the Secretariat.
- The OIG was informed that the Management Executive Committee followed up the commitments made in the Sourcing Department's 2013 roadmap to develop strategies for key products by the end of 2013. However, evidence of this was not availed to the auditors.
- The Secretariat's corporate risk register lists three key risks that affect its ability to achieve impact: treatment disruption, substandard quality of health products and theft and diversion. Although weaknesses in supply chain management are identified as key contributing factors to these risks, effective measures to tackle these risks have not been implemented.
- A Steering Committee for Health Product Procurement and Supply Management strategic matters established in July 2014 has not made progress in executing its terms of reference, namely the development of an overarching procurement and supply chain management strategy, agreement of supporting principles and related policy discussions etc.

Agreed management action 1: The Secretariat will ensure that oversight over all key procurement and supply chain activities is strengthened. In particular, this will include:

- Developing a procurement strategy that defines the function's role and approach in supporting the achievement of strategic objectives.
- Developing a principles-based strategy to in-country supply chain strengthening by the Global Fund. In particular:
 - Defining the Global Fund's scope of responsibility, oversight, and initiative with respect to in-country supply chain challenges;
 - Defining the respective roles of in-grant health system strengthening funding, day-to-day country engagement by health products management Specialists, technical assistance / capacity building, and other special supply-chain initiatives within the Global Fund's approach to supply chain strengthening;
 - Defining required resourcing levels.
- Implementing these strategies by ensuring that responsibility for each activity is assigned to the most relevant division/department within the Global Fund (see AMA2).

Owner: Head Grant Management/ Chair of the Health Product Procurement and Supply Chain Management strategic matters steering committee

Target Date: 30 September 2015

IV.2	Organizational structure over procurement and supply chain activities	Executive Level
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The 2012 restructuring of the Secretariat resulted in the integration of technical specialists (including health product management specialists) in the Grant Management Division. Conversely, the Pooled Procurement Mechanism and the Private Sector Co-Payment Mechanism were located alongside other purchasing-related functions under the Sourcing Department in the Finance Division. These functions are complementary to each other and the restructuring was widely acknowledged as positive given the new strategic direction of the Global Fund.¹⁸ However, the resultant structure does not always support the effective execution of procurement and supply chain management related activities across the Secretariat, at the global level (Sourcing Department) and in-country level (Grant Management).

This structure has created operational challenges in dealing with procurement and supply chain management matters across the Secretariat. In 2013, the Secretariat began work on resolving these challenges but this had not been resolved at the time of the audit.

- The split of over 50 staff between the two divisions affects their ability to achieve synergy in their work and gaps remain in the overall execution of procurement and supply chain related functions within the organization. For example:
 - a. Effective linkages have not been built between the health product management specialists that oversee country PSM related matters in the Grant Management division and the team in the pooled procurement function that facilitates the procurement of health products on behalf of some Principal Recipients. Relevant information is not routinely shared between the two divisions and arrangements to bring about coordination between the two teams remain inadequate. For example up to date procurement and supply management plans are not maintained by the Grant Management Division yet the Sourcing Department needs them in order to honor the annual volume allocation commitments made to manufacturers.
 - b. Although the role of the Pooled Procurement Mechanism is primarily to provide services that support Grant Management, its priorities are better aligned to the Finance Division than the Grant Management. For example, while Grant Management's key performance indicators focus on effectiveness and the Sourcing Department's key performance indicators relate to economy and efficiency. There are no joint KPIs to incentivize coordination across the functions.
 - c. The roles and interactions of the respective teams under the Pooled Procurement Mechanism are not clear, and there are differences between the defined roles in the operational policy note and the staff terms of reference.¹⁹ For example, operational policies require health product management specialists to ensure that up to date PSM plans are maintained to support the development of pooled procurement commitments forecasts annually. This activity is not reflected in job descriptions and is not undertaken.²⁰
- The Secretariat has not clarified who has overall responsibility for overseeing key components within the Pooled Procurement Mechanism processes. The OIG noted some specific incidents, which although not material in comparison to overall Pooled Procurement Mechanism spend point to the need for better oversight of the overall process:
 - a. *Principal Recipient desired dates not met:* Although lead times under the Pooled Procurement Mechanism (i.e. period between receiving approved purchase order and

¹⁸ Internal Audit of the Integration of Specialists into Country Teams (GF-OIG-13-024) 8 July 2013

¹⁹ Pooled Procurement Mechanism operational policy note, updated 11 June 2014

²⁰ The Secretariat is updating the operational policy note and it is expected to address this matter.

delivering the goods) were reduced, 82% of delivered orders by one agent (accounting for 64% of total PPM purchases) did not meet Principal Recipients' desired delivery dates.²¹ This is caused by Principal Recipients setting delivery dates without consulting the PPM team and where differences between PR desired dates and PPM delivery dates are evident, no mechanism is in place to reconcile the two dates at the start of the procurement process.

- b. *Delays in PPM procurement process:* There are also delays in procurement processes caused by Principal Recipient delaying to start procurement processes (43% submitted late given the required timelines to secure products) and providing required approvals late (an average delay of 26 days over target).²² This is because delays in completion of required process steps by Recipients are not followed up. The responsibility for ensuring that Principal Recipients undertake their roles in a timely manner is not defined and currently falls between the health product management specialists, the PPM team and procurement agents.
- c. *Delivery related issues:* There is also evidence of inadequate coordination among the different stakeholders resulting into problems once delivery of purchased products is undertaken. For example, a container of ACTs valued at USD 265,000 delivered to Ghana remained uncleared at the port for over eighteen months. At the time of the audit, the remaining shelf life of the ACTs was too short and the drugs needed to be destroyed. In another example, a shipment of ACTs valued at USD 1.7 million was delivered to a Principal Recipient in Uganda that had not made arrangements for their storage and did not have appropriate storage capacity. Additional costs have had to be incurred for storage.

Agreed management action 2: The Secretariat will work on streamlining the way in which it operates in relation to (global/in-country) supply chain and procurement activities:

- In the short term, the roles and responsibilities of those with procurement and supply chain-related duties (more particularly the Sourcing Department, the Health Product Management Hub and Health Product Management Specialists) will be reviewed and clarified. In particular, the Secretariat will review three areas:
 - Streamlining interactions around Pooled Procurement Mechanism;
 - Ensuring clarity on roles and responsibilities in relation to supply chain strengthening at country-level (see AMA1)
 - Reinforcing the role of the Global Fund's Quality Assurance function.
- In the medium term, the Secretariat will agree and implement an improved structure of procurement approved by the Executive Director. Options considered will include consolidating all procurement and supply chain management activities under one division, establishing a separate division or better clarifying and outlining which division is accountable for specific activities.

Owner: Executive Director

Target Date: 30 September 2015

²¹ Only 222 of 1,247 delivered orders were delivered on time or earlier than the desired delivery date by one Procurement Agent between late 2012 and October 2014.

²² Based on one PSA performance report for Semester 1 2014. Some delays are due to manufacturing reasons.

IV.3	Adequacy and effectiveness of the Pooled Procurement Mechanism in ensuring best value for money	Division Level
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The newly formed Pooled Procurement Mechanism has addressed key challenges inherent in the prior voluntary Pooled Procurement Mechanism.²³ The Secretariat has brought the tendering process of core health products previously handled by procurement agents in-house. This included analyzing supplier and manufacturer cost structures and capacities to inform the tendering process, allocating volumes to manufacturers in order to support sustainability of supply and strengthening Secretariat relationships by contracting directly with manufacturers for core health products.

The Secretariat increased the procurement spend under its direct control from USD 200 million to USD 1.2 billion in 2013 (USD 665 million in 2014).²⁴ This is due to strategies under the Pooled Procurement Mechanism as well as the rapid program scale-up in countries and large portfolios such as Tanzania joining the mechanism. The Pooled Procurement Mechanism has reported savings worth USD 272 million, cost reductions of 13% and 33% for long lasting insecticide-treated nets and artemisinin-based combination therapy drugs, respectively and an improvement in “On Time In Full” deliveries from 38% to 68%.²⁵

However, the development of these activities over key products has outpaced the development of the back office operations to support the implementation of the new strategies. Whilst the Secretariat’s Sourcing Department had embarked on building its back office operations, the OIG noted the following areas that remained unaddressed at the time of the audit.

Financial management

In 2014, the Pooled Procurement Mechanism initiated a transition from making full advance payments to procurement agents to an arrangement in which cash transfers are only effected against scheduled deliveries. However, at the time of the audit, this new disbursement system was running concurrently with the old one where Agents received all procurement related costs at the time of placing the order. The OIG noted that financial controls over procurement processes required improvement, particularly around Procurement Service Agents:

- Reconciliations of cash received from Procurement Service Agents are not prepared (i.e., amounts reported as transferred by the Secretariat and amounts reported as received by the agents). At the time of the audit, the two Procurement Agents were holding cash amounting to USD 225 million and the OIG found differences of USD 12m and USD 1.3m, respectively, for the two Procurement Service Agents.²⁶
- Forecasts to determine the level of the Secretariat’s quarterly cash commitments to Procurement Agents are not comprehensively reviewed, meaning that the reasonableness of forecasts is not questioned and errors can go undetected. The OIG noted errors in one quarter that resulted in the Secretariat making an over commitment of USD 4m.
- Final invoices issued by Procurement Agents are not reconciled and closed off in a timely manner. The OIG noted invoices pending closure for an average of 536 days after final delivery. At the time of the audit, 898 final invoices (65% of all delivered orders with a total cash balance of USD 30.1m) had not been closed.
- 142 out of the 898 unreconciled final invoices (with a total cash balance of USD 7.3 million) related to closed grants. These funds are no longer available to Principal Recipients but must be returned to the central pool of funds.

²³ For example, limited control since procurement processes were managed by procurement agents, high agent costs, poor visibility of innovation, lack of ownership of supplier relationships, poor funds flow to agents which delayed procurements, limited competition in pricing, and no volume leverage due to spot purchases.

²⁴ The high procurement spend in 2013 in comparison to 2014 is because 2013 coincided with the three year cyclical change of bed nets. The drop in procurement spend in 2014 is also caused by lower grant related activity due to the implementation of the new funding model.

²⁵ Executive Director’s November 2014 Report to the Board

²⁶ During the audit, the OIG was able to reconcile the two sets of data to establish that there was no malfeasance.

During the audit, the Sourcing Department proactively identified a resource to resolve the issues noted above.

Performance management

The Sourcing Department has established processes for measuring performance, including the setting of targets for measurement of performance of procurement agents and holding quarterly performance review meetings with procurement agents. However, at the time of the audit, the Sourcing Department was still developing the methodologies, terminologies and cut off dates for calculating and interpreting key performance indicator data related to the PPM. The OIG was unable to validate the accuracy of the PPM related performance results reported to the Board and its committees.

Control activities

In relation to the procurement of second line tuberculosis drugs through the Board appointed sole-provider of second line tuberculosis drugs, Global Drug Facility:

- The Secretariat has not formalized its contractual relationship with the Global Drug Facility despite purchases for second line drugs amounting to USD 196m between January 2013 and June 2014. A Memorandum of Understanding signed in 2009 between the Global Fund and the Green Light Committee mentioned the Global Drug Facility as the sole procurement agent, without articulating the roles, terms and conditions and performance measures under which the Facility would operate.²⁷ The Secretariat therefore lacks a basis for assessing the Facility's performance.
- The Secretariat has not justified its need for two Procurement Agents for the procurement of tuberculosis drugs (the Global Drug Facility is a procurement agent and it has appointed its own procurement agent, the International Development Association). The Secretariat works with one agent under the Pooled Procurement Mechanism for each product category and the OIG therefore questions the need/ value add of an additional agent especially in light of its objective to minimize agent costs.

Agreed management action: See Agreed management action 3 under the next section
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²⁷ Subsequent Memoranda of Understanding signed between the Global Fund and the Green Light Commission are silent about the Global Drug Facility being the procurement agent.

IV.4	Capability and capacity of the Sourcing Department	Division Level
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Following the appointment of the Chief Procurement Officer in early 2013, the Sourcing Department developed a vision and strategy, defined its objective and key performance indicators, reengineered its operating model and restructured its team. Under the center-led procurement model adopted by the Secretariat for its operational costs, the Sourcing Department develops strategy and policy to guide Secretariat procurement and purchasing undertaken by the divisions.

In light of changes to staff roles and the significant shift in the department's focus on key products, the Sourcing Department has invested in providing training and on the job coaching to staff over the last 18 months. However, the Sourcing Department's strategic capability is more evident with the procurement of health products than non-health products.

Underpinning the Sourcing Department's new strategy and procurement operating model is the need for a strong control framework including resources, policies and procedures, tools and systems to support the effective implementation of its activities. The rapid strategic changes in the Sourcing Department have led to a situation where its operational capacity, including monitoring and support to client-facing operations, has not matured at the same pace.

Policy framework

At the time of the audit, the Sourcing Department did not have up-to-date procurement policies. The policies in place were developed in 2009 and had not been updated to reflect changes in the Secretariat's strategic direction, structure and processes.²⁸ This has had operational consequences. For example in a sample of 270 non-health procurements (excluding Pooled Procurement Mechanism related purchases) totaling USD 70.5 million²⁹, the OIG found that:

- Seventy four percent (74%) of "competition eligible" non-health product purchase orders tested (46% in terms of value) were not competitive. The OIG notes that Secretariat regulations provide for noncompetitive purchases in "exceptional cases" and some exceptions are expected. However, this represents a high percentage of noncompetitive purchases and is a reflection of either inappropriate policies, a lack of understanding of policies and/or a lack of compliance monitoring.
- The main justifications provided by the divisions for noncompetitive purchases were compelling urgency (30%); follow-on award to an existing contract for a contractor with highly specialized services (26%); and specialized expertise and skills needed for the scope of work (14%). However, in our analysis the underlying reason was often poor planning which could have been avoided if the Sourcing Department had been involved in the purchasing process earlier. This early involvement would have given the department the ability to challenge and/or influence spending decisions.
- In the absence of competition, the Secretariat does not have compensatory controls to ensure best value is obtained. For example, the Sourcing Department is unable to check the reasonableness of rates for noncompetitive purchases. The department also does not have a mechanism to confirm satisfactory contractor performance to support cases for contract extensions.
- There are no controls to mitigate against the risk of abuse of the noncompetitive provision in the policies. For example, the process in place does not restrict the number and/or value of possible extensions.

²⁸ Subsequent to the OIG and EC audits, the Secretariat has updated its procurement policies and this was acknowledged in a follow up audit by EC in April 2015. . However, the EC report still highlights further weaknesses in the procurement processes.

²⁹ This represents 55% of non-health procurements undertaken between January 2013-June 2014 (excludes the LFA and travel related costs which have been the subject of another audit).

The OIG findings mirrored those of another audit, the 2014 European Commission audit of the Global Fund's internal control environment, which concluded that "there were material weaknesses/deficiencies in its procurement related systems, controls, rules and procedures".³⁰ Following the European Commission assessment, the department updated its procurement policies; these were approved by the Management Executive Committee in March 2015.

Control activities

- The Management Executive Committee does not undertake a thorough review of large or risky procurements as required in the procurement regulations.³¹ The threshold for Management Executive Committee approval was high (USD 1 million at the time of the audit) and as a result less than eight health and non-health purchases qualified for approval.³² In the case of the bed nets, the OIG did not see evidence that changes made to the approved proposal were resubmitted to the Management Executive Committee for ratification.³³ In the case of non-health products, there was no evidence that formal approval was obtained from the Management Executive Committee.
- Secretariat divisions have entered into financial commitments on behalf of the organization through Memoranda of Understanding without the involvement of the Sourcing Department e.g. a USD 29 million memorandum signed with an international organization. At the time of the audit, the Secretariat did not maintain a comprehensive list of commitments arising from Memoranda of Understanding, and instances were noted where the Sourcing department only became aware of commitments made under the signed memoranda when payments could not be processed due to the lack of a purchase order.
- The Secretariat has not instituted systems to support purchasing processes of operational goods and services at division level:
 - a. The Sourcing Department has not developed a comprehensive preferred supplier list to ease procurements of recurrent purchases at division level. This has led individual divisions to maintain their own preferred supplier lists.
 - b. The Secretariat's purchasing system is not fully automated. This reduces visibility over purchasing activities at division level which in turn affects its ability to monitor compliance with established procedures. Relevant documentation for purchases was not readily available during the audit.
 - c. A contract management system was not in place to monitor supplier performance and safeguard the organization from loss of contract value.

Information technology

The Secretariat does not have a management information system in place that provides procurement related data for decision making. The system in place (Global Fund Finance System) has been built for financial reporting and budgeting purposes and is unable to provide comprehensive, reliable and accurate procurement data. The Sourcing Department's requests over the past 18 months for systems to be built that can provide procurement related data have not been prioritized. In consequence:

- Decision makers do not have a clear view of all elements of the organization's procurement activity to support data-based decision making. Limited centralized visibility of Secretariat and country spend has also made it difficult to analyze the underlying causes of bottlenecks within the procurement chain, and to analyze spend data to support the development of appropriate supply strategies.
- Aggregation of information across multiple systems for performance reporting has been performed manually and is prone to errors.

³⁰ Report of the Pillar Assessment of the Global Fund to Fight Aids, Tuberculosis and Malaria, 1 December 2014

³¹ The MEC has taken on the responsibilities of the now defunct PRC. For example, the MEC did not oversee the different procurement stages and only approved the final proposal for long-lasting insecticide treated nets and malaria drugs (valued at USD 250m and USD 200m respectively).

³² The threshold for PRC approval at the World Health Organization and UNDP are USD 150k and USD 30k respectively.

³³ This was due to the sanctions panel ruling to suspend two suppliers.

- Data used to report progress on procurement related key performance indicators is incomplete. For example, the OIG noted that the data for computing Key Performance Indicator 10 related to value for money were incomplete. In 2013 PPM related savings were computed from only 63% of total spend.³⁴

In 2014, the Sourcing Department prepared a business case for an improved management information system and is currently working with the IT Department to prioritize the work into short and long term projects.

Agreed management action 3: The Secretariat will strengthen the Sourcing Department's operational capacity function to properly support and monitor procurement activities (health and non-health products). In close collaboration with the Grant Management Division, these will include, at a minimum:

- Updating its procurement regulations;
- Implementing strong financial controls around procurement activities;
- Defining the methodology and approaches for calculating key performance indicators;
- Strengthening the Department's capability with regard to non-health products; and
- Implementing an appropriate management information system to capture relevant data and to support its procurement related decision making. A thorough needs analysis to identify the required functionality will be developed and presented to the Management Executive Committee for approval.

Owner: Chief Financial Officer

Target: 30 September 2015

³⁴ Key Performance Indicator 10: spend reduction in commodity purchases made within Pooled Procurement mechanism for equivalent commodities at equivalent quality and volume

IV.5	Adequacy and effectiveness of assurance mechanisms over procurement and supply chain management in mitigating identified risks	Executive Level
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With no in-country presence, the Global Fund's business model relies on assurance from internal and external assurance providers to effectively manage the risks inherent in its programs. Recognising that the Global Fund does not have a formal articulation of its assurance framework to ensure that grant management strategies in countries and regions are being executed as intended, the Secretariat launched the Risk and Assurance project in 2014 to ensure that the information from core assurance providers is adequate.

For procurement and supply chain management matters at country level, the project will implement an overarching strategy covering key process components at country level. However, the Risk and Assurance project is a long-term project that may not be able to address material deficiencies in assurance over procurement and supply chain matters in the short term. In particular:

- *Resources:* There is a disparity between the level of resources devoted to providing assurance over procurement and supply chain matters and the magnitude of related expenditures. For example, although the Local Fund Agent is the primary source of Secretariat-directed assurance over PSM activities in country, only approximately 5% of the Local Fund Agent budget is allocated to this activity. This is disproportionate to the level of procurement-related expenditures (67% of grant funds or approximately USD 2.2 billion on average). Similarly, a single staff member has the responsibility for overseeing the entire grant portfolio's quality assurance/quality control related processes despite "substandard quality of health products" being flagged as one of the highest ranked risk areas within grants.
- *Area of focus:* PSM-related assurance by the Local Fund Agent and the Secretariat's Health Product Management specialists primarily focuses on health products. The Secretariat does not have defined assurance arrangements over non-health products, which account for an estimated 27% of annual grant disbursements.
- *Timing:* Provision of assurance over procurement and supply chain management risks by Local Fund Agents and health product management specialists has been predominantly during grant making and renewal stages. There is limited assurance obtained during grant implementation especially in non-High Impact grant portfolios.
- *Scope of work:* The assurance work takes place primarily in procurement, yet the Secretariat's internal risk assessments and prior work undertaken by the OIG have concluded that there are significant weaknesses in the supply chain management systems at the country level.

In its corporate risk register, the Secretariat lists treatment disruption (40%) and substandard quality of health products (32%) as 'high' risks that will potentially affect its ability to achieve impact.³⁵ Whilst in excess of US\$120m is spent on assurance on an annual basis, limited assurance activity is performed over these critical areas:

- Treatment disruptions:
 - a. The Secretariat obtains limited assurance over stock levels of core products, yet they are a key contributing factor to treatment disruption risks. The work of the Local Fund Agent is limited to a desk review of stock levels at the central level although stock-outs typically occur further downstream in the supply chain.
 - b. Limited assurance focus is provided over other contributing factors to treatment disruptions such as forecasting and quantification, inaccurate consumption data, challenges in logistics management. The Secretariat relies on the PSM plan to obtain assurance on these key processes and activities before grant signing. However, once approved, the Secretariat does not have any mechanism that monitors the execution

³⁵ Global Fund Risk Report: 2013-14, Embedding Risk in Grant Management

of plans or ensures that plans are updated as the need arises, especially in non-High Impact countries.

- Substandard quality of health products:
 - a. At the Secretariat, the Price and Quality Reporting (PQR) tool is used to ascertain whether procured goods are in compliance with its Quality Assurance Policy. However, this PQR only captures the source of the health products and by implication their quality at the date of procurement, and is limited to core products. Although cases of non-compliance are flagged to Country Teams, there is no evidence that these cases have been resolved. For example, the OIG noted that 16 out of the 26 cases of noncompliance flagged by the Health Product Management hub in 2013 (62%) had not been resolved at the time of the audit.
 - b. At the Country level, the Global Fund relies on national drug regulatory authorities to provide the Secretariat with assurance over quality control activities. In cases where these authorities lack the requisite capacity, the Secretariat currently does not have alternative arrangements to assure quality at country level.
- Monitoring value for money: Health product management specialists review budgets for health products during the grant making stage. During grant implementation, the primary tool available at the Secretariat for monitoring the reasonableness of prices is the PQR. However, during grant implementation, the PQR only tracks a limited number of core health products, and the monitoring of price reasonableness is at the discretion of the health product management Specialists. The OIG noted that the PQR was not updated with procurement information in a timely manner e.g. for procurements undertaken under the Pooled Procurement Mechanism, errors that had been entered in the system went unnoticed and prices that appeared higher than the average price were not queried.

Agreed management action 4: not applicable

An agreed management action is already being tracked on this matter. As reported to the Board in both of its meetings in 2014, the main aspect that needs improvement is the manner in which country teams, their managers, and the various risk owners across the Secretariat plan, obtain and evaluate adequate assurance with respect to how implementers manage their risks. This is referred to as the 'Risk and Assurance project', the central coordination and support for which was placed with the Risk Management Department following the conclusion of the first phase of the project at the end of 2014. Additional resources, including a Risk and Assurance Senior Manager / Deputy CRO, are being recruited into the department for this purpose. Pending this recruitment, a temporary individual has been retained. Planning for seven country pilots, where the new approaches will be validated, is underway. The Global Fund Risk and Assurance Committee, co-chaired by the Executive Director and the CRO, is overseeing the project.

V. Table of Agreed Actions

No.	Category	Agreed Action	Target Date
1.	Secretariat's procurement and supply chain management strategy	The Secretariat will ensure that oversight over all key procurement and supply chain activities is strengthened. In particular, this will include: - Developing a procurement strategy that defines the function's role and approach in supporting the achievement of strategic objectives. - Developing a principles-based strategy to in-country supply chain strengthening by the Global Fund. In particular: - Defining the Global Fund's scope of responsibility, oversight, and initiative with respect to in-country supply chain challenges; - Defining the respective roles of in-grant HSS funding, day-to-day country engagement by HPM Specialists, technical assistance / capacity building, and other special supply-chain initiatives within the Global Fund's approach to supply chain strengthening; - Defining required resourcing levels. - Implementing these strategies by ensuring that responsibility for each activity is assigned to the most relevant division/department within the Global Fund (see AMA2).	30 September 2015
2.	Organization of the procurement and supply chain management structure	The Secretariat will work on streamlining the way in which it operates in relation to (global/in-country) supply chain and procurement activities: In the short term, the roles and responsibilities of those with procurement and supply chain-related duties (more particularly the Sourcing Department, the HPM Hub, and HPM Specialists) will be reviewed and clarified. In particular, the Secretariat will review three areas: - Streamlining interactions around Pooled Procurement Mechanism ; - Ensuring clarity on roles and responsibilities in relation to supply chain strengthening at country-level (see AMA1) - Reinforcing the role of the Global Fund's Quality Assurance function. In the medium term, the Secretariat will agree and implement an improved structure of procurement approved by the Executive Director. Options considered will include consolidating all procurement and supply chain management activities under one division, establishing a separate division or better clarifying and outlining which division is accountable for specific activities.	30 September 2015

No.	Category	Agreed Action	Target Date
3.	The Sourcing Department's operational capacity	The Secretariat will strengthen the Sourcing Department's operational capacity function to properly support and monitor procurement activities (health and non-health products). In close collaboration with the Grant Management Division, these will include, at a minimum: - Updating its procurement regulations; - Implementing strong financial controls around procurement activities; - Defining the methodology and approaches for calculating key performance indicators; - Strengthening the Department's capability with regard to non-health products; and - Implementing an appropriate management information system to capture relevant data and to support its procurement related decision making. A thorough needs analysis to identify the required functionality will be developed and presented to the Management Executive Committee for approval.	30 September 2015
4.	Assurance mechanism over procurement and supply chain management	An agreed management action is already being tracked on this matter. As reported to the Board in both of its meetings in 2014, the main aspect that needs improvement is the manner in which country teams, their managers, and the various risk owners across the Secretariat plan, obtain and evaluate adequate assurance with respect to how implementers manage their risks. This is referred to as the 'Risk and Assurance project', the central coordination and support for which was placed with the Risk Management Department following the conclusion of the first phase of the project at the end of 2014. Additional resources, including a Risk and Assurance Senior Manager / Deputy CRO, are being recruited into the department for this purpose. Pending this recruitment, a temporary individual has been retained. Planning for seven country pilots, where the new approaches will be validated, is underway. The Global Fund Risk and Assurance Committee, co-chaired by the Executive Director and the CRO, is overseeing the project.	Not applicable

Annex A: General Audit Rating Classification

Highly Effective	No significant issues noted. Internal controls, governance and risk management processes were adequate, appropriate, and effective to provide assurance that objectives should be met.
Generally Effective	Some significant issues noted but not material to the overall achievement of the strategic objective within the audited environment. Generally, internal controls, governance and risk management processes were adequate, appropriate, and effective. However, there is room to improve.
Full Plan to Become Effective	Multiple significant and/or (a) material issue(s) noted. However, a full SMART (<i>Specific, Measurable, Achievable, Realistic and Time-bound</i>) plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee. If implemented, this plan should ensure adequate, appropriate, and effective internal controls, governance and risk management processes.
Partial Plan to Become Effective	Multiple significant and/or (a) material issue(s) noted. However, a partial SMART plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee. If implemented, this plan should improve internal controls, governance and risk management processes.
Ineffective	Multiple significant and/or (a) material issue(s) noted. Internal controls, governance and risk management processes were not adequate, appropriate, or effective. They do not provide assurance that objectives will be met. No plan to address the issues was in place at the time audit Terms of Reference were shared with the auditee.

Annex B: Methodology

The Office of the Inspector General (OIG) performs its audits in accordance with the global Institute of Internal Auditors' (IIA) definition of internal auditing, international standards for the professional practice of internal auditing (Standards) and code of ethics. These Standards help ensure the quality and professionalism of the OIG's work.

The principles and details of the OIG's audit approach are described in its Charter, Audit Manual, Code of Conduct and specific terms of reference for each engagement. These help our auditors to provide high quality professional work, and to operate efficiently and effectively. They also help safeguard the independence of the OIG's auditors and the integrity of their work. The OIG's Audit Manual contains detailed instructions for carrying out its audits, in line with the appropriate standards and expected quality.

The scope of OIG audits may be specific or broad, depending on the context, and covers risk management, governance and internal controls. Audits test and evaluate supervisory and control systems to determine whether risk is managed appropriately. Detailed testing takes place across the Global Fund as well as of grant recipients, and is used to provide specific assessments of the different areas of the organization's activities. Other sources of evidence, such as the work of other auditors/assurance providers, are also used to support the conclusions.

OIG audits typically involve an examination of programs, operations, management systems and procedures of bodies and institutions that manage Global Fund funds, to assess whether they are achieving economy, efficiency and effectiveness in the use of those resources. They may include a review of inputs (financial, human, material, organizational or regulatory means needed for the implementation of the program), outputs (deliverables of the program), results (immediate effects of the program on beneficiaries) and impacts (long-term changes in society that are attributable to Global Fund support).

Audits cover a wide range of topics with a particular focus on issues related to the impact of Global Fund investments, procurement and supply chain management, change management, and key financial and fiduciary controls.