The Global Fund
To Fight AIDS, Tuberculosis and Malaria

Office of the Inspector General

Assurance at Country Level: External Audit of Grant Recipients

Southern and Eastern Africa Regional Report

GF-OIG-13-036
20 August 2013

TABLE OF CONTENTS

A. EXECUTIVE SUMMARY

Review examined the effectiveness of external audit assurance and the extent to which the Global Fund can place reliance on it

1. The 2013 work plan of the Office of the Inspector General (OIG) includes a review of the effectiveness of external audit assurance and the extent to which the Global Fund can place reliance on this assurance in managing grants. The fieldwork for the review was conducted from 11 March to 19 April 2013 and considered a sample of 61 external audits completed between 2011 and 2013. Three of these grants related to the Southern and Eastern Africa region; we reviewed five audits from this sample.

2. The overall conclusion, findings and recommendations from the OIG review are included in the consolidated OIG report on the oversight provided by external audit of grant recipients (GF-OIG-13-029). The current report includes those findings specific to Southern and Eastern Africa region.

Good practices noted included the embedding of external audit in grant management framework and the timely delivery of assurance

3. A number of good practices were noted during the review including:

- External audit is entrenched in grant agreements and the Grant Management Assurance Framework;
- Audits of Principal Recipients and sub-recipients were almost always conducted on an annual basis;
- The Local Fund Agent has consistently used the defined template for commenting on the external audit arrangements and audit reports; and
- Most audits were delivered on a timely basis.

Some improvement is needed, including ensuring that audit opinions and management letters contain all required provisions

4. Our review found that **some improvement is needed** in the external assurance provision for the grants audited in the Southern and Eastern Africa region, specifically:

- Ensuring that audit opinions contain all required provisions and information; and
- Ensuring that the management letters from the external audit include the grading of current year findings and the status of prior year issues.

The overall recommendations for the consolidated OIG external audit report include:

- Assessing the standard of external auditors
- Improving the management of conflicts of interest

Consideration should also be given to creating a pool of prequalified auditors and decreasing the overall timeline for audit activities.

5. The review of the Southern and Eastern Africa region mirrors to a large extent the recommendations made to the Global Fund Secretariat in the consolidated report. These include:

- Adopting a process for deciding which external auditors to rely on for assurance in order to ensure a consistent standard of audit reporting;
- Implementing a process to ensure that the external auditor has no conflict of interest, including declaring all services provided to the Principal Recipient in order for the Country Team to assess any potential conflict of interest;
- Considering decreasing the timeline provided by the Global Fund for submission of external audit reports to the Secretariat; and
- Considering creating a pool of prequalified external auditors for each region to ensure that the auditors appointed have the required minimum qualifications and are able to provide quality external audit reports.

B. MESSAGE FROM THE EXECUTIVE DIRECTOR FROM THE GLOBAL FUND

The Global Fund
To Fight AIDS, Tuberculosis and Malaria

Mark Dybul, Executive Director

Mark.Dybul@theglobalfund.org
www.theglobalfund.org

T +41 58 791 1115
F +41 58 791 1701

Chemin de Blandonnet 8
1214 Vernier, Geneva
Switzerland

Ref: OED/MD/CK/SP/DM/2013.08.08-External Auditors

8th August 2013

External Audit of Grant Recipients

I would like to thank the Office of the Inspector General for its thorough and insightful work on the external audits of grant recipients.

The 2013 audit work plan of the Office of the Inspector General includes a review of the effectiveness of external audit assurance over grant recipients and the extent to which the Global Fund can rely on this assurance in managing grants.

A sample of 29 countries from all 10 regions in grant management were considered in the survey, encompassing 44 grants.

The Office of the Inspector General has made a number of general recommendations in a consolidated report as well as specific observations in separate surveys of each of the 10 regions.

The overall conclusion of the Inspector General is that existing external audit arrangements over grant recipients are not satisfactory. Controls do not allow the Global Fund to generally rely on the external audit of grant recipients for assurance.

Among other things, external audits did not consistently cover key risks relating to use of grant funds. Processes to ensure the independence and evaluate the performance of external auditors were not sufficient.

Extensive delays were noted in submission of audit reports as well as further delays in the actions taken by the Secretariat to address concerns identified by external auditors.

The Global Fund Secretariat is in the process of strengthening its current guidelines and terms of reference for the external audit of Principal Recipients and Sub-recipients. Revised guidelines have been drafted but have not yet been implemented across the grant portfolio.

The report should also be read in the context of numerous changes that are happening within the Secretariat including stronger management of Local Fund Agent budgets with more focus on higher risk and value added LFA work, the implementation of more comprehensive operational risk management, the application of the new Grant Management Assurance Framework, and the comprehensive redefinition of Grant Management and Finance processes.

The Inspector General makes five recommendations, four of them rated "very high", calling for urgent action to be taken. The Secretariat agrees with these recommendations and is in the process of implementing them.

These are as follows:

- Implement without delay the three recommendations of the High Level Review Panel relating to external audit which include: having the Audit and Ethics Committee approve minimum standards; establishing a prequalified pool of auditors; and developing a protocol for information exchange with Supreme Audit Institutions;
- Approve external auditors before disbursements are made;
- Improve the timeliness of receipt of external audit reports;
- Take prompt action when concerns are documented in audit reports of grant recipients;
- Determine how best to derive combined assurance from external audit, Local Fund Agents, the Country Coordinating Mechanism, other donors and other relevant stakeholders.

The Office of the Inspector General provides an essential form of quality control for the Global Fund. It plays an indispensable role in helping us all achieve our mission of effectively investing the world's money to save lives.

Sincerely

C. SCOPE AND OBJECTIVES

C.1 Objectives

Objective of review was to evaluate the effectiveness of external audit assurance provision

6. The overall objective of the review was to evaluate the effectiveness of external audit assurance and the extent to which the Global Fund can place reliance on this assurance in managing grants. The sub-objectives were to assess the quality of assurance provided by external audit including:

- The coverage of key risk areas and implementing entities;
- The independence and objectivity of the external auditor;
- The qualifications and competency of the external auditor, including internal quality assurance processes;
- The timeliness of the assurance provision; and
- The reliance placed on, or use of, other assurance providers and whether the opinions given conflict with other assurance providers.

C.2 Scope and Methodology

Review focused on audits completed in 2011-13

7. The scope of the review focused on a sample of external audits completed between 2011 and 2013. The review was carried out at the Global Fund Secretariat in Geneva. The review approach was as follows:

- Initial meetings with the Global Fund Secretariat to discuss and agree on the objectives, scope and approach of the review;
- Collection and review of relevant information including external audit reports, policy guidelines, key processes and procedures;
- Interviews with Fund Portfolio Managers, finance officers and other relevant staff at the Secretariat, and where necessary selected grant recipient countries;
- Limited tests of a sample of external audits; and
- Debriefing meetings with relevant staff to share emerging findings and discuss scope for improvements.

8. Our sample included two countries from the Southern and Eastern Africa region, Lesotho and Swaziland. We reviewed five audits relating to three grants.

D. BACKGROUND

Independent audits are a critical component of the Global Fund Grant Management Assurance Framework

9. The Global Fund Secretariat recognizes the external audit of grants as "a corner stone" in its Grant Management Assurance Framework.[1] External audits provide an opinion on the proper use of grant funds and provide input for decision-making on the disbursement of those funds, as well as the renewal of grants within the Global Fund's performance-based funding framework.

The PR is obligated under the grant agreement to have an independent audit of its income and expenditures

10. Article 13 of the program grant agreement contains a specific clause that obligates PRs to have independent financial statement audits relating to program revenues and expenditures.

E. GOOD PRACTICES

Good practices noted included the embedding of external audit in grant management framework and the timely delivery of assurance

11. A number of good practices were noted during the review, including:

- External audit is entrenched in grant agreements the and Assurance Framework;
- Audits of PRs and SRs were almost always conducted on an annual basis;
- The LFA has consistently used the defined template for commenting on the external audit arrangements and audit reports; and
- Most audits were delivered on a timely basis.

[1] The Grant Management Assurance Framework was issued to the Grant Management division on 11 February 2013.

F. AREAS FOR IMPROVEMENT

Some Improvement Needed	Some areas for improvement were noted in the external assurance provision for the grants audited, particularly around the content and quality of the audit report and the management letters. Some delays were noted in the timeliness of provision of audit assurance.

F.1 Coverage of key risks

Audits of financial statements should provide reasonable assurance to Global Fund

F.1.1 Contents of the Audit Opinion and Management Letter

12. According to the current guidelines, the external auditor is required to state:

- Whether disbursed funds were used for the intended purposes in accordance with the grant agreement and the approved budget;
- Whether the financial statements were compliant with accounting standards; and
- Whether their opinion was in compliance with auditing standards.

13. The current guidelines also require that the Management Letter include the following elements:

- The grading of the issues/findings;
- Details of the findings, their implications, severity and any recommendations proposed; and
- The progress made on matters arising from previous audits.

Issues noted:

- EA Management Letters not submitted
- Audit opinion not signed

14. Our review of external audit opinions and management letters highlighted that the following key elements were not consistently included:

- For two audits, the audit opinion did not indicate whether funds were used in accordance with the terms of the grant agreement;
- For two audits the external audit management letter did not indicate the implementation status of the previous year's audit findings;
- For one audit the external audit management letter did not indicate the grades of the current year audit findings; and
- For one audit the external audit management letter was not submitted.

Absence of key elements in the audit report and management letter may result in less assurance

15. If the external audit reports and management letters do not contain the required elements, there is a risk that the reports may not contain all the assurances required by the Global Fund. In addition, Country Teams may not have an adequate level of detail to monitor financial performance and/or to provide constructive feedback to the PR or SR.

F.1.2 Sub-recipient audits

16. In terms of sub-recipients, the current guidelines state that:

- The PR should prepare an audit plan to ensure that all SRs funded by the Global Fund are audited annually. The submission of the SR audit plan is a requirement during grant negotiation and the audit plan should be reviewed by the LFA and approved by the Global Fund Secretariat within six months of grant signing.
- The LFA is required to perform a review of the SR audited financial statements concurrently with the review of the PR audited financial statements.

SR audit plans, audit reports and management letter not submitted

17. We noted that for one audit, the SR audit plan, SR audit reports and management letters were not submitted by the PR. The auditor's engagement letter did not indicate the name of the SRs that should have been audited.

18. In the absence of a SR audit plan, the SR audit report and management letter, the Global Fund does not receive reasonable assurance that the funds disbursed to SRs were used for the intended purposes in accordance with the grant agreement and the approved budget.

F.2 Independence and objectivity

EA conflict of interest declarations are not obtained from the external auditors

19. The specimen audit terms of reference (TOR) for external auditors included in the current guidelines for annual audits of PRs and SRs state that the auditor must be completely impartial and independent from all aspects of management and must disclose any relationship that may impair his/her independence. We noted that there was no process in place to obtain a conflict of interest declaration from the external auditor on an annual basis.

F.3 Qualifications and Competency

Absence of a defined mechanism to monitor the EA performance

20. There was no defined mechanism to ensure or evaluate the performance of external audit. Although the LFA was required to comment on the "suitability" of the external auditor's work in the LFA review template, no opinion was required from the LFA on the quality of the work conducted by the external auditors.

Competency of the selected auditor could not be ensured

21. For one audit the competency of the selected auditor could not be verified since the LFA had not commented on the "suitability" of the auditor.

Absence of robust external auditor assessment process may result in poor quality

22. The absence of a robust external auditor assessment process and quality assurance mechanism creates a risk of poor quality audits and may not provide the required level of assurance.

F.4 Other assurance providers

External Auditor not required to engage with other assurance

23. The specimen audit TORs for external auditors included in the current guidelines for annual audits of PRs and SRs do not require the external auditor to engage with other assurance providers while

providers

planning and executing their audits.[2]

No mechanism to compare feedback of various assurance providers

24. There is no defined mechanism to compare the feedback provided by the external auditor with other assurance work performed, for example, by the LFA, other donors, or the OIG. During the review we observed one audit for which the external auditor had not raised key weaknesses that had previously been highlighted by the LFA. This included expenditure of USD 264,244 incurred prior to grant signing and inadequate monitoring of budget compared with actual expenditure.

25. Comparing the results of work performed by various assurance providers would allow Country Teams to implement remedial actions for improving the quality of work conducted by assurance providers and to replace underperforming external auditors if needed.

Timely assurance is critical for effective risk management

F.5 Timeliness of assurance

26. Timely reporting is critical to the success of the Grant Management Assurance Framework and to enable the Secretariat to make decisions on a timely basis. It is also essential that the Secretariat provide feedback to the PRs on a timely basis so that any risks identified by the external auditor are acted upon.

Significant delays experienced in the submission of audit reports

27. Per the current guidelines, PRs (including SRs where relevant) are required to submit external audit reports to the LFA within six months of the end of the financial year. The LFA is required subsequently to review the external audit report and management letter and to provide its analysis to the Secretariat within one month. Our analysis of the above timelines highlighted the following:

- A delay of 83 days for one audit in submitting the audit reports and management letters to the LFA beyond the six month timeline; and
- A delay of 88 days for one audit in submitting the LFA comments on the audit report to the Secretariat beyond the one month timeline from the receipt of the external audit report and management letter.

Submission of audit reports on timely basis is critical for the Secretariat

28. Despite the delays noted above, the timeliness of the audit reports in the Southern and Eastern Africa region compare favorably to the other grant management regions. Further improvement in the timeliness for completing external audit activities would allow the Country Team to promptly mitigate any risk identified by the external auditor.

[2] The 2013 Grant Management Assurance Framework refers to various layers of assurance in the oversight and monitoring of grants

ANNEX 1: Abbreviations

EA	External Audit
LFA	Local Fund Agent
OIG	Office of the Inspector General
PR	Principal Recipient
SR	Sub-recipient

ANNEX 2: Classification of Audit Findings and Recommendations

Rating of Functional Areas: Each functional area reviewed (e.g., timeliness) is rated as follows:

Effective	Controls evaluated were adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and the Global Fund's strategic objectives should be met.
Some Improvement Needed	Some specific control weaknesses were noted; generally however, controls evaluated were adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and the Global Fund's strategic objectives should be met.
Major Improvement Needed	Numerous control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and the Global Fund's strategic objectives should be met.
Not Satisfactory	Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and the Global Fund's strategic objectives should be met.
Critical	An absence of or fundamental weakness in one or more key controls, or a serious non-compliance. Non-mitigation will jeopardize the achievement of the Global Fund's strategic objectives. It requires urgent attention.