OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/ROMANIA'S MICROENTERPRISE ACTIVITIES

AUDIT REPORT NO. 8-186-07-003-P
July 10, 2007

FRANKFURT, GERMANY

Office of Inspector General

July 10, 2007

MEMORANDUM

TO: USAID/Romania, Acting Mission Director, Debi Mosel

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

SUBJECT: Audit of USAID/Romania's Microenterprise Activities
(Report Number 8-186-07-003-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments on the draft report, making changes where appropriate, and have included your comments in their entirety in Appendix II. The report contains no recommendations.

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

USAID/Romania's micro, small and medium enterprises (MSME) loan program was designed to: improve the legal and regulatory environment for MSMEs; promote MSME competitiveness and exports; and increase MSME access to credit. This audit was conducted by the Regional Inspector General in Frankfurt, Germany (RIG/Frankfurt) as part of a worldwide audit of USAID's microenterprise activities led by the USAID Office of Inspector General's Performance Audit Division in Washington, D.C. The objectives of this audit were to determine if USAID/Romania's microenterprise (i.e., micro-finance) activities were implemented efficiently and had achieved planned results. (See page 2.)

USAID/Romania's $4.1 million MSME loan program, managed by the Mission's primary implementing partner—Cooperative Housing Foundation International (CHF), was being efficiently implemented as evidenced by CHF's ability to carry out its loan activities in a cost efficient and sustainable manner, which was a credit to both CHF's performance as well as the Mission's monitoring and oversight of these activities. Due to CHF's effective management of its loan operations, for example, the MSME loan program was able to soon generate sufficient revenue to cover its own operating expenses by charging market interest rates and commissions and maintaining a low risk loan portfolio. This, in turn, established the foundation for a self-sustaining entity and led to the formation of an independent lending institution that was no longer reliant on USAID resources, by the end of fiscal year (FY) 2005. The Mission assisted in this effort by proactively monitoring the status of the MSME loan program's activities, which allowed the Mission to identify potential implementation issues and adjust to changing conditions. As a result of the program's efficient implementation, and in preparation for the scheduled closure of the Mission in FY 2008, the Mission ceased further funding of the loan program at of the end of FY 2005. (See page 3.)

In addition to being efficiently implemented, the Mission's MSME loan program was able to successfully achieve its planned results. During FY 2005, for example, the program exceeded six of the eight MSME loan objectives established for that fiscal year while making substantial progress in achieving the remaining two objectives. In addition to meeting the targets specified for that year, the loan program achieved its overall planned program objectives as of March 2007. Thanks to these results, reflecting the Mission and CHF's efforts, the MSME loan program was able to increase access to credit within Romania and establish a self-sustaining financial institution that was well positioned to continue to make additional credit available to existing and new MSMEs in future years. (See page 5.)

This report does not include any recommendations to be addressed by the Mission.

In its response, USAID/Romania concurred with the report's findings and conclusions and indicated that the audit produced valuable information for the Agency that should be considered for the benefit of future microenterprise programs.

Management comments are included in their entirety in Appendix II. (See page 15.)

BACKGROUND

Since the fall of communism in Romania, micro, small and medium enterprises (MSMEs) have been the engine of private sector growth and key to the creation of jobs for those laid off during privatization and as a result of the restructuring of state companies. Since the early 1990's, however, MSMEs have had little capital to invest in modern equipment and technologies to improve their productivity. Despite the availability of financing from Romanian banks during this period, few MSMEs have had access to this credit as they often could not meet the documentation or collateral requirements required to secure traditional bank loans. Further, banks generally perceived the costs and risks associated with MSME lending as being too high, thereby discouraging most banks from marketing loan products to this sector.

In FY 2003, USAID/Romania signed a cooperative agreement with Cooperative Housing Foundation International (CHF) to, among other things, provide funding for operational expenses related to creating a self sustaining non-banking financial institution (NBFI) that would provide MSMEs with access to credit. This agreement included a commitment by CHF to charge commissions and interest to recoup operating expenses and to establish a self-sustaining NBFI, by the end of FY 2007, that was no longer reliant on USAID funds for operating expenses. In FY 2005, CHF created Express Finance and in FY 2006 initiated the transfer of assets and liabilities to this newly-formed NBFI, including CHF's loan portfolios (previously maintained by CHF) as well as employee staff and field offices.

USAID/Romania ceased funding CHF's MSME operating expenses at the end of FY 2005, but will continue to fund other microenterprise (non-loan) activities through the end of the agreement which ends on September 30, 2007. Operational expenses funded under the agreement, through FY 2005, totaled $2.5 million. With regards to the MSME loan activities, USAID funding under the cooperative agreement was limited to assistance to cover operational expenses and did not include any funds to be used as loan principal.

AUDIT OBJECTIVES

This audit was performed as part of a worldwide audit of USAID's microenterprise activities led by the USAID Office of Inspector General's Performance Audit Division in Washington, D.C. The Regional Inspector General in Frankfurt, Germany conducted this audit to answer the following questions:

- **Did USAID/Romania implement its microenterprise activities efficiently?**

- **Did USAID/Romania's microenterprise activities achieve planned results?**

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

AUDIT FINDINGS

Did USAID/Romania implement its microenterprise activities efficiently?

USAID/Romania's micro, small, and medium enterprises (MSME) loan program activities were implemented efficiently, as evidenced by (1) the ability of Cooperative Housing Foundation International (CHF)─the Mission's primary implementing partner─to carry out its loan activities in a cost efficient and sustainable manner; and (2) the Mission's close monitoring and oversight of these activities. These are discussed in further detail below.

Operational Efficiency

CHF's MSME loan operations were considered to be efficiently implemented as reflected by several ratios used to measure performance efficiency. These included the (1) operating expense ratio, (2) loan write-off ratio, and (3) operational sustainability ratio.

- **Operating Expense Ratio**: For FY 2004, the MSME loan portfolio administered by CHF was considered operationally efficient based on its operating expense ratio which measures the ratio of the organization's operational cost to the average value of its outstanding loan portfolio. Policy guidance contained in USAID's Automated Directives System (ADS) 219, under mandatory reference 200-203, states that for a loan program to be considered operationally efficient, its annual non-financial cost should not exceed 30 percent of the average value of its loan portfolio after a start-up period of roughly three years. By the end of FY 2004─the second year of operation─CHF attained an operating expense ratio of 27.1 percent; and by the end of FY 2005, it was down to 22.1 percent.

- **Loan Write-off Ratio**: This ratio represents the percentage of the loan portfolio that has been written off because the loans are unlikely to be repaid. At the end of FY 2004, CHF's write-off ratio was .0 percent, meaning that no loans were written off; and in FY 2005, it was 0.1 percent. Industry benchmarks for FY 2004 could not be obtained; in FY 2005, however, the industry benchmark was 0.7 percent. By keeping the write-off ratio low, CHF was able to collect the principal and interest for most of its loans, thereby maximizing the amount of funds available for additional loans so as to generate additional revenue.

- **Operational Sustainability Ratio**: Besides maintaining low operating expense and loan write-off ratios, CHF was able to become operationally self-sustaining. The operational sustainability ratio measures whether a nonbanking financial institution (NBFI) can recover all of its administrative expenses through the interest, commissions and late fees it charges. The ratio is calculated by dividing the amount of revenue generated (through commissions, interest, and late fees) by operational expenses. A ratio of 100 percent (or larger) indicates that an NBFI is covering its expenses (or earning a profit). At the end of FY 2004, CHF's operational sustainability ratio was 81.69 percent; by the end of FY 2005, this ratio had risen to 109.5 percent, which enabled the Mission to cease funding CHF's operational costs for MSME loan program activities at that time.

Mission Monitoring

The Mission's monitoring also contributed to the efficient implementation of the MSME loan program. The Mission closely monitored its loan activities by maintaining regular contact with CHF staff as well as through site visits, review of CHF's quarterly performance reports, and semi-annual portfolio reviews, all of which enabled the Mission to manage the program in a proactive manner. Since the start of the program in FY 2003, the Mission has been performing site visits to the CHF home office in Timisora, Romania and branch offices in other Romanian counties. During these site visits, the Mission reviewed CHF's loan portfolio growth strategies, verified data contained in the quarterly reports, discussed implementation issues with CHF, and visited MSME loan recipients. During one site visit in FY 2003, for example, the loan officers' salaries were discussed with CHF staff because the Cognizant Technical Officer (CTO) noticed a high turnover of loan officers. The Mission recommended that CHF adjust the salaries for loan officers to match the local market so it would be able to retain its highly trained staff who were being recruited by local banks. Based on the Mission's recommendation, CHF increased the salary of its loan officers and introduced a new bonus system starting in FY 2003 that contributed to a higher retention rate.

In addition to site visits, the Mission monitored the program by actively reviewing CHF's quarterly performance reports and discussing concerns with CHF. Early in the program, for example, the CTO identified some data quality issues while reviewing one of the quarterly reports and discussed these with CHF. This prompted the development of a revised reporting mechanism which provided more accurate and consistent data in future quarterly reports. In addition to containing copies of CHF's quarterly performance reports, the official program files included correspondence documenting key decisions and significant issues discussed with CHF. Finally, the files showed that the Mission was performing required semi-annual portfolio reviews so as to evaluate the progress achieved to date, discuss implementation issues, and initiate appropriate corrective actions where needed. Based on the level of oversight provided, the Mission was able to closely monitor the status of activities and adjust to changing conditions as needed.

Photo of workers at a fertilizer factory in Timisoara, Romania putting fertilizer in plastic containers purchased with a short-term MSME loan. May 2007

Did USAID/Romania’s microenterprise activities achieve planned results?

USAID/Romania’s micro, small and medium enterprise (MSME) loan program activities achieved their planned results. During FY 2005, the most recent—and also final—year in which the program received funding to support operational expenses for the MSME loan activities, the program exceeded six of the eight planned objectives specified for that fiscal year while making substantial progress in achieving the remaining two. In addition to meeting its targets for that fiscal year, the Mission’s MSME loan program had achieved its overall program objectives, established at the inception of the program, as of March 2007. Further details on these results are discussed in the paragraphs below.

Achievement of FY 2005 Results

CHF’s annual work plan for FY 2005, approved by the Mission on December 6, 2004, specified eight planned results or targets relating to its MSME loan program activities. CHF achieved these planned results, exceeding annual targets specified for six of the eight areas while substantially achieving desired results for the remaining two. A comparison of planned and actual results for FY 2005 is summarized in Table 1 below.

Table 1. Planned vs. Actual Results for FY 2005

Planned Results	FY 2005 Target	FY 2005 Actual
Loan Dollars Disbursed	$ 6.0 Million	$10.5 Million
Number of Loans Disbursed	1,000	1,495
New Sources of Capital	$ 2.0 Million	$3.6 Million
Operational Sustainability	100 %	109.5 %
Portfolio at Risk Over 30 Days	Under 3 %	1.22 %
Principal Outstanding as of September 2005	$ 6.2 Million	$ 7.8 Million
Percentage of Program Loans Targeted for Women Owned Businesses	40.00 %	37.59%
Jobs Created and Sustained	10,000	8,375

Loan Dollars Disbursed: For FY 2005, the Mission’s target was for CHF to disburse $6 million in loans. By the end of FY 2005, CHF exceeded the target by $4.5 million having disbursed a total of $10.5 million in loans, ranging in size from $1,000 to $20,000—the maximum allowed under the program.

Number of Loans Disbursed: CHF's work plan also specified a target of 1,000 loans to be processed and disbursed in FY 2005. CHF disbursed 1,495 loans by the end of the fiscal year, exceeding its target by almost fifty percent. These loans varied in length and included short term loans of 3 months as well as longer term loans up to the maximum repayment period of 36 months. Interest on these loans was usually set at 16 percent; however, repeat clients received discounts on commissions and interest rates. For example, an individual seeking a second loan received a reduced interest rate of 15 percent and a flat commission of 2 percent irrespective of the size of the loan. Table 2 below provides a breakdown of the loans disbursed in FY 2005 by payment terms.

Table 2. Number of Loans Disbursed in FY 2005

Repayment Period	Number of Loans
3 months or less	227
6 to 12 months	229
15 to 24 months	928
25 to 36 months	111
Total	**1495**

New Sources of Capital: For FY 2005, the Mission's target was for CHF to raise $2 million dollars in new capital to help with the expansion of the MSME loan program. CHF was able to meet this goal and secured a total of $3.6 million in new capital from two international sources. Obtaining this capital was considered a significant accomplishment for two reasons. First, it indicated that international organizations recognized CHF as a viable financial institution capable of administering loans for the MSME market. Second, it provided evidence of the MSME loan program's potential sustainability by showing that MSME activities were no longer solely reliant on USAID funds for further expansion and could attract investment capital from other sources to finance future expansion into additional Romanian counties.

Operational Sustainability: As mentioned in the preceding section of this report, the operational sustainability ratio measures whether a non-banking financial institution (NBFI), such as CHF, can recover all of its administrative expenses through the interest, commissions and the late fees it charges. This ratio is considered a measure of financial capability and is calculated by dividing the revenue generated by the NBFI by its operational expenses. A ratio of 100 percent (or larger) indicates that an NBFI is covering its expenses (or earning a profit). By the end of FY 2005, at which time USAID/Romania planned to cease its funding of MSME loan activities, the Mission planned for Express Finance (the CHF-established NBFI) to be operationally self-sustaining (i.e., reach a sustainability ratio of at least 100 percent). By the end of FY 2005, the Mission successfully achieved this result as reflected by Express Finance's sustainability ratio, which was computed to be 109.5 percent.

Portfolio at Risk Over 30 Days: This ratio measures the percentage of loan principal that is at risk due to late payments. This ratio takes into account the amount of loan principal outstanding for loans past due over 30, 60, or 90 days and is considered a measure of the NBFI's level of risk and liquidity. The Mission used this ratio to monitor the status of CHF's loan portfolio, focusing on loans that were more than 30 days past due, and intended for CHF to maintain a risk ratio below 3 percent. For each quarter of FY 2005, CHF's portfolio at risk ratio never exceeded 3 percent and, as shown in Table 3 below, dropped to 1.22 percent by the end of the fiscal year.

Table 3. Portfolio at Risk Ratios for Loans Past Due Over 30 Days For FY 2005 (by Quarter)			
1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
3.00 %	1.78%	2.04%	1.22%

Principal Outstanding as of September 2005: The amount of loan principal outstanding measures the level of credit the program has made available to the MSME sector and is currently in the economy. The Mission planned for the total outstanding balance of loan principal to be $6.2 million as of the end September 2005. The actual outstanding balance was reported to be $7.8 million, exceeding the planned target.

Percentage of Program Loans Targeted for Women-owned Businesses: Although the Mission monitored the percentage of loans provided to women-owned businesses by tracking the number of loans and amount of dollars disbursed to these entities, the Mission considered the number of loans disbursed as more relevant since it showed the raw number of women-owned businesses assisted by the program. During FY 2005, women-owned businesses received 37.59 percent of the total loans disbursed for the year (562 of 1,495), just under the Mission's planned target of 40 percent, which we considered sufficient to conclude that this target had been substantially achieved.

Jobs Created and Sustained: This data was based on information obtained from loan recipients during the loan application process whereby recipients were asked to indicate the number of jobs the loan would create, as well as the number of employees it would help sustain. Since applicants did not always indicate the full number of jobs created and sustained, either as a result of misunderstandings on who should be included in the count or concerns that reporting the actual number might prompt further inquiries by the local government, this data was viewed by both CHF and the Mission as representing conservative estimates. Both CHF and the Mission's CTO recognized the possibility that actual figures could vary from these estimates (i.e., actually be higher), but this was considered the most practical way of compiling the data. Although neither CHF nor the Mission performed formal tests to validate this data, both stated that they checked the estimates against the progress reported under other indicators, such as the number of loans and dollars disbursed, to determine whether the job estimates appeared to be in line with trends reflected in the other indicators.

During FY 2005, CHF estimated that 8,375 jobs were created and sustained (7,800 sustained plus 575 created) as a result of USAID-funded MSME loan activities. Based on this estimate, we determined that the Mission had made substantial progress towards achieving the planned target of 10,000 jobs created and sustained.

We noted, however, that the number of jobs created and sustained in FY 2005 that was reported in the Mission's FY 2006 annual report was slightly overstated and not consistent with the supporting data reported by CHF. Specifically, the Mission's annual report indicated its MSME program helped create an additional 525 jobs while sustaining 8,375 jobs or a total of 8,900 jobs created and sustained, whereas CHF had previously reported that program activities had resulted in a total of only 8,375 jobs “created and sustained” (7,800 jobs sustained and 575 jobs created). As a result, the number of jobs reported as created and sustained was overstated by 525 jobs (8,900 minus 8,375). This discrepancy occurred as a result of an administrative error during the preparation of the Mission’s annual report after the data had been received from CHF and forwarded to the Mission’s program office. Since this error was not determined to have a material impact on the overall results reported and was correctly reported in the Mission’s FY 2006 Congressional Budget Justification, we are not issuing a formal recommendation on this issue. Nevertheless, we believe this discrepancy highlights the need for missions to take appropriate steps to ensure that the data included in its annual reports is reviewed for accuracy.

Achievement of Program Objectives

In addition to meeting its planned results for FY 2005, USAID/Romania’s MSME loan program activities had achieved their overall program objectives by FY 2007—the final year of CHF’s implementation of the program under its cooperative agreement. Specifically, the program’s MSME loan activities exceeded four of its five original objectives, outlined in CHF’s December 2002 cooperative agreement, and made substantial progress toward achieving the remaining objective. The original program objectives and actual results through March 31, 2007 are summarized in Table 4 below.

Table 4. Planned Objectives vs. Actual Results

Description	Planned Objective	Actual Results (Thru March 2007)
Loan Dollars Disbursed	\$18 Million	\$40.6 Million
Number of Loans Disbursed	1,800	5,344
New Sources of Capital	\$7 Million	\$14.4 Million
Establishment of NBFI that is able to make loans to the MSME sector and operate as an independent (self sustaining) organization by building linkages between and among commercial credit providers, and leading financial institutions	Creation of a self-sustaining NBFI that participates in a micro finance coalition and can access outside capital	Express Finance awaiting approval to be registered as NBFI and participating in microfinance coalition
Percentage of Romanian counties having access to credit through loan program activities	Greater than 50%	60%

The impact of the MSME loan program's performance with regards to expanding the amount of credit available in the Romanian economy is reflected not only by the increase in the number and total dollar amount of loans disbursed, but also by the data appearing in Chart 1 (See chart below). This chart shows the significant increase in the balance of outstanding loan principal, resulting from MSME program loans, which grew from approximately $4.1 million at the start of the program in FY 2003 to almost $12 million by the end of the second quarter in FY 2007, tripling in volume during this four year period.

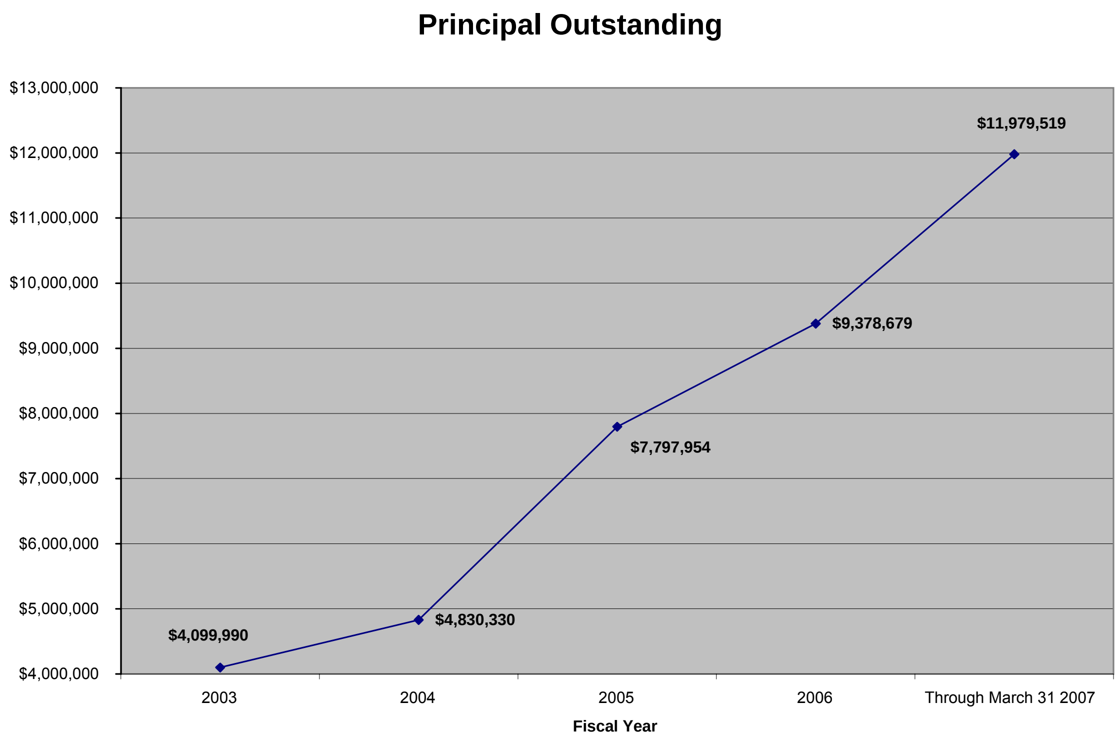

Chart 1: Chart showing the balance of outstanding loan principal (FY's 2003-2007)

In addition to expanding the amount of credit made available to MSMEs, another key objective of the Mission's MSME loan activities was to create a self-sustaining NBFI capable of continuing to provide MSMEs with access to credit without having to rely on USAID assistance. This financial institution was also expected to participate in the Romanian microfinance coalition which acts as a chamber of commerce for NBFIs by sharing information, such as best practices and training opportunities, and acting as a lobby for legislative reforms. In light of the Mission's scheduled closure in FY 2008, this objective became particularly important and critical. We determined that the objective, for the most part, had been achieved, as evidenced by the establishment of a financial institution (Express Finance) by the end of FY 2005 and its registration as an NBFI, with the National Bank of Romania, in May 2007. At the time of our audit, CHF had substantially completed efforts to transfer certain assets and liabilities, including loan portfolios and field offices, from its own operations, to Express Finance—a process expected to be completed by September 2007. In the meantime, Express Finance has become an integral part of an NBFI coalition that includes seven other NBFIs. Since this entity was considered self-sustaining, the Mission ceased its support of MSME loan operations at the end of FY 2005, while continuing to fund other microenterprise activities through the end of the CHF agreement which expires in September 2007.

The Mission's success in achieving its overall planned objectives for its MSME loan program is attributed to a variety of factors. First, the Mission was able to effect regulatory changes by the Romanian government that facilitated the creation and registration of new NBFIs. Prior to these changes, Romanian laws were such that only banks could issue loans which prevented MSMEs from having access to this capital since MSMEs were unable to meet the collateral requirements or provide the requisite documentation to secure a traditional bank loan. The Mission also assisted in revising the laws related to the registration of new businesses, allowing small businesses to register quicker, thereby increasing the pool of potential micro loan clients in Romania.

In addition to the change in the regulatory framework within Romania, CHF was able to take advantage of an improvement in the country's macro economic environment. In preparation for Romania's entrance into the European Union (EU), in January 2007, specific economic laws were changed which stabilized the economy and brought the country's double-digit inflation rates to below 5 percent. This improvement in the economy spurred smaller businesses to be created, further expanding the pool of potential micro loan clients.

The Mission also benefited from CHF's extensive experience operating in Romania and participation in earlier USAID microenterprise projects. Having maintained a presence in the country since the mid-1990s, CHF was one of the first NBFI's to be established when the Romanian government initially issued special provisions permitting NBFIs to be formed. This enabled CHF to acquire valuable experience in operating an NBFI in Romania before the current cooperative agreement was awarded. As early as the mid-1990's, CHF staff was already receiving training in the areas of business management, team building, and loan portfolio management. This early training provided CHF with a cadre of trained staff that was better prepared to manage the program's loan portfolio when the cooperative agreement was initiated in FY 2003.

Another contributing factor was that CHF generally operated in provincial counties where it was the only NBFI available. This gave the borrowers only one alternative to a traditional bank. Within these counties, CHF aggressively marketed its program and tailored the loan products to meet its client's needs. For example, some clients were primarily interested in short-term loans to meet working capital needs, such as taking advantage of temporary reduced prices being offered for raw materials and inventory. For these clients, CHF offered a short-term loan instrument to meet their needs.

According to the Mission's CTO, CHF also focused on developing clients, and not just issuing loans, with an emphasis on helping recipients develop business plans that look toward the future. This approach enabled CHF to develop a closer rapport with many of its clients and manage its loan portfolio more effectively. During interviews with loan recipients, several commented on how CHF was not only there to lend them money, but also to provide business advice. As a result of this level of support and assistance, these clients continued to seek loans from CHF despite the fact that they were paying slightly higher rates than those offered elsewhere. Clients also commented that they found the CHF loan paperwork process to be less cumbersome than what they experienced with traditional banks which resulted in more repeat business.

Finally, the loan program benefited from CHF's good performance record. Specifically, CHF was effective in actively competing for and obtaining additional capital investments. Likewise, CHF was able to demonstrate to other donors that they could efficiently manage a low risk loan portfolio while keeping administrative expenses in line. CHF's ability to contain administrative costs and reduce its loan portfolio risk added greatly to its operational sustainability. Since FY 2004, for example, CHF's loan write-off rate has been consistently below .5 percent and the loan repayment rate over 98 percent.

Together, these efforts have collectively contributed to the successful achievement of the MSME loan program's objectives. Thanks to the program's accomplishments, the Mission's program has been able to significantly increase access to credit within Romania, as well as to leave behind a financial institution that is well positioned to continue to make additional credit available to existing and new MSMEs in future years.

Photo of a worker at a factory in Timisoara, Romania making shoes from raw materials purchased with a short-term loan received through the MSME loan program. May 2007

EVALUATION OF MANAGEMENT COMMENTS

In its response to our draft report, USAID/Romania indicated that it concurred with the audit findings and conclusions and thanked the audit team for their thorough review. The Mission stated that the audit produced valuable information that should be considered for the benefit of future microenterprise programs. The Mission also provided suggestions for minor wording changes which we incorporated into the final report.

The Mission's comments are included in their entirety as Appendix II. (See page 15.)

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General in Frankfurt, Germany conducted this audit in accordance with generally accepted government auditing standards. The purpose of the audit was to determine whether USAID/Romania's microenterprise activities were being implemented efficiently and achieving their planned results. This audit was performed as part of a worldwide audit being led and coordinated by the Office of Inspector General's Performance Audits Division in Washington, D.C.

The scope of this audit was limited to the micro-finance component of USAID/Romania's microenterprise program, focusing specifically on the Mission's micro, small and medium enterprise (MSME) loan program. The Mission's primary implementing partner for this program was Cooperative Housing Foundation International (CHF), which operated under a cooperative agreement awarded in December 2002. Total funding obligated under this cooperative agreement was $15.6 million which included $4.1 million allocated for the MSME loan program to provide funding for operational expenses only, and did not include any funding to be used as loan principal. Although the Mission ceased its support of MSME loan operations at that end of FY 2005, the Mission continued to fund other microenterprise activities through the end of the CHF agreement which expires on September 30, 2007.

In planning and performing the audit, we assessed the Mission's management controls related to the implementation and monitoring of the MSME loan program. Specifically, we reviewed USAID/Romania's:

- Policies and procedures, as outlined in Mission Orders, related to program implementation and the monitoring of results.
- 2006 annual report reporting on FY 2005 results.
- Strategic plan for FYs 2003 to 2006 and related program documents.
- FY 2005 and 2006 Federal Manager's Financial Integrity Act (FMFIA) certification results.

We also reviewed CHF's management controls as they related to the implementation of its MSME loan program. Specifically the scope of this review included:

- Reviewing CHF's written procedures covering the issuance of MSME loans.
- Performing various analyses on a universe of 1,495 loans, totaling $10.5 million in disbursements made during fiscal year 2005.
- Verifying loan documentation supporting a judgmental sample of 17 loans disbursed in FY 2005.
- Interviewing eight MSME loan recipients in the cities of Timisora and Arad.

Finally, we considered relevant prior audit findings from similar audits completed at USAID/Egypt and USAID/Jordan. We performed our fieldwork at the USAID/Romania Mission in Bucharest, Romania and at the CHF home office located in Timisora, Romania, as well as at CHF's branch office in Arad, Romania. Fieldwork for the audit was performed from April 23 through May 18, 2007.

Methodology

In evaluating whether the MSME loan program was being implemented efficiently, we initially reviewed the Mission's approved strategic plan and related program implementation documents to ascertain if the Mission properly incorporated the MSME loan program in its planning process. In addition, we reviewed applicable policies, procedures and management controls related to managing for results and program implementation, including ADS 219 and related mandatory supplements; and Mission Orders 901, 1001, 1003 and 1004. We also interviewed CTOs, the implementing partner (CHF), and mission managers regarding their roles in implementing and monitoring the MSME loan program. We then evaluated the Mission's compliance with relevant program management controls and policies. Finally, to assess the efficiency of the MSME loan program, we reviewed a series of different ratios used to measure performance, identifying five that were deemed to be the most relevant to Romania's operating environment. Specifically, we reviewed and verified performance ratios relating to operating expenses, number of borrowers per loan officer, loans written off, active clients per staff member and cost per active client for fiscal years (FYs) 2004 and 2005, as they applied to CHF's loan operations. These ratios were then compared to industry benchmarks for similar institutions within Romania and Eastern Europe. Specifically, we used the benchmarks from the Shorebank Advisory Services' report on microfinance for 2004 and the Microfinance Information Exchange report for 2005.

To determine whether USAID/Romania's microenterprise (i.e., MSME loan) activities had achieved their planned results, we first compared CHF's cooperative agreement and modifications to its work plans to ensure consistency. We then reviewed the work accomplished as reported in CHF's quarterly progress reports and compared actual accomplishments against the planned results and targets specified in CHF's cooperative agreement and approved annual work plan for FY 2005. In addition to assessing progress towards planned results, we also conducted a sustainability analysis on CHF's loan operations which included assessing the number of active clients, the return on assets, the loan repayment rate, and the financial sustainability ratio.

In assessing whether the Mission's overall planned results were being achieved, we established a materiality threshold of 90 percent. That is, if at least 90 percent of the performance targets reviewed were either fully or substantially achieved, the answer to the audit objective would be positive. In assessing whether individual performance targets, such as number of loans issued, had been achieved, we applied an 80 percent threshold. In other words, if CHF had achieved less than 100 percent--but at least 80 percent--of its planned target during the audit period, CHF was judged to have made substantial progress towards achieving (or substantially achieved) its intended target.
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To test the validity of the computer processed used to answer both audit objectives including data reported by CHF in its quarterly progress reports, and financial data from CHF used in the calculation of our efficiency ratios, we:

- Tested loan data for selected recipients against supporting loan documentation.
- Verified a judgmental sample of financial data against supporting records.
- Verified the mathematical accuracy of reported ratios.
- Performed tests on CHF's loan database, including logical relationship and range tests, to verify if transactions were in compliance with CHF's written procedures.

MANAGEMENT COMMENTS

USAID | ROMANIA
FROM THE AMERICAN PEOPLE

memorandum

June 19, 2007

To: Regional Inspector General, Frankfurt, Gerard M. Custer

From: Debra I. Mosel, Acting Mission Director

Subject: Audit of USAID/Romania's Microenterprise Activities
(Report Number 8-186-07-003-P)

This memorandum is to transmit USAID/Romania's comments with regard to the draft audit report, and is in two parts. The first part relays overall comments, while the second part identifies minor corrections to be considered for the final report.

USAID/Romania thanks the Audit Team for their thorough review of the Mission's microenterprise activity implemented through CHF. Their diligence provided valuable information to the Agency to be considered in future microenterprise programs. The Mission appreciates that there were no findings or recommendations. This is important confirmation of what the Mission believed to be true about the microenterprise activity. The Mission takes seriously the point made about the non-material error in reporting of jobs created and sustained. The Mission has always had an Annual Report review process giving each office several opportunities to ensure final reporting is accurate. However, this example proves the need to strengthen that review process, an effort already undertaken by the Mission to ensure that all close-out reporting is accurate.

There are a few suggested changes by the Mission as follows:

1) (page 1, end of paragraph two) suggest to delete 'two years earlier than anticipated,' as the Mission did not plan to fund the loan program beyond FY 2005.

2) (page 4, 2/3 through first paragraph) suggest changing 'Contracting Technical Officer' to Cognizant Technical Officer.

3) (page 8, bottom) suggest footnote one be incorporated as the last sentence in the paragraph ending at the top of the page to show that the Mission did, in fact, report accurate numbers to Congress.

4) (page 13, bottom) correction to the spelling of Timisoara.

Again, the Mission thanks the Audit Team for their professionalism and diligence in completing this audit. It is important as USAID/Romania closes to ensure that the results and lessons learned from important projects are not lost. This audit is an important mechanism on its own, and as a means to maintain knowledge gained in Romania for future USAID programming.