



USAID
FROM THE AMERICAN PEOPLE

OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/CAR/KAZAKHSTAN'S MICROFINANCE ACTIVITIES

AUDIT REPORT NO. 9-901-07-008-P
September 24, 2007

WASHINGTON, DC



USAID
FROM THE AMERICAN PEOPLE

Office of Inspector General

September 24, 2007

MEMORANDUM

TO: USAID/Central Asia Regional Director, William Frej

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

SUBJECT: Audit of USAID/CAR/Kazakhstan's Microfinance Activities
(Report No. 9-901-07-008-P)

This memorandum transmits the Office of Inspector General's final report on the subject audit. We have carefully considered your comments on the draft report in finalizing the audit report and have included your response in Appendix II of the report.

This report contains four recommendations intended to strengthen USAID/CAR/Kazakhstan's microenterprise activities. Based on your comments and documentation provided, we consider that final action has been taken on all four recommendations.

Again, I want to express my appreciation for the cooperation and courtesy extended to my staff during the audit.

CONTENTS

Summary of Results	1
Background	2
Audit Objectives	3
Audit Findings	4
Did USAID/CAR/Kazakhstan implement its microenterprise activities efficiently?	4
ADS Eligibility Criteria Not Followed	5
Did USAID/CAR/Kazakhstan's microenterprise activities achieve planned results?	6
Some Performance Targets Were Not Realistic.....	8
Monitoring Needs Strengthening.....	8
Evaluation of Management Comments	11
Appendix I – Scope and Methodology	13
Appendix II – Management Comments	16
Appendix III – Definitions of Evaluation Criteria	19
Appendix IV – USAID/CAR/Kazakhstan Microfinance Organization Structure	20

SUMMARY OF RESULTS

This audit, performed by the Office of Inspector General's Performance Audits Division, is one in a series of individual worldwide mission audits of USAID's microfinance activities. The audit was conducted to determine whether USAID/Central Asian Republics (CAR)/Kazakhstan implemented its microenterprise activities efficiently and whether it achieved its planned results. (See page 3.)

With respect to the efficiency question, USAID/CAR/Kazakhstan has not, compared to industry standards, implemented its microenterprise activities efficiently, but it has improved its efficiency over the 4-year period, fiscal years 2003 to 2006. (See page 4.) Regarding the achievement of performance targets, USAID/CAR/Kazakhstan partially achieved its planned results. For its developing and expanding microfinance institutions (MFIs), USAID/CAR/Kazakhstan's microenterprise activities achieved four of the seven performance targets that the audit reviewed, while USAID/CAR/Kazakhstan's activities for its mature MFIs achieved five of its six targets that the audit reviewed. (See page 6.) Despite the progress reported, the audit identified opportunities to improve program efficiency and the achievement of performance targets. (See pages 6–10.)

This report includes four recommendations for the Central Asia Regional Director to (1) develop procedures to ensure that recipients provide the required commitment letter before the Mission signs microenterprise assistance agreements; (2) develop procedures to review annual targets for its microenterprise activities to ensure that performance targets are attainable and realistic; (3) develop procedures ensuring that written site visit reports are prepared to document the purpose and the results of each visit; and (4) develop a policy designating an alternate Cognizant Technical Officer (CTO) to assume these responsibilities when the CTO is detailed to another mission for any period of 3 months or longer. (See pages 6, 8, and 10.)

USAID/CAR/Kazakhstan did not agree with the overall conclusion reached on the first audit objective, but acted on the recommendations. We consider all recommendations closed upon report issuance. Appendix II contains USAID/CAR/Kazakhstan's comments and our evaluation of those comments.

BACKGROUND

USAID has included microenterprise activities in its strategy for economic development and poverty reduction. Microenterprises are small, informally organized commercial operations owned and operated mostly by the poor and constitute the majority of businesses in many countries. They account for a substantial share of total employment and gross domestic product, and they contribute significantly to the alleviation of poverty. USAID microenterprise program objectives are to:

- reduce poverty among microenterprise participants (owners, workers, and families);
- target the poor and the very poor;
- encourage women's participation; and
- develop sustainable microfinance institutions.

According to the USAID Office of Microenterprise, microenterprise activities comprise four major components, namely:

- Microfinance;
- Enterprise Development;
- Financial Policy; and
- Microenterprise Development Policy.

For this audit, we focused on the microfinance component of microenterprise activities. In USAID/CAR/Kazakhstan¹ the majority of microfinance activities are conducted under the regional umbrella project known as Central Asia Microfinance Alliance (CAMFA) program. CAMFA is a USAID-funded project with the goal of building and expanding the services of sustainable microfinance institutions (MFIs) and promoting poverty reduction. CAMFA works in Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan to deepen the outreach of lending organizations through the provision of technical assistance and grants coupled with access to lending capital.

On September 26, 2002, USAID/CAR/Kazakhstan entered into a cooperative agreement with ACDI/VOCA, the implementing partner,² to actualize the CAMFA concept. CAMFA comprised two phases, namely "CAMFA I" and "CAMFA II." CAMFA I covered the period October 1, 2002 through September 30, 2006, and CAMFA II began in October 2006. Under CAMFA I, USAID funding totaled \$12.4 million with approximately 24 percent or \$2.9 million of this amount being allocated to microfinance activities in Kazakhstan. Our audit covered CAMFA I microfinance activities in Kazakhstan. MFIs, as shown in Table 1, are categorized in three tiers, depending on their stage of development, financial strength, and lending capacity. To track the operating efficiency of the

¹ USAID/CAR/Kazakhstan is a regional USAID office, but this report uses the word Mission to refer to this office.

² The term "implementing partner" means an entity eligible to receive assistance under the Microenterprise Results and Accountability Act of 2004 and is a United States or an indigenous private voluntary organization, credit union, or cooperative organization; or an indigenous governmental or nongovernmental organization; a microenterprise institution; a microfinance institution; or a practitioner institution

MFIs, USAID/CAR/Kazakhstan combined the operating ratios of developing and expanding MFIs with those of mature MFIs.

Table 1: MFI Tiers

MFI Tier	Capital Provided By Implementing Partner ³	Terms in which Capital Is Provided
Infant MFIs	Not applicable	Grants and technical assistance only
Developing and Expanding MFIs	\$10,000–\$200,000 line of credit for up to 6 months	Capital provided with no interest. Capital must be provided to obtain follow-on tranches.
Mature MFIs	\$100,000–\$500,000 line of credit for up to 12 months	Capital provided with less than commercial rates

AUDIT OBJECTIVES

This audit was conducted at USAID/CAR/Kazakhstan as part of the Office of Inspector General’s 2007 annual audit plan. It was one in a planned series of individual worldwide mission audits of USAID’s microfinance activities. The audit was performed to answer the following questions:

- Did USAID/CAR/Kazakhstan implement its microenterprise activities efficiently?
- Did USAID/CAR/Kazakhstan’s microenterprise activities achieve planned results?

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

³ MFIs are classified as infant, mature, or developing and expanding MFIs based on the amount of capital provided by the implementing partner.

AUDIT FINDINGS

Did USAID/CAR/Kazakhstan implement its microenterprise activities efficiently?

Compared with the Microfinance Information Exchange⁴ benchmarks, USAID/CAR/Kazakhstan has not implemented its microfinance activities efficiently. The audit used four benchmarks from this information exchange as the criteria to determine whether, over the 4-year period, from fiscal years (FYs) 2003 to 2006, USAID/CAR/Kazakhstan’s microfinance activities were operating efficiently.

USAID/CAR/Kazakhstan's efficiency improved over a 4-year period (see Table 2). Compared with the benchmark “Borrowers per Staff Member,” the audit noted that fewer microfinance institution (MFI) borrowers were serviced relative to the benchmark. Similarly, the benchmark “Borrowers per Loan Officer” shows that fewer borrowers than the standard were serviced per loan officer.

Additionally, each of the four “Operating Expense Ratios” was higher than the benchmark percentage of 22.8 percent. Similarly, the 0.3 percent “Write-off Ratio” for 2006 shows that the Mission’s MFIs have higher loan write-offs than the industry standards. Table 2 shows the improving trend for these indicators over the 4-year period and compares benchmark industry standards with the actual indicators.

Table 2: Indicators Measuring the Efficiency of Microfinance Activities
As of September 30, 2003 through September 30, 2006

Indicators ⁵	2003	2004	2005	2006	Benchmark
Borrowers per Staff Member	42	65	55	50	66
Borrowers per Loan Officer	92	148	141	154	168
Operating Expense Ratio	33%	27%	32%	27%	22.8%
Write-off Ratio	0.2%	0.0%	0.0%	0.3%	0.2%

The actual indicators did not meet the benchmark industry standards because a new MFI was added in 2004 and two more were added in 2005. The operating expense ratios of new MFIs are normally higher than mature MFIs because of start-up costs and the number of borrowers per staff member and loan officer are lower for new MFIs. Additionally, the “Operating Expense Ratio” was adversely impacted in 2005 due to the purchase of a management information system and increased staff training costs. The “Write-off Ratio” met or exceeded the industry.

⁴ The Microfinance Information Exchange is a global, Web-based microfinance information platform providing information to sector actors and the public on microfinance institutions worldwide and seeks to develop a transparent information market to link MFIs worldwide with investors and donors. This platform currently provides data on 953 MFIs and 160 partners. The benchmarked figures were based on latest data available – 2005 data for Central Asia.

⁵ See Appendix III for calculation formulas and definitions of indicators.

standard for 3 of the 4 years reviewed. The minimal up tick in 2006 is partially attributable to a change in the write-off policy of one of the MFIs.



Photograph of microfinance customers conducting business at a branch of a mature MFI in Shymkent, Kazakhstan, March 12, 2007.

Although the audit noted improvement in the implementation of USAID/CAR/Kazakhstan's microfinance activities, the activities were not being implemented at the efficiency level of industry standards. Ensuring that MFIs provide the required commitments and strengthening USAID/CAR/Kazakhstan's monitoring would serve to improve the program's efficiency. The need to obtain the required commitments is discussed below, and the need to strengthen the Mission's monitoring is discussed on page 8. We are not making any recommendations relating to the Mission's efficiency measures as compared to benchmarks because of the improving efficiency trends noted and because of the adverse effect that newly added developing and expanding MFIs have on efficiency indicators.

ADS Eligibility Criteria Not Followed

According to Automated Directives System (ADS) 219.3.5.2, before a mission signs an agreement to provide assistance to an MFI, the management of the institution must provide the mission with a credible written commitment to (1) attain full financial sustainability on the MFI's financial service activities within no more than 7 years of the initial provision of USAID assistance, and (2) use USAID assistance to expand the availability of financial services to microentrepreneurs and other poor people.

The audit found that the Mission had not obtained such financial sustainability commitment letters from seven MFIs reviewed. Mission officials explained that they did not request and obtain written commitment letters because they assumed the requirement was incorporated in the cooperative agreement with the implementing partner. A review of the agreement did not find such language. Without being required to prepare this commitment letter, the MFI may not be aware that it needs to operate efficiently to ensure its long-term sustainability. Additionally, noncompliance with this ADS requirement increased the risk that unqualified MFIs would receive assistance. Compliance with this requirement provides evidence that the MFI knows that within 7 years it will have to operate efficiently in order to attain its full financial sustainability. Thus, we are making the following recommendation to strengthen the sustainability and improve the efficiency of the microfinance program.

Recommendation No 1: We recommend that the Central Asia Regional Director develop procedures to ensure that recipients provide the required commitment letter before USAID/CAR/Kazakhstan signs microenterprise assistance agreements.

Did USAID/CAR/Kazakhstan's microenterprise activities achieve planned results?

USAID/CAR/Kazakhstan partially achieved its planned results. For its developing and expanding MFIs, USAID/CAR/Kazakhstan's microenterprise activities achieved four of the seven performance targets that the audit reviewed, while USAID/CAR/Kazakhstan's activities for its mature MFIs achieved five of its six targets that the audit reviewed.⁶ Tables 3 and 4 show results for the developing MFIs and the mature MFIs, respectively. According to the Mission, under the CAMFA I program, reviewing developing MFI and mature MFI results separately enhances the clarity of reported results.

Table 3: Performance Targets and Actual Results for Developing and Expanding MFIs as of September 30, 2006

Performance Indicators	Performance Targets	Actual Results	Achieved ⁷
Active Portfolio (\$)	\$2,701,000	\$903,872	No
Number of Active Clients	3,000	579	No
Average Loan Size (\$)	\$243	\$1,561	Yes
Portfolio at Risk (> 1day) ⁸	7%	2%	Yes
Loan Loss Provisioning	5%	0%	Yes
Return on Assets	15%	11%	No
Operational Self Sufficiency	100%	172%	Yes

⁶ USAID/CAR/Kazakhstan did not track the "Loan Loss Provisioning" indicator for its mature MFIs.

⁷ As part of our methodology, we set materiality standards for our conclusions. See Scope and Methodology section for more information.

⁸ Portfolio at Risk indicates the potential for future loan losses based on the current performance of the loan portfolio.

Table 4: Performance Targets and Actual Results for Mature MFIs as of September 30, 2006

Performance Indicators	Performance Targets	Actual Results	Achieved
Active Portfolio (\$)	\$23,123,134	\$26,187,888	Yes
Number of Active Clients	23,567	22,469	Yes
Average Loan Size (\$)	\$999	\$1,165	Yes
Portfolio at Risk (> 1 day)	1%	0.23%	Yes
Return on Assets	13%	11%	Neutral ⁹
Operational Self Sufficiency	148%	155%	Yes



Photograph of microfinance customers receiving technical assistance in Shymkent, Kazakhstan, March 12, 2007

Although we noted significant progress in achieving performance targets, variances from planned results were caused by the following:

- Some performance targets set by the Mission and implementing partner were not realistic; and
- Mission monitoring of microfinance activities needed strengthening.

These two issues are discussed in more detail below.

⁹ See Methodology section of this report for explanation of the term “neutral.”

Some Performance Targets Were Not Realistic

According to ADS 203.3.4.5, USAID operating units should set performance targets that can optimistically, but realistically be achieved within the stated timeframe and with the available resources. Targets should be ambitious, but achievable given USAID and other donor inputs.

For its developing and expanding MFIs, USAID/CAR/Kazakhstan and the implementing partner used seven targets. One target for work performance was too conservative and, hence, was easily achieved; however, two others were too optimistic and, accordingly, were not achieved. For example, (1) actual active clients were only 19 percent of the performance target, 2,421 less than the targeted 3,000 clients, and the actual dollar amount of the portfolio was only 33 percent of the targeted amount, \$1.8 million less than the \$2.7 million target; and (2) conversely, the actual average loan size was six times the \$243 target per loan.

According to USAID/CAR/Kazakhstan and implementing partner officials, the targets were too conservative in one case and in two cases too optimistic because there was little or no historical data from the MFIs to help develop the targets. Thus, they relied on preliminary estimates. Mission officials asserted that this was the first microenterprise cooperative agreement and there was little or no historical data to follow. Additionally, the Mission did not perform adequate oversight and monitoring of the program that would have identified and adjusted excessive variances in a more timely manner. See pages 8–10 for further discussion.

Making targets more realistic keeps them relevant and encourages improved results. Targets that are set too low or too high are not useful in accurately gauging performance, enhancing the quality of the loan portfolio, and managing resources.

Recommendation No 2: We recommend that the Central Asia Regional Director develop procedures to review annual targets for its microenterprise activities to ensure that performance targets are ambitious, but achievable.

Monitoring Needs Strengthening

Summary: ADS 303.2 (f), states that Cognizant Technical Officers (CTOs) are responsible for ensuring that USAID exercises prudent management of assistance awards and for making the achievement of program objectives easier by monitoring and evaluating the recipient and its performance. USAID/CAR/Kazakhstan did not conduct any site visits of its Kazakhstan microfinance activities in FY 2006 because USAID, due to higher agencywide monitoring priorities, reassigned the CTO to another country for 8 months. Additionally, during this 8-month period, the Mission did not delegate this monitoring and management responsibility to another one of its employees. For FYs 2003 through 2005, according to Mission officials, site visits were not formally recorded because documenting each site visit became a low priority considering their workload. As a result of these monitoring and documentation weaknesses, inconsistent management of a program may have existed. In addition, management may not have timely information on program performance to measure progress and influence program decision-making and resource allocation.

ADS 303.2 (f) states that Cognizant Technical Officers (CTOs) are responsible for ensuring USAID exercises prudent management of assistance awards and for making the achievement of program objectives easier by monitoring and evaluating the recipient and its performance. This section also says that site visits are an important part of effective award management and that when the CTO makes a site visit, the CTO must write a brief report highlighting findings and put a copy in the official award file. Additionally, USAID's *Guidebook for Managers and Cognizant Technical Officers on Acquisition and Assistance* states that the CTO is responsible for ensuring that USAID exercises prudent management over assistance funds and for monitoring the recipient and the recipient's performance during the award by maintaining contact, performing site visits, and reviewing and analyzing performance and financial reports. Furthermore, the cooperative agreement requires the implementing partner to submit program reports to the CTO on a quarterly basis.

USAID/CAR/Kazakhstan's monitoring weaknesses contributed to unfavorable variances in achieving its performance targets (pages 6 and 7). For 8 months during FY 2006, the CTO was assigned to another USAID mission. During this period the USAID/CAR/Kazakhstan CTO did not conduct any site visits of its microfinance activities. Additionally, during the FY 2003 to FY 2005 period, the Mission did not formally document site visits and record findings in its award files; nor did it follow-up with the implementing partner to address performance targets that were not being met.

Monitoring weaknesses may adversely impact loan performance and loan losses. As an example where strengthened monitoring could improve loan performance, and as clearly shown in the comparative photos below, the condition of two different tractors, used as collateral for loans by two different farmers, varied markedly. We inspected two tractors: a 1968 tractor and a 1987 tractor. We observed that the 1968 tractor was in operating condition, whereas the 1987 tractor could not be started. The deteriorated condition—rusty, inoperable, and dormant appearance—of the newer tractor reduced, in our opinion, its collateral value relative to the loan it was supporting. In other examples, we noted that monitoring would have identified areas where technical agricultural assistance was needed to improve the farmers' harvest. Nevertheless, Mission personnel, through site visits and monitoring by implementing partner personnel, can work with borrowers to help ensure that the value of collateral securing loans is maintained and agricultural production is enhanced, minimizing the risk to the loan portfolio.



Photograph of a 1968 Tractor, Shymkent, Kazakhstan on March 11, 2007



Photograph of a 1987 Tractor, Shymkent, Kazakhstan on March 11, 2007

USAID/CAR/Kazakhstan did not conduct any site visits of its Kazakhstan microfinance activities in FY 2006 because USAID, due to higher agencywide monitoring priorities, reassigned USAID/CAR/Kazakhstan's CTO to another country. Additionally, during this 8-month period, the Mission did not delegate this monitoring and management responsibility to another one of its employees. For FYs 2003 through 2005, according to Mission officials, site visits were not formally recorded because documenting each site visit became a low priority considering their workload. However, according to the CTO, the CTO provided verbal briefings to the USAID office director and staff, and reported problem areas to management. In addition, the CTO did not follow-up with the implementing partner to address performance targets that were not met because the CTO's focus was more on monitoring regional performance indicators than those of Kazakhstan's specific country targets.

As a result of these monitoring and documentation weaknesses, inconsistent management of a program may exist. Additionally, in the case of a new CTO, absence of adequate documentation on prior program monitoring efforts may result in erroneous decisions and actions. Finally, as a result of not having the necessary forms for oversight and monitoring of a program, management may not have timely information on program performance to measure progress and influence program decision-making and resource allocation. To help the microfinance program build on progress made and to enhance monitoring of the program's performance, we make the following recommendations:

Recommendation No. 3: We recommend that the Central Asia Regional Director issue a mission order requiring Mission personnel to prepare – in compliance with established USAID procedures – written site visit reports after each site visit, and to document the purpose and the results of each visit.

Recommendation No. 4: We recommend that the Central Asia Regional Director develop a policy designating an alternate Cognizant Technical Officer to assume Cognizant Technical Officer responsibilities when the Cognizant Technical Officer is detailed to another mission for any period of 3 months or longer.

EVALUATION OF MANAGEMENT COMMENTS

The following summarizes our evaluation of management comments:

Overall Finding: Management did not concur with our conclusion on the first audit objective—“Did USAID/CAR/Kazakhstan implement its microenterprise activities efficiently?” Management asserted that it is inaccurate to use Microfinance Information Exchange (MIX) benchmarks as industry standards to evaluate the efficiency of its microenterprise activities because of inherent limitations in MIX benchmarks. On the second audit objective—“Did USAID/CAR/Kazakhstan’s microenterprise activities achieve planned results?”—management did not provide comment.

Evaluation of Management Comments – While we agreed and acknowledged in our report that USAID/CAR/Kazakhstan’s efficiency improved over a 4-year period covered by our audit, when compared to MIX benchmarks, USAID/CAR/Kazakhstan did not implement its microenterprise activities efficiently.

While we acknowledge management’s reservations on the use of MIX benchmarks as industry standards, we believe that MIX is a competent authoritative source of industry benchmarks established by the Consultative Group to Assist the Poorest (CGAP). CGAP is a consortium of 33 public and private development agencies working together to expand access to financial services for the poor in developing countries, and includes the Citigroup Foundation, the Deutsche Bank Americas Foundation, the Open Society Institute, and the Rockdale Foundation. Furthermore, USAID is a member of this consortium. CGAP was created by these aid agencies and industry leaders to help create permanent financial services for the poor on a large scale (often referred to as “microfinance”). CGAP’s unique membership structure and network of worldwide partners make it a potent convening platform to generate global consensus on standards and norms.

In addition we believe management’s concerns were addressed by MIX on its Web site as follows:

Microfinance institutions operate in diverse environments and differ in their scope of operations and target markets. Historically, they face difficulties in isolating adequate and comparable benchmarks. The problem of data incomparability is addressed by MIX by utilizing the most complete source of financial information and social indicators in the microfinance industry. MIX applies a set of appropriate peer groups, adjusts data for comparability and, on the basis of this, offers reliable and relevant benchmarks to the microfinance industry.

Recommendation No 1: We recommend that the Central Asia Regional Director develop procedures to ensure that recipients provide the required commitment letter before USAID/CAR/Kazakhstan signs microenterprise assistance agreements.

Evaluation of Management Comments – In response, USAID/CAR/Kazakhstan issued a notice instructing all CTOs of microenterprise program beneficiaries to obtain financial sustainability commitment letters from all microenterprise program beneficiaries prior to entering into subagreements. In addition to this notice, the CAMFA CTO issued a letter

to the CAMFA Chief of Party instructing CAMFA to sign commitment letters with all CAMFA beneficiaries.

Based on the information provided by USAID/CAR/Kazakhstan, we consider that a management decision has been reached for Recommendation No. 1, and we consider the recommendation closed upon report issuance.

Recommendation No 2: We recommend that the Central Asia Regional Director develop procedures to review annual targets for its microenterprise activities to ensure that performance targets are ambitious, but achievable.

Evaluation of Management Comments – In response and in addition to the procedures already in place, USAID/CAR/Kazakhstan issued a reminder notice to CTOs to ensure that performance targets are up-to-date, attainable, and realistic.

Based on the information provided by USAID/CAR/Kazakhstan, we consider that a management decision has been reached for Recommendation No. 2, and we consider the recommendation closed upon report issuance.

Recommendation No 3: We recommend that the Central Asia Regional Director issue a mission order requiring Mission personnel to prepare—in compliance with established USAID procedures—written site visit reports after each site visit, and to document the purpose and the results of each visit.

Evaluation of Management Comments – In response, USAID/CAR/Kazakhstan provided guidance for trip reports that included the following:

- Each technical office creates a procedure and practice of formal reporting for field trips.
- Each office develops a format and template for use on field trips.
- A field trip file is to be maintained by each office.

In addition, the Economic Growth Office Director issued a reminder notice instructing CTOs and Activity Managers to document site visits.

Based on the information provided by USAID/CAR/Kazakhstan, we consider that a management decision has been reached for Recommendation No. 3, and we consider the recommendation closed upon report issuance.

Recommendation No 4: We recommend that the Central Asia Regional Director develop a policy designating an alternate Cognizant Technical Officer to assume Cognizant Technical Officer responsibilities when the Cognizant Technical Officer is detailed to another mission for any period of 3 months or longer.

Evaluation of Management Comments – In response and in addition to the procedures already in place, USAID/CAR/Kazakhstan issued a notice reminding CTOs to notify the award recipient and the Agreement Officer as soon as possible when a CTO will be away from the office for 2 weeks or more. In these instances, the alternate CTO will carry out all CTO responsibilities, including site visits.

Based on the information provided by USAID/CAR/Kazakhstan, we consider that a management decision has been reached for Recommendation No. 4, and we consider the recommendation closed upon report issuance.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General's Performance Audits Division conducted this audit in accordance with generally accepted government auditing standards. This audit was performed as one audit in a planned series of individual worldwide mission audits of USAID's microfinance activities. The purpose of the audit was to determine if USAID/Central Asian Republics (CAR)/Kazakhstan's microenterprise activities were being implemented efficiently and were achieving performance targets.

In planning and performing the audit, we assessed the Mission's controls related to the microfinance activities. The management controls identified included the Mission's Annual Report, strategic plan, and the Mission's annual self-assessment of management controls, as required by the Federal Managers Financial Integrity Act and other applicable laws and regulations, progress reports, and day-to-day interaction between Mission staff and program implementers. We did not verify the accuracy of financial indicators used by the Mission in measuring whether USAID/CAR/Kazakhstan's activities were being implemented efficiently and whether performance targets were being achieved. However, we reviewed, analyzed and obtained explanations for those indicators with a view toward achieving our audit objectives.

The audit covered the Mission's microfinance activities—one of four microenterprise components. Microfinance activities in Kazakhstan, according to the latest USAID "Microenterprise Results Reporting" (MRR) available at the time of this audit, totaled approximately \$1.6 million in fiscal year (FY) 2005 and represented approximately 72 percent of \$2.2 million Kazakhstan microenterprise activities. Of these amounts, we selected for audit microfinance activities which totaled approximately \$1.4 million in FY 2005. Microfinance activities were selected because of the worldwide interest in this component and because of the amount of dollars USAID has invested. In October 13, 2006, the 2006 Nobel Peace Prize was awarded for using microfinance as a vehicle for poverty reduction. Additionally, in FY 2005 alone, USAID's investment in microfinance was \$93.3 million, representing 44 percent of the \$211.5 million of USAID's funding for microenterprise activities.

Background and planning work was conducted in Washington, D.C., from November 2006 through January 2007. Audit fieldwork was conducted in Kazakhstan from February 23 through March 16, 2007. For the first audit objective on efficiency, our audit focused on FYs 2003, 2004, 2005, and 2006, while for the second audit objective, performance targets, our audit focused on FY 2006. Additionally, for both objectives, our audit covered USAID/CAR/Kazakhstan's developing and expanding Microfinance Institutions (MFIs) and its mature MFIs. The scope did not address infant MFIs because these were an immaterial part of the Mission's operation.

Methodology

To answer the audit objectives, we met with implementing partner employees, MFI officials and borrowers in Kazakhstan, and USAID officials in Kazakhstan and Washington, D.C. We conducted interviews with appropriate officials and reviewed relevant documentation produced by USAID/CAR/Kazakhstan and USAID/Bureau for Economic Growth, Agriculture and Trade/Office of Poverty Reduction such as award documents including amendments, Mission correspondence, internally used worksheets for measuring results, the Mission performance plan, financial reports, and field visit reports. We reviewed MFI and implementing partner prepared documentation such as annual work plans, quarterly, and monthly reports.

Accordingly, for the first audit objective, we analyzed and reported on the combined operating efficiencies of developing and mature MFIs. However, in monitoring results, USAID/CAR/Kazakhstan tracked developing MFI results separately from its mature MFIs. Thus, for the results objective, we separately analyzed and reported our findings on the two categories: developing and expanding MFIs and mature MFIs. Combining these two categories for results reporting would, in our opinion, misleadingly skew the results of these two different classes of entities.

We conducted 13 site visits to selected MFI offices and borrowers' places of business in Almaty, Shymkent, and Turkistan, Kazakhstan. During the site visits we observed operating activities and assessed the impact of the microfinance program. We reviewed, but did not audit or test for accuracy, financial information reported in the MFIs' accounting systems and USAID/CAR/Kazakhstan's financial information reflected in the MRR system.

To test whether the microfinance program was implemented efficiently and performance targets were achieved, we analyzed, for relevance, financial indicators and pertinent documents from the implementing partner and MFIs. In addition, we assessed the reliability and validity of the reported indicators by tracing reported results from the Mission's records through the implementing partner to the MFI's accounting records and published financial statements. We specifically analyzed reported accomplishments by doing the following:

- For evaluating efficiency, we judgmentally selected four of seven efficiency indicators and we compared them with 2005 industry standards from the Microfinance Information Exchange to assess whether the MFIs were operating efficiently. As part of our audit approach, we interviewed Mission and implementing partner personnel and reviewed documentation, and performed analytical review procedures on reported data. In addition, we obtained explanations for significant variances. However, we did not audit the data reported by the MFIs.
- For evaluating performance targets and sustainability, we selected performance indicators that were most closely related to assessing performance targets and sustainability of microfinance activities. We compared results against targets to determine whether performance targets were achieved and obtained explanations for significant variances. However, we did not audit the data reported by the MFIs.

We set the following materiality standards for our conclusions: (1) If at least 90 percent of the selected results were achieved, the answer to the audit objective would be yes; (2) If at least 80 percent but less than 90 percent of the selected results were achieved, the answer to the audit objective would be neutral; and (3) If less than 80 percent of the selected results were achieved, the answer to the audit objective would be no.

While we have these threshold criteria, we also used auditor judgment to determine the applicability of the threshold percentages, taking into consideration other factors such as significance of the various outputs, environmental aspect, and timeliness of funds distribution.



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Office of the Director

To: Steven H. Bernstein, IG/A/PA Director

From: Thomas Delaney, Acting USAID/Central Asia Regional Director /s/

Date: August 16, 2007

Subject: Audit Findings of USAID/CAR Microenterprise Activities

Ref.: Report No. 9-910-07-XXX-P

We appreciate the comments and recommendations of the auditors outlined in the draft report. We find them constructive and helpful.

This memorandum contains USAID/CAR's comments on the subject draft audit report received on July 24, 2007 and includes responses and an action plan for each recommendation.

We do not concur with the overall findings that the Central Asia Microfinance Alliance (CAMFA) I program was not implemented efficiently. Reasons for our disagreement with the overall audit findings are contained in an accompanying Annex.

Recommendation No. 1: We recommend that the Central Asia Regional Director develop procedures to ensure that recipients provide the required commitment letter before the Mission signs microenterprise assistance agreements.

In response to this Recommendation, a notice has been issued by the Agreements Officer instructing all CTOs of microfinance programs to obtain financial sustainability commitment letters from all microfinance program beneficiaries prior to entering into sub-agreements. In addition to this notice, the CAMFA CTO issued a letter to the CAMFA Chief of Party instructing CAMFA to sign commitment letters with all CAMFA beneficiaries. CAMFA has already introduced this procedure into its technical assistance program and commitment letters are now being filed as project official documentation. Copies of the notice and the letter to CAMFA are attached.

Based on the above actions that have been taken, USAID/CAR requests that this recommendation be closed.

Recommendation No. 2: We recommend that the Central Asia Regional Director develop procedures to review annual targets for its microenterprise activities to ensure that performance targets are attainable and realistic.

USAID/CAR already has procedures in place to review and analyze program performance. During the annual mission-wide portfolio review, performance results and progress toward meeting planned

targets are analyzed for all activities, including microfinance activities. The annual review also ensures that each activity contains realistic and achievable targets and results. In addition, the Agreements Officer has issued a reminder notice to CTOs to ensure that performance targets are up to date, attainable, and realistic. Copies of the mission's portfolio review template and the notice are attached.

In addition, each year CAMFA sets performance targets in its action plans and agreements for training and technical assistance for each microfinance institution beneficiary. The action plans are an integral part of the agreements with each CAMFA partner. An example of a sub-agreement and an action plan are attached.

Based on these actions, USAID/CAR requests that this recommendation be closed.

Recommendation No. 3: We recommend that the Central Asia Regional Director develop procedures ensuring that written site visit reports are prepared to document the purpose and the results of each visit.

During the Mission's Management Control Review Committee (MCRC) meeting in March 2007, the acting Mission Director, provided guidance for trip reports that included the following:

- Each technical office creates a procedure and practice of formal reporting for field trips.
- Each office develops a format and template for use on field trips.
- A field trip file is to be maintained by each office.

A copy of the template for the Office of Economic Growth is attached. Based on the audit recommendation, the Economic Growth Office Director issued a reminder notice instructing CTOs and Activity Managers to document site visits using the template. All Economic Growth project monitoring visits are now documented using the template.

Based on these actions, USAID/CAR requests that this recommendation be closed.

Recommendation No. 4: We recommend that the Central Asia Regional Director develop a policy designating an alternate Cognizant Technical Officer to assume these (site visit) responsibilities when the CTO is detailed to another mission for any period of three months or longer.

A policy already exists for USAID/CAR for designating an alternate CTO. An alternate CTO is designated in the CTO designation letter for all awards. The alternate CTO is authorized to act on the CTO's behalf during the absence of the CTO. This would include conducting necessary site visits during the absence of the CTO. In addition, the Agreements Officer has issued a notice to CTOs reminding them to notify the award recipient and the Agreements Officer as soon as possible when a CTO will be away from the office for two weeks or more. In these instances, the alternate CTO will carry out all CTO responsibilities, including site visits.

Based on these actions, USAID/CAR requests that this recommendation be closed.

USAID/CAR is committed to enforcing these policies in response to the audit recommendations outlined in the draft audit report.

List of Annexes:

Annex 1	Comments on the Audit Findings
Annex 2	Agreement Officer Notice
Annex 3	Letter to CAMFA
Annex 4	Portfolio review template
Annex 5	Examples of CAMFA subagreement
Annex 6	Example of CAMFA action plan
Annex 7	Office of Economic Growth trip report template
Annex 8	Office of Economic Growth reminder notice
Annex 9	Example of CTO Designation Letter

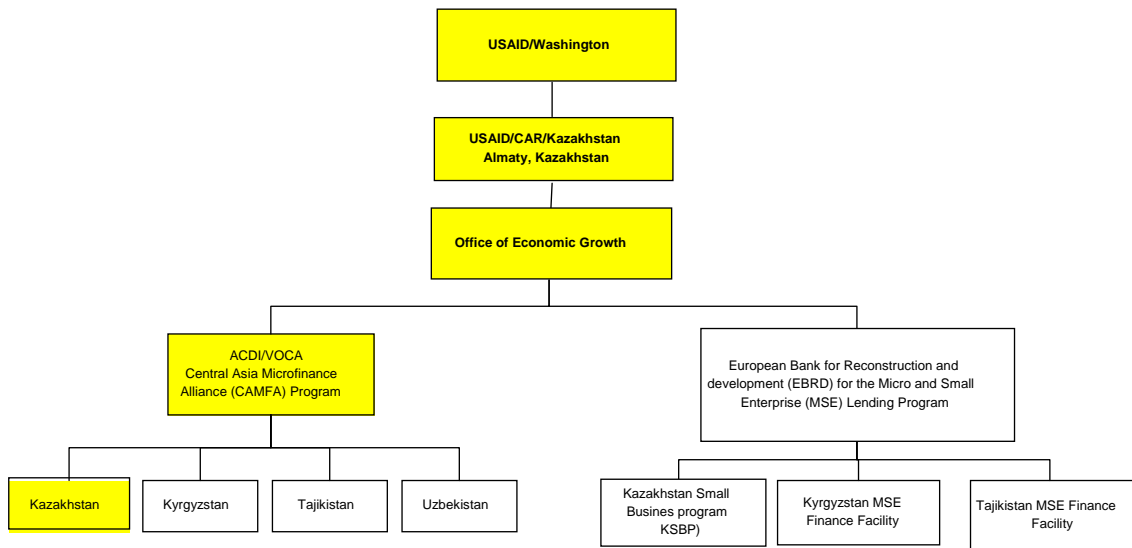
DEFINITIONS OF EVALUATION OF CRITERIA

Financial indicators and ratios used in measuring efficiency and evaluating performance

Term	Formula	Definition
Operational Self-Sufficiency	$\frac{\text{Financial Revenue}}{(\text{Financial Expense} + \text{Net Loan Loss Provision Expense} + \text{Operating Expense})}$	Measures how well an MFI can cover its costs through operating revenues.
Return on Assets	$\frac{\text{Net Operating Income} - \text{Taxes}}{\text{Average Assets}}$	Measures how well the MFI uses its assets to generate returns. This ratio is net of taxes and excludes non-operating items and donations.
Portfolio at Risk (PAR) Ratio	$\frac{(\text{PAR} > 30 \text{ Days} + \text{Value of Renegotiated Loans})}{\text{Gross Loan Portfolio}}$	The most accepted measure of portfolio quality. The most common international measurements of PAR are > 30 days and > 90 days.
Write-off Ratio	$\frac{\text{Value of Loans Written-off}}{\text{Average Gross Loan Portfolio}}$	Represents the percentage of the MFI's loans that has been removed from the balance of the gross loan portfolio because they are unlikely to be repaid. MFIs' write-off policies vary and it is recommended that managers calculate this ratio on an adjusted basis.
Operating Expense Ratio	$\frac{\text{Operating Expense}}{\text{Average Gross Loan Portfolio}}$	Highlights personnel and administrative expenses relative to the loan portfolio, and is the most commonly used efficiency indicator.
Active Portfolio	Number of Loans Outstanding	Number of outstanding loans available for clients
Active Clients	Number of Borrowers, Savers, and Clients	Number of borrowers, voluntary savers, and other clients
Borrowers per Loan Officer	$\frac{\text{Number of Active Borrowers}}{\text{Number of Loan Officers}}$	Measures the average caseload of each loan officer, or number of borrowers managed by one loan officer.
Active Clients per Staff Member Borrowers per Staff Member	$\frac{\text{Number of Active Clients}}{\text{Total Number of Personnel}}$ $\frac{\text{Number of Borrowers}}{\text{Total Number of Personnel}}$	The overall productivity of the MFI's personnel in terms of managing clients, including borrowers, voluntary savers, and other clients.
Average Outstanding Loan Size	$\frac{\text{Gross Loan Portfolio}}{\text{Number of Loans Outstanding}}$	Measures the average outstanding loan balance per borrower. This is a driver of profitability and a measure of how much of each loan is available to clients.
Loan Loss Provisioning	$\frac{\text{Uncollectible Loans Written Off}}{\text{Average Unpaid Balance of Outstanding Loans}}$	The total principal of loans written off as uncollectible during a reporting period, as a percentage of the average unpaid balance on outstanding loans over the same period. In this guidance, loans past due one year or more must be written off as uncollectible.

USAID/CAR/Kazakhstan Microfinance Organization Structure

USAID/Central Asia Program Chart



Organization units we interacted with during the audit are represented by the shaded areas.

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