

Board Chair Cover Note

Audit & Investigation Reports issued by the Global Fund's Office of the Inspector General on 1 November 2011

Dear Reader,

Today, the Global Fund has released eight audit reports, three investigation reports and one review of Global Fund systems by its Office of the Inspector General. The Inspector General regularly conducts audits and investigations. The audits are part of the Global Fund's regular and routine efforts to ensure that grant money is used as efficiently as possible. The investigations have arisen out of suspected wrong-doing found during audits.

It is unusual to release so many reports at one time. Ordinarily, reports of the Office of the Inspector General are released to the Board as and when they are finalized. On this occasion we agreed that these reports would be finalized after completion of the *'The Final Report of the High Level Independent Review Panel on Fiduciary Controls and Oversight Mechanisms of the Global Fund'*. This ensured that the Global Fund Board, Secretariat and Inspector General could focus fully on the report of the High Level Panel and its recommendations.

The reports are:

- Audit Reports: Dominican Republic, Sri Lanka, Nigeria, Swaziland; four reports relating to the work of Population Services International (South Sudan, Madagascar, Togo, and Headquarters)
- A Review of the Global Fund Travel and Travel-related Health and Security policies
- Investigation Reports: Mauritania, India, and Nigeria

The country-specific reports cover grants from different Global Fund financing 'Rounds', and have implementation start dates commencing at various times since early 2004. Together, the reports review around US\$ 1 billion of grant financing. These reports take into account as far as possible, a number of the High Level Panel's recommendations. The Reports include comments from the Principal Recipients and contain a thorough management response and action plan from the Secretariat. Increased attention has been paid by the Office of the Inspector General to the tone of the Reports, without diluting the important message that each carries.

Specifically, the Reports tell us that the Global Fund must seek to recover up to US\$ 19.2 million from grants in eight countries. Around US\$ 17 million of this amount is for activities that are poorly accounted for, were not budgeted in the work plan, or fall within the Global Fund's current definition of an ineligible expense, which is an area that the High Level Panel report suggested be clarified for Principal Recipients. Some of the grant implementer responses contest relevant findings. From the perspective of the Office of the Inspector General, the reports present the evidence that has been found and recovery should be sought in full.

The Nigeria investigation report, which led from the audit, brings to the surface once again issues with the Local Fund Agent engagement model – raised very proactively also in the Inspector General’s reports for Mali in December of last year.

Whilst in no way seeking to reduce the importance of the concerns that come from the three investigation reports, they do come at a time when the Global Fund knows that it has to transform how it manages its grants – and how – most importantly – it proactively addresses risk in its portfolio. This cannot entirely prevent mismanagement in all grants, but it will certainly provide a better framework on which resources are channeled to partner countries.

At its November 2011 meeting, the Global Fund Board will consider a Consolidated Transformation Plan to bring into effect the High Level Panel’s recommendations on risk, grant management and improved fiduciary oversight.

More reports will come from the Inspector General and irregularities will continue to be found given the increasingly complex environments in which the Global Fund works. The Global Fund continues to strive to prevent loss, and we must ensure that the organization has the systems that enable us to take purposeful and immediate action when irregularities are discovered. Where there is dishonesty, we must pursue those involved.

The Global Fund is committed to the mission of saving lives and assisting countries in building strong and sustainable health systems. Emerging as an issue over the last years, but now very firmly confirmed from the Report of the High Level Panel, the Global Fund must be transformed at all levels.

The Consolidated Transformation Plan will provide the Secretariat, the Office of the Inspector General, and the Board with the means to make this transformation, and ensure ongoing service and accountability to the people whose lives we must save, and to those that fund that cause.

Best regards,

Simon Bland
Board Chair



THE OFFICE OF THE INSPECTOR GENERAL

The Global Fund to Fight AIDS, Tuberculosis and Malaria

Audit of Global Fund Grants Managed by Population Services International

Audit Report GF-OIG-10-022
31 October 2011

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Abbreviations

| | |
|-------|--|
| ACT | Artemisinin-based Combination Therapy |
| ART | Anti-Retroviral Treatment |
| ASP | Additional Safeguard Policy |
| ARV | Anti-Retroviral |
| CCM | Country Coordinating Mechanism |
| CP | Condition Precedent |
| CPI | Consumer Price Index |
| CTA | Country Team Approach |
| DOTS | Directly Observed Treatment, Short course |
| DQA | Data Quality Audits |
| DRC | Democratic Republic of Congo |
| EECA | Eastern Europe and Central Asia |
| EFR | Enhanced Financial Reporting |
| FPM | Fund Portfolio Managers |
| HIV | Human immunodeficiency virus |
| HR | Human Resources |
| HSS | Health System Strengthening |
| IGA | Income Generating Activities |
| KPI | Key Performance Indicators |
| LAC | Latin America and Caribbean |
| LFA | Local Fund Agent |
| M&E | Monitoring and Evaluation |
| MDR | Multi-Drug Resistant |
| MENA | Middle East and North Africa |
| MESS | Monitoring and Evaluation System Strengthening |
| MOH | Ministry of Health |
| NGO | Non-Governmental Organization |
| OAI | Office of Audit and Investigations (UNDP) |
| OI | Opportunistic Infection |
| OIG | Office of the Inspector General |
| OSDV | On-Site Data Verification |
| OVC | Orphans and Vulnerable Children |
| PHPM | Public Health Policy and Management |
| PMAS | Pharmaceutical Management Advisory Services |
| PMU | Pharmaceutical Management Unit |
| PQR | Price and Quality Reporting |
| PR | Principal Recipient |
| PSI | Population Services International |
| PSM | Procurement and Supply Management |
| PUDR | Progress Update and Disbursement Request |
| PLWHA | People Living with HIV and AIDS |
| RCC | Rolling Continuation Channel |
| SR | Sub-Recipient |
| SSR | Sub-Sub-Recipient |
| TA | Technical Assistance |
| TB | Tuberculosis |

| | |
|------|------------------------------------|
| TI | Transparency International |
| TPPA | Third Party Procurement Agents |
| UN | United Nations |
| UNDP | United Nations Development Program |
| VAT | Value Added Tax |
| WHO | World Health Organization |

EXECUTIVE SUMMARY

1. In June 2010, the OIG undertook an audit of Global Fund grants managed by Population Services International. The purpose of this review was to assess the adequacy and efficiency of controls put in place by PSI in managing Global Fund grants. In this report, the OIG also synthesizes and identifies common challenges arising from the PSI related audits at a country level and identifies lessons learned that may further strengthen oversight and controls of grants managed by PSI.

2. This section briefly highlights the findings and conclusions arising from the audit. The detailed findings are contained in the rest of the report.

Background

3. PSI has been involved in implementing Global Fund supported programs as a PR, SR and SSR covering all three diseases. PSI often also sits on the Country Coordinating Mechanism (CCM) and has helped to develop proposals in some countries. It also sits on country level technical committees in some countries. PSI and its affiliates have been nominated as PR in twelve countries namely Democratic Republic of Congo, Haiti, Madagascar, Nepal, Nigeria, Pakistan, Papua New Guinea, Southern Sudan, Tanzania, Thailand and Togo and manage grants amounting to some US\$ 500 million. It is also acts as SR and SSR in over 20 countries.

4. PSI is PR in countries with challenging socio political and health sector environments e.g. Haiti, DRC, Southern Sudan, Togo, Nepal and Madagascar. These countries are characterised by:

- i. poor infrastructure, insecurity and social conditions;
- ii. inadequate capacity in terms of structures, tools, personnel etc. at all levels in the health sector;
- iii. political instability;
- iv. high levels of illiteracy; and
- v. weak national systems to support the implementation of programs e.g. PSM systems, M&E systems etc.

Despite these challenges, PSI has implemented grants in these countries with commendable results achieved.

Institutional Arrangements

5. With the exception of Nigeria, all grant agreements were signed with PSI HQ. The Global Fund operations manual requires that when an international non-governmental organization is nominated as PR, the arrangements are temporary. The relevant PR is required to build the requisite capacity of national entities to take over the role of PR. Such plans were not in place for the grants audited by the OIG which were managed by PSI. The OIG appreciates

that there are potential risks associated with transitioning to systems with inadequate capacity or quality since shortcomings in such systems can jeopardise grant implementation. However, unless a process to build the requisite capacity and transition grants to national programs is instituted, this may never happen and its runs counter to the principle of 'national ownership'.

6. The LFAs involved did not have the necessary access to the expenditure and records managed by PSI HQ. In most countries where PSI is a PR, this represents a significant proportion of overall grant expenditure. The restrictions on LFAs access to information/ documentation from PSI HQ impacted their ability to effectively execute their mandate. As a matter of urgency, the Secretariat should require LFAs to access information maintained at the PSI HQ.

7. A review of the salaries paid to staff working in the Global Fund supported programs managed by PSI revealed some benefits (e.g. bonuses, commissions, fringe benefits etc.) which although they were part of PSI's remuneration package, appeared to be excessive when set against the context of what the funds were provided for i.e. to fight the diseases. The Global Fund in its budgeting guidelines states that program funds should only be used to pay for what is reasonable so that program funds are used to maximum effect. The Global Fund should consider the appropriateness of future salary and fringe costs as part of the grant negotiation process.

8. Audit is a key Global Fund fiduciary arrangement that confirms that funds are used for their intended purposes. The OIG noted that despite the fact that a high proportion of the expenditure (between 60-90% in cases where PSI is PR) is incurred at HQ level, at the time of the audit, there was no provision to have this expenditure audited. PSI has since the end of the OIG audit made a proposal to move to a consolidated audit that would cover both HQ and field based expenditure. The Global Fund should consider whether the proposed new audit arrangements in practice meet its external audit guidelines and would result in the assurance required for decision making.

Program Related Aspects

9. PSI has made commendable contributions to the countries in which it manages Global Fund supported programs. The good performance of the grants managed by PSI is evidenced by the ratings of the performance of grants with most of the grants rated A1 to B1 and some of the grants that it manages qualifying for the Rolling Continuation Channel (RCC). PSI has made commendable contribution to the fight of the diseases in activities like social marketing and mass distribution of health products e.g. LLINs and ACTs, raising awareness among high risk target groups through interpersonal communication and mass communication activities and disseminating messages on HIV prevention.

10. The programs that were run by PSI were part of a national program with PSI running its programs alongside a public sector institution. PSI, like many other PRs, has set up parallel structures from the national ones because the national ones were viewed as being cumbersome and/or inadequate to support program implementation. This is contrary to the Global Fund principles that advocate for the use of national systems to the maximum extent possible.

11. Coordination and collaboration between the programs is a challenge not only for PSI but across PRs in other countries. The shortcomings in collaboration and coordination between PSI and other PRs partly arises from the nature of the programs supported by the Global Fund which by design and implementation concentrate on achieving predefined targets within a defined duration. While there is evidence of mechanisms to enhance collaboration in some of the countries visited, greater collaboration among PRs would go a long way in improving the effectiveness of the overall national program.

12. The OIG noted a shortcoming relating to the indicators and results reported across most of the grants arising from the different definitions/interpretations of indicators relating to the distribution of products. PSI's interpretation of distribution of products was to intermediary points and not to final users yet the 'top ten indicator' indicators mandated by the Secretariat call for evidence of distribution to the final user level. This needs to be corrected if results reported are to be consistent with the 'top ten indicators'.

13. The products that were sold under PSI's social marketing program helped address public health problems while at the same time mobilizing additional resources to help sustain the program. However, the OIG also noted the following areas that need to be addressed in order to make the program more effective:

- i. There should be product differentiation between the products that are to be given away for free and those that were to be sold. The product differentiation enables implementers identify to diversion of products;
- ii. PSI left the market to regulate itself and there is a need to put in place price control mechanisms to ensure that the products reach the intended beneficiaries at their intended price;
- iii. PSI should to the extent possible promote generic products as opposed to its own brands. This ensures that the targeted population appreciates the importance of the commodity irrespective of brand; ensures that all brands are can derive benefits from promotion; addresses the risk of sustainability i.e. in cases where particular brands are not available etc.;
- iv. PSI should institute measures to ensure that products reach their intended beneficiaries and results reported reflect this; and

- v. Strengthen the accounting for program income from social marketing activities.

Financial Management

14. PSI maintained the grant funds in a pool account. In cases where pool bank accounts are maintained for different donors, the accounting system should be able to split bank balances by donor/grant. However, PSI's accounting system was unable isolate bank balances by country, donor and grant. In consequence, the LFA was unable to validate the bank balances reported in the PUDR and could not provide the required assurance about the accuracy of program transactions and resultant bank balances. PSI should either open a separate bank account for Global Fund grants or have an accounting system that can reconcile balances in the fund accountability statements with bank balances held.

15. The grant agreement encourages PRs to maintain grant funds in an interest bearing bank account. The interest reported to the Global Fund was therefore not the actual interest earned but a manual calculation and allocation of interest by PSI. A review of the interest computation revealed that the interest reported to the Global Fund differed from the actual interest earned by PSI on grant funds because:

- i. the actual interest rates PSI received bank rates differed from the rates applied to the computation i.e. the US federal treasury interest rates; and
- ii. there were computational errors in the interest calculations. This should be corrected and recoveries made.

16. PSI's financial guidelines provided a basis against which common costs should be allocated across donors. However, the OIG noted that both the field offices (platforms) and HQ did not consistently apply the policy and in some cases this resulted in an overcharge to the Global Fund. The OIG was not therefore unable to provide assurance that the allocation of common costs across donors was reasonable.

17. The OIG reviewed the reasonableness of the PSI overhead costs and noted that:

- i. there were disparities of rates across grants and countries;
- ii. there were disparities in the way in which the fees were applied to specific expenditure categories;
- iii. there were some isolated cases where the wrong rate was applied in the computation;
- iv. there were additional direct costs related to the HQ were charged in addition to the overhead costs;
- v. rates were not adjusted to take into account the differences in responsibilities when PSI was PR or when it was SR; and

- vi. there were no independent processes to validate the overheads charged to the Global Fund.

The Global Fund established guidance on overheads in 2011 which to a large extent address the issues noted above.

Procurement and Supply Chain Management

18. A significant portion of grant funds was spent on PSM related activities. The procurement of health products and high value items was normally undertaken by PSI HQ with platforms (country offices and affiliates) taking on the low value procurements. PSI's platforms procurement policies were generally adequate to provide for procurement to be undertaken in a transparent manner in compliance with the grant agreements. However, the OIG noted that the procurement at platform level did not always follow the laid down policies resulting in a weakened control environment within which procurement was undertaken.

19. The OIG review of the procurement processes at the HQ revealed shortcomings which need to be addressed urgently in order to strengthen the control environment within which procurements are undertaken. These include:

- i. enhancing the human resource capacity of the HQ procurement team;
- ii. strengthening the bidding process by providing comprehensive bidding documents and strengthening the bid receipt and opening process;
- iii. strengthening criteria by ensuring that they are clear and provide bidders with a clear basis as to how the bids would be evaluated;
- iv. using defined criteria in evaluations;
- v. putting controls in place for procurements where a competitive process is not followed to ensure that value for money is obtained; and
- vi. strengthening contract management by ensuring that payments are effected in accordance with contract terms, ensuring that performance securities are obtained, confirming that deliveries are effected before final payments are made etc.

20. The issues noted above evidenced significant weaknesses in PSI's staff capacity to effectively procure program products. The OIG noted that all the PSM assessments undertaken by the LFA were at the country level. At the time of the audit, no assessment had been undertaken of the HQ's capacity to handle procurements despite the fact that most procurement was undertaken at this level. This is contrary to the grant agreement that stipulates that PR's capability to procure health products be assessed due to the complexity and significant risks associated with the procurement of health products.

21. PSI should:

- i. comply with the relevant procurement related conditions in the grant agreement. Specifically, if PSI HQ is to continue to be involved in PSM activities, it should be assessed periodically through an established process by the Global Fund for assessing PR PSM systems and capacity in line with the grant conditions. Measures instituted to address capacity gaps identified and/or appointing a third party procurement agent to manage procurement on behalf of PSI (article 19b);
- ii. update its policies in line with good procurement practice and ensure that they are consistently applied (article 18a) ; and
- iii. strengthen the skills set of staff in the procurement unit (article 19b).

Sub-Recipient (SR) Management

22. PSI's manuals at platform level clearly elaborate the policies and processes that are followed in the selection and management of SRs. However these policies were not always applied resulting in some shortcomings identified across the platforms:

- i. significant delays in contracting of SRs;
- ii. shortcomings in the SR selection process;
- iii. shortcomings in the review of SR accountabilities; and
- iv. inadequate SR monitoring. PSI should enforce the guidelines contained in its manuals in order to strengthen the control environment in its SRs.

Conclusion

23. PSI is a key stakeholder in the management and implementation of Global Fund activities across the globe. PSI has generally instituted good policies in the management of program funds but there is still scope to further improve their implementation at field office and HQ level. Specifically, urgent measures need to be put in place to strengthen the control environment within which the grants are being managed/ implemented in the following areas:

- i. Procurement of program products and services;
- ii. Alignment of program results reported to the 'top ten indicator' definitions;
- iii. Strengthening of financial management to ensure that charges to programs are bona-fide and reasonable; and
- iv. SR management.

24. The Global Fund arrangements for grant oversight are not fully operational in PSI's case and this limits the level of assurance the Global Fund has with regard to the management of program funds by PSI. All oversight arrangements should fully operationalized for PSI managed programs. Specifically, the CCMs and LFAs should be provided with all requisite information to enable them to undertake their respective mandates.

Specifically, LFAs should have access to the necessary information and people in order to undertake the required capacity assessments and verification of program implementation. Audits should be undertaken in compliance with the grant agreement and the Global Fund audit guidelines.

BACKGROUND

Overview

25. The Office of the Inspector General (OIG) provides the Global Fund with independent and objective assurance over the design and effectiveness of controls in place to manage the key risks affecting the Global Fund's programs and operations. The purpose of this review was to assess the adequacy and efficiency of controls put in place by PSI in managing Global Fund grants. In this report, the OIG also synthesizes and identifies common challenges arising from the PSI related audits at a country level and identifies lessons learned that may further strengthen oversight and controls of grants managed by PSI.

PSI

26. PSI was founded in 1970 to improve reproductive health using commercial marketing strategies. It is an international non-governmental organization with its headquarters in Washington DC. PSI works in more than 70 countries worldwide including 25 in Africa in malaria, reproductive health and HIV/AIDS programs. PSI has been involved in implementing Global Fund supported programs as a PR, SR and SSR in all three diseases. PSI often sits on the Country Coordinating Mechanism (CCM) and has helped to develop proposals in some countries. PSI also sits on country level technical committees in some countries.

27. The countries in which PSI has been involved in implementing Global Fund supported programs are listed below:

- i. PSI and its affiliates are PRs in the Democratic Republic of Congo, Haiti, Madagascar, Nepal, Nigeria, Pakistan, Papua New Guinea, Southern Sudan, Tanzania, Thailand and Togo. This amounts to some US\$ 500 million.
- ii. PSI and its affiliates have also been SRs/SSRs in Angola, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, China, Cote D'Ivoire, Ethiopia, Guatemala, Honduras, Kazakhstan, Laos, Lesotho, Mali, Myanmar, Namibia, Pakistan, Panama, Russia, Rwanda, South Africa and Swaziland.
- iii. PSI has been a PR/SR in multi regional grants e.g. the Caribbean region and in South Asia.

28. The table below provides a summary of those countries where PSI and its affiliates are PRs is provided in the table below:

| Country | Round | Component | Grant US\$ | Disbursement US\$ |
|-----------------------------|-------|-----------|-------------|-------------------|
| Congo (Democratic Republic) | 8 | Malaria | 77,863,857 | 66,872,873 |
| Haiti | 8 | Malaria | 31,107,242 | 18,414,516 |
| Madagascar | 1 | Malaria | 1,872,363 | 1,872,363 |
| Madagascar | 2 | HIV/AIDS | 4,992,128 | 4,992,128 |
| Madagascar | 4 | Malaria | 47,507,827 | 40,370,140 |
| Madagascar | 7 | Malaria | 6,221,004 | 6,024,799 |
| Madagascar | 8 | HIV/AIDS | 4,034,369 | 3,080,413 |
| Multicountry South Asia | 9 | HIV/AIDS | 13,688,801 | 3,845,240 |
| Nepal | 2 | Malaria | 17,991,177 | 10,588,714 |
| Nepal | 7 | Malaria | 7,024,844 | 6,467,229 |
| Nigeria (SFH) | 4 | Malaria | 30,641,591 | 25,670,295 |
| Nigeria (SFH) | 5 | HIV/AIDS | 15,324,677 | 15,324,677 |
| Nigeria (SFH) | 8 | Malaria | 87,749,801 | 48,796,177 |
| Pakistan | 8 | TB | 3,183,623 | 2,077,011 |
| Papua New Guinea | 8 | Malaria | 6,373,170 | 2,584,059 |
| Sudan | 7 | Malaria | 64,685,770 | 46,229,289 |
| Tanzania (United Republic) | 4 | HIV/AIDS | 27,459,142 | 13,474,829 |
| Thailand | 8 | HIV/AIDS | 6,415,062 | 5,562,452 |
| Togo | 4 | HIV/AIDS | 32,654,555 | 30,761,373 |
| Togo | 8 | HIV/AIDS | 10,371,643 | 2,883,854 |
| | | | 497,162,646 | 355,892,431 |

Objectives of the Audit

29. The OIG sets out the lessons learned from several country audits where PSI manages Global Fund supported programs and identifies the scope for improvement that should be considered by the PSI and the Global Fund in the light of its audit findings. The review sought to draw on findings in order to:

- i. Identify opportunities for improvement arising from common country audit findings; and
- ii. Review the key processes that are external to PSI country offices i.e. those at Headquarters.

Scope

30. The OIG has undertaken PSI specific audits in three countries where Global Fund grants were managed by PSI i.e. Madagascar, Togo and Southern Sudan. The OIG has also undertaken country audits in the past in four countries where PSI and its affiliates were PR namely Nepal, Tanzania, Nigeria and Papua New Guinea. The OIG also undertook audits in countries where PSI was SR i.e. Cambodia, the Democratic Republic of Congo, Haiti, Laos and Swaziland. Subsequent to the audit, PSI became PR in two of these countries i.e. Haiti and DRC.

31. The OIG visited PSI's Headquarters and reviewed program related activities that were managed at the HQ level. The transactions reviewed were typically not covered by the LFA work and the scope of the country external audits.

The Report

32. This report does not repeat the findings of the individual audit reports that form the basis of this report but draws from the findings of these audits. In order to make an effective contribution to accountability and facilitate improvement for the future, this report focuses on common challenges which are characterized not just by their frequency or incidence but by their effect and impact.

INSTITUTIONAL ARRANGEMENTS

Organization Structure

33. PSI has a Board of Directors that provides oversight over the whole organization's business. PSI has an elaborate organization structure at its Headquarters that manages its Headquarters but also provides support to its country offices and affiliates (platforms). This support is not only financial but technical.

34. At the platform level, the PSI office is headed by a resident Country Representative (CR) who reports to a Regional Director that is based in Washington DC. There are also reporting linkages by function between the PSI platforms and the HQ e.g. the financial and programmatic reports are sent to the Financial Analyst and Program Manager in Washington who consolidates the country results. The functional teams are not involved in direct implementation or day to day decision making of the grants.

35. The HQ team supervises and in most cases is also involved in processing additional transactions incurred at HQ related to the country programs. In fact capacity gaps that were identified at country level by many LFAs described the HQ teams as a 'stop gap measure' to address the local country capacity weaknesses. Because of their direct involvement in country operations, this team may not therefore be the appropriate body to provide oversight to the Global Fund supported programs. The Board, on the other hand, is removed from the activities that happen at the country/program level.

36. The importance of having a local governing board was appreciated in Nigeria where there was evidence of the platform's board providing oversight to program implementation. The absence of an oversight function and how that can affect program implementation was noted in Southern Sudan. PSI informed the OIG as more countries became independent from the HQ, local governing bodies would be put in place. However in the meantime, PSI may need to consider setting up a function to provide the requisite oversight to all its programs.

PSI HQ vs. PSI Platforms

Selection of national organizations as PRs

37. The Global Fund operations manual requires that multilateral organizations or international non-governmental organizations be nominated as PR only if a qualified national entity is not available. With the exception of Nigeria, all the grant agreements were signed with PSI HQ. Such arrangements are meant to be temporary with the relevant PRs being required to build the

requisite capacity of national entities to take over the role of PR.

38. In the localities audited by the OIG, there was no evidence seen of arrangements to build the requisite local capacity and transition to the national systems. The OIG appreciates that there are potential risks associated with transitioning to systems with inadequate capacity or quality since such systems can jeopardise grant implementation. However, unless a process to build the requisite capacity and transition grants to national programs is instituted, this may never happen. This runs counter to the principle of national ownership.

39. During the visit to PSI HQ, senior management stated that they were aware of the need to build capacity at country level. PSI has a capacity building team responsible for training development and knowledge management across PSI teams. However, senior management explained that in an environment where they had to implement programs in challenging environments and ensure good results, capacity building sometimes suffered.

40. PSI primarily provides capacity building to its platforms to enable them to implement programs effectively and there is limited provision for building capacity of national systems. In the cases of Togo, this translated to the transfer of funds to the national programs without a work plan on what funds would be used for. Unless well planned and executed, these interventions in the long run do not represent value for money because there was no real capacity built and after the programs close would not result in any real benefit to the national structures.

Registration of the Affiliates

41. In almost all the cases where PSI was appointed as PR, the grant agreement being signed with PSI International whilst PSI's platforms were responsible for implementing the programs in country. The OIG noted that in a couple of platforms, PSI was working with or working through entities that it did not have legal affiliation to PSI e.g. in DRC and Haiti. This raised the risk of entities accessing grant funds for which they could not be held legally accountable. At the time of the PSI audit, the OIG was assured that PSI had embarked on an exercise to address the legal relationships between PSI and its platforms.

Recommendation 1: High

- i. The Secretariat should follow up the need for PSI HQ to establish capacity building and transition plans for the countries where it is PR. PSI should work with the CCM to identify the entities (either their own platforms and independent entities) that would benefit from such capacity building.*

- ii. As part of its assessments, the LFA should confirm PSI's affiliation with local entities.*

PSI and the CCMs

42. The Global Fund encourages the involvement of stakeholders in proposal writing. PSI was involved in proposal writing in most of the countries audited by the OIG. Because PSI was involved in writing the sections of the proposals that were relevant to PSI, PSI was best placed to win the PR selection process. Good practice requires that once an organization is involved in an activity, it should not compete for downstream work that flows from the activity it has undertaken. The extent of the involvement of entities in proposal writing that are likely to have a role in program implementation should be closely regulated.

43. CCMs require certain information in order to effectively undertake their oversight role. The CCM oversight guidelines list typical information that should be available to the CCM. The OIG noted that certain information that should be available for the CCM oversight was not available since this information was not available in country level but was maintained at the HQ level. For example the survey data collected by PSI as part of its M&E was only privy to PSI and its HQ. This information was not available at the country level to aid decision making.

Recommendation 2 (Significant)

- i. PSI should share information with the CCM to enable them undertake their oversight effectively.*
- ii. The Global Fund should provide guidance that regulates the extent of the involvement of PRs in the proposal writing process.*

PSI and the LFA

44. The LFA as 'eyes and ears' of the Global Fund locally play a crucial part in the Global Fund's system of oversight and risk management. Access to and review of documentation is central to effective execution of the key LFA's roles i.e. (i) assessment of PR capacities to implement grants; (ii) verification of implementation by grant recipients; (iii) carry out on-site data verification visits; and (iv) review the CCM Request for continued funding. The LFAs faced challenges in accessing information as noted below.

45. The PR was PSI HQ but the assessment was undertaken on the local platforms. The OIG's review of the assessment undertaken by the LFA revealed that for most of the capacity gaps identified at the platform, the LFAs rationalized that PSI HQ's capacity would mitigate the risks identified. However

the LFAs were not able to validate this assumption and, in practice, some of these mitigating actions did not materialize in the execution of the program.

46. The accounting records maintained at the country level did not include the transactions incurred by PSI HQ and this comprised a significant portion (60-90%)¹ of the grant expenditure. In consequence, it was impractical for the LFA to access the details of the expenditure incurred by PSI HQ as part of the periodic verification process. LFAs related that their request for information from HQ was sometimes honoured in a tardy manner and in other instances access to the requested information was denied. This is contrary to the grant agreement that requires that PRs permit the LFA to review program books and records and ensure that all supporting documents are available for any potential review.

47. The restrictions on LFAs access to information/ documentation from PSI impacted their ability to effectively execute their mandate. The lack of complete information at the country level created challenges to the LFA's work such as:

- i. Validation of appropriateness of audit arrangements and analyzing audit reports and reporting to the Global Fund relevant information for its decision making;
- ii. Validation of controls at HQ to safeguard grant funds;
- iii. Verifying that grant funds expended by PSI HQ were used solely for program related activities;
- iv. Validation of the accuracy of the bank interest;
- v. Validation of the bank balances that are reported in the PUDR;
- vi. Assessing whether there was a reasonable allocation of common costs at HQ level;
- vii. Verifying the accuracy of overheads and procurement cost computations; and
- viii. Compliance with procurement conditions stipulated in the grant agreement e.g. that contracts were awarded in a transparent manner etc.

Recommendation 3 (High)

PSI is expected to ensure that LFAs have full access to relevant documents and sites as per the grant agreement (article 8). As a matter of urgency, all restrictions on the LFA's access to information should be addressed by the Secretariat.

Human Resource Related Matters

48. There were two types of staff working on Global Fund-supported programs, viz. international and local staff. All provisions for salaries and

¹ This is the funding spent at HQ level as a percentage of total expenditure.

fringe benefits made included in the relevant grant budgets. The OIG noted some isolated cases where some staff salaries were paid from grant funds when they had not been budgeted for e.g. in Madagascar.

49. The international staff were hired by the HQ and deployed to the platforms. The international staff entitlements were clearly stated in the PSI's personnel manual and were in accordance to the US Department of State regulations. The international staff were entitled to allowances such as relocation expenses, medical, post differential, education, travel, and cost of living/residence etc.

50. The international staff were also entitled to fringe benefits amounting to 40% of the base salary. This included:

- i. benefits at a country level such as house rental payment, gardening, housekeeping, private vehicle costs, private gas, small household appliances, school fees etc.
- ii. Fringe benefits for international staff include Federal Insurance Contributions Act (FICA)², life insurance, unemployment, disability, severance etc.

51. While these benefits were clearly part of PSI's remuneration package, the extent of the benefits could be considered to be excessive when set against the context of what the funds were provided for i.e. to fight the diseases. The Global Fund cannot dictate what PSI staff should be paid. However, as per the Global Fund budgeting guidelines, program funds should only be used to pay for what is reasonable so that program funds are used to maximum effect. The OIG noted that in most of the budgets presented to the Global Fund, the fringe benefit was just a percentage and were not broken down. The Global Fund should consider the appropriateness of some of the salary and fringe costs as part of the grant negotiation process.

52. Both international and local staff were also entitled to annual bonuses and sales commissions. The OIG noted that following issues:

- i. some staff were paid commission when they were not necessarily involved in the sale of products e.g. in Madagascar.
- ii. Some grants were charged with commission related costs yet the programs funded by the Global Fund were not social marketing related e.g. as was noted in Southern Sudan.
- iii. The bonuses were paid to both HQ and platform staff. While the payment of salaries can be linked to program activities, it is the OIG's view that the payment of bonuses cannot be justified in light of the purposes of the grants and also because the Global Fund already pays

² The (FICA) tax is a United States payroll tax imposed by the federal government on both employees and employers.

competitive rates to PSI's staff. This is also contrary to the Global Fund budgeting guidelines that state that salary costs should be budgeted at the most cost effective level to achieve the objectives of the program.

53. PSI is required to comply with the grant agreement condition that requires it to apply country laws. However, some cases were noted where taxes and social security deductions were not deducted from staff remuneration at the country level. This exposes the program to the risk of penalties by the respective governments.

Recommendation 4 High

- i. The Global Fund Secretariat should as part of grant negotiations ensure that the salaries proposed are remain reasonable so that program funds are used to maximum effect.*
- ii. In line with the Global Fund budgeting guidelines, bonuses and commissions should not be paid from grant funds.*
- iii. PSI should ensure that relevant staff salary deductions are effected in accordance with the relevant country laws.*

Audit Arrangements

External audit

54. Audit is a key Global Fund fiduciary arrangement that confirms that funds are used for their intended purposes. Both PRs and SRs should be audited. In cases where PSI is a PR, the program's audit report should be presented to the Global Fund within six months of the year end. The responsibility for ensuring that PSI is audited as an SR lies with its relevant PR.

55. The OIG's review of the audit arrangements of Global Fund supported programs where PSI was a recipient revealed the following issues:

- i. Some countries did not have audits undertaken of Global Fund supported programs e.g. Madagascar. Instead the platforms presented the Global Fund with the HQ audited financial statements. The HQ audit reports did not meet the Global Fund audit requirements i.e. they did not cover the activities undertaken at platform level and they did not identify the local program's income and expenditure.
- ii. In other cases e.g. Nepal the audited reports that were presented were for the platform and not specific to the Global Fund supported program. These audit reports did not meet the Global Fund audit requirements since they did not disclose the sources and uses of program Global Fund funds for each grant.

56. The OIG also noted that the audits undertaken at the country level did not cover expenditure incurred at the Headquarters and at the time of the audit, there was no provision in place to have the expenditure incurred at HQ audited. This was critical because in most cases where PSI was PR and/or SR, the majority (60-90%) of funds were spent at PSI's headquarters with the platforms lacking the support for the expenditure incurred in PSI's HQ.

57. An audit of PSI HQ's books of account was undertaken annually. Technically this audit was the corporate annual audit and it did not focus on the Global Fund supported programs. The resultant audit report did not meet the Global Fund audit guidelines which require that sources and uses of grant funds be disclosed. Some of the information relating to this audit was not available to the Global Fund e.g. the OIG requested and was denied access to past PSI HQ management letters.

Consolidated Audit for the HQ and Platforms

58. Subsequent to the OIG audit, PSI submitted a proposal to the Global Fund seeking to put in place a global external audit for grant funds spent at country and HQ level. Understandably this would be logistically easier to manage for PSI but the question remains as to whether it would provide the level of assurance that is required for country grants.

59. A review of the suitability of the proposed arrangements with regard to providing the requisite level of assurance identified the following issues:

- i. To achieve consolidation, there will have to be standardization of audit objectives and scope. A standardized approach and a single consolidated report would not address the peculiarities of the grants and countries. The Global Fund issues minimum guidelines and allows the countries to modify their TORs to suit their unique contexts.
- ii. When audits are undertaken as part of a bigger assignment, auditors typically do not review all the countries/grants but will base their opinion on an audit of countries and/or grants that are high risk and/or material to the whole organization. This is contrary to the grant agreement that requires that all grants are audited on an annual basis. This also raises the risk of failing to identify and address grant specific risks.
- iii. The consolidated report would provide assurance to the Global Fund on overall grant financial statements but would result in a missed opportunity to identify weaknesses at a grant implementation level and strengthen the control environment within which grants are being implemented and ensure better value for money. This also brings into question the relevance of the global report at the country level.

- iv. The audit arrangements would be removed from the country level and the relevance and/or involvement of the country oversight structures i.e. the CCM and the LFA would diminish. If past experience is anything to go by, there would be challenges over access to the reports by in country stakeholders and if access was granted, it is questionable if the information contained in the consolidated report would be adequate for their decision making. As reports are consolidated, there tends to be a loss of detail, some of which detail may be crucial for decision making.
 - v. In cases where PSI is an SR, the responsibility to ensure that it has appropriate audit arrangements in place lies with the PR. The proposed arrangement would remove this responsibility from the PR.
 - vi. There would be a need to align the reporting periods to the PSI financial reporting cycle. In such cases countries with different reporting cycles would have to reconcile financial data reported in the PUDRs and the audited financial statements.
60. A review of the proposed audit terms of reference revealed that they did not meet the key elements called for by the Global Fund's audit guidance in the following respects:
- i. The proposed TORs provided for financial statements to be audited in accordance with the auditing standards generally accepted in the USA while the guidelines provide for the International Standards on Auditing. The requirements of the two standards are different and the two standards are yet to be converged. Because the jurisdictions within which PSI operates and in which grants are implemented vary, the application of ISA would, in the OIG view, be more relevant.
 - ii. The terms of reference did not provide the required qualifications of the appropriate auditor e.g. the need to be independent. This is important because the selected auditor would cover grants across the globe and there may be audit arrangements in place at a country level that would render the auditors unsuitable.
 - iii. The TORs did not clearly define the audit scope, required opinion and coverage of the management letter. For example, the Global Fund guidelines provide for the scope of audit for each grant to be sufficient in order to provide assurance that funds were used for their intended purposes and that resultant bank balances are represented by cash in the bank. These are not specified in the TORs.
 - iv. The resultant audit opinion according to the TORs would be a 'true and fair view' opinion while the guidelines require that the audit opinion include providing assurance that the funds were used for the purposes

defined by the funding arrangements. Other important aspects such as reporting of implementation of grant activities, verifying compliance with the grant agreement and value for money would not be covered in such an audit.

- v. The TORs provide for just a summary of receipts and payments without even reconciling the balances to cash. There is no requirement to breakdown receipts and payments by category as required in the audit guidance. This makes it difficult to tie the financial reporting to the PUDR and EFR, identify discrepancies and establish accuracy of accounting records.

61. PSI's current audit regime does not meet Global Fund audit guidance and cannot be relied on to provide assurance that grant funds are used for their intended purposes. In moving to the proposed audit arrangements, the Global Fund should consider whether the proposed arrangements meet its guidance and would result in the assurance required for decision making.

Recommendation 4 (Significant)

- (i) *PSI should ensure that audit arrangements are implemented as per article 13 (audits and records) in the standard terms and conditions and the guidelines for annual audits of PRs and SRs' financial statements. PSI should also respect its obligations it has with the various in country PRs.*
- (ii) *PSI should put in place arrangements to ensure that documentation of transactions incurred at Headquarters are available for verification by the various external auditors. The audit reports should be available to the Global Fund and the respective CCMs for their oversight.*

Internal Audit

62. Although having an internal audit function is not a mandatory requirement from the Global Fund, it helps strengthen the control environment within which programs are implemented. PSI has recognized this and made provisions for an internal audit function in some of its programs. However PSI did not establish internal audit functions in some of the countries where such provisions had been made.

63. PSI HQ has a department referred to as the Overseas Financial Operations Group (OFOG). This function is described in PSI's manual as an internal audit department that provides PSI country offices with internal evaluations and risk management. The objectives of the OFOG reviews were primarily to determine compliance to PSI's finance policies and procedures and donor agreements. The selection, frequency and length of field visits are

determined by PSI HQ through a risk-based prioritization model. All the countries visited by the OIG had at some point been reviewed by OFOG.

64. PSI shared its OFOG reports with the OIG with the caveat that the reports were confidential and that none of the information in these reports could be disclosed. This runs counter to the key Global Fund principle of transparency. The OIG reviewed the OFOG reports relating to the countries it had audited but was constrained from saying what it observed in terms of substance by the confidentiality restriction. However, with regard to the Global Fund supported programs, the OIG noted the following:

- i. The OFOG reviews were an office wide review and did not focus on specific grant risks and circumstances such as the grant implementation by SRs. This was a missed opportunity to strengthen controls in program management.
- ii. The OFOG reviews focused on platforms and did not cover the Headquarters where a substantial percentage of grant funds was spent. In consequence the controls in place at HQ where most of the program expenditure happened did not benefit from these reviews.
- iii. The OFOG scope was supposed to cover compliance with the grant agreement. The cases of non-compliance noted at country level, by the OIG's audits, were not identified by the OFOG reviews.
- iv. In some countries, the control weaknesses in the OFOG report remained unaddressed. However, outstanding recommendations were highlighted in subsequent OFOG reports.

65. PSI also did not share the OFOG reports with the Global Fund nor the LFA because they maintained that the OFOG reports were confidential. This is despite the Global Fund contributing to the costs incurred in carrying out OFOG country reviews. PSI also presents these OFOG reviews as risk mitigation measures to the Global Fund and the OFOG reports would confirm their effectiveness as such. The failure to provide OFOG reports also is a missed opportunity to provide the Global Fund with information for decision making.

Recommendation 5 (Significant)

PSI should extend its OFOG mandate to cover Global Fund specific program areas identified as risky e.g. SR management and related transactions at HQ level. These OFOG reports should be provided to the LFA and Global Fund Secretariat, without confidentiality restrictions, to facilitate their decision making.

Policies

66. Most of the PSI offices visited by the OIG had elaborate manuals to guide key program implementation processes. Those that did not, e.g. Madagascar,

had embarked on a process to update them. Typically these manuals covered human resources, finance, procurement and grant management.

67. However, the control environment within which grants operate is only as strong as the implementation of the laid down policies. The guidelines stipulated in the manual were not always complied with at the platform level (see Annex 1). The OFOG reports also highlighted areas of non-compliance with laid down procedures. The policies should be enforced in order to strengthen the control environment within which the programs are being implemented.

PUBLIC HEALTH ASPECTS

Background

68. PSI has made commendable contributions to the countries in which it manages Global Fund supported programs. The good performance of the grants managed by PSI is evidenced by the ratings of the performance of grants with most of the grants rated A1 to B1. Some grants managed by PSI have qualified for the Rolling Continuation Channel (RCC) e.g. in Madagascar.

69. Some of the activities that were implemented by PSI include:
- i. The mass distribution of health products e.g. LLINs and ACTs as was seen in Southern Sudan;
 - ii. Social marketing of health related products and services e.g. LLINs and female and male condoms to at-risk populations as was seen in Togo and Madagascar;
 - iii. Raising awareness among high risk target groups through interpersonal communication and mass communication activities in Madagascar;
 - iv. Disseminating messages on HIV prevention and fighting HIV related stigmatisation through mass media campaigns in Togo etc.

70. The success of the programs managed by PSI can be attributed to factors such as:

- i. In most cases, PSI manages programs where it has its core competence and vast experience i.e. social marketing and it has applied this experience to its programs.
- ii. PSI has a good appreciation of the principles of the Global Fund especially with regard to performance based funding and this is reflected in its commitment to meet the set targets through the implementation of the activities laid out in the work plan.
- iii. The offices are provided with the requisite human resources to deliver the programs.
- iv. The HQ has hands on involvement in operations of the country offices.

71. PSI has been nominated to be PR in countries with challenging socio political and health sector environments e.g. Haiti, DRC, Southern Sudan, Togo, Nepal and Madagascar. These countries were characterised by:

- i. poor infrastructure, insecurity and social conditions;
- ii. inadequate capacity in terms of structures, tools, personnel etc. at all levels in the health sector;
- iii. political instability;
- iv. High levels of illiteracy;
- v. weak national systems to support the implementation of programs e.g. PSM systems, M&E systems etc.

Despite these challenges, PSI has implemented grants in these countries with commendable results demonstrated.

72. The shortcomings noted that affected the overall grant performance related to delays in procurement which was centralised at HQ level as was seen in the Democratic Republic of Congo and Madagascar. In Sudan, PSI concentrated on the activities that were aligned to meeting targets and this came at the cost of ignoring other program activities that were not linked to specific indicators and targets.

Harmonization³ and Alignment⁴

73. The programs that were run by PSI were part of a national program and PSI normally runs its programs alongside a public sector institution i.e. in parallel. To some extent this can be explained by the social and political context in the countries where PSI is working e.g. DRC and Haiti. Coordination and collaboration between the programs is a challenge not only for PSI but across PRs in other countries. The shortcomings in collaboration and coordination between PSI and other PRs may also arise from the nature of the programs supported by the Global Fund which by design and implementation concentrate on achieving predefined targets within a defined duration. In consequence, PSI's programs are developed vertically in order to meet predefined targets, with an emphasis on independent planning, funding, disbursement, monitoring, evaluating and reporting activities which were not aligned to national structures.

74. In the countries audited by the OIG, there were mechanisms put in place to improve the collaboration of the various programs but the extent of success varied by country. For example in Nepal, there was good collaboration between the Ministry and PSI for the distribution of nets while in Togo the effectiveness of distributing free condoms alongside the social marketing program as well as the collaboration between the peer education program run by the government and that run by PSI had not been worked out at the time of the audit. In Sudan, PSI was able to fast track the net distribution in response to a request from the government.

75. PSI like many other PRs has set up parallel structures from the national ones which they viewed as being cumbersome and/or inadequate to support program implementation. This is contrary to the Global Fund principles that advocate for the use of national systems to the maximum extent possible.

³ Harmonization refers to the use of common procedures and approaches among donors in order to reduce duplication.

⁴ Alignment refers to donors' support and use of recipient cycles and national systems.

76. The parallel systems sometimes lacked linkages with the national systems and this resulted in a loss of checks and balances that are typically built into the national systems. For example PSI set up parallel M&E structures resulting in national staff having to collect two sets of data i.e. for PSI and the national program. The national program data then went through a validation process which was not applicable to PSI's data e.g. in Madagascar and Togo. The OIG learnt that PSI has instituted national capacity strengthening mechanisms elsewhere e.g. in Thailand and perhaps such models can be replicated elsewhere.

Recommendation 6 (Significant)

- (i) In line with the Paris declaration and the Global Fund core principles, PSI should to the extent possible align its programs to the national programs. This will ensure the program remains relevant to the country's priorities and is sustainable post funding.*
- (ii) The Global Fund as part of the grant negotiation process needs to operationalize its policy and encourage PRs to use national structures, systems and procedures for implementation of program activities. In cases where parallel systems have to be set up, these structures should be for a defined period of time with relevant capacity building and transition plans for the eventual transitioning back to national structures.*

Monitoring and Evaluation

77. A general shortcoming in relation to indicators noted across most of the grants was the definition/ interpretation of indicators relating to the distribution of products. Although in most cases, the indicators were appropriately worded, they were interpreted differently by PSI and therefore the results reported differed from what they were intended to be. PSI's interpretation of distribution of products was to intermediary points and not to final users yet results should have been reported to final user level. In consequence, the interpretation was not in line with the 'top ten indicator' interpretation and the results reported could not be classified as being aligned to the 'top ten indicators'.

78. The OIG's work confirmed that the delivery of products to intermediary level did not mean that the products always reached the end users. As was noted in Madagascar, in some cases, the commodities reported as distributed remained with the distributors, some expired and remained in stores and others were returned to PSI. However, there were no adjustments effected to the results to take account of such circumstances. In such cases the results reported were overstated.

79. A key element of PSI's monitoring is the studies and/or evaluations it undertakes to measure its performance. The studies are designed and executed by PSI i.e. without the participation of external parties or technical partners in their design, implementation and validation of results. This represented a potential conflict of interest since PSI initiates and reports its own work.

80. The results of these studies were not always available to in country stakeholders e.g. as was noted in Togo and this was a missed opportunity to share information about:

- i. The program's impact in country;
- ii. The program's strengths and limitations and identification of potential improvements;
- iii. Interventions that are cost effective to inform future decisions on what to fund in the light of resource constraints; and
- iv. The qualitative aspects of programs.

Recommendation 7 (High)

- (i) PSI should align its interpretation of indicators with the 'top ten indicators'. An indicator user guide should be developed to ensure that all stakeholders have the same understanding of the indicators to aid data collection and analysis. PSI's strategy and monitoring tools will need to be adjusted to provide for the collection of data to final user, including price verification and control.*
- (ii) As the top ten indicators are being revised, this is an opportune time for the Secretariat to clearly define indicators to ensure that they do not contain any ambiguities. The Secretariat should review the interpretation of the indicators used on PSI's programs, and ensure they comply with 'top ten indicators'.*
- (iii) As Global Fund supported programs move to single stream funding (SSF), impact/outcome data will become increasingly important. In order to strengthen PSI's model of undertaking studies:*
 - The Secretariat should be consulted on the study design/protocol;*
 - The LFA along with national entities should be involved in the validation of results; and*
 - The dissemination of results nationally should be encouraged.*

Social Marketing/Sale of Health Products at Subsidized Prices

81. The sale of health products at subsidized prices was one avenue through which Global Fund supported programs get goods and services to where they are most needed. PSI has become one of the leading social marketing organizations in the world and is central to the implementation of social marketing programs funded by the Global Fund across the world. There were some common challenges identified across the countries reviewed which if

addressed can be expected to improve the effectiveness of programs in meeting their objectives.

Products

82. There was no differentiation in packaging between the products that were meant for sale and the ones meant for free distribution as was noted in Togo and Nigeria. This resulted in confusion between the products that were to be given away for free and those that were to be sold at a price. A significant potential risk is that products that should be given away free end up being sold. In consequence it was difficult to track the products that should have been distributed free of charge and those that were actually on sale.

Recommendation 8 (Requires attention)

PSI should consider differentiation between the products that are distributed for free and those for which a charge is levied. This will serve as a control to identify products that should be distributed free of charge from those that are otherwise sold on the market.

Distribution

83. In all the countries visited PSI had a well-established distribution system. However in one instance, in practice, PSI disrupted the established distribution system by supplying both wholesalers and distributors. This resulted in retailers opting to buy only from PSI and not the wholesalers even when they ran out of stock and this affected the availability of products.

84. PSI did not have a mechanism in place to monitor whether products reached their intended beneficiaries and was not in a position to report whether, what, when and at what price the products actually reached the intended end beneficiaries. This is particularly important because social marketing targets a specific need in a given population. The OIG noted in the countries where the social marketing program was implemented, that the products were found on sale in areas that were not targeted e.g. in Cambodia and Madagascar.

85. The carrying out of free product campaigns (usually through the Ministries) alongside the social marketing activities affected the sales. In some cases, sellers were therefore unwilling to hold large stocks because they thought they may get stuck with the products as was noted in Togo. There is a need to have better collaboration between the two programs in order to ensure that the two programs are complementary to one another and meet their respective objectives.

Promotion

86. Grant funds were used to promote and distribute PSI specific brands⁵. The promotion of a product instead of a brand would target behavior change without drawing attention to a particular brand and the targeted population would appreciate the product irrespective of brand.

87. Good practice points to the need for promotions that relate to commodities without drawing attention to a particular brand since this ensures that the targeted population appreciates the importance of the commodity irrespective of brand. This also ensures that all brands can derive benefits from promotion. The risk of promoting privately owned brands is that the country has limited control over key aspects of the product e.g. product type, price, availability etc. The promotion of commodities generally also addresses the risk of sustainability i.e. in cases where particular brands may not be available then the population is aware of alternatives.

Recommendation 9 (Significant)

PSI should to the extent possible promote products as opposed to own brands. In the event that a decision is made to promote a brand, consideration should be given to promoting a national brand.

Prices charged

88. One of the principles of social marketing is to provide health products to communities at the lowest possible cost. PSI set price thresholds for the products in its social marketing range and the OIG's review revealed the following shortcomings in the countries audited e.g. Cambodia, Madagascar and Togo:

- i. Set prices did not reflect the purchasing power of the targeted population;
- ii. PSI did not verify or control what prices were actually applied by wholesalers to retailers and to the final users. In consequence, the set prices were not enforced with reports prevalent in all countries visited that excessive prices were charged;
- iii. Set prices were also not marked on the packages and so the population was not aware of the price that should be paid.

89. PSI's strategy is to widen distribution networks as much as possible to ensure wider availability and accessibility as a differential cost regulator. However, in the event that this does not happen, consideration should be given to putting mechanisms in place to ensure that prices remain reasonable.

⁵ A brand is the identity of a specific product. A brand makes a particular product's features and benefits more powerful and helps differentiate it from other similar commodities available on the market with the aim of creating customer loyalty.

Recommendation 10 (High)

PSI should consider instituting measures to control the prices charged by distributors and retailers. This can take on different forms e.g. having promotion drives emphasize the recommended product price, monitoring suppliers, requiring sellers to display the recommended price, informing the population during public events, etc. In addition monitoring should be undertaken and this can take many forms including having a mystery buyer.

Income incidental to social marketing

90. The sale of products under the social marketing program has generated a considerable additional income for the programs. The grant agreement requires that income incidental to grant programs be reported to the Global Fund and used for program activities. The program income from the sale of commodities was not always reported to the Global Fund e.g. in Togo, Madagascar, DRC, Haiti and Cambodia (details in the individual audit reports). In other instances, contrary to the grant agreement, PSI spent the income incidental to the program without the requisite approval.

Recommendation 11 (Significant)

PSI should comply with the conditions stipulated in the grant agreement regarding the recording and use of program income.

Technical Assistance (TA)

91. All PSI budgets provided for technical assistance. PSI provides TA in proposal writing. During grant negotiation, PSI provides TA to its platforms to ensure activities will lead to achievement of targets. During grant implementation, this TA covers a wide range of activities from training, review of program documents etc. in order to address program challenges.

92. This technical assistance was provided by PSI headquarters staff or staff from its other platforms. However, in the OIG's view, some of the activities undertaken and charged as TA fell within the ambit of the PSI's role as PR e.g. undertaking SR assessments. Some roles charged under TA represented what could be viewed as management's supervision of its programs for which the Global Fund pays an overhead e.g. when PSI's technical experts provided support to a program activity. Unless clearly defined, the thin line between direct costs, overheads and technical assistance can be subjected to abuse.

93. Because the provision of TA was by a related party⁶, the following controls were not in place to evidence that selection and execution of services was at arm's length⁷:

- i. There was no process in place to identify the most cost effective service provider for technical assistance. Given the automatic selection for TA without making comparisons with other external TA providers, the OIG was not able to determine if value for money was obtained from the services offered and charged to the program by PSI.
- ii. The TA was often not well regulated i.e. with set objectives on what deliverables would emanate from the TA and what capacity will be built. Therefore, there was not a sound basis for assessing the effectiveness of TA.
- iii. In some cases, there was no evidence at the platform level of the services that were provided.

Recommendation 12 (Significant)

In cases where technical assistance is provided by a related party i.e. PSI or one of its platforms, controls should be put in place to ensure that the transaction is at arm's length and cost effective.

⁶ A related party is one who directly, or indirectly controls/jointly controls, has interest and/or has significant influence.

⁷ The arm's length principle is the condition where the parties to a transaction are independent and on an equal footing.

FINANCIAL MANAGEMENT ASPECTS

Financial Management System

94. All the platforms visited were using QuickBooks Pro software for recording, accounting and financial reporting. PSI HQ uses Lawson as its accounting system. QuickBooks is compatible with Lawson. Each grant has a separate project code which facilitates the classification and tracking of funds. On a monthly basis the platforms upload into PSI HQ's financial system their financial data for review and consolidation.

95. The PSI HQ accounting department makes manual adjustments to downloaded accounting data from QuickBooks to reflect the expenditure incurred in PSI HQ. The PSI HQ accounting department then generates a project status report which is used at platform level for preparing the financial and programmatic reports. Lawson has on-line capabilities which allow platforms to view and generate reports but not input data or make changes to transactions.

96. The OIG noted that QuickBooks was not well suited to the size of PSI platform activities especially with its limitations in making entries for large amounts e.g. in Madagascar. However at the time of the audit, PSI was rolling out Lawson to its platforms and this was expected to resolve some of the problems noted.

97. In addition to QuickBooks, the platforms in Togo and Madagascar maintained other programs i.e. they had sales software; human resources management software; and a purchase management software. However there was no interface between the QuickBooks program and the different software programs used in order to undertake analyses and/or reconciliations. Data was transferred manually which created room for error.

Recommendation 13 (Requires attention):

PSI should consider linking the various data from different systems e.g. accounting and sales systems to ensure sharing of information and reconciliation of records maintained. The reconciliations of records maintained by the different departments will assure the accuracy of records maintained.

Treasury Management

98. In almost all cases, the grant agreements between the Global Fund and PSI were signed with PSI HQ and not the platforms. The Global Fund disbursed funds to PSI HQ's bank account. PSI operated pool bank accounts at the platform level for all the monies received from different donors. The platforms

normally maintained two local accounts, one in US dollars and the other in the relevant local currency.

99. The platforms submitted requests for funds to PSI HQ, which then disbursed funds to the platform. The requests did not set out requirements by donor or grant but generally covered the country office funding needs. The funds sent on a quarterly basis were not differentiated by donor. In consequence, it was not possible to reconcile the cash balances held in the country level bank account by donor or by grant.

100. The Global Fund does not require PRs to maintain separate bank accounts but this is based on the assurance that such PRs have accounting systems that can separate transactions. In cases where pool bank accounts are maintained for different donors, the accounting system in place should be able to split the income, expenditure and bank balances by donor. PSI's accounting systems in Washington and at the platforms were able to classify income and expenditure by accounting code but were unable to isolate bank balances by country, donor and grant.

101. The Global Fund requires that the LFA validate the balance of grant funds held at the end of each period, as reported in the PUDR, to a bank balance. The LFAs in all countries audited told the OIG that they were unable to confirm the receipt of funds by PSI, verify expenditure incurred at the Headquarters as well as bank balances reported in the PUDR. In consequence, they were unable to provide assurance on the accuracy of all the program transactions and related bank balances.

Recommendation 14 (High)

PSI should consider either:

- (i) Maintaining separate bank accounts for all Global Fund resources managed by PSI HQ; or*
- (ii) Having an accounting system that can reconcile balances in the fund accountability statements with bank balances held.*

Maintenance of Interest Bearing Bank Accounts

102. The grant agreement encourages PRs to maintain grant funds in an interest bearing bank account. However, in most platforms, PSI funds were not maintained in bank accounts that were interest bearing. Not only did this represent non-compliance with the grant agreement but was also a missed opportunity to increase (through the interest earned) the resources that are available for implementing program activities.

103. PSI HQ maintained one bank account that was interest bearing for all grant funds for different countries and donors. The HQ office apportioned

interest to country grants using US federal treasury interest rates based on the balance of funds held for each individual grant i.e. total received from Global Fund less reported expenditures for the month. The interest reported to the Global Fund was therefore not the actual interest earned but a notional calculation and allocation of interest by PSI. The interest computed was reported in the PUDR and available for program implementation.

104. The OIG reviewed the interest computation and noted that the program income that was recorded and reported to the Global Fund differed from the interest that was actually earned by PSI on grant funds as detailed below:

- i. PSI applied the US federal rates to the Global Fund supported program funds instead of the rates that were actually applied to the funds by the respective banks. For example in some periods, the US federal rate was higher than the bank rate i.e. between January 2004 and December 2007 and in the period January 2008 to June 2010, the US federal rate was lower than the bank rate.
- ii. In addition to the application of incorrect interest rates, there were also computational errors noted in the interest earned schedules provided to the OIG. The OIG selected three grants, and recomputed the interest and noted the following:

| | Interest reported by PSI US\$ | Recalculation by the OIG ⁸ US\$ | Difference US\$ |
|-----------------------------|-------------------------------------|--|--------------------|
| MDG-405-G07-M ⁹ | 130,816.81 | 144,090.69 | 12,273.88 |
| SUD-708-G09-M ¹⁰ | 12,461.56 | 25,322.13 | 12,860.57 |
| TGO-405-G04H ¹¹ | 206,310.28 | 185,762.37 | -20,547.90 |

- iii. No interest was earned on grant funds between January 2004 and March 2005. PSI explained that during that period the bank account was not interest bearing. The bank statements were not provided to the OIG to confirm this.
- iv. The funds that were held by PSI from the social marketing program were not included in the interest calculation.

⁸ OIG calculated the interest from January 2008 to August 2009

⁹ Calculation from January 2008 to August 2009

¹⁰ Calculation from November 2008 to December 2009

¹¹ Calculation from January 2008 to March 2010

Recommendation 15 (High)

- (a) *PSI should ensure that all bank accounts at HQ and platform level bear interest at a reasonable commercial rate. The interest should be reported and used for program related activities.*
- (b) *PSI should recalculate the interest accrued on all grant funds held with the proper amounts debited/ credited to the relevant grants. These calculations would be verified by the Secretariat.*

Allocation of Common Costs

105. Grant funds were used to meet common administration costs e.g. utility, rent, salaries, fuel maintenance etc. which should have typically been shared with other funders. PSI's financial guidelines provided the basis against which common costs would be allocated across donors. The basis of allocation of costs was the percentage of the project to the overall budget adjusted for significant one-off items. The proposed basis of allocation was generally reasonable.

106. While the allocation basis in the policy manual was reasonable, the OIG noted that both the platforms and HQ did not consistently apply the policy and in some cases this resulted in an overcharge to the Global Fund. For example training for distributors covered grant activities as well as PSI's other lines of business in Madagascar. However, all the training costs were charged to the Global Fund account. The OIG was not therefore unable to provide assurance that the allocation of common costs across donors was reasonable.

Recommendation 16 (High)

PSI should ensure that the basis of allocation of common costs is consistently applied.

Overhead Costs

Background

107. The costs incurred by PSI in managing programs comprised the direct costs incurred at country level directly charged to the program and the costs incurred by PSI Headquarters to support the platform otherwise known as the overhead. The Global Fund provided guidance in 2011 to address the risks related to overheads charged by INGOs and the work of the OIG has been adjusted to take this policy into consideration.

108. PSI HQ was involved in the management of grants at country level and this was central to PSI's success at country level. The HQ support included financial accounting, treasury management, reporting support, management support,

human resources administration support, legal support, IT support, internal audit, routine technical assistance and capacity building of in country staff. The guidance stated that the percentage based charge was designed to cover costs incurred by the HQ of INGOs. Based on the Global Fund new guidance on overheads, PSI HQ was eligible to charge overheads.

Rates applied

109. At the time of the OIG's visit to PSI, fees were negotiated separately for each individual grant. PSI management acknowledged that there were significant discrepancies between fee structures and explained that they were at the mercy of CCM and Global Fund negotiations. This sometimes resulted in:

- i. delays in grant negotiations and the start of the programs e.g. in Togo;
- ii. significant inconsistencies in rates across grants; and
- iii. inconsistencies in how those rates are applied to specific expenditures.

110. Grant agreements (in cases where PSI was a PR) and contracts between PSI and its PRs (in cases where PSI was an SR) did not clearly disclose agreed fee rates nor the direct expenditures against which such rates would be applied. The associated budgets typically included the fee rates proposed but did not specify the expenditure categories against which these rates would be applied. In practice, fees were calculated automatically in PSI's Lawson system by multiplying the ledger account activity with the approved fee rate. The OIG could not ascertain whether the bases against which these rates were applied were appropriate since they had not been defined and agreed upon with the Global Fund.

111. PSI charged a procurement fee for procurements undertaken by the HQ on behalf of the programs. The services offered by HQ and fees charged were akin to those of a procurement agent. In most cases, the rates charged were within the range that third party procurement agents would typically charge. However, the fees charged by agents include a profit element. It is questionable whether PSI the Global Fund should have been charged this profit element when it was acting as PR. Secondly, if there was a need to use an agent, then a competitive process should be run to identify the best suited agent. This concern has been addressed in the new policy.

112. The administration fee ranged from 5 to 14.9% with the majority of PSI PRs charging between 10-12%. The procurement fees charged were between 1% and 12% with the majority charging 5%. This demonstrated that rate inequalities existed but it was difficult to generalize the specific circumstances that surrounded different grants in different countries that resulted in the differing rates. This could however infer that the grants that charged higher overhead fees than others had a lower level of funds available for program implementation.

113. The new guidelines provide the maximum rates that are applicable to eligible INGOs requesting HQ support costs/ICR for new grant agreements or grant extensions signed from 18 April 2011. However there may be a need to clarify the bases (exact expenditure categories) against which such rates can be applied.

Application of the rates

114. Because the fees were negotiated individually for every grant, significant discrepancies arose in the rates themselves as well as in the way in which the fees were applied to specific expenditure categories. The OIG noted inconsistencies in the manner in which these rates were applied to the underlying expenditures. Due care needs to be taken in ensuring that the underlying expenditure accounts to which the fee rates were applied were appropriate and consistent.

115. The OIG reviewed the fees charged to the Global Fund and selected a sample of fee rates that appeared unusual, and reviewed them against the underlying grant agreement and related budgets to determine the appropriateness of fees charged. These are detailed in the table below:

| Activity account | Category account | Description | Country | Fee type | Fee rate |
|------------------|------------------|---------------|--------------|----------------|----------|
| 2254 | 65010 | Male condoms | Haiti | Procurement | 5% |
| 2642 | 65010 | Male condoms | Tanzania | Administration | 10% |
| 2827 | 65140 | Bed nets | Sudan | Administration | 12% |
| 3251 | 65140 | Bed nets | Angola | Administration | 12% |
| 3340 | 65140 | Bed nets | Angola | Procurement | 12% |
| 3232 | 65120 | HIV test kits | South Africa | Administration | 12% |
| 2602 | 65120 | HIV test kits | South Africa | Procurement | 5% |

116. The OIG noted the following shortcomings in the application of rates by PSI:

- i. The administrative and procurement fee rates were set at the same rate e.g. in Haiti, Angola and Tanzania where both rates were set at 5% and 10%. This was unusual because the level of effort for administering the grants was considerably different from that related to procurement;
- ii. The wrong rate was applied to the expenditure category i.e. the administrative rate was applied instead of the procurement rate in Sudan and South Africa (Activity 3232) above; and
- iii. Activity 3232 was also unusual because the budget did not make any reference to the purchase of HIV test kits under this grant. The accounting information indicated that such purchases had in fact been

made and thus the procurement rate applied. PSI was unable to explain this anomaly.

117. The OIG also noted that the cost of procurement undertaken at country level was included in the total procurement cost figure for purposes of calculating the procurement fee earned for services provided by PSI HQ. In 2008 and 2009, the procurement undertaken by platforms amounted to some US\$ 19 million i.e. 31% of total procurement costs. Because all staff costs, including those of the staff involved in local procurement, were typically covered by the Global Fund grants, it is unclear what additional costs would be incurred at HQ related to these local procurements that necessitated the charging of this procurement fee.

118. The responsibilities and corresponding level of effort exercised by the platforms and the HQ when PSI was the PR was different i.e. much greater than when PSI was an SR. However, the OIG also noted that differentiation about whether PSI would be PR and/or SR was not made during negotiations. PSI management was of the view that the level of effort from HQ was the same in both scenarios. The new guidelines support the position of the OIG and differentiate the management fee rates in cases where an INGO is a PR from those where it is an SR.

119. At the time of the audit, in cases where PSI was PR, it included expenditures incurred by its SRs when calculating its overhead fees. Essentially, both PSI and its SRs (non PSI) earned a fee on the same expenditures incurred by the SRs which amounts to a double charge to the same expenditure items as was seen in Southern Sudan. The multiple charging of management fees at the different levels i.e. at PR, SR and SSR level resulted in significant percentages of grant funds going towards the management fees and reduced the funds that were available for fighting the diseases. The new guidelines support the position of the OIG and address this issue.

120. There were instances noted where the fee structure set up in Lawson called for the same expenditure category to be charged using the procurement fee and the administrative fee rate. PSI did not provide an explanation for this. While none of the specific general ledger accounts in question had accrued costs for the grants in question (and hence there was no actual fee implication at the time), this configuration needs to be addressed so that it does not result in over-billing the Global Fund for fees.

Reasonableness of the overhead

121. The OIG sought to ascertain whether the fees charged to the Global Fund as overheads were accurately calculated. The OIG was provided with the transactional accounting detail for all direct costs incurred from grant

inception to date. Based on the data, the total fees earned by PSI on Global Fund grants were recalculated in 2008 and 2009. However, PSI's accounting system did not track fee revenue earned from donors into a specific revenue general ledger account and so the OIG was unable to compare the value it calculated and ascertain the reasonableness of fees charged.

122. The OIG also sought to assess the reasonableness of fees charged by PSI by reviewing PSI's indirect cost pool. However the OIG was unable to calculate a prospective indirect/direct cost rate pending finalization of PSI's 2009 accounting ledgers. The OIG reviewed the draft 2009 financial statements and noted that most of the costs that were included in the indirect cost pool were reasonable. The audit financial statements had not been finalised by late 2010 when the last visit to PSI was undertaken.

123. The OIG review of PSI's indirect cost pool resulted in the identification of certain aspects that would need to be considered in assessing the reasonableness of the administrative and procurement fee rates as detailed below:

- i. The OIG identified certain costs in the indirect cost pool that the Global Fund would consider as ineligible. These included costs related to bids and proposals i.e. US\$ 800,000, bonuses i.e. US\$ 681,000 and 'employee morale' i.e. US\$ 83,000). Indeed the recently released guidance deems such costs as unallowable.
- ii. The OIG also noted certain costs included in the 2009 indirect cost pool that might be considered "one-time" costs, the inclusion of which would not be applicable for purposes of calculating a prospective fee rate. For example included in the costs were the entire training costs of the new Lawson ERP system amounting to US\$ 1.7 million.

124. The OIG's review of PSI's indirect cost pool for reasonableness revealed two aspects that can potentially impact the rates of overheads charged to the Global Fund. These are detailed below.

Funding of the overheads from unrestricted funds

125. The OIG learnt that in 2007 PSI funded the organization's overhead costs with US\$ 4.3 million from its unrestricted funds earned from investments and foreign exchange gains. This effectively decreased the indirect cost pool for 2007 from US\$ 22.2 million to US\$ 17.9 million and had the effect of lowering amounts owed by donors e.g. USAID as overhead costs. PSI informed the OIG that this was the only time that PSI has made such an allocation and it was not envisaged that this would happen again.

126. The Global Fund should have benefited from this pay down because the

unrestricted revenue was partly earned from the Global Fund since it was funding over 25% of PSI operations with projections for 2010 being 30%. In other words, if the Global Fund lowered or eliminated its fees paid to PSI, PSI would have less available funds for investment purposes. However, the Global Fund did not benefit from this pay down because its fees were calculated on a fixed percentage of direct costs. PSI explained that the actual overhead in 2007 was higher than the US Government approved rate and this is what caused the payment from the reserves. According to PSI, the Global Fund could not benefit from this 'subsidy' because it was paying an overhead fee that was negotiated for each grant and not an indirect cost rate as was the case with other donors.

Rental income from the building purchased

127. In late 2007, PSI purchased the building in Washington DC where it had previously been renting office space. The land and building were recorded in the 2008 financial statements at approximately \$50 million. Since PSI is a not for profit organisation and is primarily financed by various donors, the Global Fund along with other donors may have effectively assisted PSI in acquiring the asset.

128. PSI leases approximately 50% of the office space in the HQ building to other third parties through its wholly owned property management subsidiary. In 2008, PSI generated a small operating loss from this leasing activity because of the depreciation and maintenance costs. However it is conceivable that PSI will in the future derive significant profits in future years from its real estate activities. PSI should therefore consider offsetting its net rental income against the indirect cost pool in order to reduce the overheads. PSI explained that donors have already derived benefits from the purchase of the building because of a resultant reduction in office rent associated costs. PSI contends that it would be impossible to offset any future profits from the overheads because such funds would go towards settling the loan.

Processes for verification of reasonableness of costs

129. The overhead costs were computed by the HQ and these computations were not available to LFAs for verification. These costs were also not subjected to external audit. The OIG noted that other donors reserved the right to review the actual indirect costs periodically to ensure that the charges remained reasonable. However, this was not the case for the Global Fund.

130. The new guidelines provide for the LFA to verify that headquarters support costs remain within the maximum upper-ceiling. The LFA will also be able to verify on a regular basis that rates charged to the grant are in accordance with the agreed rates per the detailed budget. The guidelines also provide for an audit of these costs on an annual basis and a report provided to

the Global Fund nine months following the end of the year.

Recommendation 17 (High)

The Global Fund should consider the additional aspects that remain unaddressed in its new guidelines on overheads. This includes:

- i. The appendices to the grant agreements should clearly disclose agreed fee rates and the direct expenditures against which such rates would be applied.*
- ii. The Global Fund should institute measures to review the supporting documentation relating to overheads for the grants to which the new policy is not applicable in order to ensure that grant funds are used towards program purposes.*
- iii. The Global Fund should require LFAs to verify the reasonableness of overhead in accordance with agreed upon conditions and allocation of common costs across donors for all grants to which the new policy is applicable.*

Note: Refunds related to overheads are called for in the OIG country specific audits.

Other Expenditure Related Matters

131. The OIG noted that in addition to the direct costs incurred at the country level in 2008 and 2009 amounting to US\$ 63 million, an additional US\$ 2 million were charged to grants as direct costs incurred at HQ level. It was therefore not expected that direct costs related to the Regional Offices or HQ should be budgeted in the grant. This implies that under the new guidance, the direct costs incurred at HQ would typically be disallowed unless prior justification was provided to the Global Fund for approval.

132. The OIG reviewed a small sample of direct expenditure at HQ level to confirm the effectiveness of controls over HQ expenditure and noted the following issues:

- i. The supporting documentation for some of the expenditure in the sample selected was not available. In some cases, the rationale for charging expenditures to a specific account was not provided or clear;
- ii. There were expenditures related to other donors' projects that were charged to the Global Fund. PSI stated that it would reallocate the expenditures after the audit;
- iii. There were expenditures that were wholly charged to the Global Fund account for country staff yet typically such costs should have been covered by other donors as well e.g. country expatriate allowances.
- iv. The OIG noted that there was a misclassification of expenditure across budget lines. The misclassification of expenditure suggests that financial

- statements are not representative of the actual activities and transactions that took place.
- v. The vouchers did not show the specific program numbers to which the expenditures should be charged. As a result, the OIG could not confirm that the appropriate accounts had been charged; and
 - vi. Expenditure that should have typically been charged to the overhead was sometimes charged as a direct cost to the programs e.g. evacuation insurance, PSI retreats, PSI HQ office supplies, expenditure relating to the HQ accounting unit etc.

133. In most countries reviewed by the OIG, the OIG noted that PSI had incurred some ineligible expenditure i.e. expenditure that was not in line with the program objectives and in some cases for which prior approval was not obtained from the Global Fund. This was evidence that the budgetary control mechanisms were not operating effectively.

134. The grant agreement stipulates that all assistance financed under the agreement should be free from all taxes, customs duties, tariffs, import duties and VAT. There was no evidence that some PRs sought tax exemption status, e.g. in Nepal. The OIG also noted that most PRs/SRs still paid taxes on all purchases irrespective of whether they had tax exemption status e.g. in Madagascar. This reduced the funds available for fighting the diseases.

Recommendation 18 (High)

PSI should strengthen its control over expenditure to ensure that charges to country grants remain reasonable. Specifically:

- i. All expenditure incurred at the HQ should be supported with proper third party supporting documentation;*
- ii. An independent official should review postings to ensure that they are effected to the correct accounts; and*
- iii. PSI should ensure that it consistently applies its policy on allocation of costs among donors.*

PROCUREMENT AND SUPPLY CHAIN MANAGEMENT

135. A significant portion of grant funds was spent on PSM related activities. The procurement of health products and high value items was normally undertaken by PSI HQ with platforms taking on the low value procurements. The OIG reviewed procurements at HQ level based on the requirements in the grant agreement as well as the *Operational principles for good pharmaceutical procurement* as referenced in the grant agreements.

136. The country audits covered procurements undertaken at the platform level and the OIG's visit to PSI HQ covered a sample of 19 procurements amounting to US\$ 30 million. The transactions audited ranged from US\$ 50,000 to US\$ 10 million and covered both health and non-health products. The sample included procurements related to Global Fund supported programs in nine countries namely Togo, Madagascar, Congo, Mali, Tanzania, Haiti, Sudan, Nigeria and Laos and the procurements had been undertaken between 2004 and 2010.

Procurements at Platform Level

137. PSI's platforms in most cases had well documented comprehensive procurement policies and procedures in their manuals. These policies are generally adequate to ensure procurement is undertaken in a transparent manner and is compliant with the grant agreements. However, the OIG noted that PSI did not follow the laid down policies resulting in a weakened control environment within which procurement was undertaken. This was especially noted in Sudan and Madagascar.

138. The OIG noted that there were shortcomings in the procurement processes in most of the platforms and this often resulted in purchases that did not represent value for money. The shortcomings noted at a platform level related to:

- i. Procurements were undertaken following the sole source method. However the stipulated controls in the manual were not always followed to reduce the risk of abuse e.g. obtaining the requisite approval;
- ii. The solicitations to bidders were not always clear and the time provided for solicitation was in some cases inadequate;
- iii. Solicitations did not always provide all the required information necessary for a prospective bidder to prepare a bid; and
- iv. Contracts were not always awarded in a transparent manner.

139. With regard to logistics management, the OIG noted that there were stock outs in some countries where PSI was the PR e.g. Togo and Madagascar. Storage capacity/conditions needed to be strengthened in most of the countries visited to mitigate the risk of leakages.

Procurements at HQ Level

Requisitioning

140. The purchase process was started by the submission of purchase requisitions to the HQ. The following issues were noted with the purchase requisitioning process:

- i. Contrary to PSI's procurement manual, there were no purchase requisitions on file for four procurements worth US\$ 3.13 million e.g. purchase of condoms in Togo and Tanzania and bed nets in Madagascar;
- ii. In many of the cases reviewed i.e. 13 instances worth US\$ 15.04 million, the purchase requisitions were incomplete. Missing information included details about availability of budget, detailed specification of products required, the expected date of delivery etc.; and
- iii. In 13 instances worth US\$ 15.04 million, the purchase requisitions were not signed as evidence of approval by the designated personnel.

Recommendation 19: Requires attention

PSI should endeavor to comply with its laid down procedures in order to strengthen the control environment within which purchases are undertaken. Purchase requisitions should be comprehensively prepared and approved as required in PSI's procedures manual.

Bidding process

141. The grant agreement requires that the all solicitations for contract bids be clearly notified to all prospective bidders and that they should be given sufficient time to respond to such solicitation. The grant agreement also required that all contracts be awarded in a transparent and competitive basis. This was dependent on the methods of procurement employed.

142. PSI's procurement manual did not specify the thresholds for the different procurement processes. PSI defined the procurement processes that would be employed but without giving consideration to the purchase amounts. The type of procurement method selected affects how the bid is run, the number of entities that would be invited to bid, the timelines allowed for them to prepare bids etc. In consequence, 12 of the 19 purchases ranging from US\$ 41,247 to US\$ 9.95 million were undertaken using the 'shopping' method. In such cases, the processes applied were inadequate to allow the appropriate level of competition to enable PSI to obtain competitive prices for quality products.

143. At the time of the audit and contrary to good practice, PSI had not undertaken a pre-qualification¹² process for bidders that would typically be called upon to bid when following the shopping method. There was also no mechanism in place for prospective suppliers to be monitored through a process which considered product quality, service reliability, delivery time and financial viability. Pre- and post-qualification procedures help eliminate substandard suppliers.

144. In four cases with purchases worth US\$ 8.85 million, PSI selected a supplier following the sole source method. Justification provided was in some cases deficient. For example the procurement of bed nets through sole source under three contracts worth US\$ 8.4 million was that in country market research conducted revealed that particular nets were preferred to nets by other suppliers. The OIG noted however that subsequent tenders were not restricted to this manufacturer.

145. The procurement of mobile vehicle units¹³ also followed the sole source method. PSI informed the OIG that identification of the company to supply the additional components was initially outsourced but no evidence was provided to this effect. Good procurement practice calls for those who developed any item should be excluded from further supply of those developed items.

146. In cases of sole sourcing, there was also no evidence that at the time, PSI took steps to ensure that the prices obtained were reasonable. In the case above, PSI provided a price comparison to justify the reasonableness of price for nets under the sole source contracts. However, the prices related to different quantities, timing and countries and so were not comparable.

147. The OIG noted instances where the terms and conditions specified in the IFB were incomplete/ incorrect. The important terms and conditions that were not included are detailed below:

- i. In all cases the expected delivery date for products/ sample were not specified in the IFB although the due date of delivery and sample availability date were often among the criteria used for bid evaluation;
- ii. Two IFBs for purchase of condoms did not require submission of samples as part of the bid submission process. In the absence of samples, the technical analysis of quality of product could not be performed.
- iii. In four cases, the last date of request for further information from vendors was not specified in IFB.
- iv. One of the IFBs mentioned that the information could be disclosed to DFID personnel although the purchase related to the Global Fund grant.

¹² Pre-qualification is the procedure of evaluating supplier capacity and reputation before bids are solicited for specific products.

¹³ These were motor vehicles with additional components.

148. The OIG noted three instances worth US\$ 8.4 million where the bid documents mentioned a specific brand name and this automatically eliminated all other possible suppliers. Good procurement practice encourages bidders not to mention brand names in the bidding documents. The justification provided for this was that “This is the only vendor providing those particular nets requested by the country”. Even in cases where there is only one supplier, good procurement practice encourages that bid documents do not mention brand names but provide a generic description of what is required since specifying brand names in bid documents limits competition and favours specific suppliers.

149. PSI’s bid receipt process was not regulated to ensure bid security, confidentiality and integrity. With regard to the bid opening, the following shortcomings were noted:

- i. PSI sometimes allowed bidders to submit bids electronically but there was no system in place to assure the receipt and security of bids;
- ii. Bidders could also provide bids by telefax but the fax machine was not limited for the use of the procurement office only. This raised the risk of access of bids;
- iii. In two cases, bidders were encouraged to submit quotations through unsealed bids which is contrary to procurement good practice and can compromise the process.
- iv. The date and time of submission were not recorded and this raised the risk that bids could be withdrawn and modified. There was also no control in place to prevent acceptance of bids from vendors after the cut-off time for receipt of bids.

150. In the majority of purchases reviewed, there was no evidence on file that public bid opening ceremonies were held e.g. in the case of the purchase for condoms for Togo valued at US\$ 2.28 million that was not opened publicly. Tender processes that are secretive tend to be perceived to be corrupt or unfair and whether true or not, such charges can be damaging and would result in the public loss of confidence in procurement systems. The public opening of bids promotes the principle of fairness which is essential to attract the best suppliers and achieve good prices.

151. In one invitation to bid, there was no requirement for bidders to submit bid securities. Bidders were instead required to make declarations that they would not participate in future bidding processes for six months if they did not meet set bidding terms and conditions. This representation does not suffice since it does not meet the objective of getting a bid security in place. There were also instances noted where although bid securities were required in the IFBs, they were not in practice obtained from bidders.

152. The OIG also noted that bidders that did not have valid bid securities were not rejected. Best practice provides for the rejection of bids that lack valid bid securities. In the case of procurement of bed nets for Mali, PSI awarded the contract to a company that had an invalid bid security. In this case, the contract was awarded to a company for which the bid security validity period was less than that required. This bid should not have been evaluated in the first place.

Recommendation 20: Significant

- (i) The procurement policy should specify the thresholds for purchases to be made through the different tendering methods. PSI should consider prequalifying its vendors that would be called upon to submit proposals under the 'shopping' method.*
- (ii) The option to sole source suppliers should be used on an exceptional basis. In cases where sole sourcing is used, proper justification should be made and approval obtained from a senior official independent of the procurement process. PSI should also ensure that in such cases, due diligence is undertaken to ensure that the prices paid represent value for money.*
- (iii) PSI should consider standardizing bid documents used in the procurement processes. Alternatively PSI should consider creating a checklist for bid documents to ensure that they are comprehensive and contain all appropriate conditions to protect the organization and provides adequate information to bidders for bidding purposes. Bid documents should be reviewed by a senior official independent of the preparer and approved.*
- (iv) The bid opening processes should be strengthened by (a) securing the process for receipt of bids i.e. whether electronic or physical; (b) recording the dates and times of receipt of bids; (c) for certain bid thresholds (definitely for the larger bids, opting to have public bid openings); and (d) A record of bids received from vendors should be maintained. This record should be closed at the cut-off time for receipt of bids from vendors.*
- (v) Bid security documents should be obtained from all the vendors submitting the bids. PSI should not accept invalid bid securities and bids with invalid bid securities should not be evaluated.*

Evaluation process

153. The grant agreement required that all solicitations for goods and services provide all information necessary for a prospective bidder to prepare a

bid and, as such, shall be based upon a clear and accurate description of the proposed terms and conditions of the contract and the goods or services to be acquired. The OIG reviewed the evaluation and vendor selection processes and noted the following inconsistencies to good procurement practice.

154. In six cases amounting to US\$ 1 million there were no quotations available on file to facilitate an independent review of the evaluation process. In another instance, the OIG noted vendor selection procedures were not performed at the time of extension of contract with the vendor. The time gap between date of contract and its extension was more than one year.

155. Best practice dictates that bidders are notified about the criteria that would be applied during evaluations and that this criterion is consistently applied during evaluations. There was no evidence on file that the bid evaluation criteria was approved prior to issuing the invitation to bid. In several cases, PSI's criteria was not aligned with these principles as is detailed in the paragraphs below.

156. There were cases noted where the stipulated criteria were not applied to the evaluation process. In the procurement of bed nets for Mali, PSI mentioned the scores for evaluation in the bidding documents i.e. price (50%) and FOB date (50%). During evaluations, only the PSI price was considered in evaluating the tenders.

157. Contrary to procurement good practice, some criteria were vague/ not specific. In some cases e.g. the procurement of bed nets for Mali, the IFB stated that "other appropriate factors may also be taken into account". These 'other appropriate factors' were not defined and therefore bidders were unable to prepare bids accordingly. This left evaluators with the discretion to apply criteria that were unknown to bidders and raised the risk of manipulation of criteria.

158. The tender documents were silent about how the criteria would be applied in the selection of the vendors. It was not clear what factors would be mandatory for a bid to be eligible for evaluation i.e. those documents which if absent, incomplete or insufficient would make a prospective bidder ineligible to bid for the particular procurement. For example in the case of condoms procurement for Togo, bidders that did not have country approval were automatically disqualified yet this was not stated as mandatory in the bid documents.

159. With regard to scorings and weightings of criteria, the following were noted:

- i. Scorings/ weightings were not always pre-determined and communicated to potential suppliers. In other cases, the weights were sometimes

- favorable to particular bidders e.g. PSI gave equal or slightly more consideration to delivery of bed nets over price. In such instances the supplier's production capacity automatically gave them advantage because the fastest manufacturer (which was primarily driven by manufacturing capacity) scored the highest technical marks and so did not have to reduce their prices significantly to be awarded the contract. This practice therefore did not always result in purchases being made at the lowest possible price as encouraged in the grant agreements.
- ii. There were cases where the weightings allocated did not match the description of services required. For example, the procurement of anti-malaria drugs for Madagascar had some ten evaluation criteria and sub-criteria including price. The IFB stated that *"The Goods are urgently needed. The Supplier is instructed to keep this fact in mind in making shipping arrangements, and is responsible to ensure that such arrangements are effective to result in transport to destination promptly upon shipment, by the most direct and expeditious route from the point and port of shipment."* However the resultant criteria were not prioritized to give priority to delivery.
 - iii. Weightings did not take into account considerations relating to the grant agreement. The grant agreement encourages PRs to get the lowest possible price of products that comply with the quality assurance standards specified in this agreement. This "lowest possible price" takes into account the unit price for the products, product registration, the delivery and insurance costs, and the delivery timeframe and method. PSI's criteria did not give cost any priority (by way of criteria scoring) as is emphasized in the grant agreement.

160. The above criteria shortcomings can best be illustrated in the procurement of bed nets for Mali. PSI listed three criteria namely price, FOB date and any other factors with no weights allocated to guide how the evaluation would be undertaken. The criteria 'any other factors' was not defined at the bidding and evaluation stage. Although PSI had listed three evaluation criteria, the evaluation was primarily centered around one criteria i.e. price. The criteria did not state that price would be given overriding priority over the other two factors. Criteria such as best FOB date were not taken into account e.g. the successful bid quoted its FOB as 9 weeks yet there was a bid that proposed two weeks for sampling.

161. There were no criteria standards in place to ensure the uniform application of evaluation criteria. Standards define the minimum level of acceptability for any criteria and provide the basis on which bids will be evaluated as meeting, exceeding, or failing the solicitation requirement. The definition of delivery date was the date at which goods were available for

inspection before shipment yet ordinarily in procurement, delivery would be when goods reach in country.

162. Another example of criteria that could have benefited from a standard was 'registration of the manufacturer in accordance with the condom requirements of respective country'. This was seen in the procurement of condoms for Tanzania and Togo. It was unclear whether the vendor having no registration and had not even commenced a registration process would still be considered and evaluated. It is also unclear if this registration was an evaluation criteria or a pre-requisite to be evaluated. In case this is an evaluation criterion, it is unclear how much weight/score PSI gives to this particular criteria within the total score. In practice, PSI disqualified all bidders without registration in place and in the case of Tanzania, these were the most expensive bidders.

163. In several instances it was unclear how the stipulated criteria were applied to come up with objective evaluations of bids. The OIG noted instances where the lowest bid was not selected but in the absence of proper criteria and the lack of documented justification on file, it was difficult to assess if the criteria had been applied appropriately.

164. For Tanzania, proof of registration was given paramount importance and this resulted in procuring from a bidder that was more expensive than other bidders. In another instance, the contract was awarded to the selected vendor based on the sampling dates (there was a difference of three days) at a higher price yet the criteria did not highlight sample availability as the overriding factor.

165. The OIG noted that there were no approvals by the technical and purchase committee on file to evidence the approval of 11 out of the 19 purchases sampled. In 8 cases, the purchase documents were not approved by Country Representative (CR), Program Manager (PM) and Regional Director (RD) as required by PSI's procurement policy manual.

Recommendation 21 High

- (i) The criteria for evaluation of bids should be strengthened by (a) setting standards to define what is acceptable for each criteria; (b) ensuring that they are clear to provide bidders with a clear basis of how the bids would be evaluated; and (c) having them reviewed by a senior official independent of the preparer and approved.*
- (ii) Once approved, the criteria should be respected during the bidding process.*
- (iii) All vendor selection should be approved by the purchase and technical evaluation committee.*

Contract management

166. The OIG's review of the contracting process revealed the following shortcomings in the contract management process:

- i. In one instance, there was no signed contract on file. The extension to the contract had also not been signed.
- ii. In one instance the contract price was higher than the price quoted by the vendor. This was not explained.
- iii. In two cases, the quantities stated in the contracts exceeded the amounts stated in the RFP.
- iv. In two instances, the performance security clause was not incorporated in the contract.
- v. In most of the transactions reviewed, PSI did not obtain performance securities from the selected service providers.
- vi. In most of the cases reviewed, the notification of contract award was not on the procurement file.
- vii. There was also no evidence on file in most cases that tests to verify the quality of products was obtained from vendors prior to commencement of manufacturing/dispatch of material as required by the contract.

167. Over half of the contracts reviewed did not specify the due delivery date although a penalty clause for delayed delivery was specified in the contract. Instead in the delivery section of the contract, PSI mentioned the place of final destination and the commercial term, based on which those goods should be delivered e.g. CIP Bamako, Mali. In consequence, suppliers did not have any obligation to deliver goods to Mali by any specific time. Moreover, PSI could not withhold penalties for late delivery, since the delivery date was not mentioned in the contract.

168. A comparison of the dates stipulated in the RFP with the actual delivery dates revealed that there were delays in the delivery of products. However the right to impose penalties could not be exercised because the due date of delivery was not specified in the contract or the purchase order. In the case of the procurement of a vehicle for Haiti, the PO had 31 October 2006 as the delivery date. Actual delivery happened on 23 February 2007 but no penalties were effected. PSI explained that a wrong delivery date had been entered on the PO.

169. In several cases, there was no evidence of receipt of products purchased. The OIG noted that some platforms had received deliveries that were short of purchase quantities. In Madagascar some of these shortages were rectified.

170. The OIG noted that PSI effected advances before goods were shipped or before they arrived. For example PSI paid the vendor 80-90% of each shipment

price before those shipments reached Togo, Mali and Madagascar. This was also the case for the procurement of condoms for Tanzania where 100% was paid before delivery. Given the fact that no delivery deadline had been mentioned in the contract and that vendors are paid large proportions of funds before delivery is effected, there is reduced motivation for vendors to deliver goods at the earliest possible date.

171. With regard to payments, the following shortcomings were noted:
- i. In many cases, there was no evidence that the supporting documentation required for payments was in place at the time payment was effected. Such documentation included certificate of Insurance, certificates of origin, manufacturer's certificates of quality, manufacturer's statements of compliance with applicable goods manufacturing practice etc.;
 - ii. There were also instances where the payments effected exceeded what was stipulated in the contract terms e.g. payment of 90% instead of 80% of contract price;
 - iii. In one instance, the payment exceeded the purchase price of a vehicle by US\$ 1,189 with no explanation provided;
 - iv. Payment requests were not available on file for some payments; and
 - v. In other instances, payment requests were not approved.

172. The OIG noted that some contracts were awarded without performance securities¹⁴ e.g. the procurement of anti-malarial drugs for Madagascar and Nigeria. This is contrary to the terms of PSI contracts that required performance securities to be in place. Best practice calls for such securities to be a pre-condition for a contract.

Recommendation 22: High

- (i) Contracts entered into with the vendor should include details of performance security requirements and the due date of delivery.*
- (ii) Performance security should be obtained from the selected vendors. PSI should keep performance securities (and/or copies of those), provided by contractors' banks in a safe place so they can be located in case they are needed.*
- (iii) All contracts and extensions should be signed by the designated personnel from PSI and vendor.*
- (iv) Notification of award of contract should be sent to all the participating vendors.*
- (v) Evidence of quality test of material prior to commencement of manufacturing or dispatch should be obtained from vendors in accordance with the contract.*

¹⁴ A performance security is a bank guarantee or other form of security that secured the obligations of suppliers under the procurement contract, in accordance with the requirements in the bidding documents.

- (vi) *Quantity ordered should not exceed the quantity requisitioned. In case excess quantities are ordered, justification should be documented.*
- (vii) *Evidence of receipt of goods should be maintained. No invoices should be processed without evidence of receipt of material. Where applicable, evidence of the quality tests undertaken should form part of the supporting documentation prior to final payments.*
- (viii) *The contracts should contain expected delivery dates. Penalties should be imposed on the vendor as per the agreement in case of delayed delivery.*
- (ix) *Payment requests should be prepared and approved as per the authority matrix for all payments to vendors. All vendor payments should be made in compliance to terms and conditions of the contract. Any deviation in invoice price and PO price should be approved by the persons approving the PO.*

Quality assurance

173. The Global Fund's quality assurance policy defines the requirements for finished pharmaceutical products funded from Global Fund resources. The PSI PRs generally complied with the policy with regard to the type of products procured. However, in all countries audited, the quality assurance testing of pharmaceuticals along the supply chain was either not done at all, or when done it was not in conformance with the policy i.e. tests were not carried out in WHO prequalified reference laboratories or accredited in accordance with ISO17025.

174. The grant agreement requires PRs to perform random tests of samples of pharmaceutical products procured with Global Fund resources for quality control purposes. The Global Fund quality control policy further states that samples should be taken along the whole supply management chain and that these tests should be undertaken in a WHO recognized or ISO accredited laboratory.

Recommendation 23 High

PSI should comply with the conditions stipulated in the grant agreement. Specifically, the PRs should quality assure their pharmaceutical products in line with the grant agreement.

Management of the HQ Procurement Function

175. The grant agreement states that due to the complexity and significant risks of the procurement of health products, grant funds may not be used to finance such procurement until the Global Fund has assessed the PR's capability to manage such procurement. The OIG noted that all the PSM assessments undertaken by the LFA were at the country level. No assessment

had been undertaken of the HQ's capacity to handle procurements in line with the Global Fund policies although most of the procurement was undertaken there.

176. The OIG was presented with three versions of guidelines and/or manuals directing PSI procurement operations. The OIG noted that there were enhanced controls listed in PSI's latest procurement manual. At the time of the audit, PSI's latest procurement manual had a "confidential" seal on it and it had not been posted on PSI's website. Nevertheless this manual called on vendors and interested parties to refer to it in cases of need.

177. The OIG's review of the procurements that have been implemented by PSI indicates that there is a need to strengthen the competencies and performance of the procurement function. A review of the resumes of the personnel that were involved in the procurement at the time of the audit revealed that they lacked procurement related qualifications and experience prior to joining PSI. The *Operational principles for good pharmaceutical procurement* calls for the use of personnel that have a combination of knowledge, skills and experience in pharmaceutical procurement.

178. There was also inadequate segregation of duties among the staff that were involved in the procurement processes. The officer that sent out the RFQs was also responsible for receiving and evaluating the bids. According to the *Operational principles for good pharmaceutical procurement*, without appropriate separation of function and authority the procurement process is much more susceptible to influence by special interests e.g. prejudicing supplier qualification decisions, manipulating the final award of tender and slanting product specifications to limit competition.

179. In the absence of proper segregation of duties, the control environment is safeguarded through the increased involvement of senior management in transactions. However, there was limited evidence of independent management involvement in procurement processes to ensure transparency, accountability and security of the process. The procurement manual provides for various approvals which were sometimes not available e.g. on evaluation reports. The OIG also noted some errors that would have been picked up if the processes were reviewed by a senior independent official e.g. the evaluation report and contract for Madagascar's bed nets listed the bid opening date as June 18, 2009 instead of September 21, 2009. One evaluation report for Mali had Togo in its text.

180. The OIG noted that in earlier procurements, the evaluation was solely undertaken by the procurement officer. The latest manual provided for evaluations to be undertaken by committees. These committees were constituted in latter procurements and they often included the procurement

officers. The *Operational principles for good pharmaceutical procurement* advocate for having evaluation committees independent of the procurement office.

181. PSI did not have a system that recorded the transactions from start to finish. PSI's financial management system captured some but not all key procurement related transactions. The *Operational principles for good pharmaceutical procurement* encourage that a reliable management information system (MIS) is in place to facilitate the planning and management of procurements. This is important for sharing information on the status of the procurement process between platform and HQ. PSI was installing a new system and consideration should be given to include a procurement module.

Recommendation 24 (High)

PSI should significantly strengthen its capacity to manage the procurement function. Specifically:

- (i) PSI should comply with the relevant procurement related conditions in the grant agreement. If PSI HQ is to continue to be involved in PSM activities, it should be assessed periodically through an established process by the Global Fund for assessing PR PSM systems and capacity in line with the grant conditions. Measures instituted to address capacity gaps identified and/or appointing a third party procurement agent to manage procurement on behalf of PSI;*
- (ii) PSI should strengthen the capacity of its procurement unit by ensuring that staff have appropriate skills and tools to manage the procurement process.*
- (iii) The record keeping around procurement processes should be strengthened.*
- (iv) PSI should clearly mention delivery deadlines to final destinations both in the bidding documents and in the contracts.*
- (v) There should be segregation of duties in the procurement function. PSI should strengthen the management oversight over the procurement process.*

SUB-RECIPIENT MANAGEMENT

182. The Global Fund model provides for PRs to take responsibility for managing SRs. Almost all PRs implement program activities through SRs and SSRs. The effectiveness of SR management is therefore a key success factor to programs. However, most PSI PRs were seldom managing SRs effectively.

183. The OIG noted that PSI's manuals at platform level clearly elaborated the policies and processes that are followed in the selection and management of SRs. However these policies were not always applied as detailed in the paragraphs below.

184. PSI has laid down procedures for the SR selection processes at a country level. However the OIG noted that there were issues with the selection of SRs in Sudan and Togo with concerns raised in both cases over the selection processes followed. This contributed to delays in the appointment of SRs which affected grant implementation.

185. The OIG noted that in five countries (annex 1) that there was no assessment of the capacity of the SRs prior to working with them. The OIG's review revealed that SRs had significant capacity weaknesses, but no capacity building was undertaken to enable them to implement the programs better.

186. The guidelines for annual audits of PRs and SRs stipulate that the responsibility to have all SRs audited lies with the PR. In the cases where PSI was PR, the OIG noted that such audit plans were not in place and in many cases these audits did not happen.

187. The OIG noted some shortcomings with the SRs and this was reflective of the platform's mechanisms in place to monitor SR financial and programmatic performance e.g. in Togo, Madagascar, Sudan and Nepal. The OIG visited SRs as part of its audits and noted some generic issues that should have been picked up by PRs during their monitoring, for example:

- i. lack of proper supporting documentation;
- ii. budget/actual analyses that were not undertaken resulting in ineligible activities going undetected; and
- iii. some SRs have not accounted for program funds at the time of the audit etc.

Related recoveries have been identified in the OIG's country specific audits.

Recommendation 25: Significant

PSI should enforce the guidelines contained in its manuals in order to strengthen the control environment of SRs.

Annex 1: Findings Identified by Country

| | Togo | Madagascar | Sudan | Nigeria | Nepal | DRC | Haiti |
|---|------|------------|-------|---------|-------|-----|-------|
| Institutional aspects | | | | | | | |
| No relationship between PSI and platform | | | ✓ | ✓ | | ✓ | ✓ |
| Governance issues | | | ✓ | ✓ | | | |
| Audit arrangements not adequate | | ✓ | | | ✓ | ✓ | |
| Tax exemption not obtained | | | ✓ | | ✓ | | |
| Policies and procedures not adequate | | ✓ | | | | ✓ | |
| Noncompliance with laid down PSI policies | ✓ | ✓ | ✓ | | | ✓ | |
| Salary issues | | ✓ | | | ✓ | | |
| Country laws not complied with | | ✓ | | | ✓ | | |
| Programmatic aspects | | | | | | | |
| Program managed by PSI not aligned to the national program | ✓ | | | | | | |
| Creation of parallel structures | ✓ | ✓ | ✓ | | | ✓ | |
| PSI brand promoted under social marketing (SM) | ✓ | ✓ | | | | | |
| No product differentiation between products that are sold and those handed out free of charge | ✓ | | | ✓ | | | |
| Inappropriate pricing strategy under SM | ✓ | ✓ | | | | ✓ | ✓ |
| No price control mechanism under SM | ✓ | ✓ | | | | ✓ | ✓ |
| Inappropriate definition and application of SM indicators | ✓ | ✓ | | | | ✓ | ✓ |
| Data collection, quality assurance and consolidation issues | ✓ | ✓ | ✓ | | | ✓ | ✓ |
| Unavailability of products | ✓ | ✓ | | | | | |
| Financial management aspects | | | | | | | |
| Commingling of funds | ✓ | ✓ | ✓ | | | ✓ | ✓ |
| Banks were not interest bearing | ✓ | | ✓ | | | ✓ | ✓ |
| Data from various data collection systems is not synchronized | ✓ | ✓ | | | | ✓ | |
| Unsupported/ Ineligible expenditure | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ |
| Issues with allocation of common costs | ✓ | ✓ | ✓ | | ✓ | ✓ | |
| Program income not reported | ✓ | ✓ | | | | ✓ | ✓ |
| Grant funds used to pay taxes | | ✓ | | | ✓ | | |
| Financial management system not adequate | | ✓ | | ✓ | | | |
| Significant budget overruns | | ✓ | ✓ | | | ✓ | |
| Advances ledger not maintained | | | | | ✓ | | |

Audit of Global Fund Grants Managed by Population Services International

| | Togo | Madagascar | Sudan | Nigeria | Nepal | DRC | Haiti |
|---|------|------------|-------|---------|-------|-----|-------|
| Procurement and supply chain management | | | | | | | |
| Procurement best practice not applied to local purchases | | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Storage issues | | ✓ | ✓ | ✓ | ✓ | | |
| Quality assurance issues noted | | ✓ | ✓ | ✓ | | | |
| Distribution challenges | ✓ | ✓ | | | | | |
| SR management | | | | | | | |
| Issues with SR identification | ✓ | | ✓ | ✓ | | | |
| Issues with assessment and capacity building of SRs | ✓ | ✓ | ✓ | ✓ | ✓ | | |
| PR did not have an SR audit plan | ✓ | ✓ | | | | | |
| SR accountability reports were not comprehensively reviewed and followed up | ✓ | ✓ | ✓ | ✓ | | | |
| Issues with monitoring SRs | ✓ | ✓ | ✓ | | ✓ | | |
| Oversight | | | | | | | |
| PSI involved in proposal writing | ✓ | | | | | | |
| PSI did not provide information to CCM for oversight | ✓ | ✓ | | | | | |
| LFA had access issues | ✓ | ✓ | ✓ | | | | |

Annex 2: Secretariat Response to the OIG Population Services International (PSI) Audit Report

18 October 2011

John Parsons
Inspector General
Office of the Inspector General
The Global Fund
Chemin de Blandonnet 8
1214 Vernier
Switzerland

Dear John,

The Global Fund Secretariat thanks the Office of the Inspector General (OIG) for sharing its draft report on audit of Population Services International (PSI). We recognise that this is a synthesis of audit findings in 7 countries where PSI is PR.

In this letter the Secretariat provides a brief summary of the contextual background and achievement by PSI. This letter also highlights specific areas that need immediate attention and actions the Secretariat and PSI have taken or will take to address these key risks identified in programs currently managed by PSI.

A. Contextual background

Population Services International (PSI) is a key partner to Global Fund and as at the time of audit was Principal Recipient (PR) in multiple countries with a total disbursed amount of over US\$ 350 million. PSI also manages Global Fund programs at the SR and SSR level in over 20 other countries.

Often, PSI is PR in countries with challenging social and health sector environments such as Haiti, Democratic Republic of Congo, Southern Sudan, Nepal, and Madagascar. PSI continues to implement programs in these challenging conditions and in a lot of the cases has achieved commendable results.

The Secretariat has already initiated efforts to support PSI to address key areas of concern flagged by the OIG. Implementation of the OIG recommendations has already started and the Secretariat will follow up to ensure financial and procurement practices are properly aligned to Global Fund policies and procedures. Further, a biennial assessment of PSI's procurement, financial systems and processes will help identify weaknesses and strengthen PSI performance going forward.

PSI currently has presence in over 70 countries and Global Fund will seek for more opportunities to work with PSI and especially leverage on PSI's network of organisations to fight HIV/AIDS, malaria and tuberculosis. Going forward, the Secretariat will strengthen the relationship with PSI and work closely at both the headquarters and country level to resolve any challenges facing delivery of Global Fund programs.

B. Secretariat's response to OIG recommendations

| OIG Recommendations | Secretariat response and measures to address the identified risks and weaknesses |
|---|---|
| <p>Streamlining work with the LFA</p> <p>The OIG noted that:</p> <ul style="list-style-type: none"> i. The PR was ultimately PSI HQ and not the local in country platforms; and ii. As per requirement no capacity assessment, especially of key areas of procurement and finance, had been done since we contracted PSI HQ. Yet a large amount of transactions were carried out at the HQ level. <p>In addition, the lack of complete information at the country level created challenges to the LFA work especially around validation of procurement and financial management practices and information such as bank balance, computation of overheads and interest earned.</p> <p>As a result the OIG recommends that:</p> <ul style="list-style-type: none"> i. PSI ensure that LFAs have full access to relevant documents and sites as per the Grant Agreement; and ii. As a matter of urgency, all restriction on the LFAs access to information should be addressed by the Secretariat. | <p>The Secretariat recognises that access to and review of documentation is central to effective execution of the LFA role. The Secretariat has already engaged PSI to develop a solution that will ensure:</p> <ul style="list-style-type: none"> i. LFAs that work with PSI in country platforms have access to information and documents necessary to complete their regular reviews. ii. Access to information does not burden PSI with numerous requests from the different LFAs and that requests are well coordinated. <p>Further, the Secretariat will every two years carry out a capacity assessment of PSI headquarters in Washington DC. The scope of this review will include assessment of procurement processes, financial systems, financial management capacity and both internal and external audit arrangements.</p> |
| <p>Enhancing procurement capacity</p> <p>PSI should significantly strengthen its capacity to manage the procurement function. Specifically:</p> <ul style="list-style-type: none"> i. PSI should comply with the relevant procurement related conditions in the grant agreement. If PSI HQ is to continue to be involved in PSM activities, it should be assessed periodically through an | <p>To address Recommendations 19-24 of the Audit Report, which include issues relating to compliance with procurement procedures, tender adjudication, monitoring supplier performance and adherence to the Global Fund Quality Assurance Policy for Pharmaceutical Products, the Secretariat will henceforth assess the capacity and systems of PSI HQ to procure health products using grant funds. The Secretariat will work with PSI</p> |

| | |
|---|--|
| <p>established process by the Global Fund for assessing PR PSM systems and capacity in line with the grant conditions. Measures instituted to address capacity gaps identified and/or appointing a third party procurement agent to manage procurement on behalf of PSI;</p> <p>ii. PSI should strengthen the capacity of its procurement unit by ensuring that staff have appropriate skills and tools to manage the procurement process.</p> <p>iii. The record keeping around procurement processes should be strengthened.</p> <p>iv. PSI should clearly mention delivery deadlines to final destinations both in the bidding documents and in the contracts.</p> <p>v. There should be segregation of duties in the procurement function. PSI should strengthen the management oversight over the procurement process.</p> | <p>HQ to schedule this assessment, in line with the normal practice of scheduling PR PSM Assessments.</p> |
| <p>Audit arrangements with PSI</p> <p>The OIG noted the need to strengthen audit arrangements with PSI HQ and the platforms in country. This includes PSI compliance to Article 13 of the Grant Agreement and best practice as outlined in Guidelines for Annual Audits of PRs and SRs Financial Statements.</p> | <p>The Secretariat agrees with the OIG assessment and recommendations.</p> <p>The Secretariat has already engaged PSI on this issue and there are on-going discussions on a PSI proposal to perform a global consolidated audit.</p> <p>The Secretariat will ensure that audit arrangements with PSI meet requirements as per the Grant Agreement, including appropriate scope for audit at both the in-country and headquarters levels. Specific focus will be on the need to have audits per each separate grant as well as audits that cover expenditure at the PSI HQ, including a review of the Indirect Cost Recovery.</p> <p>Sharing of audit management letters is an additional area which the Secretariat is also following up on.</p> |
| <p>Comingling of funds at HQ level</p> <p>Comingling of funds at HQ level and</p> | <p>The Secretariat agrees with the OIG that comingling of funds at the headquarters and sometimes at country level poses</p> |

| | |
|--|--|
| <p>related challenges especially verification of cash balances and computation of interest earned.</p> | <p>challenges. For instance, it does not allow LFAs to perform the required cash reconciliations.</p> <p>The Secretariat will immediately recommend to PSI to retain one headquarters account for Global Fund, separate from other donor funds. This will improve financial accountability and provide a clearer basis for allocation of interest earned to the Global Fund grants.</p> <p>In parallel, the LFA will be requested to assess whether PSI is able to disaggregate the theoretical Global Fund bank balance and breakdown expenditure by Grant. Based on the assessment the Secretariat will then take appropriate action.</p> |
| <p>Internal audit functions at PSI</p> <p>Internal audit functions (OFOG) at PSI should extend their mandate to cover Global Fund specific program areas identified as risky e.g. SR management and related transactions at HQ level. These OFOG reports should be provided to the LFA and Global Fund Secretariat, without confidentiality restrictions, to facilitate their decision making.</p> | <p>The Secretariat has engaged with the Civil Society Principal Recipient Network (CSPRN) to explore ways of strengthening internal audit functions and address a key concern around disclosure of internal audit findings and reports. The Secretariat has prepared a draft guidance document and this is going through Global Fund internal review and approval processes. This will be finalised for implementation by end of 2011.</p> |
| <p>Financial management review</p> <p>The OIG highlighted various financial management weaknesses with corresponding recommendations 4, 11 & 16-18 covering financial reporting, allocation of common costs, accounting for HQ expenditure, salary review and an overall need to enhance financial control mechanism.</p> | <p>The Secretariat has taken note of OIG findings and recommendations and will carry out a financial management review at headquarter level. The proposed assessment will be carried out on a biennial basis (every 2 years) to ensure financial processes and systems remain effective and can be relied upon. To facilitate effective decision making, the results will be shared with the respective teams managing PSI grants at the Secretariat.</p> <p>In its upcoming annual review of Guidelines and Assessments, the Secretariat will review those pertaining to allocation and documentation of overheads ensuring thorough guidance is available to its principal recipients.</p> |
| <p>Reporting on indicators</p> | <p>In our view, this is a correct finding on the part of the OIG. Often we find that what is</p> |

| | |
|--|--|
| <p>The OIG noted a shortcoming relating to the indicators and results reported across most of the grants arising from the different definitions/ interpretations of indicators relating to the distribution of products. PSI's interpretation of distribution of products was to intermediary points and not to final users yet the 'top ten indicators' mandated by the Secretariat call for evidence of distribution to the final user level. This needs to be corrected if results reported are to be consistent with the 'top ten indicators'.</p> | <p>being measured is condom distribution to regional warehouses or SSRs when the indicator says 'condoms distributed to people'. Whenever possible, when the distribution is done at health facility or community levels and depending on the strategy used, we strongly recommend to collect and report on condom distribution to the beneficiaries. However, considering the difficulties in measuring condom distribution at beneficiaries level where the distributors are commercial actors, it is not realistic to request that they report on end users. Therefore, the new M&E toolkit on HIV does not have this indicator on condom distribution. It is recommended to monitor condom use at outcome level.</p> |
|--|--|

The Secretariat thanks the Office of the Inspector General (OIG) for its draft report and looks forward to a constructive engagement on issues raised in this letter and during follow up on recommendations.

Sincerely,

Mark Eldon-Edington
Director of Country Programs

Annex 3: PSI Response to the OIG Report



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October 14, 2011

Mr. John Parsons
Inspector General
The Global Fund to Fight AIDS, TB and Malaria
Chemin de Blandonnet 8
1214 Vernier-Geneva, Switzerland

Dear Mr. Parsons, *Dear John,*

Thank you for sharing the final OIG Report on Audits of Grants Managed by Population Services International (PSI). PSI appreciates the time and effort the OIG has spent in its extensive review of PSI's policies and procedures, and recognizes the critical importance of the OIG's recommendations. PSI would like to reaffirm its commitment to continuously improving our performance in grant management.

As indicated previously, PSI largely accepts the observations and recommendations presented by the OIG with a few notable exceptions, and agrees that there are several key areas where PSI can improve its execution. Specifically, PSI is committed to ensuring country ownership and alignment with national strategies and priorities; strict adherence to and compliance with the Global Fund's policies, terms and conditions; improved management of sub-recipients; and implementation of robust financial and procurement policies and practices at both PSI Headquarters and country offices.

While PSI acknowledges the many valid points presented by the OIG in this audit, we would like to note that there are a few observations in the Headquarters report that are directly related to questioned costs and requests for reimbursement in the PSI country-specific reports with which PSI disagrees. PSI stands by our statements that the costs in question were reasonable and allowable, and we look forward to working closely with the OIG and the Secretariat to resolve these issues.

PSI appreciates that the OIG intends to include our detailed management responses in the final report and looks forward to the final publication of this document. However, PSI respectfully requests that the OIG consider the following revisions before publication:

1. With respect to redacting the specific country names in the procurement and supply chain management section, PSI would like to note that there are several paragraphs that still cite specific countries, namely: paragraphs 137, 139, 157, 169, and 179. PSI respectfully requests that the OIG correct these paragraphs before final issuance of the report;

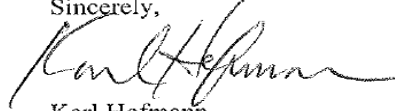
Mr. John Parsons
October 14, 2011
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2. Related to the above, PSI requests the removal of specific country names in PSI's management responses; and
3. The OIG's letter dated October 10, 2011 indicated that PSI's additional comments (regarding factual errors) were addressed by the OIG in the management response section of the final report. PSI notes that the issues included in the factual errors' section were not fully addressed and requests that the OIG update relevant sections of the report accordingly. Please see the attachment for more details.

Should you determine a need for additional clarification on any point, PSI would welcome the opportunity to discuss our positions in greater detail.

PSI would like to reiterate its appreciation of the OIG's ongoing support and commitment as we continue to improve Global Fund grant implementation and achieve global health impact. Sincerely,

Sincerely,



Karl Hofmann
President/CEO

KH:cmf

cc: Dr. Michel Kazatchkine, Executive Director, Global Fund Secretariat
Dr. Debrework Zewdie, Deputy Executive, Director, Global Fund
Mr. Mark Edington, Director Country Programs, Global Fund
Mr. Oren Ginzburg, Unit Director, Quality Assurance and Support Services Unit, Global Fund

Subsequent to above letter from PSI, the OIG undertook a careful review of the items listed. We have made a number of textual edits and redacted specific country names as requested. The OIG is satisfied that there are no further remaining factual errors. Our written response to PSI is appended as Annex 3(i) below.

Annex 3(i): OIG Response to the PSI Letter

Our Ref: OIG/ JP_10/022
28 October 2011

Mr. Karl Hofmann
Population Service International
Washington DC

Dear Mr. Hofmann,

Thank you for the comments on the final draft report and action plan. I have considered the additional comments made with regard to the final draft report and detail below how these have been addressed.

1. The additional references to specific countries in the procurement and supply chain management section and the action plan have been redacted in order to ensure that the report highlights areas for improvement without exposing your organisation to any risks.
2. Paragraph 93: the report has not been amended because in accordance to the definition of a related party according to the International Accounting Standard (IAS) 24, the platforms are related parties. IAS 24 defines a related party a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity') [IAS 24.9].
 - (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - has control or joint control over the reporting entity;
 - has significant influence over the reporting entity; or
 - is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
 - (b) An entity is related to a reporting entity if any of the following conditions applies:
 - The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - Both entities are joint ventures of the same third party.
 - One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
 - The entity is controlled or jointly controlled by a person identified in (a).

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- A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
3. Paragraph 95: The reference to the 'manual adjustment' has been removed as requested.
 4. Paragraph 120: PSI requests that the language in the report is changed from "All resultant errors are supposed to have been corrected" to "All of these errors have been corrected". You will appreciate that the OIG has not undertaken work to confirm that errors were corrected. The OIG therefore lacks the requisite evidence to support the statement as requested by PSI.
 5. Paragraph 126: PSI's response has been incorporated in the final report.
 6. Paragraph 127: PSI's response has been incorporated in the final report.
 7. Paragraph 128: PSI's response has been incorporated in the final report.

Should you wish to discuss with me any of the matters raised in this report, I would welcome an opportunity to do so.

Yours sincerely,



John Parsons
Inspector General

cc: Dr Michel Kazatchkine, Executive Director, the Global Fund
Dr Debrework Zewdie, Deputy Executive Director, the Global Fund
Mr Mark Edington, Director, Country Programs, the Global Fund
Mr Oren Ginzberg, Director, a.i, Quality Assurance and Support Services, the Global Fund

Annex 4: PSI and CCM Responses to the Recommendations and Management Action Plan

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|---|--|-------------------|-------------|-------------|
| Institutional Arrangements | | | | |
| <p><u>RECOMMENDATION #1 (HIGH):</u> i. The Secretariat should follow up the need for PSI HQ to establish capacity building and transition plans for the countries where it is PR. PSI should work with the CCM to identify the entities (either their own platforms and independent entities) that would benefit from such capacity building.</p> <p>ii. As part of its assessments, the LFA should confirm PSI's affiliation with local entities.</p> | <p>1i. PSI fully supports the Global Fund's operating principle of country ownership, and as Principal Recipient (PR), has consistently demonstrated its support for programs that reflect country ownership and ones that value country-directed program development and implementation processes. In addition, PSI is committed to building onto existing national structures to ensure that PSI's efforts support and complement national strategic policies and priorities.</p> <p>As noted by the OIG, PSI serves as PR in several countries with complex operating environments and serious capacity constraints. Despite these challenges, PSI is committed to continuing its work to collaborate with national entities. Toward that end, PSI has focused considerable attention on increasing its institutional learning and competencies in the areas of SR management and capacity building, with the goal of transitioning knowledge to both civil society and government partners.</p> <p>With respect to the July, 2009 Information Note in the GF's Operations Manual that requires multilateral and international NGOs to develop capacity building and transition plans to enable local entities to assume the PR-ship, PSI looks forward to working with the Secretariat and CCMs to more fully evaluate the countries where this would be most feasible. In addition to identifying the specific entities that would benefit from this capacity building, PSI will continue to work with the Secretariat to identify the financial and human resources needed to support the activities necessary to achieve the objectives.</p> <p>1ii: PSI stands ready to work with the LFA to confirm PSI's affiliation with local entities, and would be happy to provide information and documentation to the LFA upon request.</p> | | | |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|---|---|-------------------|-------------|-------------|
| <p>RECOMMENDATION #2 (SIGNIFICANT):</p> <p>i. PSI should share information with the CCM to enable them undertaken their oversight effectively.</p> <p>ii. The Global Fund should provide guidance that regulates the extent of the involvement of PRs in the proposal writing process.</p> | <p>2i. PSI agrees with the importance of sharing information with the CCM to enable them to perform their oversight role effectively, and encourages PRs to present performance results at regular CCM meetings and to oversight and technical committees as established in the country. In addition, PSI has adapted oversight tools and templates developed by Grant Management Solutions which are designed to provide CCMs with a graphics-based summary of key programmatic, financial, and SR management metrics. PSI has shared the templates with all of its PRs, and has conducted trainings on how to develop and communicate important grant information to the CCM.</p> <p>2ii. PSI looks forward to receiving guidance from the GF regarding involvement of PRs in the proposal writing process. Nearly all CCMs have a procedure to completely separate the selection of PRs and SRs from the technical teams working on the proposals, so that there is no conflict of interest. PSI, in coordination with the Civil Society PR Network, insists that it is essential for a proposed PR to be involved in the proposal development process to ensure that targets are attainable and can be achieved with the budget and resources planned by the CCM. Excluding the proposed PR has led to situations where the PR was unable to complete the activities because key elements of the budget or workplan were omitted.</p> | | | |
| <p>RECOMMENDATION #3 (HIGH)</p> <p>PSI is expected to ensure that LFAs have full access to relevant documents and sites as per the grant agreement (article 8). As a matter of urgency, all restrictions on the LFA's access to information should be addressed by the Secretariat.</p> | <p>As highlighted in the OIG report, a large percentage of transactions occur at the PSI HQ level. PSI would like to draw attention to the fact that with the exception of a very small portion of expenditures related to international staff salaries, fringe, travel and overhead charges, the vast majority of costs originating from PSI headquarters are for the large-scale procurement of bed nets, condoms, testing reagents, etc. Purchasing these items at the HQ level not only allows PSI to assure the lowest cost for quality products, but also helps to minimize the risks of corruption, poor quality, and unreliability. Centralized and consolidated procurement practices have been supported by the Secretariat for several years; in addition, the recent Final Report of the High Level Independent Review Panel on Fiduciary Controls and Oversight Mechanisms of the GFTAM recommended the continuation and perhaps expansion of the centralized, bulk-purchasing systems.</p> | | | |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
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| | <p>Historically PSI HQ has also repeatedly invited the LFAs (or a US-based representative) to visit its HQ's office to access documents. PSI's HQ has a policy that it will not send original documents outside of the organization (since original documents are required to support other audits performed in PSI's HQ) and will work with and LFA or auditor to meet documentation needs within PSI's policy guidelines. PSI has offered to send certified copies of HQ documents to the LFAs. However, some LFAs maintain that original documents are necessary, so more discussion and/or clarification would be welcomed from the Secretariat on this point. PSI has been working with the LFA Manager from the GF Secretariat to standardize procedures for LFAs, as the wide variation in LFA assessment practice poses challenges to PRs.</p> <p>At country level, the LFAs frequently request large sample sizes, in some cases up to 100%, with a turnaround time of 24-48 hours when they are reviewing expenses. Responding to this type of request requires significant time and energy, as the compilation of thousands of pages of documents is extremely labor intensive. Given the GF reduction in overhead support of international NGOs, this repeated coping of documents and cumbersome methodology of review is not practical for PSI, given its large grant portfolio. PSI is in contact with the Secretariat on 2010 donor audit solutions as well as forward looking solutions that meet the needs of the GF while not unduly burdening the headquarters organization.</p> | | | |
| <p>RECOMMENDATION #4 (SIGNIFICANT) (i) PSI should ensure that audit arrangements are implemented as <i>per article 13 (audits and records)</i> in the standard terms and conditions and the guidelines for annual audits of PRs and SRs' financial statements. PSI should also respect its obligations it has with the various in country PRs.</p> | <p>4i. PSI would like to better understand the rationale behind the OIG's suggestion that using the ISA (International Auditing Standard) would be more relevant for PSI's audits than using US Generally Accepted Accounting Principles (GAAP). PSI is a US-based organization and subject to all of the requirements of GAAP; GAAP's principles are in most cases similar to and certainly equally rigorous to those of the International Accounting Standards.</p> <p>As discussed previously with the OIG, PSI has several layers of financial and donor audits. Country platforms should have local financial audits as a control feature, as well as local donor cost audits whenever a donor requires this. Since the Global Fund's</p> | | | <p>Although PSI is a US based organization, the grants it manages are country grants. ISA would therefore be more applicable to the different country contexts than US GAAPs.</p> |

Audit of Global Fund Grants Managed by Population Services International

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|----------------|---|-------------------|-------------|---|
| | <p>publication of new audit guidelines, PSI HQ has engaged with its country offices to ensure their audits are fully compliant. PSI will continue these efforts.</p> <p>PSI also performs a global financial audit by an internationally recognized public accounting firm and as such, PSI can submit any qualification to the firm, including the need to be independent. This audit provides a consolidated assurance of the financial reporting and controls for all of PSI platforms and HQ operations. In addition to this, PSI has historically provided donors with a donor schedule completed as a part of its annual audit that provides details of its grant funds, cash receipts, expenditures and balances. These reports have been available for a number of years but PSI is open and willing to further refine these donor reports to meet all the needs of the GF. PSI initiated these discussions in early 2011 and is continuing these discussions with the finance team of the Secretariat to come to an agreement of the specific nature of the report and audit coverage for this report.</p> <p>Since PSI is a global organization with headquarters operations it welcomes a single review of its headquarters operations and a single set of recommendations for improvement annually by an independent third party. PSI does not agree that individual LFA's should all individually review and offer "areas for improvement" to PSI headquarters operations. This could result in 30+ different reviews and perspectives.</p> <p>PSI does however understand and respect that the LFA's need to know if there are areas for improvement, not only at the country level but also at HQ. As such, PSI is confident that a management letter from the global auditors specifically related to GF grants in conjunction with the GF global donor audit will meet these needs, since all HQ operations are standard and a single report on improvements is the most appropriate and cost effective monitoring tool. PSI's expectation is that the details of the GF donor audit will be agreed on with the staff of the Secretariat by the 4th quarter of 2011.</p> <p>PSI is open to and continues to discuss terms of the donor audit with</p> | | | <p>As stated by PSI, the global audits would be more convenient for PSI but would not provide the required assurance to the Global Fund on how grants are spent at a country level.</p> |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|---|---|-------------------|-------------|---------------------------|
| (ii) PSI should put in place arrangements to ensure that documentation of transactions incurred at Headquarters are available for verification by the various external auditors. The audit reports should be available to the Global Fund and the respective CCMs for their oversight. | <p>the GF and looks forward to a rapid conclusion to the discussion.</p> <p>4iii. PSI, as above, welcomes the conversation and looks forward to finalizing an agreement with GF regarding the auditing of its global records by a single set of external auditors to include specific management letter comments relevant to the GF grants. PSI thinks that this single approach will bring the necessary assurances to all levels of the GF.</p> <p>As stated elsewhere in the response, PSI is open to and continues to discuss terms of the donor audit and looks forward to a rapid conclusion to the discussion.</p> | | | See the OIG comment above |
| <p><u>RECOMMENDATION #5 (SIGNIFICANT)</u></p> <p>PSI should extend its OFOG mandate to cover Global Fund specific program areas identified as risky e.g. SR management and related transactions at HQ level. These OFOG reports should be provided to the LFA and Global Fund Secretariat, without confidentiality restrictions, to facilitate their decision making.</p> | <p>5. The "Overseas Financial Operations Group" (OFOG) has been replaced by the "Global Internal Audit" (GIA) department at PSI, which is responsible for performing internal audit assessments across the PSI network, including both field and headquarters locations. The GIA mandate includes reviewing management of sub-awardees and visiting sub-awardees if appropriate, as well as following up on the status of previous recommendations. The GIA department applies a risk-based approach to its assessments, which are performed to assess the effectiveness of internal controls as well as compliance with donor, regulatory, PSI and local law requirements. PSI's internal audit approach follows a sample-based testing across the projects managed by a platform.</p> <p>Global Internal Audit visits to platforms focus on testing the transactions originated in country, while separate assessments are performed of transactions and controls processed through headquarters.</p> <p>PSI firmly maintains that internal audit reports should remain confidential in order for the internal audit process to remain effective and independent. PSI, along with other members of the Civil Society Principal Recipients Network, continues to work with the Secretariat regarding the sharing of internal audit reports, and looks forward to finding an approach that meets the needs of both the Global Fund and PRs with an internal audit function.</p> | | | |

Audit of Global Fund Grants Managed by Population Services International

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|--|--|-------------------|-------------|-------------|
| Program/ Public Health Related Aspects | | | | |
| <p><u>RECOMMENDATION #6 (SIGNIFICANT):</u></p> <p>(i) In line with the Paris declaration and the Global Fund core principles, PSI should to the extent possible align its programs to the national programs. This will ensure the program remains relevant to the country's priorities and is sustainable post funding.</p> <p>(ii) The Global Fund as part of the grant negotiation process needs to operationalize its policy and encourage PRs to use national structures, systems and procedures for implementation of program activities. In cases where parallel systems have to be set up, these structures should be for a defined period of time with relevant capacity building and transition plans for the eventual transitioning back to</p> | <p>6i. As noted by the OIG, coordination and collaboration between programs and across multiple governmental entities is a challenge in many countries, and while not perfect, PSI as PR strives to achieve a high degree of harmonization and alignment with national strategies. National policies and programs, such as National Strategic Plans and National Strategic Frameworks, are taken into account by PSI whenever possible when designing and implementing activities in the countries where it operates. In addition, by means such as participating in national-level working groups, and working closely with the CCMs, PSI strives to align its programs with national priorities. For the Global Fund, PSI implements the programs designed by CCMs, and generally has less control over program design.</p> <p>In certain situations however, established national policies may not exist, as cited in the Sudan and Togo OIG country reports. For example, in the case of Togo, PSI based its HIV peer education program on the Ministry of Health national plan. However, the Ministry of Education did not have an established sector plan at this time, making it difficult to ensure harmonization between PSI's peer education strategies and those of the Ministry of Education. In addition, peer education activities for HIV awareness within the formal education system and peer education activities for HIV prevention beyond the school setting should be complementary but not necessarily identical nor directly comparable.</p> <p>6ii. PSI understands and agrees with the need to support national structures and priorities, and looks forward to receiving additional operational guidelines from the Global Fund regarding how PRs and the CCMs can work with national structures more effectively and efficiently. PSI notes, however, that under some circumstances the High Level Panel and other structures have provided conflicting advice, and that it may be necessary to use parallel structures under certain circumstances to safeguard Global Fund resources.</p> | | | |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|---|--|-------------------|-------------|---|
| national structures. | | | | |
| <p>RECOMMENDATION #7 (HIGH):</p> <p>(i) PSI should align its interpretation of indicators with the 'top ten indicators'. An indicator user guide should be developed to ensure that all stakeholders have the same understanding of the indicators to aid data collection and analysis. PSI's strategy and monitoring tools will need to be adjusted to provide for the collection of data to final user, including price verification and control.</p> <p>(ii) As the top ten indicators are being revised, this is an opportune time for the Secretariat to clearly define indicators to ensure that they do not contain any ambiguities. The Secretariat should review the interpretation of the indicators used on PSI's programs, and ensure they comply with 'top ten indicators'.</p> <p>(iii) As Global Fund supported programs move to single stream funding (SSF), impact/outcome data will become increasingly important. In order to strengthen PSI's model of undertaking studies:</p> <ul style="list-style-type: none"> The Secretariat should be consulted on the study | <p>7i. PSI distributes products through a variety of complementary approaches, including mass campaigns, public sector free distribution, community-based distribution, and social marketing via private commercial agents and distributors. With respect to the latter, PSI requests that the OIG consider that private sector approaches to distribution may require special consideration in regards to monitoring tools as commercial actors are not paid public servants nor employees of PSI, and are under no obligation to report end-user data. Insisting upon definitive data to final user from commercial actors may preclude implementers from harnessing alternative distribution systems other than the public sector. This is vital when taking in account that in the vast majority of countries where PSI and the GF operate, large percentages of the target population tend to live more than five kilometers from public health facilities and often rely on private actors for health services and products. PSI looks forward to working with the Secretariat to determine how best to incorporate this into the indicator user guide.</p> <p>7ii. PSI is committed to working with the Secretariat to ensure alignment with the top ten indicators, and looks forward to further guidance from the Secretariat regarding interpretation of the indicators.</p> <p>7(iii) PSI is confident about the objectivity and transparency of its research and study designs, and works closely with the Global Fund and the CCMs to ensure that any proposed research included in proposals and budgets will provide valid and actionable data to support programming decisions. PSI's research tools are grounded in established marketing and public health research approaches, and are tailored to provide actionable evidence for decision-makers. PSI's Tracking Results Continuously (TRaC) surveys are produced according</p> | | | <p>The use of private sector approaches to distribution should not affect the manner in which results are identified for reporting. Any variances to the manner in which the top ten indicators are interpreted should be treated as an exception and be considered by the relevant experts in the Secretariat.</p> |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|--|---|-------------------|-------------|-------------|
| <p>design/protocol;</p> <ul style="list-style-type: none"> • The LFA along with national entities should be involved in the validation of results; and • The dissemination of results nationally should be encouraged. | <p>to standardized analytical methods and are presented internally and externally in reports, which contain a set of summary tables to support decision-making and corresponding text. Regardless of the findings (negative or positive), reports are disseminated to country-level stakeholders and are posted on its website at www.psi.org/research. In addition, PSI has an "open source" policy with respect to research and data, and shares its data sets and methodology to external parties via an online application on PSI's website: http://www.psi.org/sites/default/files/publication_files/PSI%20data%20use%20and%20authorship%20policies_6-15-11.pdf</p> <p>When funding permits, PSI welcomes the opportunity to work with third parties on its research. PSI currently has studies underway with London School of Hygiene and Tropical Medicine (LSHTM), Jameel Poverty Action Laboratory (JPAL) of the Massachusetts Institute of Technology (MIT), Innovations in Poverty Action (IPA) at Yale University, OPTIONS (a subsidiary of Marie Stopes International), Population Council, and the Global Health Group at the University of California San Francisco (UCSF). PSI also collaborates with Emory University, George Washington University, University of North Carolina (Chapel Hill), Tulane University, University of Washington, University of the Witwatersrand, the Ghana Social and Public Health Sciences Unit of the Medical Research Council, and the U.S. Centers for Disease Control. A list of research partnerships can be found at http://psi.org/resources/research-metrics/partners?phpMyAdmin=D673WcPmz30VmXalcHmZXgbNRE3.</p> <p>PSI welcomes the input of qualified individuals to its research processes, and would be happy to work with the Secretariat and the LFA to determine how they would like to be involved in the study design/protocol and validation of results.</p> <p>At the country level, PSI works closely with the CCM, government partners, and additional key stakeholders to ensure they have access to PSI's research methodology and results. PSI platforms regularly disseminate research results via several channels: sharing of reports electronically and during stakeholder and technical working group meetings, in-country and regional conferences on disease-specific</p> | | | |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
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| | areas, and presentations to the CCMs. | | | |
| <p><u>RECOMMENDATION #8 (REQUIRES ATTN):</u> PSI should consider differentiation between the products that are distributed for free and those for which a charge is levied. This will serve as a control to identify products that should be distributed free of charge from those that are otherwise sold on the market.</p> <p><u>RECOMMENDATION #9 (SIGNIFICANT):</u> PSI should to the extent possible promote products as opposed to own brands. In the event that a decision is made to promote a brand, consideration should be given to promoting a national brand.</p> | <p>8. As outlined in greater detail in PSI's response to OIG Recommendation 9, PSI maintains that branded products - whether free or sold - play an integral role in social marketing. Private sector strategies, regardless of pricing of products and or services to consumers, use differentiation via brand as well as other marketing tools to increase uptake of similar, if not the same products or services targeting differing socioeconomic beneficiaries, including free product and services. Unbranded, free products can sometimes have negative quality perception, and do not always allow for the product or services to be targeted at the right audience in order to achieve the best health impact value for money.</p> <p>However, PSI does track the distinction between free and sold products, e.g. condoms, and PSI country programs are required to routinely report the two categories separately. PSI uses various distribution channels to distribute health products to target groups, including both free distribution and via existing private sector agents. Furthermore, "sold" products are packaged distinctly, often with a recommended sales price printed on the package (or a sticker if the price changes). Free products are typically distributed in bulk, and in some cases, will sometimes be marked as "Free" or "Donation of the XXX". While some "sold" product is indeed free to the consumer - either via free samples of institutional sales that are then distributed for free - these remain a small minority of the overall "sold" category.</p> <p>9. PSI's continues to promote the importance of brands in its social marketing approach. A brand is a powerful way to embed in a single name everything consumers know and feel about a product or a service. As such, brands become decision-making tools for consumers. PSI's evidence-based approach to the development of brands also ensures that PSI is developing brands that resonate with its target audiences. Essentially, brands help organizations to create a strong and positive link between the "product" and "the consumer". The more equity a brand gets, the more value the product has in the eyes of the consumers and the more likely the product will be used. This is why</p> | | | The OIG noted that this was not the case in Togo and Nigeria. |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|--|---|-------------------|-------------|-------------|
| <p><u>RECOMMENDATION #10 (HIGH):</u> PSI should consider instituting measures to control the prices charged by distributors and retailers. This can take on different forms e.g. having promotion drives emphasize the recommended product price, monitoring suppliers, requiring sellers to display the recommended price, informing the population during public events, etc. In addition monitoring should be undertaken and this can take many forms including having a mystery buyer.</p> | <p>PSI, with support of its donors, invests significant time and resources to develop, nurture and protect effective brands.</p> <p>In addition to promoting brands, PSI frequently supports national initiatives to promote a health product or service category, e.g. BCC campaigns to support condom usage (unbranded), and often supplies generic products to support national efforts.</p> <p>Where countries intend to invest in the development of a national brand, PSI stands ready to provide technical expertise and actively participate on any and all feasibility studies for the development and promotion of the brand, and has done so in countries such as Malawi.</p> <p>10. Currently, PSI's primary means of price control is derived from MAP research studies. The MAP tool is used to measure coverage and quality of coverage by geographical zones, and access and equity of access to condoms by the target groups. The quality of coverage measures how well recommended prices are being adhered to, as well as the visibility of products, and the adherence to standard stock management procedures. PSI platforms conduct a MAP study every 2 years, or as allowed by funding, which enables PSI to continue to monitor and control prices at the point of sale. In addition, to supplement the MAP studies and provide more frequent and actionable data points on pricing and other issues, PSI's sales staff, promoters, and distributors routinely monitor and verify product prices, placement and promotion, and stock levels during regular visits to outlets. The information collected is used to highlight product trends, but also to identify problems, that require corrective actions.</p> <p>Given the importance of price in ensuring access and equity, PSI will continue to work with its platforms and partners and in consultation with the Secretariat to identify additional cost effective controls of tracking prices for inclusion in new grant and budget proposals. PSI would also welcome discussing possible modifications to its existing research plans with the Secretariat and CCMs. Price controls, however, do incur costs and these must be included in donor</p> | | | |

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
|--|--|-------------------|-------------|--|
| <p>RECOMMENDATION #11 (SIGNIFICANT): PSI should comply with the conditions stipulated in the grant agreement regarding the recording and use of program income.</p> | <p>budgets.</p> <p>11. PSI acknowledges that there have been some reporting errors in some PI statements, and continues to strive to improve its reporting, but maintains that PSI has been fully compliant with the guidance provided in the Standard Terms and Conditions of the GF grant agreement (11c) regarding use of program income. PSI uses PI to support programmatic activities and objectives, and reports program income generated by product or service sales - and the associated expenditures - in PSI's PU/DR reports.</p> <p>The requirement to obtain specific advance approval from the Global Fund Secretariat to use program income in support of the grant has not been previously communicated to PSI. Article 11(c) of the Standard Terms and Conditions, "Any revenues earned by the Principal Recipient or Sub-Recipients from Program activities, including but not limited to revenues from 'social marketing activities', shall be accounted for and used solely for Program purposes;" there is no further guidance on Program Income in the Operational Policy Manual or any other manual that PSI is familiar with. Thus, PSI has no requirement to seek permission, although PSI normally does.</p> | | | <p>The program income is normally not included in the approved work plan and budget thus the need to revert to the Secretariat through the CCM on how best such funds can be used.</p> |
| <p>RECOMMENDATION #12 (SIGNIFICANT):</p> | <p>12. PSI's organization is a network of branch offices and wholly</p> | | | <p>Based on the definition by IAS 24¹⁵ PSI's</p> |

¹⁵ A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity') [IAS 24.9].

(a) A person or a close member of that person's family is related to a reporting entity if that person:

- (i) has control or joint control over the reporting entity;
- (ii) has significant influence over the reporting entity; or
- (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

| Recommendation | PSI's Management Response | Responsible party | Action date | OIG comment |
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| In cases where technical assistance is provided by a related party i.e. PSI or one of its platforms, controls should be put in place to ensure that the transaction is at arm's length and cost effective. | <p>consolidated affiliates. As such the term related party is not appropriately used since these affiliates are all consolidated into the financial statements of PSI. While PSI affiliates may have separate registration status or legal status within the countries where they operate, under US law, they are part of one organization and under US Generally Accepted Accounting Principles, to which they must comply. Under these accounting principles, these affiliates do not meet the definition of a related party nor a third party. These affiliates are in fact one and the same as the parent organization PSI. This topic has come up repeatedly in many of the GF audits and is a clear misinterpretation of the organizational structure of PSI.</p> <p>The inclusion of project-specific technical assistance (TA) is a budgeted activity that is proposed and approved by the GF. PSI stands by the quality and value of the technical assistance provided by its technical departments, and asserts that it is more cost effective to utilize technical experts that can work across multiple countries, programs and regions and only charge the grant for the actual work performed. PSI asserts that having trained personnel familiar with PSI's country's programs and operations saves both time and money versus having to hire an external party. PSI's technical assistance practices are consistent with most other international NGOs and are generally accepted by donors. However, whenever PSI determines that it does not have the right technical expert for a particular need, it conducts a competitive bidding process to locate external consultants to perform the work, as allowed by the approved budget.</p> | | | <p>platforms are related parties.</p> <p>Because the affiliates are part of PSI, then it remains questionable whether any charges should be made to the grant funds for services offered by the PR.</p> <p>The SOW should also reflect the technical expertise required for the assignment and in cases where the service is provided internally, comparisons obtained to</p> |

- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
- (iii) Both entities are joint ventures of the same third party.
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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| | PSI agrees with the OIG that TA should be well regulated, and has a process designed to ensure that result. PSI requires that all countries requesting technical assistance submit a detailed scope of work (SOW) to the technical or program department in advance of the trip. The SOW outlines the duration, objectives and deliverables of the trip. Upon completion of the trip, the assistance provider is required to submit a trip report that details the activities undertaken, and a brief narrative describing the success or failure in achieving the SOW's deliverables. PSI would welcome additional information from the OIG about the examples they noted in paragraph 93, so that the issue can be more fully addressed. | | | evidence that this is the most cost effective mechanism. |
| Financial Management Aspects | | | | |
| <u>RECOMMENDATION #13 (REQUIRES ATTN):</u> PSI should consider linking the various data from different systems e.g. accounting and sales systems to ensure sharing of information and reconciliation of records maintained. The reconciliations of records maintained by the different departments will assure the accuracy of records maintained. | 13. PSI disagrees with the factual information in paragraph 95. Each month there is an automatic upload of Quickbooks file information into the Lawson financial system. Since new accounts can be set up locally, there is a security process in which each QuickBooks file runs through to ensure that all authorized accounts and program codes exist within the Lawson system. Each month there can be transactions imported from Quickbooks that may not have authorized account coding. In these cases the transactions are automatically rejected and posted to a suspense account in the Lawson accounting system. It is then a manual process for field staff to research and attach proper codes so that the information can be correctly recorded. This clearing process is done by journal entries initiated at the platform level and reviewed by program and accounting staff. Transactions at the headquarters level are not processed manually to either the country Quickbooks files or to the Lawson Consolidated financial system. All normal headquarters' transactions are processed through the many modules of Lawson. The Lawson system includes several automated integrated modules that manage the general ledger, cash posting, donor billing, activity (grants) management, accounts payable, inventory, purchasing and supply chain. Lawson is a fully integrated system to which electronic files from QuickBooks are uploaded to it each month so that Lawson becomes the system with 100% of the expenses and revenue of each platform and of headquarters. Lawson is considered the system of record for preparing all donor | | | Text amended to capture PSI's comment |

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| | <p>reports. The final project report is an automated report from Lawson. For purposes of preparing donor reports, data may be utilized from the automated reports and presented as needed by the donor on the final reports. Approximately 90% of all billing and donor reports are created directly out of the Lawson system. The remaining 10% of bills are produced locally and are reconciled back to the Lawson records to ensure that bills tie to the Lawson data. However, new policies were put in place in 2011 that require the reconciliation of any local billing reports to the Lawson financial system. If the OIG requires a copy of the new procedure, PSI would be more than willing to provide it.</p> <p>PSI does agree with the general observation to improve the integration of its different systems. This has been a strategic priority and will continue to be so for the foreseeable future. Currently, PSI does provide reconciliations of data between systems to assure the accuracy of its information. This is evidenced by PSI's policy manual and though internal audit reviews and external financial audits.</p> | | | |
| <p>RECOMMENDATION #14 (HIGH): PSI should consider either: (i) Maintaining separate bank accounts for all Global Fund resources managed by PSI HQ; or (ii) Having an accounting system that can reconcile balances in the fund accountability statements with bank balances held.</p> | <p>14i, ii. The cash balance reported by PSI is not theoretical, as PSI recognizes that the net amount of any sums received from the Global Fund less expenditures to date is the amount due to/from the Global Fund at any point in time.</p> <p>PSI can and does reconcile all its donor funds through an activity management system within its Lawson financial system that tracks all receipts from donors on an activity by activity basis, fees and revenue earned, and expenditures. This system was implemented in January 2008. Since the system conversion, additional controls and reports have been developed and implemented to ensure that at any point in time for any award, contract or activity, the system can produce reports that identify the exact amount of the outstanding funds held from the GF by PSI on a grant by grant basis.</p> <p>PSI is pleased to work with the Secretariat or with any LFA to provide these reports. In addition, PSI's system of controls and the reports are extensively audited by global auditors each year and do provide absolute assurance of the tracking of all funds received from PSI's</p> | | | <p>The requirement that the fund balance is agreed to a cash balance is a requirement that is verified periodically by the LFA.</p> <p>However in PSI's case, the cash balance cannot be tied to money in the bank.</p> |

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| | <p>donors. As the OIG noted, PSI pools its cash funds in its headquarters' banks, and so the accuracy of the donor reports are the controlling factor and assurance of proper accounting for all funds received, spent and all balances for GF grants.</p> <p>PSI's global auditors extensively audit this aspect of our business. Verifying correct balances of funds received and appropriate documentation for expenditures is a main focus of the audit.</p> <p>PSI's global auditors understand fund/activity accounting and provide assurance through their annual audit of PSI that all cash is properly accounted for and that all donor account balances are accurate.</p> <p>All PSI platforms are required to reconcile bank accounts monthly. This is tested by our Global Internal Audit group regularly and is also monitored monthly at the headquarters level through monthly reporting package reviews. The GF Secretariat has generally approved the in country reconciliations as meeting their needs, and PSI continues to work with the Secretariat to provide additional information requested.</p> | | | |
| <p>RECOMMENDATION #15 (HIGH): (a) PSI should ensure that all bank accounts at HQ and platform level bear interest at a reasonable commercial rate. The interest should be reported and used for program related activities.</p> <p>(b) PSI should recalculate the interest accrued on all grant funds held with the proper amounts debited/credited to the relevant</p> | <p>15a. PSI always makes its best effort to maintain funds in interest bearing account, and any interest received is accounted for on donor reports. These are not always available especially in local country situations. As the OIG is aware, interest rates are also at an all time low but accounts are still sought for even this minor interest income.</p> <p>PSI, as noted above, receives most of its donor funds at its headquarters operations and considers this as appropriate for the tightest level of controls. PSI further mitigates potential opportunities for funds mismanagement by minimizing the level of local funding to that of no more than a 4 to 6 week of local cash need. This practice has the effect of low balances in countries and low interest earned on these accounts.</p> <p>15b. As noted by the OIG, PSI has historically utilized the US Federal Rates in its interest rate application to all its grants. This policy was instituted in the early 2000's and has been consistently applied. This methodology was used for ease of application and to allow</p> | | | <p>The issue was not only with the interest rates applied but also</p> |

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| grants. These calculations would be verified by the Secretariat. | <p>transparency in the interest rate used since US banking rates are tied to US Treasury rates. Over the timeframe of the OIG audit the Federal rate has been slightly different than the banks rate (both higher and lower by a few fractions of less than one percent).</p> <p>After the OIG raised its concern with using the US Federal Reserve rates, PSI reviewed its policy and in response to the GF recommendation has changed to an actual interest rate application starting in 2011 and going forward.</p> <p>While the report in this section has noted "underreported " interest income, the report failed to disclose all the grants to which the application of the US federal treasury interest rate actually caused an over application of interest (interest applied to the grant over the interest rate earned by PSI for a particular period). PSI previously provided a schedule to the GF OIG audit staff during their field work that summarized both the over and under application of interest. Given the over and under applications that have occurred over 8 years and resulted in more interest applied to the GF grants, PSI maintains there is no repayment of funds due to the GF.</p> | | | with the manual computations undertaken by PSI. These recomputations have not been shared with the OIG as stated by PSI and so the OIG is not able to provide assurance that grants have been credited with accurate interest. |
| <u>RECOMMENDATION #16 (HIGH)</u> PSI should ensure that the basis of allocation of common costs is consistently applied. | 16. PSI acknowledges and agrees that it can improve its common cost allocation process and has an improvement action plan in place. PSI has revised its methodology for distributing platform (field office) common costs in a fair and reasonable way. This revised methodology was tested in five pilot countries during the first and second quarters of 2011. The proposed methodology, updated procedures, policy and implementation will be rolled out starting October 3rd, 2011, in a phased implementation schedule to all countries. Upon deployment, common cost will be applied consistently to all future budgets and costs. The approved PSI common cost policy will be provided to the Global Fund upon request. | | | |
| <u>RECOMMENDATION #17 (HIGH)</u> The Global Fund should consider the additional aspects that remain unaddressed in its new guidelines on | 17i-iii: PSI would like to note several inaccuracies related to the observations linked to Recommendation 17. With respect to paragraph 120, PSI converted from the Costpoint accounting system to the Lawson system in January 2008. During that conversion, there were a | | | PSI comment has been inserted |

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| <p>overheads. This includes:</p> <p>i. The appendices to the grant agreements should clearly disclose agreed fee rates and the direct expenditures against which such rates would be applied.</p> <p>ii. The Global Fund should institute measures to review the supporting documentation relating to overheads for the grants to which the new policy is not applicable in order to ensure that grant funds are used towards program purposes.</p> <p>iii. The Global Fund should require LFAs to verify the reasonableness of overhead in accordance with agreed upon conditions and allocation of common costs across donors for all grants to which the new policy is applicable.</p> | <p>few cases where the cross-walked tables resulted in incorrect charges to grants. All of these errors have been corrected and any errors were re-billed in subsequent billings to PSI's donors. Current audit results by PSI's external auditors have found no lingering errors of this nature.</p> <p>Regarding paragraph 125, PSI's actual overhead was higher than its rates indicated in 2007. PSI absorbed these costs with gains from investments. Since that time investment returns have shown large losses in several years due to the global economic crisis.</p> <p>Related to the above, in response to paragraph 126, PSI does not agree that any amounts would be due back to the GF, as the actual overhead rate was higher than the US Government approved rate.</p> <p>Paragraph 127 correctly notes that PSI purchased a building in which it has its headquarters office in November, 2007. However, the purchase did not use any donor funds; the building was 100% financed. All of PSI donors have benefited from this purchase as they are allocated only the actual cost of occupancy vs. the higher cost had PSI headquarters continued to pay rent. The cost savings reflected in PSI's OH rates reflects approximately a savings of \$10/sq. foot over the same space in a rental agreement in the same location. PSI's current overhead rates have consistently reflected the actual cost so all donors have benefited from this purchase.</p> <p>In response to paragraph 128, PSI disagrees that it should offset further its overhead pool if it should make any profit on the building in the future. PSI currently reflects its actual operating costs for the purposes of OH. There has been no donor funds used to purchase the building. In addition, PSI needs to have a positive margin on its building over time to accommodate payments on principle of its loan and for capital investments to maintain the building.</p> <p>PSI's specific comments on the recommendation are:</p> <p>i. Noted. PSI has since April 18, 2011 complied with the Global Fund's headquarters' support costs policy and has provided the Secretariat</p> | | | <p>The figures provided in the report were provided to the OIG by PSI.</p> <p>Since PSI is a not for profit organization, some of the funds to purchase the building would have come from grant funds from donors.</p> |

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| | <p>with all requested information about which direct costs are applied to calculate overhead.</p> <p>ii. PSI is unclear which grants in its portfolio would not follow the new policy, and would appreciate additional information about that, as it is PSI's intention to use the new policy for all grants signed from April 2011 onward. For grants signed previous to April 2011, PSI will work with the Secretariat to provide information.</p> <p>iii. PSI is implementing the new policy and is committed to providing information on the reasonableness of its overheads. Like other PRs, a standardized approach to this issue would be appreciated, as it can be time-consuming and difficult to interpret the varying requests from a large number different LFAs, each received at least every 6 months.</p> | | | |
| <p>RECOMMENDATION #18 (HIGH) PSI should strengthen its control over expenditure to ensure that charges to country grants remain reasonable. Specifically: i. All expenditure incurred at the HQ should be supported with proper third party supporting documentation;</p> | <p>18i. PSI acknowledges and agrees with the OIG on the importance of having controls in place to ensure reasonable and accurate charges to grants. As such, PSI requires third party supporting documentation for all expenditures in accordance with PSI's established policies. PSI currently verifies that all documentation is appropriate prior to it being charged to a grant. Without specific references to the documents provided to the OIG, PSI does not have enough information to more fully respond to the comment that the OIG felt that the documents they received were not adequately supported.</p> <p>For example, referring to Paragraph 132 i., PSI is not aware of any unsupported expenditures in the sampling by the OIG. In referencing the exit conference documents there were some payroll expenditure documents outstanding at the end of the field work but PSI provided these items in a follow up email to the GF. There were no other items noted as missing at the time of the audit.</p> <p>PSI agrees that documentation explaining allocations between donors should be strengthened and new training has taken place to improve</p> | | | <p>The expenditure that was unsupported mostly related to consultants fees charged to platforms where there were not contracts and TORs to support the payment.</p> |

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| <p>ii. An independent official should review postings to ensure that they are effected to the correct accounts; and</p> <p>iii. PSI should ensure that it consistently applies its policy on allocation of costs among donors.</p> | <p>these processes with staff.</p> <p>Paragraph 132vi. PSI disagrees with the judgment that expenses should have been charged to overhead. In cases where items can be strictly identified to a donor or to a project and they have been approved in the budget, PSI policy is that direct charging is a more accurate reflection of donor expenses. PSI is consistent across donors in applying this policy and would find it administratively burdensome to treat each donor differently with respect to direct and indirect charges and would actually be in violation with US Government regulation if they did treat these allocations inconsistently across donors.</p> <p>Paragraph 134. PSI does in fact attempt to obtain tax exemptions in every country it operates in. PSI relies solely on donor funds and in circumstances in which a country does not grant exemption from PSI, taxes become part of the cost of doing business in that country and thus a donor cost. PSI would welcome the GF support with country officials in granting PSI or other GF recipients exemption from local taxes. The GF Secretariat, Board and High Level Panel have all noted the challenges of receiving tax exemptions, and this problem is particularly acute for NGO and INGO implementers. PSI welcomes support to help address this challenge.</p> <p>18ii. PSI maintains that its current review procedures for posting expenditures are adequate. Reviews of program expenditures are made at numerous levels within the organization both at the platform and HQ levels, involving the accountant team, program staff and directors, and country representatives.</p> <p>18iii. PSI receives approval for all direct charges from its donors including GF. PSI does not duplicate charges between direct charges and overhead; this is audited by its Global financial auditors for verification. PSI is improving its common cost allocation methodology to be more consistent between donors and contends this is responsive to the OIG recommendation. Please see response to recommendation</p> | | | <p>Examples of such charges are the charging of (i) general accounting services; (ii) OFOG related costs and (iii) field office staff attending a PSI regional retreat costs.</p> <p>Examples of mispostings include the posting of total some country bills e.g. postage costs to the Global Fund supported program.</p> |

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| | 16 above for more detail about common cost allocation. | | | |
| Procurement and Supply Chain Management | | | | |
| <p><u>RECOMMENDATION #19 (REQUIRES ATTN):</u> PSI should endeavor to comply with its laid down procedures in order to strengthen the control environment within which purchases are undertaken. Purchase requisitions should be comprehensively prepared and approved as required in PSI's procedures manual.</p> | <p>19. This issue was not brought to PSI's attention prior to the draft report that was issued for management responses. PSI recognizes the importance of preparing and approving purchase requisitions in accordance with its established policies, and welcomes the opportunity to provide a report showing electronic approvals of purchase requisitions generated from its ERP system. Electronic approvals have been utilized since 2006/2007.</p> | | | <p>There was no evidence of approval on some of the requisitions provided to the OIG.</p> |
| <p><u>RECOMMENDATION #20 (SIGNIFICANT):</u> (i) The procurement policy should specify the thresholds for purchases to be made through the different tendering methods. PSI should consider prequalifying its vendors that would be called upon to submit proposals under the 'shopping' method.</p> | <p>20i. PSI's Procurement Manual is intended to provide guidance to meet the requirements of its diverse pool of funders. Consequently, while the manual does not have hard and fast thresholds for each type of procurement method, it provides guidance on the types of commodities that should be purchased using specific methods. For example, the manual provides that, in general, tenders are used for ethical products such as bed nets, male condoms etc., which are typically PSI's highest-volume, highest-dollar value procurements.</p> <p>It is not accurate to state that PSI does not pre-qualify its vendors and does not have a list of preferred vendors. For example, PSI conducts male condom pre-qualification every two years. For ACTs, bed nets, and female condoms, PSI uses the Global Fund and/or WHO pre-qualification list. Therefore, PSI does not think there is any further need for pre-qualification. For other products, PSI routinely vets suppliers and sends out solicitations to a list of preferred vendors resulting from the vetting process.</p> <p>The OIG observation that three bed net orders in Country B were sole sourced does not take into account the context for these procurements., At the time these orders were placed, 2004-2005, there were only two WHOPES recommended suppliers; one making polyester nets and the other polyethylene. The Global Fund approved</p> | | | <p>In cases where PSI applied the shopping method, the OIG was not provided with a list of pre-qualified suppliers from which the short list was derived.</p> <p>The need to ensure that value for money is obtained is not addressed and so</p> |

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| <p>(ii) The option to sole source suppliers should be used on an exceptional basis. In cases where sole sourcing is used, proper justification should be made and approval obtained from a senior official independent of the procurement process. PSI should also ensure that in such cases, due diligence is undertaken to ensure that the prices paid represent value for money.</p> <p>(iii) PSI should consider standardizing bid documents used in the procurement processes. Alternatively PSI should consider creating a checklist for bid documents to ensure that they are comprehensive and contain all appropriate conditions to protect the organization and provides adequate information to bidders for bidding purposes. Bid documents should be reviewed by a senior official independent of the preparer and approved.</p> | <p>the purchase of polyester nets in the approved PSM in which PSI justified its intent to socially market and procure polyester nets due to consumer preference. Extensive market-based research was provided to the Global Fund to explain the request, and it was approved by the donor. This documentation was proffered to the OIG at the time of the audit and PSI would be happy to discuss this particular procurement issue in greater detail.</p> <p>20ii. PSI concurs with the OIG that sole sourcing should be used in exceptional circumstances and should be approved by a senior manager, such as a Country Representative, in accordance with PSI's authority matrix. PSI's Procurement Manual explicitly states that no sole source procurement can occur without approval, and a detailed sole source justification memo must be included as part of the procurement file.</p> <p>PSI acknowledges the need to reinforce the circumstances under which sole source procurements can be performed and the approval and documentation processes to be followed.</p> <p>20iii. PSI does in fact have standardized bidding documents. These standard bidding documents are substantially equivalent in content to the World Bank standard bidding document preferred by the OIG, and contain (1) Cover Page, (2) Table of Contents, (3) Part I Bidding Instructions and Procedures, (4) Part II Technical Specifications and Standard for [insert product], (5) Part III Terms and Conditions of the Contract, (6) Annex A Bid Form, (7) Annex B Bid Security and (8) Annex C Form of Contract.</p> <p>PSI takes note of the OIG's suggestion for a checklist to provide further guidance to procurement personnel, especially when minor revision and amendments to the standard documents need to be made, and to take into account specific requirements for a particular order. A checklist is one of several options that PSI is currently exploring.</p> | | | <p>it remains an issue.</p> |

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| <p>(iv) The bid opening processes should be strengthened by (a) securing the process for receipt of bids i.e. whether electronic or physical; (b) recording the dates and times of receipt of bids; (c) for certain bid thresholds (definitely for the larger bids, opting to have public bid openings); and (d) A record of bids received from vendors should be maintained. This record should be closed at the cut-off time for receipt of bids from vendors.</p> <p>(v) Bid security documents should be obtained from all the vendors submitting the bids. PSI should not accept invalid bid securities and bids with invalid bid securities should not be evaluated.</p> | <p>20iv. PSI supports the concept of public bid opening ("PBO") and usually uses the technique when deemed necessary or appropriate for a particular type of item such as nets. The OIG suggestion to strengthen receipt and record of bids has been noted, and PSI intends to reinforce and improve these processes.</p> <p>20v. PSI's practice is to obtain bid security as part of the tender process. Contrary to the OIG view, a bid securing declaration is a recognized alternative to bid security. In exceptional circumstances, PSI may opt for a bid securing declaration.</p> | | | |
| <p>RECOMMENDATION #21 (HIGH):</p> <p>(i) The criteria for evaluation of bids should be strengthened by (a) setting standards to define what is acceptable for each criteria; (b) ensuring that they are clear to provide bidders with a clear basis of how the bids would be evaluated; and (c) having them reviewed by a senior official independent of the preparer and approved.</p> <p>(ii) Once approved, the criteria should be respected during the</p> | <p>21i, ii. The OIG report suggests that PSI's evaluation criteria are not clear, and could possibly lead to the risk of manipulation of criteria. In response, PSI would like to respectfully assert that the report does not accurately reflect PSI's evaluation methodology. Subject to a degree of variation, for most key items PSI buys as a Global Fund PR, a three-tier evaluation is applied. First, an overarching general standard, usually "best value," "value for money," or "most advantageous to the purchaser" is stated. Second, two mandatory "principal" criteria - price and "delivery" (availability for sampling) are prescribed. Third, an optional additional criterion ("any other appropriate factor") may be applied when relevant.</p> <p>PSI maintains that these factors are sufficiently clear as to not hinder the objectivity of the evaluation process. The general best value or value for money standard is widely used, and is properly considered to</p> | | | <p>Evidence has been provided from the sample selected demonstrates that this is not always the case.</p> |

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| <p>bidding process.</p> <p>(iii) All vendor selection should be approved by the purchase and technical evaluation committee.</p> | <p>be the main goal of the procurement process even when not expressly stated as a factor. The "principal" factors are well-established criteria, widely used by virtually all buyers of goods, whether public or private sector. The additional third criterion is admittedly broad, but it is designed to allow PSI to apply any other factor relevant to achieving the general standard, e.g., program budget, commodity quality, packaging quality, performance record, vendor ability to perform, etc.</p> <p>21iii. The decision to award a contract to a specific vendor is not solely made by the Procurement Officer. PSI's established practice is to share the evaluation report with the PSI program staff for comments and questions, and PSI is able to provide email communication to show that such consultations have taken place. Going forward, PSI will endeavor to make sure that these consultations are included in the procurement records.</p> <p>PSI maintains that it is not accurate to conclude that it was unclear in the Country C condom procurement whether a vendor without registration (or who hadn't commenced the registration process) would still be considered and evaluated. The Country C IFB XXX, Section 2.6 (b) (3) clearly stated: "Registration of the manufacturer as a producer of male latex condoms in accordance with the requirements of the Country C Board of Standards. Official documentation from the Country C Board of Standards should be presented as to proof of registration or as to proof that the registration process has been initiated by the manufacturer and is in process." This was a third principal factor in addition to price and delivery, since registration is often a time-consuming and lengthy process and is therefore an important criterion. PSI maintains that it was clear that a vendor without registration or one who had not already initiated the registration process would fail to meet this evaluation criterion.</p> <p>The OIG questions whether registration is an evaluation criteria or a pre-requisite. Given that PSI must comply with national laws and as such, cannot procure from a supplier without registration, it is immaterial whether the criterion is pre-requisite or not.</p> | | | <p>The recommendation encourages PSI to constitute a technical committee to evaluate bids.</p> <p>If a criteria is not listed as a pre-requisite then disqualifying suppliers on this basis is not in line with good procurement practice. And if such a criterion is taken to be a pre-requisite then PSI should have limited the bidding to those suppliers that were already registered or already in the process of</p> |

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| | | | | registering. |
| <p>RECOMMENDATION #22 (HIGH)</p> <p>(i) Contracts entered into with the vendor should include details of performance security requirements and the due date of delivery.</p> <p>(ii) Performance security should be obtained from the selected vendors. PSI should keep performance securities (and/or copies of those), provided by contractors' banks in a safe place so they can be located in case they are needed.</p> <p>(iii) All contracts and extensions should be signed by the designated personnel from PSI and vendor.</p> <p>(iv) Notification of award of contract should be sent to all the participating vendors.</p> <p>(v) Evidence of quality test of material prior to commencement of manufacturing or dispatch should be obtained from vendors in accordance with the contract.</p> <p>(vi) Quantity ordered should not exceed the quantity requisitioned. In case excess quantities are ordered, justification should be documented.</p> <p>(vii) Evidence of receipt of goods should be maintained. No invoices</p> | <p>22i. PSI uses standard contract templates with requirements for performance security and delivery as defined by PSI.</p> <p>22ii. Where applicable, PSI does obtain performance securities for procurement of pharmaceuticals. On receipt of the performance security, one copy is made for the file and the original is kept in a file by the Procurement Assistant. On a periodic basis, the Procurement Assistant looks through the file and returns expired performance securities back to the supplier.</p> <p>22iii. PSI recognizes the importance of having all original contracts and follow-on amendments reviewed and signed by both PSI and the vendor, and has a policy in place reflecting this.</p> <p>22iv. Noted. Since the audit, PSI has taken steps to remind its buyers to ensure that both winner and rejected vendors receive notification of award (or non-award).</p> <p>22v. This observation was not raised during the audit. If the OIG had requested the pre-shipment inspection and test reports, PSI would have been more than willing to furnish them, as it is PSI's established policy to conduct pre-shipment inspection and/or testing for all ethical products prior to authorizing shipment.</p> <p>22vi. Typically, PSI orders the quantity raised in the requisition. In the circumstances where the requisitioned versus ordered quantity differs, such a difference is raised by the platforms, not the Procurement Department. However, PSI shall take steps to improve its documentation of such issues.</p> <p>22vii. PSI recognizes the importance of and will reiterate its requirement that a confirmation of receipt is sent in by the platforms</p> | | | <p>(22v) The OIG requested for all documentation relating to procurements and this included evidence of pre-shipment testing.</p> |

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| <p>should be processed without evidence of receipt of material. Where applicable, evidence of the quality tests undertaken should form part of the supporting documentation prior to final payments.</p> <p>(viii) The contracts should contain expected delivery dates. Penalties should be imposed on the vendor as per the agreement in case of delayed delivery.</p> <p>(ix) Payment requests should be prepared and approved as per the authority matrix for all payments to vendors. All vendor payments should be made in compliance to terms and conditions of the contract. Any deviation in invoice price and PO price should be approved by the persons approving the PO.</p> | <p>as evidence of receipt of goods. Such a confirmation of receipt is required for final balance payment.</p> <p>22viii. While it is correct that PSI's contracts do not state a deadline for "delivery" to final destination (i.e. destination delivery), PSI does not concur with the assertion that our contracts do not contain expected delivery dates. PSI contracts clearly define delivery as the date on which the product is ready for independent pre-shipment inspection and testing (i.e. the sampling date). The liquidated damages clause is linked to the sampling date and provides for assessment of damages in the event the vendor does not meet the contractual sampling date.</p> <p>22ix. PSI has an approval process for payment requests in place. A Payment Request Form is prepared by the Procurement Assistant and signed off by the relevant buyer. A payment request above \$100,000 is countersigned by the Procurement Director or designee in the absence of the Director. The Payment Request Form, together with the commercial invoice and other relevant supporting documents, is sent to Accounts Payable, which make payment only if the required approvals are on the payment request.</p> <p>PSI would like to note that this observation was not raised during the audit, and welcomes the opportunity to provide additional support to the OIG on specific samples tested.</p> | | | <p>(22viii) The OIG has explained in the report why PSI's definition of delivery is not aligned to procurement good practice.</p> <p>The records provided to the OIG did not contain evidence of the approval.</p> |
| <p>RECOMMENDATION #23 (HIGH) PSI should comply with the conditions stipulated in the grant agreement. Specifically, the PRs should quality assure their pharmaceutical products in line with the grant agreement.</p> | <p>23. PSI follows Global Fund's QA policy in the procurement of ACTs and other pharmaceuticals. As part of the procurement process, PSI routinely conducts pre-shipment inspection and testing of pharmaceuticals. PSI uses WHO pre-qualified and/ ISO 17025 accredited laboratories.</p> <p>PSI is in the process of reviewing its system of quality assurance along the supply chain in-country to identify improvement opportunities.</p> | | | <p>No evidence of this was provided to the OIG in some cases as detailed in the report.</p> |

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| <p>RECOMMENDATION #24 (HIGH) PSI should significantly strengthen its capacity to manage the procurement function. Specifically: (i) PSI should comply with the relevant procurement related conditions in the grant agreement. If PSI HQ is to continue to be involved in PSM activities, it should be assessed periodically through an established process by the Global Fund for assessing PR PSM systems and capacity in line with the grant conditions. Measures instituted to address capacity gaps identified and/or appointing a third party procurement agent to manage procurement on behalf of PSI;</p> | <p>24i. PSI looks forward to working with the Secretariat to identify an efficient process for assessing its headquarters capabilities as part of the PR PSM assessment. As part of ongoing efforts to improve the quality of its work, PSI recently engaged an independent third party to review the policies, procedures, and application of internal controls and donor requirements in the Procurement Department. PSI will implement the recommendations raised by the OIG and the independent evaluator.</p> | | | |

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| <p>(ii) PSI should strengthen the capacity of its procurement unit by ensuring that staff have appropriate skills and tools to manage the procurement process.</p> <p>(iii) The record keeping around procurement processes should be strengthened.</p> <p>(iv) PSI should clearly mention delivery deadlines to final destinations both in the bidding documents and in the contracts.</p> | <p>24 ii. PSI stands behind the competency of its procurement staff and of its internal capacity development processes that allow staff to constantly improve their skills and progress throughout the organization. Hiring qualified staff is but one way of acquiring staff with appropriate skills; continually providing opportunities to gain new skills and experience is integral to building their capacity. PSI's procurement staff brings unique backgrounds and skill sets to PSI: for example, more than half of the staff are bilingual, and close to three quarters have lived and/or worked abroad in the countries where PSI works. This international experience equips them to understand the operating context of PSI's programs, enabling them to be more responsive and sensitive to the needs of PSI's platforms. Staff members at minimum hold a bachelor degree, and at least five staff members have a master degree in business, public health or international development. Over half have held positions in which purchasing, logistics or government contracting was part of the job.</p> <p>PSI is committed to the professional development of its staff and has added to its training portfolio a globally recognized procurement certification and training for the entire staff, commencing October 2011.</p> <p>24iii. Noted. PSI is committed to continually improving its record keeping process. In 2011, PSI created a binder checklist to ensure that all relevant supporting documentation is placed in the procurement file from various sources, e.g. emails, computer drives, etc.</p> <p>24iv. Please refer to the response to recommendation 22 (viii) above for goods that undergo pre-shipment inspection and testing. For other goods, PSI has reminded its staff about the importance of accurate delivery dates on purchase orders and has mandated that each purchase order must be accompanied with a letter of instruction with additional specific details for the order.</p> | | | |

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| <p>(v) There should be segregation of duties in the procurement function. PSI should strengthen the management oversight over the procurement process.</p> | <p>24v. PSI continues to review and revise responsibilities and duties with the Procurement Department to allow for both segregation of duties and improved efficiencies. The Procurement Department does not work in a silo, and its segregation of duties and oversight can be evidenced by the way in which the department works with other teams, as follows:</p> <p><u>Drug selection</u>: The choice is made by programs/ platforms with assistance from technical teams such as the Sexual, Reproductive Health & TB team and Malaria Control & Child Survival team.</p> <p><u>Quantification</u>: Programs/platforms instruct Procurement Officers on quantities to procure at the given time.</p> <p><u>Product specification</u>: With assistance from technical teams, program staff instruct the Procurement Officer on the specifications, e.g. formulation, packaging, dosage, flavor, etc.</p> <p><u>Selection of suppliers</u>: During pre-qualification, Procurement Officers involve technical teams, program staff and quality assurance experts, as applicable.</p> <p><u>Tender adjudication</u>: Procurement Officers conduct the evaluation and issue a report for review and consideration by platforms. No order is placed without this consultation. Going forward, PSI shall better record the outcomes of these consultations in the evaluation narrative to ensure a complete and comprehensive picture.</p> | | | |

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| Sub-Recipient Management | | | | |
| <p>RECOMMENDATION #25 (SIGNIFICANT): PSI should enforce the guidelines contained in its manuals in order to strengthen the control environment of SRs.</p> | <p>As noted by the OIG, PSI has detailed manuals at the platform level that clearly elaborate the policies and procedures related to the selection and management of SRs. To strengthen the control and monitoring environment around the management of sub recipients (SR), and ensure that the policies and procedures are adhered to in a consistent manner, PSI is in the process of implementing several initiatives at the PSI headquarters and platform level. SR management tools are being developed to supplement the existing SR manual, and ongoing trainings are planned for PSI HQ and platform staff. For example, regional trainings on SR Management and Monitoring have been planned for October - November 2011 for Southern Africa, East Africa and Asia/Eastern Europe. These trainings will focus on implementing best practices in the solicitation, selection, assessment, monitoring and closeout of sub recipients. The tools and templates that will be shared at these trainings will complement the guidelines in PSI's SR management manual, and participants will have the opportunity to discuss their application and use in their own platforms/country context. Examples of these tools include a solicitation template, proposal evaluation score sheet, log for tracking incoming proposals, and negotiation memo. PSI has also developed illustrative special conditions and accompanying guidance that platform staff can use and adapt as determined by the results of a sub recipient's capacity and risk assessment. PSI has also developed guidance on the ongoing monitoring of sub recipients and will be working with platforms to develop monitoring plans to track site-visits, findings action plans for sub recipients.</p> <p>PSI's Grants and Contracts Department at HQ has begun tracking all sub recipients quarterly to strengthen monitoring. This will help HQ and platforms keep a track of active sub recipients, any amendments/modifications issued and anticipate and plan for a timely and complete closeout in compliance with funder regulations.</p> | | | |