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OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/UGANDA'S DEVELOPMENT CREDIT AUTHORITY

AUDIT REPORT NO. 4-617-06-004-P

February 13, 2006

PRETORIA, SOUTH AFRICA

Office of Inspector General

February 13, 2006

MEMORANDUM

TO: USAID/Uganda Mission Director, Margot Ellis

FROM: Regional Inspector General/Pretoria, Jay Rollins /s/

SUBJECT: Audit of USAID/Uganda's Development Credit Authority (Report No. 4-617-06-004-P)

This memorandum transmits our report on the subject audit. In finalizing this report, we considered management comments on the draft report and have included those comments in their entirety, as Appendix II.

This report has five recommendations to improve USAID/Uganda's oversight of its Development Credit Authority. In response to the draft report USAID/Uganda concurred with four recommendations and included corrective action plans and target completion dates. As part of this concurrence, Recommendation Nos. 4 and 5, which called for the de-obligation of $100,000 and $5,317 respectively, the Mission has agreed with this action. We consider that a management decision has been reached for Recommendation Nos. 1, 2, 4, and 5. Please provide the Office of Audit, Performance, and Compliance Division with the necessary documentation to achieve final action on these recommendations. In the case of Recommendation No. 3, USAID/Uganda provided concurrence but no implementation plan. A management decision can be reached for Recommendation No. 3 when USAID/Uganda provides an implementation plan and target completion date. Please advise my office within 30 days of the actions you have planned or taken to implement Recommendation No. 3.

I appreciate the cooperation and courtesy extended to my staff throughout the audit.

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SUMMARY OF RESULTS

The Regional Inspector General/Pretoria conducted this audit to determine whether USAID/Uganda managed its Development Credit Authority (DCA) guarantees to ensure that selected intended results were achieved. (See pages 2-3.)

USAID/Uganda managed its DCA guarantees to ensure that selected intended results were achieved. The Mission's DCA guarantees successfully increased the supply of credit for small and medium enterprises (SMEs) through financial institutions. As of September 30, 2005, three of the seven financial institutions that participated under the Mission's Phase I guarantees had already utilized their maximum portfolio amounts. The total loans guaranteed under Phases I and II amounted to $12.1 million. (See pages 3-4.)

Although USAID/Uganda had successfully achieved its intended results, the Mission needed to improve its oversight of the DCA guarantees. The audit identified the following areas that showed the need to strengthen the DCA guarantees. The Mission had not developed DCA utilization goals for determining whether the DCAs were being under- or over-utilized, nor had it required that its monitoring contractor visit the financial institutions. (See pages 5-6.) Also, the Mission had not conducted site visits or reviewed DCA guarantee files at financial institutions. (See pages 7-8.) In addition, the Mission and its contractor did not require the financial institutions to provide sufficient loan guarantee information to allow for proper accountability and monitoring. (See pages 8-10.) Finally, one of the participating financial institutions had written only one guaranteed loan. In this case, the Mission needs to take action to deobligate $105,317 in associated subsidy funds for this financial institution in order to put the funds to better use. (See pages 10-11.)

This report includes five recommendations to assist USAID/Uganda in improving its oversight of its Development Credit Authority. (See pages 6, 8, 10, and 11.) In response to the draft report USAID/Uganda concurred with four recommendations and provided corrective action plans and target completion dates. (See pages 15-17.) As part of this concurrence, Recommendation Nos. 4 and 5, which called for the de-obligation of $100,000 and $5,317 respectively, the Mission has agreed with this action. Therefore, we consider that a management decision has been reached for Recommendation Nos. 1, 2, 4, and 5. In the case of Recommendation No. 3, the Mission provided concurrence but it did not provide an implementation plan to address the recommendation. A management decision can be reached for Recommendation No. 3 when USAID/Uganda provides an implementation plan and target date to RIG/Pretoria.

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 guarantees are designed to overcome lending obstacles encountered in the commercial banking sector, which is often unwilling to lend funds to a particular sector of borrower(s). USAID's DCA guarantees loans up to a certain amount, thus encouraging commercial banks to finance targeted development projects that otherwise would most likely not be funded. These guarantees also encourage local private-sector lending and stimulate the development of local capital markets.

Congress gave USAID the general authority to provide loan and bond guarantees in its Fiscal Year 1998 Appropriations Act. In April 1999, the Office of Management and Budget certified USAID's capacity to properly manage credit programs—to accurately assess risk and to operate viable financial management and accounting systems. Subsequently, USAID began to exercise its DCA authority.

DCA credit guarantees are typically designed by USAID's overseas missions and managed jointly by the mission and USAID's Office of Development Credit (ODC). Guarantees typically cover up to 50 percent of a loan. Missions are primarily responsible for developmental monitoring, while ODC is primarily responsible for financial monitoring.

While four types of DCA guarantees are available, USAID/Uganda has used only one type—the loan portfolio guarantee.[1] USAID/Uganda's loan portfolio guarantees were composed of two multi-institutional DCAs and one collateral management/warehouse receipts initiative. The fiscal year 2001 loan portfolio guarantees are referred to later in this report as Phase I. The Phase I program was approved for a five-year period ending on January 31, 2007. Fiscal year 2005 loan portfolio guarantees are referred to as Phase II in this report. The Phase II program was approved for a four-year period ending May 31, 2009. USAID/Uganda's third program the collateral management/warehouse receipts loan portfolio guarantee included three institutions and was approved for a three-year period ending in December 2008. As of September 30, 2005, Phase I had resulted in 256 DCA-guaranteed loans, making credit of $22.5 million available while guaranteeing a maximum of $11.25 million. Under Phase II, as of the same date, there were 55 guaranteed loans, making $1.74 million of credit available while guaranteeing a maximum of $0.87 million. At the time of this audit, there were no collateral management/warehouse receipts activities to report.

AUDIT OBJECTIVE

This audit was conducted at USAID/Uganda as part of a planned series of individual mission audits of USAID's Development Credit Authority. The audit was conducted to answer the following question:

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[1]In a loan portfolio guarantee, USAID signs an agreement with a partnering bank and agrees to partially guarantee individual loans made by the bank to borrowers meeting strict eligibility guidelines in such areas as type of borrower and project, projected positive cash flows, creditworthiness, and other factors.

- Did USAID/Uganda manage its Development Credit Authority guarantees to ensure that selected intended results were achieved?

Appendix I contains a discussion of the audit's scope and methodology.

AUDIT FINDINGS

USAID/Uganda had managed its Development Credit Authority (DCA) guarantees to ensure that selected intended results were achieved, but it also identified several areas where additional oversight would result in improved accountability and monitoring.

USAID/Uganda managed two multi-institutional DCA guarantees—henceforth referred to as Phase I and Phase II. In addition, the Mission's loan portfolio guarantees also included one collateral management/warehouse receipts initiative. Phase I included seven financial institutions that included lending to micro finance institutions and ends in 2007. The Phase I guarantee was intended to strengthen the ability of financial institutions to finance loans to businesses in targeted sectors in the Ugandan economy, thereby stimulating economic growth. Specifically, the guarantee agreements supported the Mission's Strategic Objective (SO) 7, described as "Expanded Sustainable Economic Opportunities for Rural Sector Growth." The DCA guaranteed loans strived to address the objective, "Strengthen the Financial Sector's Contribution to Economic Growth", found under this SO. As of September 30, 2005, three of the seven financial institutions under Phase I had utilized their entire portfolio amounts; the other four financial institutions remained with portfolio utilizations ranging from 47.5 to 93.3 percent.

A December 2003 independent consultant's assessment of USAID/Uganda's Phase I guarantee noted that the Mission had "made substantial progress toward its goals…to foster increased lending for productive purposes with emphasis on sectors that are believed to be currently underserved by the financial sector. These sectors include Small and Medium Sized Enterprise (SME) loans (between $1,500 and $212,500 in size), as well as agriculture/natural resource credits, export related/foreign exchange earning enterprises and Micro-Finance Institutions." In addition, the Mission's *Annual Report for Fiscal Year 2005* reported that the DCA guaranteed loans had achieved a positive impact by "increasing demand and supply of credit for small and medium enterprises (SMEs) and financial institutions to lend to new clients."

Phase II included (a) five financial institutions that were also participants under Phase I, of which one is a micro-finance deposit taking institution. This Phase II guarantee was developed in response to the demand for guaranteed loans experienced under Phase I. Phase II was targeted towards the "missing middle" borrowers with a lower maximum portfolio amount available to a single borrower ($250,000, down from $1 million available under Phase I).

The collateral management/warehouse receipts loan portfolio guarantee was developed for three financial institutions to receive private non-perishable grains warehouse receipts as collateral. The intent was to increase the ability of traders (including farmer owned cooperatives) to buy more grain earlier from farmers, improving the quality of the traded grain and increasing price stability for farmers. The collateral management/warehouse receipts loan portfolio had no activities available to audit.

To ensure that loans made under a portfolio guarantee were used to achieve intended results, each agreement between USAID and the partner financial institution provided specific loan eligibility guidelines. When a partner financial institution approved and disbursed a loan under a guarantee, it informed the Mission's contractor (who had been delegated DCA monitoring responsibilities by the Mission) by notification letter. When questions about the notification letter arose, the contractor contacted the respective financial institution for additional information. Once the contractor received notification from a financial institution of a guaranteed loan, it sent an acknowledgement of notification letter to that institution.

USAID/Uganda's loan guarantees funded activities that have made a positive impact on the respective borrowers and helped fulfill the Mission's development objectives. Financial institutions' officials interviewed during the audit expressed support for the DCA guarantees. They noted that because of the guarantees, they were able to provide borrowers with loans that they would not have otherwise provided. We visited two borrowers who had obtained a DCA guaranteed loan from two different financial institutions and found that the borrowers used the loans for the purposes for which they were intended. For example:

- One loan guarantee was provided to a medium-sized fish processing company. After being in business for 5 years, the company decided to refurbish its equipment and used the DCA guaranteed loan to purchase new refrigerator and freezer units for storing fish. This allowed the company to export frozen and chilled fish products throughout the world, including the Middle East and Europe.

- Loan guarantees benefited a grain export company. The company had difficulty obtaining previous loans because it did not have sufficient collateral. They were able to get DCA guaranteed loan to provide working capital. Most of their products were sold to the United Nations' World Food Programme. However, the uncertainty of the commodity market remains a major challenge for this company.

Photograph of fish-processing activities at a company that is a DCA guarantee loan recipient. Included in the photo are a RIG/Pretoria auditor and company officials. The company is located in Kampala, Uganda. (Photograph taken in October 2005 by a RIG/Pretoria auditor.)

Although USAID/Uganda achieved intended results, the audit identified areas where increased oversight would result in improved accountability and monitoring. The subsequent sections of this report will more fully address these areas for improvement.

Interim Utilization Goals Are Needed to Assist with Monitoring

Summary: The Mission did not have a process to gauge whether DCA guarantee utilizations were outperforming or underperforming planned utilizations—a process required in the DCA *Operations Manual*. The Mission could not determine if performance was being under- or over-utilized because it did not have interim utilization goals for the guarantees. Instead, the Mission focused on using the complete loan guarantees by the end of the guarantee period to gauge performance. Because it did not have sufficient and timely information on guarantee utilizations, the Mission did not provide a timely remedy for under-utilization of one guarantee.

The *DCA Operations Manual*, section IV (E), requires USAID's Office of Development Credit to monitor utilization of guarantees by financial institutions in a timely manner. It also requires missions to provide feedback to determine whether the use of DCA guarantees has out-performed or under-performed planned utilization.

The Mission did not establish interim utilization goals for its loan guarantees. Nor did the Mission have a process for determining whether the participating financial institutions were utilizing their guarantees in a timely manner. The Mission did maintain cumulative utilization rates for each of its participating financial institutions, but, without targets to compare against, there was no basis to determine whether performance was being under- or over-utilized.

Instead of focusing on interim utilization goals, the Mission focused on utilizing the complete loan guarantee portfolio by the end of the loan guarantee period. There was no emphasis on establishing interim utilization goals as a check for determining progress for each financial institution. DCA guarantee portfolio amounts were allocated to the financial institutions for use in specified periods—generally 5 years for Phase I activities and 4 years for Phase II activities—without setting interim goals for the utilization of those funds.

Because it did not have interim utilization goals, the Mission was not able to provide a timely remedy for under-utilization of a guarantee. For instance, one of the participating financial institutions was provided a $4 million loan portfolio guarantee in February of 2002. The financial institution did not provide its first DCA-guaranteed loan, valued at $278,552, until December of 2002—a 10-month lag. The loan portfolio guarantee amount was eventually reduced to $466,445 because only one DCA guaranteed credit loan had been written. No additional DCA guaranteed loans were given by this financial institution. The Mission's management noted that, in this case, the use of interim utilization goals would have been helpful to compare against annual goals since, without goals, it was difficult to know whether the financial institution was over-or under-performing. In this case, the Mission could have acted sooner to remedy the situation either by encouraging additional utilization or, if deemed appropriate, by withdrawing the guarantee earlier for use by other financial institutions.

In addition, under Phase I, as of September 30, 2005, two financial institutions had used 47.5 percent and 55.7 percent of their respective DCA portfolios but—as in the case of the above-mentioned financial institution—without interim utilization goals, there was no basis on which to determine if these financial institutions were over- or under-performing. As of September 30, 2005, Phase I had 17 months left, and Phase II had been in existence for about half a year (with 3.5 years remaining). As of that date, Phase I's overall utilization rate was at 85 percent while Phase II was at 11 percent.

In order to be in a position to fully utilize the loan guarantee portfolios before time runs out for the DCA guaranteed loan, the Mission needs to act quickly to set interim utilization goals. If goals are not established, the possibility exists that the Mission will not be in a position to take any remedial action for DCA funds that will not be utilized. To assist the Mission in this effort, we are providing the following recommendation.

> *Recommendation No. 1: We recommend that USAID/Uganda develop interim utilization goals for the Development Credit Authority guarantees. Having such goals in place, the Mission will have information that will enable it to better monitor progress toward achieving the utilization goals.*

Proactive Monitoring Is Needed

Summary: The Mission did not monitor the DCA guarantees by periodically conducting site visits or reviewing the DCA guarantee loan files at financial institutions as required by both the Office of Management and Budget (OMB) and USAID. This was caused by the Mission delegating its monitoring responsibilities to a contractor, and as part of this monitoring process, it did not require the contractor to perform site visits because they were not aware that it needed to be done. Without proactive monitoring of the guarantees through periodic site visits and file reviews, there was reduced assurance that guaranteed loans were in compliance with guarantee requirements.

OMB Circular A-129, Appendix A, Section III.B.3, states that to evaluate and enforce “lender and servicer performance,” agencies should conduct on-site reviews and summarize review findings in written reports with recommended corrective actions. It further states that agencies should conduct annual on-site reviews of all “lenders and servicers” with substantial loan volume or questionable programs. In compliance with the OMB requirement, USAID’s *DCA Operations Manual*, section II.C.10, requires mission officer(s) responsible for a DCA activity to conduct and report on site visits to the guaranteed party, in this case, the financial institutions. The site visits should be done annually from the date the agreement is signed, particularly for guarantees with substantial loan volumes, signs of deterioration in guaranteed loan(s), or high default rates. Further, it denotes that the responsible mission staff should meet with the partner financial institution management, establish the status of the project, and determine compliance and performance issues. If possible, as part of the site visit, the *Operations Manual* provides for requesting at least one visit to a borrower that received a DCA-guaranteed loan. The summary of the visit should include details of (1) the loan amount and purpose, (2) the loan terms, (3) the justification for using the DCA guarantee, (4) how the loan was repaid, and (5) the resulting benefits for the borrower.

The Mission did not proactively monitor the DCA guaranteed loans by periodically conducting site visits and reviewing the DCA guaranteed loan files at financial institutions. Two of the five financial institutions visited during this audit stated that they would welcome visits by the Mission to obtain guidance, as well as to receive feedback on their existing DCA guaranteed loan processes. The Mission did not conduct this type of monitoring, or require that it be done by their contractor, because they were not aware that it needed to be done.

The Mission had delegated its monitoring responsibilities to a contractor and, as part of this monitoring process, did not require the contractor to perform any site visits. The contractor’s monitoring was limited to checking data input by the financial institutions into USAID’s Credit Management System, reviewing notification letters sent by the financial institutions, and phoning or emailing contacts.

Because there was no proactive monitoring taking place through site visits or file reviews, there was reduced assurance that the guaranteed loans were in compliance with guarantee requirements.

Site visits are an important activity that, if done properly, can provide the Mission better assurance that its DCA guarantees are complying with guarantee requirements and adhering to the intent of guarantees. Proactive monitoring would also establish proper oversight of the DCA activities of the financial institutions. In order to strengthen this management control and improve the monitoring of DCA guaranteed loans, we are making the following recommendation.

Recommendation No. 2: We recommend that USAID/Uganda develop Mission-specific procedures to require periodic site visits by Mission personnel and/or their contractor to financial institutions and borrowers in order to improve the monitoring of Development Credit Authority loan guarantees. Such visits should include a review of guaranteed loan files. When site visits have been performed, the visits should be documented and maintained in the Mission's files.

Additional Information Needed to Assist with Accountability and Monitoring

Summary: Both U.S. Standards for Internal Control and USAID's Automated Directives System (ADS) recognize accountability as an important precept for government programs. The Mission and its contractor did not have sufficient loan guarantee information on key items such as: (1) borrower address, (2) collateral, and (3) the basis of borrower eligibility to ensure proper accountability. This situation had developed because the Mission and/or its contractor did not require that the financial institutions include this additional information in the notification letters that they sent. Due to this lack of information, it was difficult to determine whether all DCA guaranteed loan resources were expended as intended.

The U.S. Standards for Internal Control in the Federal Government (November 1999), states that internal control is part of an organization's management that provides reasonable assurance of achieving the following objectives, (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations. Internal control which is synonymous with management control helps government program managers to achieve desired results through effective stewardship of public resources. Similarly, USAID's ADS glossary identifies management controls as "The organization, policies, and procedures used to reasonably ensure that (a) programs achieve their intended results; (b) resources are used in accordance with the Agency's mission; (c) programs and resources are protected from waste, fraud, and mismanagement; (d) laws and regulations are followed; and (e) reliable and timely information is obtained, maintained, reported, and used for decision making."

The written information that the contractor (who was delegated the Mission's monitoring responsibilities) obtained from the financial institutions about their loan guarantees did not identify key items such as the (1) address of the borrower, (2) collateral and its value (if any), and (3) rationale why the borrower was eligible for the loan guarantee. Thus, the Mission and the contractor did not have sufficient loan guarantee information readily available to provide for proper accountability and monitoring.

This situation had developed because the Mission and/or its contractor did not require this additional information in the notification letters that are received from the financial institutions. Notification letters on DCA-guaranteed loans were sent from the financial institutions to the contractor to provide basic information such as borrower name and loan terms. This reporting method was the primary means that the contractor used for obtaining DCA guaranteed loan information from the financial institutions. According to the contractor's staff, when questions arose from the notification letters, they would contact the financial institution by phone or email to obtain additional information or clarification.

Because the contractor did not know the borrowers' addresses, collaterals used to secure the loans, and rationale for borrowers' eligibility, it was difficult to determine if all of the DCA guarantee resources had been expended as intended and the guarantees were proactively monitored. In the case of collateral, USAID's contractor was not aware of collateral and its value used to secure a loan until a claim was made on a defaulted loan. Moreover, USAID and its contractor did not know the basis of why a borrower was deemed eligible for the DCA guarantee (e.g., not having sufficient collateral, new customer unable to obtain a regular loan, etc.). The audit team found the following examples where insufficient loan guarantee information resulted in accountability and monitoring issues:

- The audit team was not able to determine where DCA guarantee loans had been provided (rural versus metropolitan areas) using the contractor's data because the borrowers' addresses were missing from that data.

- One loan guarantee had been written for a business which did not exist when the loan was guaranteed (the financial institution identified this problem when the business defaulted on the loan).

- One borrower used the same collateral for DCA guarantee loans from two different financial institutions. Only when the borrower defaulted on both loans did USAID's contractor become aware that the same collateral had been pledged.

- USAID's contractor had to contact a participating DCA financial institution to determine whether or not a newspaper advertisement regarding the sale of a borrower's property was collateral used to secure a DCA-guaranteed loan. The financial institution verified that the property was indeed the same collateral used for the guarantee.

- A review of financial institution loan files found cases where the DCA guaranteed loan borrowers had previous and ongoing relationships with the financial institution. In such cases, there was no loan documentation that provided a rationale of why this borrower was selected for the DCA-guaranteed loan; as a result, the audit team needed to ask financial institution officials for an explanation.

In order for the Mission and its contractor to better fulfill their accountability and monitoring responsibilities, additional information needs to be obtained from the participating financial institutions. This information could be most easily included when the financial institutions submit notification letters. With the receipt of this additional information, the Mission and/or its contractor would be able to strengthen management controls to ensure that DCA resources are (1) used as intended, (2) protected from waste, fraud, and mismanagement, and (3) utilized in compliance with established regulations and guidelines. This additional information could also be used to enhance proactive monitoring activities as described in the previous section. To help the Mission strengthen its accountability and monitoring responsibilities, we are recommending the following:

Recommendation No. 3: We recommend that USAID/Uganda submit written notification to the financial institutions participating in the Development Credit Authority requiring that the borrower's address, type and value of collateral (when it is used to secure the loan guarantee), and the basis for determining borrower eligibility be included in the notification letter for all future loan guarantees. If appraisals are required by the financial institutions to secure the loan, appraisal copies should also be provided with the notification letters.

Deobligation of DCA Subsidies Can Put Funds to Better Use

Summary: The *DCA Operations Manual* provides for the deobligation of subsidy funds if a determination is made that not all of the funds will be used. The Mission has DCA subsidy funds valued at $105,317 available to deobligate from one of the financial institutions participating in the DCA. The Mission had not taken the necessary action to deobligate these unused subsidy funds because they were awaiting formal clearance to proceed. As a result, as long as these funds remain idle, this portion of DCA funding will not be used for its intended purpose.

The *DCA Operations Manual*, section VI(B), states that if it is determined that either all or a portion of the subsidy funds in the Program Account will not be used, then the Mission, specifically the obligating official, should consider deobligating the funds. One of the steps involved in deobligating DCA program account funds includes the approval of the Mission Director. Further, it states that upon the Mission Director's approval, the Mission Controller submits the approved memo and the termination letter to the bureau and deobligates the funds in the Mission Accounting and Control System (MACS). Once this has been accomplished, and if the Mission intends to use the deobligated funds for a new DCA guarantee, the "Mission Officer" prepares a memo to the Bureau to reobligate these funds for another approved DCA guarantee. It also states that if the mission intends to re-use the funds for another DCA guarantee, the funds will be returned to the mission for reobligation by the end of the next quarter.

USAID/Uganda had DCA subsidy funds valued at $105,317 which were available to deobligate. There were two reasons why these funds were available for deobligation. First, the Mission Director had reduced the guaranteed loan portfolio amount of one financial institution from $4 million to $466,445. This occurred because this institution, under Phase I of the DCA guarantee, had written only one guaranteed loan valued at $278,552. According to a Mission official, the Mission had negotiated with USAID's Office of Development Credit to deobligate and then reobligate the $100,000 in subsidy funds associated with the reduction in the loan portfolio amount for use in another of the Mission's DCA guarantees. However, USAID/Uganda's Controller had not deobligated the $100,000 in subsidy funds in MACS, as specified in the DCA *Operations Manual*. Second, this same financial institution had an unused portion of its loan portfolio valued at $187,893 ($466,445 - $278,552). The Mission had not deobligated the $5,317 of subsidy funds associated with an unused loan portfolio valued at $187,893.

The Mission had not taken the necessary action to deobligate these unused subsidy funds to ensure that it could re-obligate the funds as soon as possible to benefit DCA guaranteed loans. The Mission had not deobligated the $100,000 in subsidy funds associated with the prior reduction in the loan portfolio amount that it had negotiated with USAID's Office of Development Credit because according to a Mission Official they were awaiting formal clearance from the Office of Management and Budget (OMB) and USAID's Bureau of Policy and Program Coordination (PPC). However, a requirement for a formal clearance process involving both OMB and PPC prior to the Mission de-obligating the DCA funds does not appear as part of the procedural steps identified earlier in this section of the report. The Mission had not deobligated the $5,317 of subsidy funds associated with the unused loan portfolio because according to the Mission, discussions with the financial institution had led them to believe that there was a potential borrower for the unused loan portfolio. However, these plans never came to fruition, and the financial institution expressed no interest in providing future loans under DCA guaranteed loans. As a result, $105,317 in DCA funding that was meant to strengthen the Ugandan financial sector and benefit eligible borrowers was not being used for its intended purpose. Having these subsidy funds made available through the deobligation/reobligation process for the DCA guarantees would result in the ability of the Mission to leverage a considerable amount of guaranteed loans. For instance, in the case of the financial institution from which the subsidy funds could be deobligated, re-obligating the $105,317 could result in over $3.7 million that the Mission would have available for DCA guaranteed loans.

Although the Mission had taken initial action to deobligate $100,000 of subsidy funds for DCA guarantees, the Mission's Controller needs to complete the deobligation of these funds in MACs. Once completed, additional action needs to be taken to ensure that these funds are reobligated. Taking action to complete the process that is required to deobligate these funds will result in the Mission being in a better position to ensure that it obtains these reobligated funds in a timely manner. In addition, because the same financial institution does not intend to utilize the unused balance of its DCA portfolio, the Mission needs to deobligate these funds so that they can be put to better use and to ensure that it receives the funds as soon as possible to benefit the DCA loan guarantees. As long as these funds remain idle, this portion of DCA funding will not be used for its intended purpose.

> *Recommendation No. 4: We recommend that USAID/Uganda deobligate the $100,000 in subsidy funds associated with the reduction in the loan portfolio amount for the one inactive financial institution.*
>
> *Recommendation No. 5: We recommend that USAID/Uganda deobligate $5,317 in subsidy funds related to the unused loan guarantee for one inactive financial institution.*

EVALUATION OF MANAGEMENT COMMENTS

In responding to our draft report, USAID/Uganda management concurred with four of the recommendations and provided action plans and target completion dates. For Recommendation No. 1, the Mission indicated that it will incorporate targets into its Performance Management Plan and that these targets will be analyzed semiannually. The target date for completing this recommendation is March 30, 2006. In the case of recommendation No. 2, the Mission noted that electronic and paper copies of summaries of the site visit schedule, site visit reports, and biennial reviews will be maintained in the program files. It is anticipated that final action for this recommendation will be achieved by March 30, 2006. In the case of Recommendation No. 4, the Mission reported that it had completed the process to de-obligate $100,000 in January 2006. However, USAID/Uganda did not provide any supporting documentation for this action. They also noted their intent to re-obligate these funds prior to the end of fiscal year 2006 for supporting other Development Credit Authority guarantees in Uganda. For Recommendation No. 5, USAID/Uganda stated that it will terminate the remaining DCA facility and de-obligate $5,317 of remaining subsidy funds. March 31, 2006, is the target date for de-obligating these funds. It is anticipated that these funds will be re-obligated by September 30, 2006. Based on the above information, we consider that a management decision has been reached for Recommendation Nos. 1, 2, 4, and 5.

For Recommendation No. 3, the Mission concurred with the recommendation but did not provide an implementation plan to address several important facets of the recommendation. These include submitting written notification to the financial institutions participating in the Development Credit Authority requiring that the (1) borrower's address, (2) type and value of collateral (when it is used to secure the loan guarantee), and (3) the basis for determining borrower eligibility be included in the notification letter for all future loan guarantees. The recommendation also noted that if appraisals are required by the financial institutions to secure the loan, appraisal copies should also be provided with the notification letters. A management decision can be reached for Recommendation No. 3 when USAID/Uganda provides an implementation plan and target completion date to RIG/Pretoria.

In addition, in its comments the Mission provided supplemental information for the background section of this report. Some of this information has been included in this report to provide clarity. Report formatting requirements for the background section did not allow this information in its entirety to be inserted into the body of the report. However, the Mission’s comments have been included verbatim as Appendix II to this report.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/Pretoria conducted this audit in accordance with generally accepted government auditing standards. The audit was conducted at USAID/Uganda and at various participating financial institutions in Kampala, Uganda from October 17 through 28, 2005. It was designed to ascertain whether USAID/Uganda managed its Development Credit Authority (DCA) guarantees to ensure that selected intended results were achieved.

In planning and performing the audit, we assessed the effectiveness of internal controls related to DCA guarantees. We identified pertinent internal controls such as (1) the Mission's documentation pertinent to managing its DCA guarantees, (2) the partnering financial institutions' procedures regarding DCA guaranteed loan approvals, and (3) the Mission's annual self-assessment of internal controls in accordance with the Federal Managers Financial Integrity Act. Relevant criteria included USAID's Automated Directives System 249, USAID's Office of Development Credit's 2004 *DCA Operations Manual,* and Office of Management and Budget Circular No. A-129.

The audit scope encompassed USAID/Uganda's DCA guaranteed loans as of September 30, 2005 for its Phase I and Phase II programs. The 256 loans guaranteed under Phase I made credit of $22.5 million available, while guaranteeing a maximum of $11.5 million. The 55 loans guaranteed under Phase II made credit of $1.7 million available, while guaranteeing a maximum of $0.87 million. As of September 30, 2005, USAID had signed 143 guarantees world-wide, which accounted for a cumulative utilization of nearly $317 million (these figures are unaudited).

The intended results related to USAID/Uganda's DCA guaranteed loan portfolio guarantees selected for review included among other things, determining whether:

- Loans supported the strategic objective(s) specified in the documentation submitted by the Mission.

- Loans were made to qualified borrowers for qualified projects as specified in the guarantee agreement between USAID and the partnering financial institution.

- Activities funded by the loan guarantees represented the intended purpose stipulated in the partnering financial institutions' loan files.

The audit scope did not include DCA guarantee macro-level results, such as impact on unemployment, job creation, or other economic growth indicators. In addition, there were no prior audit findings affecting the areas reviewed in this audit. There was a scope limitation during the audit because one of the financial institutions selected for review canceled our scheduled borrower loan file reviews and a site visit.

Methodology

To answer the audit objective, we performed reviews of five financial institutions participating in USAID/Uganda's loan guarantees as of September 30, 2005. These five financial institutions were chosen because they represented different sectors—international financial institutions, indigenous financial institutions, and continental Africa-based financial institutions. We also included those financial institutions which had experienced default claims under DCA guarantees.

For four of the five financial institutions we visited, we were able to review DCA-guaranteed loans selected on a judgmental basis. Where possible, the judgmental basis for the reviews for each financial institution included representation of loans that were deemed "problem loans" (with a loan default being claimed or with incidents of late payment) as identified by the financial institutions, along with loans which were considered "good loans." We reviewed the files of all defaulted borrowers where the financial institutions have filed claims; as of September 30, 2005, three claims were filed. In this effort, we verified compliance with USAID's requirements in terms of notice of default, attempts to recover amounts due, and adherence to the filing waiting period.

We interviewed Mission staff and the Mission's contractor staff responsible for DCA monitoring and reviewed their pertinent documents. We also interviewed financial institution officials and reviewed selected DCA guaranteed loan files. When necessary, we supplemented information found in the DCA guaranteed loan files by questioning financial institution officials on specifics of the DCA-guaranteed loan. We also interviewed selected borrowers and conducted site visits to observe certain activities funded under the DCA guaranteed loans.

We did not set a materiality threshold for the audit objective as the nature of the audit did not lend itself to the establishment of such a threshold.

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FROM THE AMERICAN PEOPLE

MEMORANDUM

TO: **Regional Inspector General/Pretoria, Jay Rollins**

FROM: **Margot Ellis, Mission Director, USAID/Uganda**

SUBJECT: **USAID/Uganda Comments on the 12/29/2005 Draft Audit of USAID/Uganda's Development Credit Authority Program (Report No. 4-617-06-XXX-P)**

DATE: February 3, 2006

The Mission has reviewed the draft copy of the RIG Audit Report of USAID/Uganda's Development Credit Authority and concurs with all five recommendations. The Mission has initiated actions to address these recommendations, and is preparing supporting documentation for closure. Further, Mission will work with the EGAT/Office of Development Credit (ODC) to on implementation of recommendations No. 2 and 3.

Mission's response to the 5 recommendations

Recommendation No. 1: *We recommend that USAID/Uganda develop interim utilization goals for the Development Credit Authority program.*

Mission Response: Mission concurs with this recommendation. The Mission will incorporate these targets into its Performance Management Plan. [Target Date for Completion: March 30, 2006)

The targets will subsequently be analyzed semiannually following the submission of a bank's Qualifying Loan Schedule (QLS) to determine follow-up actions based on a guarantee's under- or over-performance of targets.

Recommendation No. 2: *We recommend that USAID/Uganda develop Mission specific procedures to require periodic site visits by Mission personnel and/or their contractor to financial institutions and borrowers in order to improve the monitoring of Development Credit Authority loan guarantees. When site visits have been performed, the visits should be documented and maintained in the program files.*

Mission Response: Mission concurs with this recommendation. [Target Date for Completion: March 30, 2006]

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Electronic and paper copies of summaries of the site visit schedule, site visit reports and biennial reviews will be maintained in the program files.

Recommendation No. 3: *We recommend that USAID/Uganda submit written notification to the financial institutions participating in the Development Credit Authority program requiring that the borrower's address, type and value of collateral (when it is used to secure the loan guarantee), and the basis for determining borrower eligibility be included in the notification letter for all future loan guarantees. If appraisals are required by the financial institutions to secure the loan, appraisal copies should also be provided with the notification letters.*

Mission Response: Mission concurs with this recommendation. [Target Date for Completion: March 30, 2006].

It should be noted that, in most of the examples of inadequate accountability provided in the audit report, USAID/Uganda and its contractor were able to effectively hold the financial institution accountable for misrepresentation of information by the borrower (i.e., with respect to collateral) prior to the claim request. With respect to other information requirements (e.g., borrower's address and value of collateral), in June 2004 the USAID/Uganda contractor identified the need for such additional information on the online Transaction Report for the USAID Credit Management System (CMS) database. This Transaction Report captures the relevant information from the financial institution's notification letter in CMS. All subsequent transactions data on borrower addresses and collateral values is requested, received and recorded in CMS, although the type of collateral used (e.g., buildings, land, equipment, vehicles, warehoused commodities et al), is not recorded. With the additional monitoring activities described in the previous recommendation, the Mission believes that the accountability and use of USG funds will be further strengthened.

Recommendation No. 4: *We recommend that USAID/Uganda de-obligate the $100,000 in subsidy funds associated with the reduction in the loan portfolio amount for the one inactive financial institution.*

Mission Response: Mission concurs with this recommendation. USAID/Uganda initiated and completed the process to de-obligate $100,000 in January 2006. We intend to re-obligate these funds prior to the end of FY2006 to support other DCA guarantees in Uganda. According to ODC and the AID/Washington Bureau for Policy and Program Coordination (PPC), although the Mission has completed the required de-obligation in MACS, re-obligation cannot occur before the end of the third quarter FY 2006. [Target Date for Completion: September 30, 2006]

Recommendation No. 5: *We recommend that USAID/Uganda de-obligate $5,317 in subsidy funds related to the unused loan guarantee for one inactive financial institution.*

Mission Response: Mission concurs with this recommendation. USAID/Uganda will immediately proceed to terminate the remaining DCA facility and de-obligate $5,317 of remaining subsidy funds. This action should be completed by the end of the second quarter of FY 2006. As discussed under Recommendation No. 4, we will re-obligate the $100,000 plus $5,317 by the close of FY 2006 in order to support other DCA guarantees in Uganda. [Target Date for Completion: March 30, 2006 (deobligation) and September 30, 2006 (reobligation)].

Incorporating additional information in the background for clarity

(1) The second sentence of paragraph four of the background which begins *"USAID/Uganda's loan portfolio guarantees were composed of two multi-institutional DCA programs..."* has incomplete information regarding phase I and II LPGs. The audit should clearly make this distinction specifically and we recommend substitution of the referenced sentence with the following for clarity.

"USAID/Uganda's loan portfolio guarantees are composed of two multi-institutional DCA programs and one collateral management/warehouse receipts initiative. FY 2001-funded LPGs are also referred to as phase 1 multi-institution guarantees in the audit document. FY 2005- funded LPGs are referred to as phase 2. The performance audit conducted in October 2005 focused on FY 2001 and 2005 LPGs that target micro, small and medium enterprise financing, and did ***not*** *audit the collateral management LPG."*

(2) In addition we recommend that the background section incorporate a description of the three LPGs following the proposed language above with the text below to avoid ambiguity.

a) An FY 2001 Micro, Small and Medium (MSME) Loan Portfolio Guarantee (LPG) with seven institutions which includes lending to micro finance institutions (MFIs).
b) An FY 2005 Rural MSME LPG with five institutions that targets rural enterprises, and includes a transformed MFI, referred to as a micro finance deposit taking institution (MDI).
c) An FY 2005 Collateral Management/Warehouse Receipts LPG with three institutions for non-perishable grain commodities that will increase the ability by traders (including farmer-owned cooperatives) to buy more grain earlier from farmers, improving the quality of the traded grain and increasing price stability for farmers in the market place.

The first DCA program was approved for a period of five years through January 31, 2007, with a facility of US$30,385,000 broken down as follows:

	Facility	**Subsidy**
Allied Bank International	2,000,000	51,200
Barclays Bank	4,000,000	113,200
Centenary Rural Development Bank	4,385,000	163,999
Citibank	4,000,000 ($3,500,000)	113,200
Nile Bank	2,000,000	77,400
Stanbic Bank	6,000,000	208,800
Standard Chartered Bank	8,000,000	247,200

The second DCA program was approved for a period of four years through May 31, 2009, with a facility of US$17,700,000. It includes a transformed and regulated deposit taking MFI that receives USAID technical support.

	Facility	Subsidy
Centenary Rural Development Bank	3,000,000	156,300
Nile Bank	4,000,000	219,600
Stanbic Bank	2,700,000	156,060
Standard Chartered Bank	6,000,000	346,800
Uganda Microfinance Union Ltd.	2,000,000	121,200

The third DCA program is for a Collateral Management/Warehouse Receipts program that was approved for a period of three years (or six harvest seasons) through December 2008, with a facility of US$11,654,000, disaggregated as follows:

	Facility	Subsidy
Barclays Bank	4,170,000	172,221
Stanbic Bank	3,314,000	145,173
Standard Chartered Bank	4,170,000	182,646

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