OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID'S DEVELOPMENT CREDIT AUTHORITY

AUDIT REPORT NO. 9-000-06-009-P
SEPTEMBER 25, 2006

WASHINGTON, DC

Office of Inspector General

September 25, 2006

MEMORANDUM

TO: EGAT/DC Director, John E. Wasielewski

FROM: IG/A/PA Director, Steven H. Bernstein /s/

SUBJECT: Audit of USAID's Development Credit Authority (Report No. 9-000-06-009-P)

This memorandum transmits the final report on the subject audit. This report summarizes the audit work conducted at USAID offices in Washington, D.C. and at five USAID missions. In finalizing this report, we considered your comments on our draft report and have included them, in their entirety, in Appendix II.

This report contains four recommendations to strengthen USAID's management of its DCA guarantees. In your comments on our draft report, you concurred with all four recommendations and described planned actions to address our concerns. As a result, management decisions have been reached on all four recommendations.

I want to express my sincere appreciation to you and your staff for your cooperation and courtesy throughout this audit.

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SUMMARY OF RESULTS

The Development Credit Authority (DCA) 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 a particular sector or borrower, such as small and medium enterprises, 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, effectively preventing small and medium enterprises and others from obtaining credit. To help overcome some of these lending obstacles, USAID has used DCA partial credit guarantees to encourage commercial banks to finance development projects that otherwise might not be funded (see page 2).

This report addresses Agency-wide issues identified during the course of five Office of Inspector General audits conducted at selected USAID missions worldwide and summarizes the results of these audits.[1] Appendix III is a summary of audit recommendations included in the five audits, both by type of recommendation and by auditee. Appendix IV is a list of related audit reports issued.

These audits were designed to determine if USAID managed its DCA guarantees to ensure that selected intended results were achieved (see page 3).

In most, but not all, cases tested USAID managed its DCA guarantees to ensure that many selected intended results were achieved. However, USAID needs to strengthen procedures related to (1) borrower and loan eligibility and (2) establishing and monitoring utilization targets, and reviewing related unused subsidies (see page 4).

This report includes four recommendations to strengthen USAID's management of its DCA guarantees (see pages 8, 10, and 11). USAID's Office of Development Credit concurred with all four recommendations and described planned actions to address our concerns. As a result, management decisions have been reached on all four recommendations (see page 12).

Management comments are included in their entirety in Appendix II.

[1] The five USAID missions audited were Bulgaria, Guatemala, Russia, Uganda, and the Regional Development Mission/Asia. During the course of these audits, we also issued a Memorandum Report recommending that USAID collect approximately $435,000 in U.S. Treasury interest on its DCA financing account and ensure that future interest is calculated and collected in a timely manner.

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 commercial banks are often unwilling to lend to a particular sector or borrower, such as small and medium enterprises, because of the risk involved, the lender's low liquidity, or the borrower's lack of credit history. Even when credit is available in these countries, lenders frequently impose burdensome collateral requirements and short repayment periods, effectively discouraging or preventing small and medium enterprises and others from obtaining credit.

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

DCA credit guarantees are typically designed by USAID's missions, but managed jointly by the issuing mission and the ODC. While several types of guarantees are available, the majority of USAID's guarantees are loan portfolio guarantees, which cover a pool of loans made by a partner bank to eligible borrowers in a sector specified by USAID. USAID also uses loan and bond guarantees. A loan guarantee covers a loan made by a partner bank to one borrower to fund a defined activity. A bond guarantee is used to support the issuance of various types of bonds—the funds generated from these bond offerings are intended for activities which require substantial up-front capital investments, such as local municipal infrastructure or utility projects.

In the OMB's fiscal year 2005 assessment, USAID's DCA received a rating of "moderately effective," ranking it among the top 44 percent of all Federal programs assessed. Although DCA scored high in program purpose, design, and strategic planning, the OMB determined that program results and accountability needed to be strengthened.

As of September 30, 2005, USAID had signed 143 DCA guarantee agreements, making nearly $1.1 billion in credit available to previously underserved markets, while generating nearly $317 million in loans from lenders to local borrowers. The five missions audited accounted for 26 guarantees, generating over 10,000 loans and nearly $109 million in credit.

AUDIT OBJECTIVE

The Office of Inspector General conducted this worldwide audit of USAID's Development Credit Authority as part of its fiscal year 2005 and 2006 audit plans. The audit was designed to answer the following objective:

- Did USAID 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

In most, but not all, cases tested USAID managed its Development Credit Authority (DCA) guarantees to ensure that many selected intended results were achieved. However, USAID needs to strengthen procedures related to (1) borrower and loan eligibility and (2) establishing and monitoring utilization targets, and reviewing related unused subsidies.

In general, USAID managed its guarantees to ensure that many intended results tested were achieved. For example, mission staff:

- Conducted semi-annual site visits to partner banks and verified that borrowers and loan purposes met eligibility guidelines specified in the guarantee agreement. (USAID/Bulgaria)

- Received and reviewed performance data, maintained regular contact with partner banks, and conducted annual visits to selected lenders. (USAID/Russia)

- Conducted annual visits to and maintained regular contact with partner banks, and acted as liaison between the Office of Development Credit (ODC) and the banks. (USAID's Regional Development Mission (RDM)/Asia)

Overall, the missions audited achieved 82 percent of the 34 intended results tested.[2] As shown in the table on the next page, two of the five missions achieved 100 percent of the intended results tested; one achieved 86 percent; one achieved 71 percent; and the remaining mission achieved 57 percent. A checkmark indicates that the intended result was achieved, while an "X" indicates the result was not achieved.

[2] As detailed in the table on the next page, seven selected intended results were tested at four missions: Guatemala, Russia, RDM/Asia, and Uganda. At USAID/Bulgaria, six selected intended results were tested. Therefore, in total, 34 selected intended results were tested.

Table Showing Whether Missions Achieved the Intended Results Audited

Intended Result	Bulgaria	Guatemala	Russia	RDM/Asia	Uganda
Utilization targets were achieved	✓	✓ [3]	✓	X	X
Guarantees supported strategic objectives specified in approved proposal	✓	✓	✓	✓	✓
As evidenced by inclusion in the mission's most recent Annual Report, guarantees contributed to achieving a mission's strategic objective(s)	✓	✓	✓	✓	✓
Loans were made to qualified borrowers for qualified projects, as specified in the guarantee agreement	✓	✓	X	X	X
Activities funded by guarantees represented the intended loan purpose stipulated in the banks' loan files	✓	✓	✓	✓	✓
Biennial reviews were performed	✓	✓	✓	✓	✓
Utilization fees were current [4]	**n/a**	✓	✓	✓	X
Percentage of selected intended results achieved	**100%**	**100%**	**86%**	**71%**	**57%**

The table above shows that the guarantees at all five missions supported the strategic objective(s) specified in the guarantee agreement proposals and that loans placed under guarantee coverage funded activities representing the intended loan purpose stipulated in the banks' loan files. For example, in Uganda, a loan guarantee provided funding to a medium-sized fish processing company to refurbish its refrigeration equipment, allowing the company to export frozen and chilled fish products throughout the world. This loan guarantee helped the Mission meet its strategic objective of "Expanded Sustainable Economic Opportunities for Rural Sector Growth."

[3] Although USAID/Guatemala met its aggregate utilization targets, it did not meet its utilization target for its bond guarantee.

[4] Utilization fees were not included as an intended result in the audit scope for USAID/Bulgaria. Late utilization fees were isolated to USAID/Uganda, and were not discussed in the related audit report (see Report No. 4-617-06-004-P, *Audit of USAID/Uganda's Development Credit Authority*, February 13, 2006).

Photograph taken in October 2005 of an OIG auditor and company officials at a fish processing company in Kampala, Uganda that began exporting fish products as a result of a guaranteed loan.

Furthermore, as evidenced by inclusion in all five missions' most recent annual reports, the guarantees contributed to achieving one or more of the missions' strategic objectives. Additionally, biennial reviews were conducted in a timely manner.[5]

Although USAID achieved many of the intended results tested, we identified several areas in which strengthened oversight of DCA guarantees can ensure that USAID achieves more of its intended results. These issues are discussed in the following sections.

Eligibility Needs To Be Clarified and Verified

Summary: USAID policy restricts DCA financing to those development projects that otherwise would not be funded. In addition, each loan portfolio guarantee agreement includes loan eligibility requirements. However, at three of the five missions audited, guaranteed loans were provided to ineligible borrowers. Also, one lender provided guaranteed loans to borrowers who could have obtained credit without the guarantee. This occurred because the banks either did not understand the eligibility requirements or ignored them. In addition, the ineligible loans were not detected because the missions did not review loan eligibility. Furthermore, the guidance was not clear. As a result, the amount of credit available to fund targeted development projects for eligible borrowers was significantly reduced.

[5] The missions' annual reports are USAID's principal tool for assessing program performance and communicating this information to USAID management and external audiences, such as Congress and the Office of Management and Budget (OMB). Biennial reviews are bank site visits conducted by the ODC and are required by OMB Circular No. A-129, *Policies for Federal Credit Programs*, and the *DCA Operations Manual*. Biennial reviews have a larger scope than the annual mission bank site visits.

USAID's Automated Directives System (ADS) 249, *Development Credit Authority*, restricts DCA financing to those development projects that otherwise would not be funded and requires that DCA financing not be used unless it is probable that the transaction would not go forward without it. It also states that USAID should act as a lender of last resort to bridge market imperfections, which exist where capital markets fail to provide private sector lending to otherwise creditworthy projects or sectors. USAID's *DCA Operations Manual* further explains that this guiding principle of "additionality" implies that the guaranteed party would not extend the loan without the DCA guarantee. However, neither ADS 249 nor the *Operations Manual* clearly states whether this additionality requirement applies to projects or activities funded by loans issued under a loan portfolio guarantee or only to loan guarantees (for which the agreement is approved for a specified borrower for a defined project or activity).

Federal guidance states that credit subsidies should be used to provide assistance in overcoming capital market imperfections and that loan guarantees may make credit available when private financial sources would not otherwise do so.[6] Additionally, each loan portfolio guarantee agreement between USAID and a partner bank includes specific loan and borrower eligibility requirements.

However, at three of the five missions audited, partner banks issued loans, under loan portfolio guarantees, to ineligible borrowers. For example:

- A lender routinely provided loans to borrowers who could have obtained credit without the guarantee, including four loans to borrowers who exceeded the asset ceiling prescribed in the loan guarantee agreement.[7] (USAID/Russia)

- A lender provided a loan to a business which did not exist when the loan was guaranteed. The lender later identified this problem when the business defaulted on the loan. (USAID/Uganda)

- Two lenders made guaranteed loans to borrowers exceeding the maximum cumulative principal ceiling specified in the guarantee agreement. Loans to one of these borrowers exceeded the $500,000 ceiling by more than $1.5 million. The ODC removed these loans from guarantee coverage subsequent to our audit fieldwork.[8] (RDM/Asia)

Regarding the loans to borrowers who could have obtained credit without the guarantee, ADS 249 and the *Operations Manual* were unclear as to whether the additionality requirement applied to projects funded by loans issued under a loan portfolio guarantee or only to loan guarantees. For example, while both ADS 249 and the *Operations Manual* state that additionality is a DCA "guiding principle" and that DCA financing must

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[6] OMB Circular No. A-129, *Policies for Federal Credit Programs*, November 2000.

[7] These 4 ineligible loans represented 21 percent of the 19 loans included in our audit sample of this lender's guaranteed loans.

[8] These 2 ineligible loans represented 17 percent of the 12 loans included in our audit sample of the two partner banks' active loan portfolio agreements.

not be used unless it is probable that the transaction would not go forward without it, neither clearly articulates whether this “transaction” refers to the portfolio guarantee itself or to each of the underlying loans. ODC attempted to ensure additionality by charging utilization fees and tried to monitor additionality through annual questionnaires completed by partner banks. However, additionality was not an eligibility requirement for loans issued under a loan portfolio guarantee.

Partner banks made ineligible loans because they either did not understand the eligibility requirements or ignored them. In addition, USAID did not detect the ineligible loans because missions were not required to (and therefore did not) verify borrower and loan eligibility, either at the time loans were made or during the required annual bank visits. Instead, USAID relied on partner banks to comply with the terms of the guarantee agreements and verified eligibility when a bank submitted a claim request for payment.

Detailed guidance related to administering USAID’s guarantees is provided in the *DCA Operations Manual.* Although the *Operations Manual* alludes to compliance checks on the transaction reports submitted by partner banks to missions and to the ODC for each loan placed under guarantee coverage, it does not require that eligibility be verified at the time loans are placed under guarantee coverage. In fact, the *Operations Manual* states that loans are assumed to be approved for guarantee coverage unless USAID contacts the guaranteed party to clarify the proper enrollment of loans under coverage.

Due to the ineligible loans, the amount of credit available to fund targeted development projects for eligible borrowers was significantly reduced.

To ensure that partner banks are extending DCA guaranteed loans to those borrowers the guarantees are designed to benefit, USAID needs to require missions to verify the eligibility of loans issued under its loan portfolio guarantees and to clarify its additionality guidance. Accordingly, we are making the following recommendations to help ensure that partner banks are meeting eligibility requirements for loans issued under loan portfolio guarantees.

Recommendation No. 1: We recommend that the Director of the Office of Development Credit develop and issue policies and procedures to verify the eligibility of loans issued under loan portfolio guarantees.

Recommendation No. 2: We recommend that the Director of the Office of Development Credit clarify additionality requirements, for loans issued under portfolio guarantees, in Automated Directives System 249 and the Development Credit Authority Operations Manual.

Monitoring Needs To Be Strengthened

Summary: USAID policy requires that missions establish performance management systems to measure progress towards their intended strategic objectives. The *DCA Operations Manual* requires monitoring utilization targets, visiting partner banks annually, and de-obligating subsidy funds when funds will not be used.[9] However, at several of the missions audited, guarantees were not fully monitored. Two missions had either not established or monitored utilization targets, and also had unused subsidies that could potentially be put to better use. Additionally, one of these missions did not conduct the required bank site visits. The lack of monitoring occurred because USAID guidance did not clearly articulate roles and responsibilities related to establishing and monitoring utilization targets or reviewing unused subsidies. As a result, USAID's ability to monitor and track progress towards achieving intended results was limited, and funds that could be used to extend credit in targeted underserved sectors were not being used for their intended purpose.

ADS 203, *Assessing and Learning*, states that missions are responsible for establishing systems to measure progress towards their intended strategic objectives. Additionally, ADS 200, *Introduction to Managing for Results*, defines performance management as, "…the systematic process of monitoring the results of activities; collecting and analyzing performance information to track progress toward planned results; using performance information to influence program decision-making and resource allocation; and communicating results achieved, or not attained, to advance organizational learning and tell the Agency's story."

However, at several of the missions audited, guarantees were not fully monitored, as discussed in the following sections.

Utilization targets were not always established or monitored – The *DCA Operations Manual* discusses both ODC and mission monitoring responsibilities. It states that although monitoring is a coordinated effort between the mission and the ODC, missions are solely responsible for development monitoring while the ODC and missions share responsibility for financial monitoring. The *Operations Manual* also identifies circumstances in which the ODC should contact the mission to address lack of loan portfolio guarantee utilization. Additionally, the *Operations Manual* requires missions to review utilization data annually, in preparation for the annual mission visit to partner banks, and explains mission responsibilities for conducting and reporting on these annual bank site visits.

Nevertheless, at two of the five missions audited, guarantees were not fully monitored.

[9] Utilization refers to the number and dollar amount of loans disbursed by a partner bank under a loan portfolio guarantee, and to funds disbursed under a bond guarantee.

For example:

- One mission had not established utilization targets for any of its guarantees, and therefore, could not determine if its partner banks were making progress toward planned results. Additionally, the Mission did not conduct the required annual bank site visits. (USAID/Uganda)

- One mission did not use its utilization targets for two of its three guarantees to monitor progress or take action on under-utilization in a timely manner. In addition, the Mission had not established targets for its third guarantee and the guarantee had not been utilized. Although both Mission and ODC staff conducted site visits to the partner bank, no remedial action was taken to resolve collateral problems identified as the cause for the lack of utilization. (RDM/Asia)

The lack of monitoring occurred because USAID guidance did not clearly articulate roles and responsibilities related to establishing and monitoring utilization targets or reviewing unused subsidies. Furthermore, at one mission, staff focused on using its guarantees by the end of the agreement period rather than by interim dates and stated that it was not aware that bank site visits needed to be conducted. Another mission did not have procedures to detect and resolve performance issues.

The underlying reason for the confusion over establishing and monitoring utilization targets was that DCA guidance does not clearly articulate these roles and responsibilities. For example, although the *Operations Manual* states that missions need to review the most current utilization data in preparation for their annual bank site visit, it does not require missions to compare actual utilization against targets or to take action to resolve utilization issues discussed during the site visit. Instead, it indicates that the ODC would contact missions to address under-utilization, apparently shifting responsibility from the missions to the ODC. In addition, the *Operations Manual* does not state who is responsible for establishing targets, although it does state that ODC will verify the targets semiannually.

The lack of clearly delineated monitoring roles and responsibilities hampered USAID's ability to fully monitor its guarantees. As a result, USAID's ability to track progress towards achieving intended results was limited. Accordingly, we are making the following recommendation to strengthen the monitoring of USAID's guarantee utilization.

> *Recommendation No. 3: We recommend that the Director of the Office of Development Credit clarify roles and responsibilities related to establishing and monitoring guarantee utilization targets in its Development Credit Authority guidance.*

Unused subsidies were not always reviewed – The *DCA Operations Manual* states that if either all or a portion of the subsidy funds in the DCA program account will not be used, the mission should consider de-obligating the funds.[10] This de-obligation allows

[10] DCA subsidies represent the estimated long-term cost to the U.S. Government of a loan guarantee, including claim payments on any defaulted loans. Subsidies are calculated using OMB risk models and are set aside, i.e., obligated, in a holding account until the guarantee is utilized.

the mission to use the subsidy funds for another guarantee.

Reviewing the unused subsidies should be an integral component of monitoring guarantee utilization. However, two of the five missions audited had unused subsidies that could potentially be put to better use. For example:

- One mission had set aside $535,000 in subsidy funds, of which approximately only 34 percent had been used for its guarantees. In addition, it was becoming increasingly difficult for the partner banks to extend credit under these guarantees due to the expiration date of the guarantee agreement. (RDM/Asia)

- Another mission had unused subsidies totaling more than $105,000, which were not expected to be used for the original guarantee. (USAID/Uganda)

The unused subsidies had not been de-obligated because one mission had not reviewed its unused subsidies while the second mission had not completely understood the de-obligation process.

As a result, funds that could be used to extend credit in targeted underserved markets were not being used for their intended purpose. To ensure that subsidies do not remain unnecessarily idle, we are making the following recommendation.

Recommendation No. 4: We recommend that the Director of the Office of Development Credit issue guidance that missions review their unused subsidies, as part of the ongoing monitoring process, to determine whether they can be de-obligated and put to better use.

EVALUATION OF MANAGEMENT COMMENTS

In its response to our draft report, USAID's Office of Development Credit (ODC) concurred with all four recommendations and described planned actions to address our concerns. As a result, management decisions have been reached on all four recommendations.

To address Recommendation No. 1, during fiscal year 2007, ODC plans to expand its biennial review procedures to include a broader sample of loans to test for a limited number of eligibility requirements. More specifically, the biennial reviews will include a larger quantity of loans than currently checked, with the eligibility criteria for each review limited to a few clauses of a guarantee agreement's loan eligibility definitions. Accordingly, a management decision has been reached on this recommendation.

To address Recommendation No. 2, during fiscal year 2007, ODC plans to clarify additionality requirements in Automated Directives System 249, the Development Credit Authority (DCA) Operations Manual, and in its DCA Monitoring Plan Template—which is customized for each proposed DCA guarantee. Accordingly, a management decision has been reached on this recommendation.

To address Recommendation No. 3, during fiscal year 2007, ODC plans to more clearly define mission and ODC procedures regarding establishing and managing utilization targets in revisions to the DCA Operations Manual and DCA Monitoring Plan referred to in the paragraph above. Accordingly, a management decision has been reached on this recommendation.

To address Recommendation No. 4, during fiscal year 2007, ODC plans to issue guidance regarding mission review of unused subsidies. This guidance will be linked to the utilization target procedures described in the paragraph above. Accordingly, a management decision has been reached on this recommendation.

Management comments are included in their entirety in Appendix II.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted audits at five USAID missions in accordance with U.S. generally accepted government auditing standards. These audits were designed to determine if USAID managed its Development Credit Authority (DCA) guarantees to ensure that selected intended results were achieved.

In planning and performing these audits, the effectiveness of internal controls related to DCA guarantees was assessed. Pertinent internal controls were identified, such as (1) procedures for managing and monitoring DCA guarantees, (2) partner banks' procedures regarding DCA loan approvals and payments, and (3) missions' annual self-assessments of internal controls in accordance with the Federal Managers' Financial Integrity Act. Relevant criteria included USAID's Automated Directives System 249, *Development Credit Authority*; USAID's Office of Development Credit's *DCA Operations Manual*; and Office of Management and Budget Circular No. A-129, *Policies for Federal Credit Programs*.

In answering the audit objective for four of the five mission audits, the audit scope included mission guarantees as of September 30, 2005. However, due to the timing of the audit conducted at USAID/Bulgaria—it was the first of the five audits conducted—its audit scope included DCA guarantees as of September 30, 2004, rather than 2005. The five missions audited accounted for a total of 26 guarantees—24 loan portfolio guarantees, 1 bond guarantee, and 1 loan guarantee. We performed audit work on 14 of these 26 guarantees. There were no prior audit findings affecting the areas reviewed in these audits.

The following selected intended results were reviewed to determine whether:

- Utilization targets were achieved.
- Guarantees supported strategic objectives specified in the proposal approved by USAID's Credit Review Board.
- Guarantees contributed to achieving one or more of the mission's strategic objectives, as evidenced by inclusion in the mission's most recent annual report.
- Loans were made to qualified borrowers for qualified projects, as specified in the guarantee agreement.
- Activities funded by guarantees represented the intended loan purpose stipulated in the partner banks' loan files.
- Biennial reviews were appropriately performed.
- Utilization fees were current.[11]

[11] This intended result was not included in the scope at USAID/Bulgaria.

This report summarizes the audit work conducted at USAID offices in Washington, D.C. and at five USAID missions. Audit fieldwork was conducted from January 2005 to February 2006 at:

- USAID/Washington from January 2005 to May 2005 and from July 5 to August 16, 2005, and at USAID/Bulgaria—in Sofia and at various bank office locations and borrowers' sites in Bulgaria—from June 2 to June 29, 2005.

- USAID/Regional Development Mission/Asia—at the Mission's country representative office in Vietnam and at various bank office locations and borrowers' sites throughout Vietnam—from October 4 to October 21, 2005.

- USAID/Guatemala—in Guatemala City, at the headquarters of two lenders in Guatemala City, and at various bank office locations and borrowers' sites throughout Guatemala—from October 11 to October 28, 2005.

- USAID/Uganda–-in Kampala and at various participating financial institutions in Kampala—from October 17 to October 28, 2005.

- USAID/Russia—in Moscow and at the headquarters of two lenders, in Moscow and Rostov-an-Don—from January 11 to February 3, 2006.

Methodology

To answer the audit objective, we performed detailed reviews of 14 of the 26 guarantees signed by the five missions at the time of our audits. The five missions were judgmentally selected based on a variety of factors, including the number, dollar, and type of guarantees. In doing so, we conducted interviews with mission staff, managers and loan officers at partner banks, and borrowers. In addition, we performed detailed reviews of 134 judgmentally selected loan files at partner banks' headquarters and branch offices.

We also conducted interviews with mission staff regarding interaction with USAID's Office of Development Credit, bank and borrower site visits, and other monitoring activities. We reviewed pertinent guarantee agreements and loan documentation maintained at mission offices and partner banks, and conducted over 50 site visits to selected borrower locations to observe activities funded by the DCA guaranteed loans. Additionally, we conducted interviews with USAID/Washington staff in both the Office of Development Credit and Office of Financial Management/Loan Management Division.

To answer the audit objective, we established the following materiality thresholds:

- If at least 90 percent of the selected intended results were achieved, the answer to the audit objective would be positive.

- If at least 80 percent, but less than 90 percent, of the selected intended results were achieved, the answer to the audit objective would be qualified.

- If less than 80 percent of the selected intended results were achieved, the answer to the audit objective would be negative.

MEMORANDUM

TO: IG/A/PA, Steven H. Bernstein

FROM: AA/EGAT, Jacqueline E. Schafer /s/

THRU: EGAT/DC, John E. Wasielewski /s/

SUBJECT: Management Comments for Draft Report on Audit of USAID's Development Credit Authority (Report No. 9-000-06-XXX-P)

The USAID Office of Development Credit (EGAT/DC) appreciates the opportunity to respond to the draft audit report. EGAT/DC accepts the audit report's recommendations and will take action to implement the recommendations. Furthermore, we request IG/A/PA acceptance of our management decision in response to the four recommendations outlined below.

Recommendation No. 1: EGAT/DC accepts this recommendation to develop and issue policies and procedures to improve the verification of loan eligibility issued under loan portfolio guarantees. EGAT/DC acknowledges that three out of the five Mission-based audits of DCA guarantees identified several loans that were ineligible for DCA guarantee coverage, e.g., borrower asset sizes and loan amounts that exceeded limits established in the respective guarantee agreements. However, EGAT/DC attests that it has more precise and in-depth procedures in place to confirm loan eligibility prior to the payment of a claim in case of a loan default, which is more critical in terms of USAID risk exposure. Nevertheless, it is important to improve loan eligibility to further ensure optimal use of loan portfolio guarantees for borrowers intended to benefit from the extension of credit via a DCA guarantee. In FY2007, EGAT/DC will further expand biennial review procedures to include a broader sample of loans to test for a limited number of eligibility requirements. More specifically, the biennial review will include a larger quantity of loans than currently checked, but the eligibility criteria for each review will be limited to a few clauses of a guarantee agreement's loan eligibility definitions.

Recommendation No. 2: EGAT/DC accepts this recommendation to clarify additionality requirements for loan portfolio guarantees in ADS 249 as well as in supporting guidelines developed by EGAT/DC. These guidelines include but are not limited to a revision of the DCA Operations Manual in FY2007, as well as an updated template for the DCA Monitoring Plan to be customized for each proposed DCA guarantee in FY2007. In the ADS 249 revision, the aforementioned clarification will more clearly describe that loan portfolio guarantee additionality is intended to be realized at an aggregate level and not on a loan-by-loan basis. In other words, objectives related to ensuring additionality for a loan portfolio guarantee should pertain to widening access to credit to a new group of potential borrowers. This objective will be measured via more standardized review procedures to be conducted by EGAT/DC throughout the life of the guarantee. These revised procedures will be reflected in the updated versions of the Operations Manual and Monitoring Plan.

Recommendation No. 3: EGAT/DC accepts this recommendation to clarify roles and responsibilities between EGAT/DC and Missions as they pertain to the formation and management of utilization targets. In the two cases mentioned in the draft audit report in which missions were not actively managing utilization targets, it should be noted that both missions began to actively use utilization targets in FY2006. Procedures for EGAT/DC and Mission will be more clearly defined in the revised version of the DCA Operations Manual and the DCA Monitoring Plan.

Recommendation No. 4: EGAT/DC accepts this recommendation to issue more precise guidance on how and when EGAT/DC should advise USAID missions to review unused subsidies related to under-utilized DCA guarantees. This guidance will be closely linked to the utilization target procedures mentioned in Recommendation No. 3. Further, the DCA Operations Manual will provide more detailed instructions on the timing and extent of EGAT/DC recommendations for missions to review unused subsidies, keeping in mind that the termination and/or reduction of DCA guarantee facilities is often considered as a last resort when there is no possible expectation that the guarantee can be revitalized.

The USAID Office of Development Credit would like to express its appreciation to the USAID Office of Inspector General for its acceptance of the management decisions pertaining to these four recommendations. Please do not hesitate to ask for additional information. EGAT/DC would like to thank you and your staff for your hard work in developing an extremely useful report that will enhance USAID monitoring compliance of its DCA guarantees.

SUMMARY OF AUDIT RECOMMENDATIONS

Table III-1: Audit Recommendations by Type

	Mission/Operating Unit Audited					
Recommendation	**USAID/ W[12]**	**Bulgaria**	**RDM/ Asia**	**Guatemala**	**Uganda**	**Russia**
Calculate and collect interest from the U.S. Treasury on USAID's DCA financing account	✓					
Ensure that future interest is calculated and collected in a timely manner	✓					
Develop an action plan to utilize a bond guarantee				✓		
Establish utilization targets and/or evaluate progress toward reaching targets			✓		✓	
Establish performance indicators in the Mission's Performance Monitoring Plan				✓		
Obtain performance information on a bank-to-bank loan						✓
Review loan and borrower eligibility			✓			✓
Restrict loans to qualified borrowers who would not otherwise qualify for other loans offered by the lender						✓
Conduct periodic site visits to banks and borrowers					✓	
Document, track, and promptly resolve significant problems identified during bank site visits			✓			
De-obligate funds for unused or underused loan portfolio guarantees so that the funds can be used for another guarantee			✓		✓	
Identify and address banks' needs for technical assistance			✓			
Inform banks to provide sufficient information to the Mission for loans made under a loan portfolio guarantee					✓	

[12] USAID/W refers to USAID/Washington.

Table III-2: Recommendations by Mission/Operating Unit Audited

Mission/ Operating Unit Audited	Recommendation	Status as of June 30, 2006
USAID/W Report No. 9-000-05-001-S	✓ Calculate and collect interest from the U.S. Treasury on its guarantee financing account ✓ Ensure that future interest is calculated and collected in a timely manner	Management decision reached Management decision reached
Bulgaria Report No. 9-183-06-002-P	No recommendations	
RDM/Asia Report No. 5-440-06-004-P	✓ Establish cumulative utilization targets for its student loan portfolio guarantee; develop and implement procedures to regularly report on utilization ✓ Use established cumulative utilization targets to monitor and evaluate the performance of loan portfolio guarantees ✓ Document, track, and promptly resolve significant problems afftecting loan guarantee performance identified in bank site visits ✓ Examine its SME loan portfolio guarantees to determine if subsidy funds can be deobligated and put to better use ✓ Periodically review eligibility of loans under its loan portfolio guarantees ✓ Establish a plan of action that identifies the areas where its partner banks need technical assistance and includes milestones to provide the needed technical assistance	Management decision reached Management decision reached Management decision reached Management decision reached Management decision reached Management decision reached
Guatemala Report No. 1-520-06-002-P	✓ Establish achievable and realistic performance indicators and targets in its Performance Monitoring Plan ✓ Request an action plan that includes a timeline of necessary steps to utilize its bond guarantee	Final action taken Final action taken

Table III-2, Continued: Recommendations by Mission/Operating Unit Audited

Mission/ Operating Unit Audited	Recommendation	Status as of June 30, 2006
Uganda Report No. 4-617-06-004-P	✓ Develop interim utilization goals for loan portfolio guarantees to better monitor and evaluate their progress	Management decision reached
	✓ Develop procedures (including loan file reviews) to require and document periodic site visits to banks and borrowers	Management decision reached
	✓ Provide banks with details of what loan information—especially related to eligibity and collateral—should be included with the notification letter sent to the Mission for loans made under a loan portfolio guarantee	Management decision reached
	✓ De-obligate $100,000 in subsidy funds associated with the reduction in the loan portfolio amount for one inactive bank	Management decision reached
	✓ De-obligate $5,317 in subsidy funds related to the unused loan guarantee for one inactive bank	Management decision reached
Russia Report No. 8-118-06-002-P	✓ Modify its standard loan portfolio guarantee agreement to include provisions requiring that guaranteed loans be restricted to qualified borrowers who would not qualify for other loans offered by the lender	Management decision reached
	✓ Increase the extent of testing performed during site visits in verifying that borrowers meet eligibility requirements	Management decision reached
	✓ Obtain performance information for its bank-to-bank guaranteed loan	Final action taken

WORLDWIDE AUDIT REPORTS ISSUED

The following six reports were issued as a part of the worldwide audit of USAID's Development Credit Authority. They are available at USAID's website at http://www.usaid.gov/oig/public/aud_usaid.htm.

Report No. 9-000-05-001-S, *Memorandum Regarding the Calculation and Collection of U.S. Treasury Interest on the Development Credit Authority Guarantee Financing Account*, July 21, 2005.

Report No. 9-183-06-002-P, *Audit of USAID/Bulgaria's Development Credit Authority*, October 25, 2005.

Report No. 1-520-06-002-P, *Audit of USAID/Guatemala's Development Credit Authority*, January 11, 2006.

Report No. 4-617-06-004-P, *Audit of USAID/Uganda's Development Credit Authority*, February 13, 2006.

Report No. 5-440-06-004-P, *Audit of USAID Regional Development Mission/Asia's Development Credit Authority*, May 11, 2006.

Report No. 8-118-06-002-P, *Audit of USAID/Russia's Development Credit Authority*, May 22, 2006.

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