Office of Inspector General

July 21, 2005

MEMORANDUM

TO: M/FM/LM Supervisor, Acting Chief William Fuller Jr.

FROM: IG/A/PA Director, Nathan S. Lokos /s/

SUBJECT: Memorandum Regarding the Calculation and Collection of U.S. Treasury Interest on the Development Credit Authority Guarantee Financing Account (Report No. 9-000-05-001-S)

This memorandum transmits our finding and recommendations regarding the need to calculate and collect interest from the U.S. Treasury on the Development Credit Authority (DCA) financing account. Your comments on our draft memorandum were considered and are included as an attachment to this final memorandum.

This memorandum includes two recommendations. Recommendation No. 1 recommends that USAID calculate and collect the interest due to USAID from the U.S. Treasury on its guarantee financing account. We estimate that USAID will save approximately $435,000 as a result of collecting this interest from Treasury and USAID management concurs with this amount. Recommendation No. 2 recommends that USAID implement systems and procedures to ensure that future interest is calculated and collected in a timely manner. Management decisions have been reached on both recommendations. Please provide documentation supporting final action on Recommendations No. 1 and 2 to USAID's Office of Management Planning and Innovation.

This memorandum is not an audit report. The finding was developed during the survey phase of our work on USAID's DCA. We are issuing this memorandum because our summary report for the worldwide effort will not be issued until all participating Regional Inspector General's reports have been completed, most likely in the summer of 2006. We believe that these recommendations should be brought to your attention and acted upon before that time.

I want to express my sincere appreciation for the cooperation and courtesy extended to my staff during this work.

CC: M/FM/LM Eirdis Davis

BACKGROUND

The Development Credit Authority (DCA) is a broad financing authority that allows USAID to use credit to pursue any of the development purposes specified under the Foreign Assistance Act of 1961, as amended. The DCA is designed to overcome lending obstacles encountered in the commercial banking sector, which is often unwilling to lend funds to a particular sector or borrower(s). DCA credit guarantees encourage commercial banks to finance targeted development projects that otherwise would not have been funded, encourage local private-sector lending, and stimulate the development of local capital markets. Guarantees typically cover up to 50 percent of a loan.

When a project is identified and a Mission has made a decision to use a DCA agreement, funds are transferred from relevant appropriations to the DCA program account. Once the proposed agreement is approved by USAID's Credit Review Board and the Action Memo is approved by USAID's CFO, the Mission obligates funds.[1] In some cases, lenders disburse 100 percent of the loans immediately. In other cases, lenders disburse loans over the life of the agreement. On a semi-annual basis, USAID disburses funds from the program account obligation and deposits corresponding amounts into the financing account. These "subsidy outlays" are made based on a calculation including the credit subsidy amount (see footnote 1), the value of loans disbursed by lenders, and the total cumulative disbursements allowed per each agreement. In addition to the financing account receiving the subsidy outlays, the financing account:

- Receives origination and utilization fees paid by the lenders.
- Disburses claim payments, if any, and receives related recoveries.
- Experiences upward and downward adjustments based on annual re-estimates of subsidies.

U.S. Treasury financing accounts are unique in that they earn annual interest from the U.S. Treasury which, together with the existing balances, is available to USAID to pay future claims.

DISCUSSION

OMB Circular A-11, Section 185, states that 1) the basic purpose of a guarantee financing account is to accumulate funds to finance future default costs and 2) the balance of the financing account earns interest at the same rate as the discount rate

[1]The obligated funds, called the "credit subsidy amount", is initially calculated and then re-estimated over the life of the underlying loans, based on the Office of Management and Budget (OMB) risk models, using the net present value of cash flows method. The credit subsidy amount is calculated by the Office of Development Credit (ODC), reviewed by USAID's Credit Review Board, and approved by USAID's Chief Financial Officer.

used to calculate the subsidy cost. The Circular also states that each agency is responsible for calculating the interest income at the end of each year.[2]

However, despite this requirement, USAID has not calculated, billed or collected interest on the DCA financing account. In the absence of an automated system to calculate the interest due from Treasury, USAID M/FM/LM staff had attempted to manually calculate interest due, by reconciling the DCA cash flows by cohort year—the year in which the guarantee agreement was signed and the related subsidy cost was obligated—using Excel, but were unable to do so.[3]

The Office of Financial Management/Loan Management Division (M/FM/LM) estimates that the interest earned through September 30, 2004 is approximately $435,000. As the cash balances in the financing account have grown as the program expanded, interest due at September 30, 2005 is expected to be significantly higher. While M/FM/LM staff had recognized the importance of collecting the interest and had met with OMB to discuss the issue, at the time of our survey work, M/FM/LM staff were focused on other priorities.

As a result of this situation, funds approximating $435,000 that should be available to pay guarantee claims have not been collected from Treasury and made available to USAID. Accordingly, we are making the following recommendations.

> *Recommendation No. 1: We recommend that the Office of Financial Management/Loan Management Division calculate and collect the interest due to USAID from the U.S. Treasury on its guarantee financing account.*
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> *Recommendation No. 2: We recommend that the Office of Financial Management/Loan Management Division implement systems and procedures to ensure that future interest is calculated and collected in a timely manner.*

EVALUATION OF MANAGEMENT COMMENTS

USAID management concurred with our recommendations and indicated that M/FM/LM is in the process of calculating the interest income due USAID. Management also indicated that the interest calculations would be submitted to Treasury for payment to USAID's account. Accordingly, a management decision has been reached on Recommendation No. 1.

[2] When calculating interest income, the interest rate for cash accumulations is determined by the date that the commercial lender disburses the loan being guaranteed. In addition, estimates for the fourth quarter can be used, adjusting this estimate as actual lender data is accumulated.

[3] An automated system to handle this calculation was not built into USAID's core financial accounting system (Phoenix) because at the time Phoenix was being developed, USAID did not have the legislative authority to extend DCA guarantees and a similar program, the Micro and Small Enterprise Development program, was winding down. Under these circumstances, an automated system was not considered a priority.

In addition, management stated that a working group had been established to address the modifications to Phoenix that would be necessary to track financing account transactions on a cohort basis, which would facilitate future interest calculations. We believe that this illustrates management's commitment to ensuring that future interest is calculated and collected in a timely manner. Accordingly, we believe a management decision has been reached on Recommendation No. 2. However, before final action can be achieved, we believe that USAID must complete the above mentioned modifications to Phoenix and develop the necessary policies and procedures to ensure that interest income is calculated and collected.

Management's comments are included in their entirety in the attachment to this memorandum.

July 8, 2005

MEMORANDUM

TO: IG/A/PA Director, Nathan S. Lokos

FROM: M/FM/LMD Acting Chief William F. Fuller, Jr. /s/

SUBJECT: Management Comments to Draft Memorandum Regarding Calculation and Collection of US Treasury Interest on the Development Credit Authority Guarantee Financing Account (Report No. 9-000-05-00X-S)

REF: a) NLokos/WFuller Memo dated 06/23/2005

Thank you for the opportunity to respond to the subject draft memorandum. We appreciate your analysis on the Development Credit Authority (DCA) Guarantee Financing Account Treasury Interest Process. As noted by the Office of Management and Budget (OMB) in February 2005, the demands placed on Federal Agencies to maintain specialized COHORT accounting are great. Irregardless, we agree with this responsibility and concur with the two-part proposed audit recommendation as outlined below.

RECOMMENDATION No. 1: We recommend that the Office of Financial Management/Loan Management Division: (1) calculate and collect the interest due to USAID from the U.S. Treasury on its guarantee financing account, and (2) implement systems and procedures to ensure that future interest is calculated and collected in a timely manner.

MANAGEMENT COMMENTS**:**

(1) FM/LMD concurs that the estimated interest earned through September 30, 2004 was approximately $435,000. FM/LMD is in the process of retroactively calculating the Treasury Financing Fund Balance 72X4266 by COHORT balances by each fiscal year end. These balances will be used as inputs into the OMB Interest Calculator to calculate the total interest income due to USAID from FY00 to FY05. Interest calculations will be submitted to the Treasury not later than the end of September 2005 for payment to USAID's Account in FY06.

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(2) A JFMIP working group, headed by the Deputy to M/FM/FS, has been established to address required modifications to Phoenix to establish fields which will enable the tracking of financing account fund balance transactions on a COHORT basis. Going forward, this will facilitate the timely calculation of annual interest income due to the DCA Financing Account. We anticipate this will occur during fiscal year 2006.

In closing, we will continue to work towards improving our management responsibility of the guarantee financing account.

cc: M/FM/LM Eirdis Davis
M/FM/CAR Don Douglass