USAID
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OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/RUSSIA'S DEVELOPMENT CREDIT AUTHORITY

AUDIT REPORT NO. 8-118-06-002-P
May 22, 2006

FRANKFURT, GERMANY

Office of Inspector General

May 22, 2006

MEMORANDUM

TO: USAID/Russia Mission Director, Terry Myers

FROM: Regional Inspector General/Frankfurt, Gerard M. Custer /s/

SUBJECT: Audit of USAID/Russia's Development Credit Authority (Report No. 8-118-06-002-P)

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

The report contains three recommendations. In your written comments, you concurred with all three recommendations and described actions the Mission plans to take to address the auditors' concerns. Based on your comments, management decisions have been reached for Recommendations Nos. 1 and 2 and final action has been taken for Recommendation No. 3. Please coordinate final action for Recommendations Nos. 1 and 2 with USAID's Bureau for Management, Office of the Chief Financial Officer, Audit Performance and Compliance Division (M/CFO/APC).

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

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SUMMARY OF RESULTS

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. Access to credit is a chronic problem in less developed countries. The commercial banking sector is often unwilling to lend funds to small and medium enterprises (SMEs) because of the perceived risks and lack of credit history. In those instances where financing is available, lenders frequently impose burdensome collateral requirements and short repayment periods which effectively prevent SMEs from being able to obtain credit. To help overcome some of these lending obstacles, USAID has used DCA partial loan guarantees to encourage commercial banks to finance development projects that otherwise might not be funded.

This audit was performed by the Regional Inspector General in Frankfurt as part of a worldwide audit of USAID's DCA loan guarantees. The objective of the audit was to determine whether USAID/Russia managed its DCA loan guarantees to ensure that selected intended results were being achieved. (See page 3.)

USAID/Russia generally managed its portfolio of DCA loan guarantees to ensure that selected intended results were being achieved. For example, all three of the lenders receiving loan guarantees from the Mission were found to be achieving their loan utilization targets as of September 30, 2005. The activities selected for review under two of these loan guarantees were determined to be consistent with the intended purpose of the loans they were funded under and supported the Mission's strategic objectives. During a field visit to one lender, the audit team observed how the Mission's loan guarantees were enabling qualified SMEs in southern Russia to have improved access to credit for the purposes of starting-up or expanding their businesses. (See page 4.)

The audit, however, identified two areas where improvements were needed to address existing problems and strengthen USAID/Russia's procedures for monitoring its loan guarantees. For example, one of the Mission's lenders was routinely awarding USAID-guaranteed loans to borrowers that could otherwise obtain credit without the guarantee, rather than to those creditworthy borrowers that lacked access to this credit, thereby undermining the intent of the guarantees. (See page 6.) In addition, the Mission was not receiving sufficient information from another lender to effectively monitor results. This lender, after receiving its loan guarantee, had awarded a guaranteed bank-to-bank loan to a secondary lender to provide the latter with capital for making loans to SMEs. The Mission's agreement with the prime lender, however, did not include reporting provisions requiring it to furnish performance information on the individual loans made by the secondary lender to the Russian SMEs—creating a reporting gap. (See page 8.)

The report contains three recommendations to address the two deficiencies identified above and improve USAID/Russia's monitoring over its DCA loan guarantee portfolio. (See pages 7 and 9.) Mission management concurred with the recommendations and intends to implement corrective actions when making future DCA guarantees and reviewing loan activities. Based on the actions taken and planned, we consider that a management decision has been reached for Recommendation Nos. 1 and 2 and final action has been taken for Recommendation No. 3. USAID/Russia's comments are included as Appendix II to this report (page 13).

BACKGROUND

Empirical studies have shown that credit to the private sector plays a crucial role in economic growth and that developed countries enjoy higher growth rates partly because they have more vigorous credit markets. Unfortunately, this is seldom the case in less developed countries where the commercial banking sector is often unwilling to lend funds to small and medium enterprises (SMEs) because of the perceived risks, lack of credit history and the lender's low liquidity. Even when credit is available in these countries, lenders frequently impose burdensome collateral requirements and short repayment periods, which effectively discourage or prevent SMEs from obtaining credit.

Authorized by Congress in FY 1998 and certified by OMB in FY 1999, the Development Credit Authority (DCA) provides USAID missions with a tool they can use to help overcome some of the lending obstacles that exist in many underserved markets. This Authority, implemented through the USAID Office of Development Credit (ODC), allows missions to partner with local lending institutions in making resources available to SMEs to support specific development objectives. Through the use of loan guarantees, in which missions insure a portion of the risk with the lenders, USAID is able to encourage lenders to extend credit for projects that otherwise might not receive funding and, in doing so, stimulate new private investment and the development of local capital markets.

DCA guarantees are designed by USAID's overseas missions and managed jointly by the mission and ODC in Washington, D.C. In managing these guarantees, missions are primarily responsible for developmental monitoring, while the ODC is responsible for the financial monitoring. As of September 2005, USAID's DCA loan guarantees had established 143 public-private partnerships and generated approximately $317 million in loans from lenders to local borrowers.[1]

USAID/Russia's portfolio of DCA loan guarantees consisted of agreements with three lenders; two of which involved loan portfolio guarantees while the third was a loan guarantee that resulted in a bank-to-bank loan. The maximum amount of credit to be generated from these guarantees, as of September 30, 2005, totaled $17 million, of which USAID agreed to guarantee up to 50 percent or $8.5 million as shown below.[1]

Financial Institution	***Date Started***	***Maximum Portfolio Amount***	***Maximum Contingent Liability***	***Current Utilization Percent***	***Final Date for Placing New Loans***
SDM Bank	9/24/2003	$3 million	$1.5 million	99.85%	9/24/2008
Center Invest Bank	9/24/2002	$6 million	$3 million	43.62%	9/23/2007
ZAO Raiffeisen Bank	12/28/2004	$8 million	$4 million	87.53%	12/24/2006
Total		$17 million	$8.5 million		

As of September 30, 2005, no claims for delinquent loans had been made.

[1] These figures are unaudited.

AUDIT OBJECTIVE

This audit was performed as part of a series of audits conducted worldwide on USAID's Development Credit Authority. As part of its fiscal year 2006 audit plan, the Regional Inspector General in Frankfurt performed this audit to answer the following question:

- Did USAID/Russia 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.

Map of Russia with arrows indicating the two cities—Moscow and Rostov—where the audit team conducted fieldwork which included site visits to projects funded with DCA-guaranteed loans.

AUDIT FINDINGS

For the areas reviewed, USAID/Russia generally managed its Development Credit Authority (DCA) guarantees to ensure that selected intended results were achieved. Improvements, however, are needed to strengthen accountability and monitoring. Specifically, USAID/Russia's procedures for managing its DCA loan guarantees need to be improved to ensure that: 1) guaranteed loans are awarded in a manner that directs credit to underserved markets (i.e., to borrowers who would otherwise not qualify for the loans) and not simply used to subsidize the lender's operations; and 2) the Mission receives performance data from all of its partner banks (i.e., lenders) in sufficient detail to monitor the loan activity under each of its loan agreements. These issues are discussed further on pages 6 through 9.

In monitoring the status of activities and progress in meeting utilization targets under each of its DCA loan guarantee agreements, USAID/Russia received and reviewed updated performance data generated by USAID's Credit Management System (CMS) database. Mission staff also maintained regular contact with its lenders via telephone and through annual visits to selected lenders as well as received financial statements and documents related to the lender's performance as rated by an independent source.

The audit also determined that the following selected results were being achieved:

- ✓ All of the Mission's lenders had met their utilization targets and were on track to issue the entire amount of authorized credit well in the advance of the end of the agreement period. For example, one lender had issued the full amount of its guaranteed financing by November 2005, only two years into its 5-year term, while another lender had awarded 50 percent of its financing in its initial year.

- ✓ Loan guarantees were contributing toward achieving the Mission's strategic objectives and were supporting the objectives specified in its action memo.

- ✓ Activities funded by the loan guarantees were consistent with the loan purpose.

In addition to the above results, the audit team observed first-hand, during a field visit to one lender, how USAID/Russia's loan guarantees were making a positive impact for a number of small and medium enterprise (SME) borrowers. Because of the USAID loan guarantee, this lender was able to reduce its risk and lower its collateral requirements, thereby allowing its borrowers to have access to credit they would otherwise not be able to obtain for start-up or expansion purposes. We visited several such borrowers and saw how each benefited from their USAID guaranteed loan. For example:

- One loan was awarded to a small wholesaler of construction materials who used the proceeds to purchase additional insulation materials and open two new branch offices in an effort to increase its customer base. The company employs 21 employees and serves the entire southern Russia region. The owner was very grateful for the USAID guaranteed loan since he did not have enough collateral to obtain a regular business loan.

- A second loan was awarded to a construction and concrete business with 47 employees. The business received a USAID guaranteed loan totaling 2.5 million Russian Rubles (approximately $86,207) which the company used to modernize its concrete making machine so as to produce better quality concrete, and in greater quantities, thereby allowing the company to take on larger construction projects. The loan also helped the business to later accumulate enough collateral to qualify for a regular loan.

Photo of a cement maker that was modernized using the proceeds from a USAID guaranteed loan. This upgrade doubled the equipment's production capacity and improved the quality of the concrete produced, enabling the borrower, a construction company, to expand into larger and more lucrative construction projects. (Rostov-an-Don, Russia; January 19, 2006)

- Another loan was made to a small wholesaler of kielbasa (sausage) with 25 employees. Prior to receiving its USAID guaranteed loan, the business experienced difficulty obtaining financing from other banks since most of the business' funds were tied up in its inventory of food, making it difficult to meet the collateral requirements. Using the proceeds from the loan, the business was able to obtain a contract with a mayonnaise supplier which allowed the business to diversify its inventory and increase its customer base.

- USAID's loan guarantee also benefited a local wholesaler of metal doors with 30 employees. This was the first loan this borrower had ever obtained for his business. Thanks to the loan, he was able to open a new shop and now has enough collateral to qualify for a regular business loan.

Despite these successes and the Mission's efforts to monitor its DCA loan guarantees, two areas were identified where improvements were needed to strengthen accountability and oversight. These are discussed in detail in the following sections.

Loan Guarantees Were Not Always Used to Benefit Borrowers in Underserved Markets

Summary: DCA loan guarantees are intended to provide USAID Missions with a tool which may be used to encourage the use of credit and stimulate investment in underserved markets. To achieve this, USAID policy restricts DCA financing to those development projects that otherwise would not be funded. One of USAID/Russia's lenders, however, was found to be providing loans to borrowers that could obtain the credit without the guarantee, including some borrowers who exceeded the asset ceilings prescribed in the Mission's loan guarantee agreement. This occurred because USAID's monitoring over this activity was not sufficient to detect and address these types of deficiencies. As a result, borrowers that should not have received a USAID guaranteed loan tied up large portions of the loan utilization that should have been made available to other borrowers—those DCA was designed to benefit—thereby limiting the impact of the Mission's loan guarantees.

The Development Credit Authority (DCA) provides overseas USAID Missions with a tool by which they may encourage the use of credit and expand financial services in underserved markets. To stimulate financing within underserved markets, USAID guaranteed loans are intended as a source of private capital for projects that otherwise would not be funded. Specifically, USAID's Automated Directive System (ADS), section 249.3.1(g) states that "DCA financing must not be used unless it is probable that the transaction would not go forward without it, taking into consideration whether such financing is available for the term needed and at a reasonable cost."

Contrary to this guidance, USAID guaranteed loans were not always being awarded to those borrowers the DCA was designed to assist. One lender revealed during a field visit that its primary motivation for participating in the Mission's DCA loan guarantee activity was to improve its image in order to attract other investors and acknowledged that it had made little effort to extend its guaranteed loans to new eligible borrowers; in fact, half of the lender's borrowers receiving guaranteed loans involved clients that had earlier received non-guaranteed loans. Despite the fact that the lender's credit risk was reduced by the USAID loan guarantee, the lender made no effort to revise its loan terms (e.g., collateral requirements, repayment period and interest rates). Instead, the lender continued to make loans to borrowers who would have qualified for the loans without the USAID guarantee. We also noted that four of the borrowers receiving guaranteed loans did not qualify for these loans as their asset levels exceeded the prescribed ceilings. These loans together represented 47 percent of the lender's guaranteed loans to date.

USAID/Russia's Action Memorandum Plan for this lender stated that the Mission would encourage the lender to extend loans to commercially viable SMEs which might not otherwise be able to access credit. However, the Mission's subsequent guarantee agreement with the lender did not include language that restricted USAID guaranteed loans to only those borrowers who could not have obtained credit without the DCA loan guarantee. Missions are permitted to make additions to the standard language contained in the agreement when deemed necessary. A USAID/Russia representative stated that modifying the DCA guarantee agreement to include a provision addressing this issue would not pose a problem. Given the competition among lenders for the DCA guarantee, lenders would likely be willing to accept the additional requirement.

It was also noted that USAID/Russia had not detected this problem during its annual site visit to the lender. In October 2005, the Mission made a visit to this lender in conjunction with a biennial visit by staff from USAID's Office of Development Credit (ODC). During this visit, the team reviewed the credit files for two judgmentally selected loans as required. While the report summarizing the results from this visit indicated that both borrowers had received prior loans, there was no indication the Mission was aware that a number of the guaranteed loans were being issued to borrowers that were not eligible in the sense that the borrowers either qualified for non-guaranteed loans or exceeded the asset ceiling prescribed in the guarantee agreement. In contrast, our review of 19 loan files from this same lender, representing 45 percent of the lender's total number of USAID-guaranteed loan transactions, disclosed four instances where borrowers had exceeded the asset ceiling and were therefore ineligible for the guaranteed loan. The lender openly acknowledged that all of the borrowers receiving the USAID-guaranteed loans would have been eligible for a regular (i.e., non-USAID guaranteed) loan. While the visit by the Mission and ODC met the minimum requirements of the DCA Operations Manual, it was clear that the extent and scope of the testing done during this visit was not sufficient to detect the type of eligibility discrepancies identified.

With all of the lender's USAID-guaranteed loans, totaling approximately $2.2 million, being awarded to borrowers who were already eligible to receive non-USAID guaranteed loans, this significantly reduced the amount of credit available for eligible SMEs who otherwise would not be able to obtain it—those the DCA was designed to benefit. Further, with no relaxation in the lender's loan requirements (e.g., collateral), despite its reduced risk, the DCA loan guarantees merely subsidized this lender's operations which undermined the intent of the loan guarantee in stimulating new investment to underserved markets.

To prevent lenders from following this practice in the future, USAID/Russia needs to include additional language in its loan guarantee agreements with its lenders to clarify the eligibility requirements and ensure that USAID-guaranteed loans are restricted to only those qualified borrowers who otherwise would not be able to receive the credit through the lender's other loan programs. In addition, the Mission needs to modify the scope and nature of the spot testing it performs in conjunction with field visits to improve its monitoring and ability to detect potential performance problems. To assist the Mission in this effort, we are providing the following recommendations.

Recommendation No. 1: We recommend that USAID/Russia modify its standard Development Credit Authority loan guarantee agreement to include provisions requiring that USAID-guaranteed loans be restricted to qualified borrowers that would not otherwise qualify for other loans offered by the lender.

Recommendation No. 2: We recommend that USAID/Russia, in conjunction with the Office of Development Credit, revise its verification and review procedures by increasing the extent of the testing to be performed during site visits in verifying that borrowers meet the prescribed eligibility requirements.

Reporting Provisions Need to be Revised to Improve Performance Monitoring

Summary: USAID/Russia was not receiving sufficient performance information from one of its lenders to monitor the status of the loans made to individual borrowers (i.e., SMEs). The Mission had signed an agreement with this lender—a non-Russian financial institution—to make a bank-to-bank loan to a Russian lender so that the latter would have sufficient capital to make loans to qualified SMEs. Although the Mission's agreement with the non-Russian (prime) lender required performance information on the bank-to-bank loan, the reporting provisions contained in the agreement did not extend to the subsequent loans made by the Russian lender to the SMEs. As a result of this reporting gap, the Mission has not been receiving sufficiently detailed information at the borrower level to effectively monitor the overall performance of the small business loans made in connection with the USAID loan guarantee and to determine whether the desired results were being achieved.

The DCA Operations Manual specifies the reporting requirements that are to be included in all DCA loan guarantee agreements. Part II, section 10(i) of the Manual, for example, requires that lenders, at a minimum, submit a Qualifying Loan Schedule on a semi-annual basis listing all new loans placed under coverage, outstanding loans, and loans dropped from coverage during the past six months. This schedule is intended to enable both the Mission and ODC to monitor the status of the lender's guaranteed loan activities and to take appropriate action when issues arise. Under normal circumstances, the data reported by the lender in this loan schedule would involve individual USAID-guaranteed loans made to SMEs.

USAID/Russia, however, was not receiving sufficient information from one of its lenders on the status and overall performance of the individual loans that were being awarded to the SMEs (through a secondary lender). This two tiered financing arrangement, involving two separate lenders, was prompted in response to an earlier attempt by the Mission to initiate a bond guarantee with one of the lenders. Originally, the Mission drafted a guarantee agreement with the NBD Bank (NBD), a local Russian financial institution, to back a bond issuance intended to provide funds for the lender to expand its existing small business loan program. Shortly before the signing of this agreement, however, it was discovered that the bond issuance was not allowed by Russian law. USAID/Russia subsequently signed a loan guarantee agreement with another lender, ZAO Raiffeisen Bank Austria (Raiffeisen), to lend NBD the capital needed to expand its small business loan portfolio.

Although the Mission's loan guarantee agreement with Raiffeisen required performance information on the bank-to-bank loan, between Raiffeisen and NBD, the reporting provisions contained in the agreement did not extend to the subsequent loans made by NBD to its borrowers—the small businesses the loan guarantee was intended to benefit. According to the original draft agreement with NBD, the proposed bond guarantee included provisions for reporting information about NBD's loan portfolio to USAID. Unfortunately, this agreement was never finalized, and the reporting provisions included in the agreement, covering NBD's loans to its SMEs, were not incorporated into the subsequent agreement with Raiffeisen.

With Raiffeisen's performance reporting limited to its bank-to-bank loan with NBD, the Mission has not been receiving sufficient information on NBD's borrowers to effectively monitor and assess the overall performance of the small business loans made in connection with USAID's loan guarantee. This, in turn, has reduced the Mission's ability to detect potential problems associated with NBD's loans to SMEs, which represents a large portion of the Mission's total DCA portfolio. Under its agreement with Raiffeisen, the Mission agreed to provide a 50 percent guarantee on the $8 million Raiffeisen loaned to NBD—representing 47 percent of the Mission's total loan guarantee portfolio.

In order for the Mission to effectively monitor the performance of its loan guarantees, it needs to receive information on loan activity at the borrower (i.e., SME) level. To improve the monitoring under this DCA guarantee, we are recommending the following:

> *Recommendation No. 3: We recommend that USAID/Russia develop procedures to ensure that the Mission obtains sufficiently detailed performance information from the NBD Bank to determine if the desired results are being achieved under its Development Credit Authority loan guarantee agreement with Raiffieisen Bank Austria*.

EVALUATION OF MANAGEMENT COMMENTS

In response to our draft report, USAID/Russia concurred with the audit recommendations, and detailed the actions it has taken or plans to take to implement the recommendations, including target completion dates where applicable. Based on our review of the actions taken and planned by the Mission, we consider that management decisions have been reached on Recommendation Nos. 1 and 2 and that final action has been taken on Recommendation No. 3.

In response to Recommendation No. 1, Mission management stated it would incorporate new language into the standard DCA loan guarantee agreement. The specific language developed by USIAD/Russia will be presented to DCA/EGAT and, if approved, they will be incorporated in future DCA agreements. Based on the response from the Mission, we consider that a management decision is reached on Recommendation No. 1

In response to Recommendation No. 2, Mission management stated that it would, in the future, expand the scope of annual testing to include at least five percent of the client's loan files and incorporate new client oriented questionnaires in the testing. Based on the response from the Mission, we consider that a management decision has been reached on Recommendation No. 2.

In response to Recommendation No. 3, Mission management stated that it reached an agreement with NBD bank to provide detailed information on the loans granted. In addition, the Mission received the first report from NBD on April 4, 2006, which it provided to us along with related correspondence between the Mission and NBD. Based on the Mission's response and actions taken, we consider that the recommendation has been implemented and that final action has been taken on Recommendation No. 3.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General in Frankfurt audited USAID/Russia's management of its Development Credit Authority (DCA) loan guarantee portfolio in accordance with generally accepted government auditing standards. This audit was performed as part of a series of audits that were conducted worldwide and led by the Performance Audits Division of the Office of Inspector General. The purpose of the audit was to determine whether USAID/Russia managed its DCA loan 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 regarding the Mission's procedures for managing and monitoring its DCA guarantees. These controls included Mission interaction with partner banks and borrowers, site visits, establishment of targets and indicators, and receipt and review of loan schedules.

The audit universe consisted of the three active loan guarantee agreements included in the Mission's loan guarantee portfolio at the time of the audit fieldwork. Total loans authorized to be awarded under these three agreements totaled $17 million, of which $8.5 million was guaranteed by USAID/Russia. As of September 2005, the loan portfolios under the three guaranteed loan agreements consisted of 119 individual loans.

Detailed testing was performed at the financial institutions (i.e., lenders) for two of the three loan guarantees. The two included guarantees with the Center-Invest Bank (CIB) and SDM Bank, both of which had submitted their data to ODC for review as of September 30, 2005. Our work on each included a review of a judgmentally-selected sample of loan files. We limited our review of the third guarantee— an agreement with ZAO Raiffeisen Bank Austria (Raiffeisen) involving a bank-to-bank loan—to a review of records relating to the management and monitoring of the loan guarantee agreement. We reviewed the status of the individual loans awarded under all three loan guarantees.

Mission fieldwork was conducted from January 11 through February 3, 2006, at the USAID/Russia Mission in Moscow, Russia. In addition, the audit team made visits to the headquarters of the two lenders reviewed: CIB in Rostov-an-Don, Russia and the SDM Bank in Moscow, Russia. During these visits, the audit team reviewed 16 of 76 judgmentally selected loan files at CIB and 19 of 42 loan files at SDM. We conducted site visits to 16 borrowers (9 in Moscow and 7 in Rostov-an-Don).

Methodology

To answer the audit objective, we interviewed Mission staff and inquired about their interaction with the USAID Office of Development Credit, partner banks, and borrowers. We also inquired about site visits and procedures for monitoring activities, such as setting targets and indicators and reviewing and verifying loan schedules. In addition, we examined Mission files and records related to the DCA loan guarantees. We also assessed whether loan guarantees were contributing toward achieving the Mission's strategic objectives and were supporting the objectives specified in its action memo. And lastly we determined if loan guarantee utilization fees were current.

We interviewed officials from two partner lenders, CIB and SDM Bank. Our testing consisted of a review of the loan files for 16 judgmentally-selected loan files at CIB and 19 loan files at SDM. In addition, we made site visits to 16 selected borrowers receiving financing from the two lenders in order to observe the activities funded by the selected loans. Our interviews with the lenders included questions designed to verify information gathered based on our review of the loan files. We also asked the borrowers for their opinion regarding the loan and the loan process.

In reviewing the loan file for each of the judgmentally selected USAID-guaranteed loans in the lender's portfolio and interviewing lenders and borrowers, we determined whether:

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

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

- USAID/Russia achieved adequate utilization for the dollar amount of loans generated, on an aggregate basis, as of September 30, 2005.

- The lender provided justification that the borrower could not receive credit without the USAID guarantee.

- The lender had employed adequate techniques for determining borrower repayment ability and creditworthiness.

- The lender verified and monitored the business existence and use of loan proceeds.

- The lender made any decrease in its requirements due to the USAID guarantee loan, such as reduction of collateral requirements or length of loan term.

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.

MANAGEMENT COMMENTS

USAID | RUSSIA
FROM THE AMERICAN PEOPLE

DATE:	May 10, 2006
TO:	Regional Inspector General, Frankfurt – Gerard M. Custer
FROM:	USAID/Russia Mission Director – Terry Myers /s/
SUBJECT:	Audit of USAID/Russia Development Credit Authority (DCA) Program Request for Closure of Audit Recommendations 1-3
REF:	Audit Report No. 8-118-06-002-P dated March 21, 2006

The Mission's Office of Financial Management, the Office of Regional Development (ORD), and the Office of the Director have reviewed the subject report and response of the Regional Inspector General (RIG) Office to the Mission memorandum of April 21, 2006. USAID/Russia appreciates the recommendations of the audit report, the professionalism of the auditors, and the opportunity to comment on the draft report on USAID/Russia Development Credit Authority (DCA) Program. USAID/Russia concurs with the observations and recommendations made by the RIG.

As discussed below, we have set forth plans of action to respond to Recommendations Nos. 1 and 2 and a request to close Recommendation No. 3 as presented in the draft audit.

Recommendation No. 1: *We recommend that USAID/Russia modify its standard Development Credit Authority loan guarantee agreement to include provisions requiring that USAID-guaranteed loans be restricted to qualified borrowers that would not otherwise qualify for other loans offered by the lender.*

Recommendation No. 2: *We recommend that USAID/Russia, in conjunction with the Office of Development Credit, revise its verification and review procedures by increasing the extent of the testing to be performed during site visits in verifying that borrowers meet the prescribed eligibility requirements.*

Management Decision

(1) In regard to Audit Report #8-118-06-002-P dated March 21, 2006, Recommendations Nos. 1 and 2, Mission management agrees with the recommendations. However, ORD cannot change the language, or introduce changes to the signed DCA agreements with the banks under review, as at the time of the audit the DCA guarantees have been fully utilized. USAID/Russia does not plan to obligate additional DCA loan guarantee agreements during FY 2006.

(2) For any new agreements, ORD will ensure that specific procedures and more restrictive definitions for DCA guarantee users will be established and developed based on the nature of the DCA deals and the participants. These specifics developed by ORD will be discussed with DCA/EGAT, and if approved, they will be incorporated in standard DCA agreements. For example, ORD will suggest that new DCA guarantees include:
   - A condition that the guarantee will not be provided for repeat clients/borrowers;
     A more restrictive definition for those institutions/firms/enterprises/banks, etc. that may receive a DCA guarantee; and,
     A condition that banks that are established by financial industrial groups as treasury operations will not be selected for DCA deals.

(3) The Mission agrees with Recommendation No. 2 to increase the scope and extent of testing performed by the Mission's staff during site visits. The Mission will annually test at least 5% of the clients' files. Before the audit, the program staff conducted testing semi-annually based on the standard questionnaire developed by DCA/EGAT (see Attachment #1, Monitoring Plan – Check List for Semiannual Bank Visits). ORD will expand the questionnaire currently in use by adding more specific questions similar to those asked by the auditors during their recent site visits (see Attachment #2). A new questionnaire will be client-oriented and will reflect specifics of new deals concluded with new market participants (not necessarily with banks). A new questionnaire will be started and completed simultaneously with new deals' negotiations as soon as the new players will be known.

(4) We expect to take a final action and obtain a response from DCA/EGAT concerning establishment of the new procedures and development of a new questionnaire no later than March 20, 2007.

Recommendation No. 3: *We recommend that USAID/Russia develop procedures to ensure that the Mission obtains sufficiently detailed performance information from the NBD Bank to determine if the desired results are being achieved under its Development Credit Authority loan guarantee agreement with Raiffieisen Bank Austria*.

Management Decision

(1) In February 2006 Mission management agreed with NBD Bank that the bank will submit semi-annual reports to USAID/Russia on all loans issued under their USAID bank-to- bank guarantee. These reports will contain general information on lending

outreach to include: the total number of loans issued, the amounts of individual loans, and the total amount of the active portfolio. Further, NBD bank agreed to provide detailed information on each loan, including such information as amount, term, and loan type. This information is similar to that required from DCA loan guarantee lenders for the Contract Monitoring System (CMS). It was further agreed with NBD Bank that the lending data will be for our internal use only.

The Date of Final Action
The date of final action is April 4, 2006, when the first report from NBD Bank was received by USAID/Russia. The report contained all requested data as of March 3, 2006. The subject report and the correspondence between the CTO, ORD, USAID/R and NBD bank requesting a semi-annual report from NBD bank are attached to this memorandum (see Attachment #3).
Additionally, attached is the memorandum issued by ORD's CTO to ORD's internal files confirming that negotiations were held with NBD bank on the type, format, and frequency of NBD's reporting to USAID under the DCA program (see Attachment #4).

Final Action
USAID/Russia requests that this recommendation be closed.

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