USAID
OFFICE OF INSPECTOR GENERAL

Audit of USAID's Credit Program and Related Internal Controls for Fiscal Year 2000

Audit Report No. 0-000-01-002-F

February 15, 2001

**U.S. Agency for
International Development**

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM FOR CFO, Michael T. Smokovich

FROM: IG/A/FA, Alvin A. Brown

SUBJECT: Independent Auditor's Report on USAID's Credit Program and Related Internal Controls for Fiscal Year 2000. Report No. 0-000-01-002-F

This memorandum audit report is our report on U.S. Agency for International Development's (USAID's) Credit Program. This report is part of our review of its consolidated financial statements as required by the Government Management and Reform Act of 1994. This act requires USAID to prepare and submit audited financial statements to the Office of Management and Budget (OMB) for the preceding fiscal year that cover all accounts and associated activity of the agency.

This report is one in a series of reports that communicate the results of our audits conducted on the selected line items reported in the USAID fiscal year 2000 balance sheet. The audit was performed to determine whether USAID established adequate internal controls to compute and report its credit program account balances as of September 30, 2000. We determined that USAID did establish adequate internal controls to compute and report its Credit Program account balances as of September 30, 2000. However, we identified a reportable condition relating to USAID's Credit Program loans receivable.

We received and considered your comments provided to the draft report. This report makes one recommendation to improve USAID's accounting for its loan portfolio and strengthen related internal controls. Based on your comments to the draft report, we acknowledge your agreement and action taken, we accept your management decision and the correction action taken as final action for the audit recommendation. See **Appendix II** for USAID Management's comments.

I would like to express my sincerest appreciation for the courtesies extended by your staff to the auditors.

Background

In previous years, the Office of Inspector General's (OIG) ability to express an opinion was impaired by inadequate financial accounting and performance measurement systems, and related material weaknesses in internal controls. The OIG concluded that these deficiencies in the financial accounting systems[1] created consequential risks that the financial statements including the performance overview information could contain material misstatements. The amount of substantive testing required to express an opinion on the fairness of the financial statements would have been prohibitive and unattainable by the statutory deadline of March 1 for submitting the audited financial statements to OMB. Accordingly, the OIG did not express an opinion on the fairness of the financial statements.

As a result of the problems noted in previous years' audits, the OIG agreed with USAID to focus our fiscal year 1999 audit efforts on the material line items on its balance sheet. This agreement held true for our fiscal year 2000 audit.

USAID administers a large portfolio of loans and loan guarantees extended to foreign governments and foreign non-government entities. The loan service includes receipt and disbursement of funds, loan accounting, collections, maintenance of documents and financial management reporting. USAID's Credit Program loan portfolio consists of direct loans, loans fully guaranteed by USAID, and portfolios of loans having partial guarantee.

<u>Direct Loans</u>

USAID manages a portfolio of over 2,000 direct loans with outstanding balances in excess of $10 billion dollars. USAID made these loans to borrowers in approximately 90 countries under various foreign assistance programs dating back to the 1960's. With a few exceptions, no direct loans have been made by USAID since the mid 1980's. Direct loans are issued in both U.S. dollars and foreign currency.

<u>Loan Guarantees</u>

USAID co-signs loans that are made by commercial lenders under the Urban and Environment Credit Program. The purpose of the program is to assist in providing long-term financing for low-income shelter and neighborhood infrastructure-upgrading programs in developing countries and to stimulate the participation of the private sector in the economic

[1] According to OMB Circular A-127 and the Chief Financial Officers' Act, a financial management system includes supporting systems that contain the information needed to carry out financial management functions, manage financial operations, and report financial status information. The systems provide the information managers need to (1) carry out their fiduciary responsibilities, (2) deter fraud, waste, and abuse; and (3) relate financial consequences to agency program performance. Thus, in addition to basic accounting functions, USAID's financial management system includes supporting systems that perform performance measurement, budget, and procurement functions.

development of lesser developed countries. In the case of borrower default, USAID is liable for one hundred percent of the lenders' unrecoverable loss.

USAID also provides partial guarantees of loans made by foreign financial institutions to Micro and Small Enterprises in developing countries. The purpose is to encourage the growth of small businesses and to extend the benefits of a market economy to lower income citizens. There are currently 49 financial institutions in 20 foreign countries with portfolios covered under the loan guarantee program.

In 1998, USAID entered into a contract with Riggs National Bank (Riggs Bank) to provide loan servicing and financial management services for USAID's loan portfolios. Riggs Bank's responsibilities include, but are not limited to, the following: 1) downloading daily wire transfer data for loan collections; 2) preparing and sending Notice of Payment Due to all borrowing countries; 3) receiving loan collections; 4) making claim payments; 5) reconciling all accounts; 6) computing interest earned on fund balance; 7) updating loan status in the Marshall & Ilsley Commercial Loan System (M&I system, which is hereafter referred to as The subsidiary ledger); 8) preparing annual verification letters to all borrowers to confirm outstanding loan balances; 9) preparing interim and annual reports; and 10) providing external data calls to OMB, the U.S. Treasury, and the U.S. Department of State.

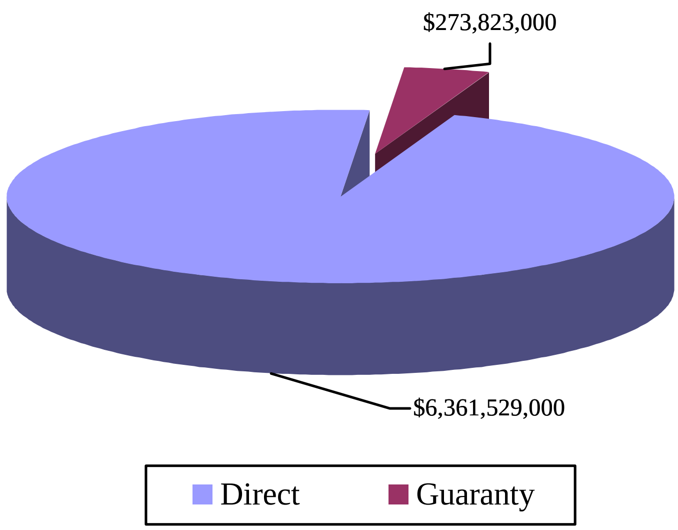
USAID Loan Management Division's (USAID/LM's) responsibilities include, but are not limited to, the following: 1) administering the program and monitoring the contract with Riggs Bank; 2) monitoring the conversion of two legacy loan systems – Loan Accounting Information System and Housing Guaranty Portfolio Management System to Riggs Bank's loan system; 3) reviewing Notices of Payment Due; 4) receiving and disbursing funds; 5) verifying processed system transactions; 6) reviewing loan status reports provided by Riggs Bank; 7) maintaining accounting records; 8) maintaining continuous communication with Riggs Bank to resolve any and all post conversion issues; and 9) preparing financial statements based on the reports generated through Riggs Bank's loan system.

As of October 1, 1999, USAID's legacy systems were discontinued when Riggs Bank's loan system became USAID's subsidiary ledger for its loan portfolios.

At September 30, 2000, USAID's Credit Program had total net receivables of about $6.6 billion. Of the net receivable amount, direct loans accounted for approximately $6.4 billion and guaranteed loans accounted for the remainder.

The following shows the loan programs that are included in USAID's Credit Program net receivable balance:

Direct Loan Program - $6.4 billion[2]
Guaranteed Loan Program - $273.8 million[3]



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[2] Direct Loan Program includes "direct" loans and "direct Micro and Small Enterprise Development (MSED)" loans. This figure includes both Pre-Credit Reform and Post-Credit Reform loans. See Footnote Disclosure (5) – Credit Program Receivables and Liabilities for Loan Guarantees – to the financial statements.

[3] This amount represents defaulted guaranteed loans from Pre-1992 Guarantees. See Footnote Disclosure (5) – Credit Program Receivables and Liabilities for Loan Guarantees – to the financial statements.

Audit Objective

This audit was performed to support the fiscal year 2000 Government Management Reform Act (GMRA) audit of USAID's consolidated financial statements. Consistent with our fiscal year 1999 audit, USAID Office of Inspector General (OIG) agreed with the Office of Financial Management that it would be advantageous for the fiscal year 2000 audit to concentrate on selected major balance sheet line items. Accordingly, the following is the objective of this audit:

> **Did USAID Establish Adequate Internal Controls to Compute and Report its Credit Program Account Balances as of September 30, 2000?**

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- Transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability over assets;

- Funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and

- Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that the Office of Management and Budget, or USAID Management have identified as being significant and for which compliance can be objectively measured and evaluated.

Our consideration of internal control would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect USAID's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

See Appendix I for a discussion about our audit scope and methodology.

Audit Finding

Did USAID Establish Adequate Internal Controls to Compute and Report its Credit Program Account Balances as of September 30, 2000?

Overall, we determined that USAID established adequate internal controls to compute and report its Credit Program account balances as of September 30, 2000. However, we identified a reportable condition relating to USAID's Credit Program loans receivable. At September 30, 2000, there was an absolute difference of approximately $459 million between USAID's general ledger and its subsidiary ledger. We identified an absolute difference of approximately $316 million and USAID/LM identified an additional $143 million during the year-end reconciliation. (See Appendix III for a summary of the differences that we identified by loan program.)

These discrepancies occurred because of the following:

- Riggs Bank posted adjustments to its loan system throughout fiscal years 1999 and 2000 under USAID Management's direction.

- USAID/LM used the September 30, 1999 closing balances from its legacy systems and adjusted those balances, with only the current year's activity recorded in USAID's subsidiary ledger, to prepare its Credit Program trial balance for fiscal year 2000. USAID/LM did not record all the adjustments posted to its subsidiary ledger during 1999 and 2000.

Of the total differences ($459 million), USAID/LM was able to identify and reconcile an absolute amount of approximately $366 million ($182 million net). USAID/LM made the necessary adjustments for these differences. USAID/LM also posted a one-time unsupported adjustment with an absolute value of approximately $93 million ($85 million net) for the remaining unreconciled differences between USAID's general ledger and its subsidiary ledger. These entries were necessary to bring USAID's general ledger into agreement with its subsidiary ledger.

We agreed with the one-time adjustment that USAID/LM posted. However, we recommend that USAID/LM make a footnote disclosure to the financial statements to explain the adjustment. Thus, we propose the following recommendation to improve USAID's reporting for its loan portfolios.

> **<u>Recommendation</u>: We recommend that the Office of Financial Management make a footnote disclosure in the financial statements stating that a one-time adjustment was made to the Loans Receivable account in the general ledger.**

Management Comments and Our Evaluation

USAID's Management agreed with the finding and recommendation made in this report. The Chief Financial Officer said that Management was delighted to note that, for the second year in a row, the September 30, 2000 credit program account balances were accurate. Management also modified Footnote 5 to the financial statements to disclose the one-time adjustment to the credit program receivables as recommended.

Based on Management's acceptance of the audit recommendation and action taken, we accept your Management's decision and the correction action taken as final action for the audit recommendation.

SCOPE AND METHODOLOGY

Scope

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the accounts audited are free from material misstatement.

Consistent with our fiscal year 1999 audit, USAID's Office of Inspector General agreed with the Office of Financial Management that it would be advantageous for the fiscal year 2000 audit to concentrate on selected major balance sheet items. Accordingly, the scope of this audit was limited to the review of USAID's Credit Program account balances as of September 30, 2000. Therefore, this report does not contain an opinion about the fairness of the statements taken as a whole.

At September 30, 2000, USAID's Credit Program had total net receivables of about $6.6 billion. The amount audited was $1.2 billion (or 18.6 percent). We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the accounts audited are free from material misstatement.

We obtained an understanding of the Credit Program account balances reported in USAID's fiscal year 2000 balance sheet. We determined whether the amounts were reasonably accurate; whether applicable policies and procedures were established; and whether they had been placed in operation to meet Generally Accepted Accounting Principle objectives and other regulations. We considered all reasonable efforts made by USAID to improve the management of the Credit Program and respond to our previous recommendations relating to the operations of this portfolio.

A materiality threshold of 5 percent was calculated. Based on USAID's fiscal year 1999 Net Cost of Operations ($6.2 billion), any amount over $314 million will be considered material and included in our review of USAID's fiscal year 2000 Balance Sheet.

Methodology

In accomplishing our audit objective, we reviewed significant line items related to USAID's fiscal year 2000 balance sheet. These line items included advances, accounts payable, fund balance with Treasury, and loans receivable. The purpose of this report is to communicate the results of our review of USAID's Credit Program for the period ended September 30, 2000. This report specifically addresses the issues identified in our review of the Credit Program on the fiscal year 2000 balance sheet.

To accomplish our Credit Program audit objective, we:

- Obtained an understanding of the components of internal control and assessed the level of control risk relevant to the assertions embodied in the class of transactions, account balances, and disclosure components of the financial statements;

- Performed tests of compliance with laws and regulations that could have a direct and material effect on USAID's Credit Program;

- Reviewed Riggs National Bank's policies and procedures for servicing USAID loans;

- Conducted meetings with USAID/LMD and Riggs Bank officials;

- Statistically confirmed USAID loan account balances with all 10 borrowing countries;

- Judgmentally selected and tested loan collections for the month of March 2000; and

- Discussed the confirmed differences with Riggs National Bank.

USAID MANAGEMENT COMMENTS

February 1, 2001

MEMORANDUM

TO: IG/A/FA, Alvin A. Brown

FROM: CFO, Michael T. Smokovich

SUBJECT: Audit of USAID's Credit Program and Related Internal Controls for Fiscal Year 2000

We have reviewed your draft report on the subject audit and agree with your findings and recommendation. We are pleased to note that for the second year in a row you have determined that the credit program balances are accurate. We modified Footnote 5 to the Financial Statements to disclose the one-time adjustments to the credit program receivables.

I would like to thank you and your staff for the professional and cooperative manner in which the audit was conducted.

Cc: M/CFO, S. Owens
M/CFO, T. Cully
M/MPI, S. Malone-Gilmer
M/FM/LM, M. Washington
M/FM/LM, C. VandenAssem
M/FM, D. Ostermeyer
M/FM/CAR, T. Vapniarek
M/FM/CAR, E. White

Summary of Discrepancies by Loan Program (in millions)

Direct Loan Program

Account Category	USAID Trial Balance	Riggs Loan Records	Absolute $ Var.	% Var.
Interest Receivable	344.2	378.4	34.1	9%
Loans Receivable	10,269.2	10,126.0	143.2	1%
Loans Rec'ble-MOV	73.0	21.4	51.6	241%
Loans Rec'ble–N/MOV	35.4	22.9	12.5	54%
Receivables	**10,721.8**	**10,548.7**	**241.4**	**2%**
Actual Collections-Prin.	694.5	730.3	35.8	5%
Actual Collections–Int.	268.3	268.6	0.3	0.1%
Collections	**962.8**	**998.9**	**36.1**	**4%**
Unapplied Collections	9.9	16.9	7.0	41%

Housing Guaranty Loan Program

Account Category	USAID Trial Balance	Riggs Loan Records	Absolute $ Var.	% Var.
Sub Claims Receivable	49.7	32.5	17.2	53%
Resked Claims Receivable	464.0	428.0	36.0	8%
Int. Rec'ble-Resked Loan	36.8	42.4	5.6	13%
Penalty Int Receivable	12.8	0.0	12.8	100%
Receivables	**563.3**	**502.9**	**71.6**	**14%**
Actual Collections-Prin.	13.2	18.1	4.9	27%
Actual Collections-Int.	14.7	18.9	4.2	22%
Actual Collections-Fees	8.4	8.5	0.1	1%
Collections	**36.3**	**45.5**	**9.2**	**20%**
Unapplied Collections	13.0	3.0	10.0	300%

Micro and Small Enterprises Development (MSED) Program

Account Category	USAID Trial Balance	Riggs Loan Records	Absolute $ Var.	% Var.
Loans Receivable	5.6	2.5	3.1	124%

The total variance (in absolute value) for USAID's Credit Program loans receivable amounted to approximately $316 million ($241.4 + $71.6 + $3.1).