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AUDIT OF
CARIBBEAN FINANCIAL SERVICES CORPORATION
PROJECT NO. 538-0084
AID REGIONAL DEVELOPMENT OFFICE/CARIBBEAN

Audit Report No. 1-538-87-04
October 31, 1986

AGENCY FOR INTERNATIONAL DEVELOPMENT

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October 31, 1986

MEMORANDUM

TO : Mr. James Holtaway, Director, RDO/C

FROM : RIG/A/T, Coinage N. Gothard, Jr.

Coinage N. Gothard

SUBJECT: Audit of Caribbean Financial Services Corporation (Project No. 538-0084), Report No. 1-538-87-04

This report presents the results of audit of the Caribbean Financial Services Corporation, Project No. 538-0084. The Office of the Regional Inspector General for Audit/Tegucigalpa made an economy and efficiency audit of the Caribbean Financial Services Corporation Project. The audit objectives were to determine whether CFSC had managed and utilized resources economically and efficiently, and whether the Corporation had complied with pertinent laws and regulations. Specific audit objectives were to evaluate CFSC's administrative procedures, lending criteria and practices, compliance with the loan and grant agreement, and fiscal practices and internal controls.

Staffing of the Caribbean Financial Service Corporation (CFSC) was not adequate to effectively administer the loan program, and adjustments were needed in the Corporation's lending criteria and practices. Although the Corporation's internal controls were adequate, certain of its fiscal policies and practices slowed the disbursement of loan and grant funds. As of March 31, 1986 the Corporation had made eight subloans with the $1.9 million in advances and direct payments it had received from AID. However, RDO/C financial monitoring of the project was deficient since $550,000 in advances had remained outstanding for almost a year. The Corporation had underutilized both loan and grant funds. AID's Regional Development Office/Caribbean had disbursed $1.9 million in loan funds to CFSC leaving nine months for the Corporation to receive and disburse $7.4 million to meet established project benchmarks. The Corporation had not found ways to use $364,000 in grant funds. Staffing was inadequate to efficiently and effectively implement all the components of the project, and the Corporation's credit and investment policy was too broad and lacked focus. Past and present Corporation Board members had opportunities to benefit from the Corporation's operations and investments. RDO/C monitoring of advances was deficient, and financial reporting on this project was inaccurate and therefore misleading to recipients.

We determined that $15.4 million or 89 percent of AID loan funds remained idle while 59 percent of the revised project implementation period remained. As of June, 1986 CFSC had used only $36,000 of the $400,000 available to it in RDO/C grant funds. CFSC had insufficient staff to efficiently and effectively implement all the components of Project No. 538-0084. The Corporation's management believed that in order to keep day-to-day operations cost-effective, staffing needed to be kept to a minimum. CFSC staffing consisted of the managing director, one loan officer, and one secretary. The credit and investment policy of CFSC was too broad and lacked focus due to the absence of criteria or targets regarding: investments in start-up and in other non-tourism projects; working capital loans; the establishment of a lower loan limit; and use of Corporation funds to finance non-AID loans. Also, the Corporation had fallen short in its job creation achievements. Several past and present Board members of CFSC could potentially benefit from CFSC's operations and investments. Board members' influence or relationship with other Board members could benefit themselves, their relatives, or the companies they either have represented or with which they were associated. Finally, two AID Regional Development Office/Caribbean reports on advances and disbursements, and on major outputs of the Caribbean Financial Services Corporation Project were inaccurate and therefore misleading to recipients.

We have recommended that: idle loan and grant funds be deobligated if plans for their effective use cannot be developed; either CFSC staffing be increased or project components be reduced; CFSC adjust its credit and investment policy, and amend certain Acts, By-Laws and General Policies; and RDO/C issue instructions regarding the verification of base data prior to reporting to AID/Washington.

Except for Recommendation No. 5, your responses and actions have indicated general agreement with the report's findings and recommendations.

Please provide written notice within 30 days of any additional information related to actions planned or taken to implement the recommendations.

EXECUTIVE SUMMARY

The Caribbean Financial Services Corporation Project (No. 538-0084) consisted of a $17.3 million loan and $400,000 grant to establish and capitalize the Caribbean Financial Services Corporation, and enable the Corporation to provide term financing (up to 15 years), and other financial services not traditionally available to private sector enterprises in the English-speaking Caribbean and Belize. The goal of the project was to stimulate expansion of the productive private sector in the English-speaking Caribbean, thereby creating employment, income, and foreign exchange earnings. AID's Regional Development Office/Caribbean executed the loan and grant agreement on July 29, 1983; the project, as amended, is to end on December 31, 1989. As of March 1986, $15.4 million of the $17.3 million in loan funds, and $364,000 of the $400,000 in grant funds, remained in the pipeline. At the same time, the Corporation's use of its own funds had the potential of depleting its equity from $2.7 million to $0.9 million if the borrowers were to default.

The Office of the Regional Inspector General for Audit/Tegucigalpa made an economy and efficiency audit of the Caribbean Financial Services Corporation. Specific audit objectives were to evaluate the Corporation's administrative procedures, lending criteria and practices, compliance with the loan and grant agreement, and fiscal practices and internal controls. Staffing of the Caribbean Financial Services Corporation was not adequate to effectively administer the loan program, and adjustments were needed in the Corporation's lending criteria and practices. Although the Corporation's internal controls were adequate, fiscal policies and practices slowed the disbursement of loan and grant funds.

AID's Regional Development Office/Caribbean had disbursed $1.9 million in loan funds to the Corporation leaving nine months for the Corporation to receive and disburse $7.4 million to meet established project benchmarks. The Corporation had not found ways to use $364,000 in grant funds. We made recommendations to assist in speeding up the disbursement, or reprogramming, of loan and grant resources. Staffing was not adequate to efficiently and effectively implement the components of the project, and the Corporation's credit and investment policy was too broad and lacked focus. We made recommendations to ensure adequate staffing, and cause the establishment of targets on investments. Past and present Corporation Board members had opportunities to benefit from the Corporation's operations and investments. We recommended that Corporation policies be modified. Mission reporting on project status was inaccurate and therefore misleading to recipients. We recommended that it develop an adequate data reporting system.

Office of the Inspector General

AUDIT OF
CARIBBEAN FINANCIAL SERVICES CORPORATION
PROJECT NO. 538-0084
AID REGIONAL DEVELOPMENT OFFICE/CARIBBEAN

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AID REGIONAL DEVELOPMENT OFFICE/CARIBBEAN

PART I - INTRODUCTION

A. Background

The Caribbean Financial Services Corporation Project No. 538-0084 consisted of a $17.3 million loan and $400,000 grant to establish and capitalize the Caribbean Financial Services Corporation (CFSC) and enable it to provide term financing (up to 15 years) and other financial services not traditionally available to private sector enterprises in the English-speaking Caribbean and Belize. The goal of the project was to stimulate expansion of the productive private sector in the English-speaking Caribbean, thereby creating employment, income, and foreign exchange earnings. AID's Regional Development Office/Caribbean (RDO/C) executed the loan and grant agreement on July 29, 1983; the project assistance completion date, as amended, is December 31, 1989. As of March 1986, $1.9 million of the $17.3 million in loan funds and $36,000 of the $400,000 in grant funds had been disbursed; also, CFSC had disbursed $1.8 million in its own funds to finance subloans not yet remitted to, or deemed ineligible for payment by AID.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa made an economy and efficiency audit of the Caribbean Financial Services Corporation Project. The audit objectives were to determine whether CFSC had managed and utilized resources economically and efficiently, and whether the Corporation had complied with pertinent laws and regulations. Specific audit objectives were to evaluate CFSC's administrative procedures, lending criteria and practices, compliance with the loan and grant agreement, and fiscal practices and internal controls.

Audit work was performed at the AID Regional Development Office/Caribbean and at CFSC's headquarters, both located in Bridgetown, Barbados. Field verifications were made in Antigua, Barbados, St. Kitts, and St. Lucia. The audit was made during the period May 28, 1986 through July 31, 1986, and covered the period from project inception (July 29, 1983) through March 31, 1986. An exit conference was held on July 31, 1986 and AID Regional Development Office/ Caribbean responded to the draft report on October 28, 1986. Their comments were considered in the preparation of this report. The audit was made in accordance with generally accepted government auditing standards.

AUDIT OF
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PART II - RESULTS OF AUDIT

Staffing of the Caribbean Financial Service Corporation (CFSC) was not adequate to effectively administer the loan program, and adjustments were needed in the Corporation's lending criteria and practices. Although the Corporation's internal controls were adequate, certain of its fiscal policies and practices slowed the disbursement of loan and grant funds.

As of March 31, 1986 the Corporation had made eight subloans with the $1.9 million in advances and direct payments it had received from AID. However, RDO/C financial monitoring of the project was deficient since $550,000 in advances had remained outstanding for almost a year.

The Corporation had underutilized both loans and grant funds. AID's Regional Development Office/Caribbean had disbursed $1.9 million in loan funds to CFSC leaving nine months for the Corporation to receive and disburse $7.4 million to meet established project benchmarks. The Corporation had not found ways to use $364,000 in grant funds. Staffing was inadequate to efficiently and effectively implement all the components of the project, and the Corporation's credit and investment policy was too broad and lacked focus. Past and present Corporation Board members had opportunities to benefit from the Corporation's operations and investments. RDO/C monitoring of advances was deficient, and financial reporting on this project was inaccurate and therefore misleading to recipients.

We have made recommendations to: assist in speeding the utilization or reprogramming of loan and grant funds; ensure adequate staffing; develop targets for investments; modify Corporation policies; and devise an adequate data reporting system.

A. Findings and Recommendations

1. Loan Funds Were Idle

Project planners envisioned that the disbursement of loan funds by the Caribbean Financial Services Corporation (CFSC) to project beneficiaries in the form of direct lending, discounting, and general financial services would approximate $9.3 million by the end of December 1986. While the AID Regional Development Office/Caribbean (RDO/C) listed $5 million in accrued expenditures under this project, the Mission had actually disbursed only $1.9 million to the Corporation as of March 31, 1986. Notwithstanding this slow progress, twice in slightly more than a two-year period, AID had increased project obligations from $8 million to $17.3 million. On August 29, 1985 AID required CFSC to increase its equity contribution to the project from $2 million to $3 million; as of August 1986, CFSC was short of the mark by $350,000. CFSC's lagging loan portfolio was attributable to the fact that it had maintained a conservative lending approach, ignoring economically feasible albeit riskier lending possibilities, and favoring more traditional, established, low-risk applicants. As a result, $15.4 million or 89 percent of AID loan funds remained idle while 59 percent of the revised project implementation period remained. CFSC needs to accelerate its utilization of project funds by raising its visibility and by attempting to serve all the sectors targeted under the project. A plan for more effective use of project funds needs to be established.

Recommendation No. 1

We recommend that the AID Regional Development Office/ Caribbean:

a) assist the Caribbean Financial Services Corporation in either developing a specific plan for the effective use of project funds obligated under Project No. 538-0084; or,

b) deobligate and transfer idle funds to another eligible project if the development of such a plan is not feasible.

Discussion

The project paper contained a cost estimate and financial plan calling for $12 million in RDO/C loan assistance and $400,000 in RDO/C grant assistance. To further capitalize the project CFSC was to contribute $2 million in shareholders' equity. On August 31, 1983 and August 29, 1985 RDO/C increased loan obligations by $4 million and $5.3 million respectively, thereby increasing RDO/C loan assistance from an original obligation of $8 million to $17.3 million. On the latter date, CFSC was required to increase paid-in equity to $3 million. RDO/C noted that CFSC did not have to increase the equity contribution until such time that CFSC begins to draw down the last $5.3 million in obligations. As of August 30, 1986, however, CFSC had increased its equity to only $2.65 million. The increase in loan obligations was not accompanied by a corresponding adjustment of the financial plan contained in the project paper; the unadjusted financial plan, therefore, was not commensurate with the project's new targets and goals.

Based on the original cost estimate and financial plan, CFSC was to have used, by the end of December 1986, $9.3 million in RDO/C loan funds in the form of direct lending, discounting, and general financial services.

Direct Lending - By December 31, 1986, CFSC was expected to have used $4.4 million in RDO/C loan funds for direct lending activities. As of March 31, 1986, CFSC's portfolio consisted of 24 approved loans in the amount of $6 million. (There were three additional loan applications pending CFSC approval.) Of the 24 CFSC had disbursed 18 of the loans in the amount of $3.7 million. However, not all of the 24 loan approvals were allocable to RDO/C. Some did not meet the criteria for AID financing (for example, loans made to firms in Guyana, a country in default to the United States Government, and loans for projects with questionable developmental impact) and had therefore been financed from CFSC's own funds. The specific number and value of non-RDO/C loans was not classified in the Corporation's records, rather, this was developed through audit.

RDO/C had listed in its financial and project status reports $5 million in accrued expenditures based on a handwritten memorandum from the project officer to an employee in the Controller's office. According to the employee, no detail or justification was requested to support the $5 million figure. According to the Controller's records, only $1.9 million had been disbursed by RDO/C to CFSC for eight loans. This $1.9 million in payments included $550,000 in outstanding advances. As of March 31, 1986, the $550,000 in advances had been outstanding for almost a year. Actual lending by CFSC had been far less than anticipated, and a serious breakdown in reporting had occurred. Direct lending was only one of three project components to be implemented by CFSC, however.

Discounting - According to the project paper, CFSC was to have used $4.3 million in RDO/C loan funds for discounting by the end of December 1986. According to the loan agreement, CFSC discounting would involve the execution of umbrella agreements with commercial banks, which would define the mechanism for loan discounting. The actual discount rate was to be negotiated on an institution-by-institution basis, but the participating financial institutions were expected to receive a yield of four to five percent for originating, servicing, and taking the commercial risk on subloans As of June 30, 1986, there were no RDO/C loan fund disbursements for this purpose. CFSC's Managing Director argued that Eastern Caribbean economic trends, coupled with excess liquidity being experienced by commercial banks, did not warrant CFSC's involvement in a discount program. Thus, CFSC had yet to enter into any umbrella agreements for that purpose with commercial banks.

General Financial Services - By December 31, 1986 CFSC was to have used $500,000 in RDO/C loan funds for general financial services. Under this heading CFSC was to explore the potential offered by activities such as leasing, warehouse bonding, inventory financing, export financing, debt guaranteeing, loan syndication, cash management, and financial advisory services. These were to be geared to the productive private sector which project designers felt was not being adequately served in these areas. As of June 30, 1986 expenditures under this project component were nil because CFSC had not taken any action to implement it. CFSC obviously lacked the staffing necessary to activate this activity.

In summary, CFSC had not implemented programs for discounting and general financial services. Its direct lending program had fallen far short of expectations. CFSC's conservative approach, coupled with an apparent excess of AID loan funds, needs to be addressed. Unless a specific plan is developed and implemented, RDO/C resources for the project will not be economically and efficiently utilized in accordance with AID mandates.

In response to our preliminary finding statements, RDO/C advised us that CFSC had devised a mechanism in lieu of the discount procedure which achieved the same purpose, and which was being used. They felt that failure to mention this would leave the false impression that CFSC was not collaborating with commercial banks as anticipated under the planned discount operation. However, neither RDO/C nor CFSC furnished evidence that the Corporation had devised a substitute for the discount program. Project disbursements of $1.9 million had been made for eight subloans under the direct lending component only.

Management Comments

CFSC advised RDO/C that it was preparing a portfolio development plan, and expected to resolve the recommendation within 30 days of receipt of the audit report.

Office of Inspector General Comments

Recommendation No. 1 remains open pending management's formulation of an effective development plan.

2. Grant Funds Were Not Used

As of June, 1986 the Caribbean Financial Services Corporation (CFSC) had used only $36,000 of the $400,000 available to it in RDO/C grant funds. The AID Regional Development Office/Caribbean (RDO/C) granted the funds to CFSC to contract a project coordinator, carry out a search for a qualified Managing Director, and provide technical assistance in establishing the basic operational procedures of CFSC. All of these components were carried out at about 9 percent of the estimated cost. As a result, $364,000 lay idle.

Recommendation No. 2

We recommend that the AID Regional Development Office/Caribbean deobligate $364,000 in funds granted to the Caribbean Financial Services Corporation under Project No. 538-0084, or amend the grant in accordance with a specific plan in order to effectively utilize grant resources.

Discussion

As of June 1986 -- after almost three years of project activities -- CFSC had used $36,000 of the $400,000 in grant funds provided by RDO/C. The purpose of the grant was to assist CFSC in financing foreign exchange and local currency costs for Project No. 538-0084, as well as for CFSC start-up costs, which were to include the provision of technical assistance in establishing basic operational, administrative, and accounting systems.

From CFSC's viewpoint, the project started at a time when Eastern Caribbean economies were experiencing a recession. Thus, CFSC management was particularly cautious in using AID grant funds. To date, CFSC has maintained that basic policy. Consequently, just at the time when CFSC should have been most active in counteracting the effects of the regionwide recession, it had failed to do so to its own and potential beneficiaries' detriment.

Management Comments

CFSC advised RDO/C that it was preparing a grant use plan, and expected to resolve the recommendation within 30 days of receipt of the audit report.

Inspector General Comments

Recommendation No. 2 remains open pending management's development of an effective plan to use AID grant funds and subsequent incorporation of the plan in a grant amendment, or pending management actions to deobligate.

3. Corporation Staffing Was Inadequate

The Caribbean Financial Services Corporation (CFSC) had insufficient staff to efficiently and effectively implement all the components of Project No. 538-0084. The Corporation's management believed that in order to keep day-to-day operations cost-effective, staffing needed to be kept to a minimum. CFSC staffing consisted of the managing director, one loan officer, and one secretary. Project planners, on the other hand, had envisioned that CFSC would provide an array of discounting, direct lending, and general financial services. In order to effectively carry out these project components, the Corporation needed to either hire, or consult with, individuals with expertise in accounting, insurance and bonding, customer investigations and services, marketing, and overall management. CFSC had not begun to address the majority of the project's objectives and the benefits expected from CFSC activity had not materialized.

Recommendation No. 3

We recommend that the AID Regional Development Office/Caribbean either:

a) ensure that the Caribbean Financial Services Corporation obtains sufficient personnel to effectively implement all the components of Project No. 538-0084; or,

b) reduce the components of Project No. 538-0084, and the associated project budget, to a level commensurate with the corporate strategy and level of operations of the Caribbean Financial Services Corporation.

Discussion

In order to carry out its development strategy CFSC was to recruit and train an adequate complement of quality staff. CFSC's business plan consisted of developing and implementing: operational and administrative procedures; accounting and management information systems; credit analysis and monitoring activities. The business plan was incorporated in all the project components -- direct lending, discounting, and general financial services. Under these components, CFSC would provide services ranging from lending to leasing and warehouse bonding, including cash management and financial advisory services. At the time of our review, however, CFSC staffing was composed of the managing director, one loan officer, and one secretary.

Up to July 1986, CFSC management had resisted the introduction of technical assistance and expansion of staff, except for an accounting position to be filled by October 1986. They argued that minimum staffing was needed in order to keep CFSC's day-to-day operations cost-effective.

Because it had inadequate staff, CFSC had not yet begun to address major project objectives. Nor could CFSC expand its scope of operations to assist other markets; provide other non-available financial services as envisioned in the project paper; efficiently utilize and monitor use of loan funds; or effectively attain project milestones.

Management Comments

CFSC advised RDO/C that it was preparing a staff expansion plan, and expected to resolve the recommendation within 30 days of receipt of the audit report.

Inspector General Comments

Recommendation No. 3 remains open pending management's development of a realistic staff expansion plan.

4. Adjustments In Investment Policy Were Needed

The credit and investment policy of the Caribbean Financial Services Corporation (CFSC) was too broad and lacked focus due to the absence of criteria or targets regarding: investments in start-up and in other non-tourism projects; working capital loans; the establishment of a lower loan limit; and use of Corporation funds to finance non-AID loans. Also, the Corporation was off target regarding the employment opportunities its services were to generate. Clear, well-defined credit procedures and lending policies are necessary in order for CFSC to carry out its tasks effectively and accomplish planned objectives. CFSC's Board of Directors' functions were primarily operational rather than advisory or policy setting, and thus the Corporation lacked overall policy direction. As a result, the Corporation had not been working towards accomplishing the goals set forth in the loan and grant agreement; its loan portfolio was unbalanced in terms of targeted economic activities; and the number of employment opportunities generated by CFSC operations and investments had not had their expected impact. Also, several of the Corporation's lending decisions were based on clients' appeal and relationships with Board members rather than project viability and developmental impact. Moreover, actions taken in approving and rejecting loans gave the appearance of a less than systematic decision-making process.

Recommendation No. 4

We recommend that the AID Regional Development Office/Caribbean take action to have the Caribbean Financial Services Corporation:

a) establish targets regarding investments in business start-up and non-tourism projects;

b) determine a loan limit range, and formally document the lower loan limit in its policy and procedures;

c) develop and formally document its policy on loans to finance working capital;

d) clearly define, and submit to AID for approval, its policy for using its funds to finance non-AID-funded loans; and

e) direct its policy and planning efforts to meet the objectives and targets of Project No. 538-0084, or otherwise the Regional Development Office/Caribbean should modify them to coincide with the Caribbean Financial Services Corporation's actual credit and investment policies.

Discussion

CFSC had primarily concentrated on financing established, expanding businesses, and, as a matter of general practice, making loans in amounts not less than $100,000. The tourist sector share in its loan portfolio as of March 31, 1986 was 44 percent, while other sectors of the Eastern Caribbean economy had received disproportionally less support. CFSC management had been operating with a banking, profit-oriented mentality, lending primarily for traditional purposes with low financial risk. Consequently, loan applications for new projects start-ups and for small, non-traditional but feasible and productive activities were seldom approved. To illustrate, about 89 percent of the approved loan applications were for the expansion of well-established businesses.

We visited nine firms to determine the reasons for loan rejection or acceptance.

St. Lucia - Two new business start-ups, one a nail manufacturing operation and the other a computer services firm, were turned down by CFSC. On the other hand, loans for expansion purposes were awarded to a resort hotel established in 1905, and an edible oil manufacturing plant founded in 1952 (see Exhibit 1, Page 1). CFSC responded that the principal sponsor of the computer services firm was not reliable.

St. Kitts - Two firms, one a poultry operation and the other an electronic components producer, were awarded CFSC loans. While the poultry operation was considered by CFSC to be a start-up enterprise, the principal of the firm had been in the business all his life, with already established ties to the business community; the electronic components producer was awarded a loan to expand already ongoing operations.

Barbados - A well established biscuit company received a CFSC loan for plant expansion and a traditional household appliance firm received a loan to finance working capital.

Antigua - CFSC made a loan to a hotel that had been in business for 26 years (see Exhibit 1, Page 2). In a break from normal lending practices, CFSC lent $50,000 to a new water sports business (see Exhibit 1, Page 3). The owner of this business was a nephew of one of CFSC's Directors.

CFSC justifications for approving or rejecting loan applications differed depending on the situation, and reflected a need to develop uniform criteria and targets regarding investments in business start-ups and in non-tourism projects. Recognizing this fact, on March 31, 1986, RDO/C reported: "...during the next six months we expect CFSC to consider at least one 'pioneering' loan and begin at least one activity in the 'other financial services' area."

In addition to the above, the following anomalies in CFSC's lending policy were also noted:

-- On June 25, 1985 CFSC lent $300,000 to a household appliance firm to finance working capital. However, on February 13, 1986 CFSC informed a mattress manufacturer that its $350,000 loan application had been turned down on the basis that CFSC did not make working capital loans. A $350,000 loan application from a building supplier was rejected on the same basis. The working capital loan approved for the household appliance firm was secured with a bank letter of credit; there was no evidence, however, that the other applicants had been given the opportunity to seek bank guaranties for their loan applications.

-- On January 31, 1985 CFSC's Board of Directors approved a $50,000 loan to a nephew of one of its members to purchase equipment for a water sports business. Yet, on October 26, 1984, the Board had rejected a similar loan application on the basis that "this line of business was not identified as falling within CFSC's lending strategy."

There was no evidence that RDO/C was aware of the above discrepancies in CFSC's lending policy, and thus there had been no attempt by RDO/C to have the Corporation take corrective action.

Tourism - As of March 31, 1986, 44 percent of the CFSC loan portfolio was devoted to tourism. RDO/C recognized this imbalance and stated in its March 31, 1986 progress report: "If CFSC is to use its concessionary capital base to promote the diversification and modernization of the regional economy, it will have to allocate a larger share of its lending to innovative projects in manufacturing, agri-industry and non-tourism services." We fully agree with RDO/C's assessment which needs to be effectively communicated to CFSC.

Loan Limits - AID had placed an upper loan limit on CFSC lending practices. The loan and grant agreement executed by RDO/C with CFSC limited the maximum total amount of outstanding loans to any subborrower to be no more that 15 percent of the Corporation's equity base at the time subloans were made.

CFSC had not developed an established policy on lower loan limits. The CFSC Managing Director told us that the "practiced" lower lending limit was $100,000. We found that 23 of 27 loan applications (including the three applications pending approval) or 85 percent exceeded $100,000. The remaining four loans were in the amounts of $50,000, $25,000, $75,000 and $35,000. The first was made to a relative of a Board member; the second (delinquent) was made to finance equipment for a handbag manufacturer. This loan was made despite the fact that CFSC had reviewed the credit history of the owner and found that a loan would not have been an acceptable risk because his other business activities were in default on loan payments. On January 23, 1986, CFSC noted that the interest on the CFSC loan was current but the principal was in arrears. The third loan was executed with a firm in Guyana (this country is in default to the United States Government); the fourth loan was made to a construction firm for the purchase of equipment. The source of financing for each of these four loans was CFSC funding.

CFSC Funding - It was CFSC policy to charge 11 percent interest on commercial loans and five percent interest on employee loans. CFSC had lent (with terms of up to 15 years) $72,000 at five percent interest to two of its employees (a loan officer and a secretary). Also, CFSC paid from its own funds hotel and other subsistence expenses four times a year for non-resident Board members to attend Board meetings in Barbados.

CFSC occasionally held luncheons and buffet dinners, extraordinary meetings, and entertainment functions for Board members and guests. Expenditures generated from these functions depleted Corporate funds. Further, at the second annual meeting of CFSC's shareholders, held on June 27, 1986, a new budget line to cover Board Directors' annual fees was approved; these fees now in effect were to be paid out in addition to reimbursing the expenses "normally" incurred by the Directors.

As of March 31, 1986 CFSC had executed 18 of 24 approved loans in the amount of $3.7 million; eight of the loans, totaling $1.9 million, had been financed by RDO/C, and CFSC had used its own funding to finance the remaining loans that were either ineligible for financing, or not yet approved by RDO/C. In order to fund the loans totaling $1.8 million, CFSC could deplete its equity base from $2.7 million to $0.9 million if these loans default.

In our opinion, CFSC needs to reexamine the use of its own funds in order to avoid facing the type of crisis which was being experienced by the Barbados Development Bank (BDB). The Barbados Minister of Finance was quoted in a local newspaper as saying that "an independent agency has reported that 64 percent of its (BDB'S) loan portfolio is contaminated and almost half of its equity has been wiped out."

Job Impact - Project planners envisioned that a major CFSC project subgoal was to be the substantial creation of new jobs as a direct result of Corporation-sponsored activities. According to project paper estimates, these activities should have generated, by March 1986, 2,392 project-related new jobs; yet, only 57 jobs (or 24 percent of those targeted) plus 206 non-project-related jobs had been created. A summary of CFSC's relatively minor impact on the regional labor market follows:

Project-Related Activities 1/ Loan Recipient	Loan Amount ($000)	Job Impact (# of new jobs)
B.R.C. (West Indies) Ltd. (Steel building manufacturing; Barbados)	325	22
Gulfstream Industries (Household appliances assembly; Barbados)	300	0
Copra Manufacturers, Ltd. (Edible oil manufacturing; St. Lucia)	350	0
Andrew E. Holm 2/ (Hotel expansion; Antigua)	350	15
H.M.B. Holdings, Ltd. (Hotel upgrading; Antigua)	120	0
West India Buiscuit Co. 2/ (Food manufacturing; Barbados)	200	6
Fish of Barbados (Fish processing; Barbados)	110	6
Hill Milling, Co. (Rice milling; Barbados)	185	8
Totals	$1,940	57

Non-Project-Related Activities 3/ (figures in aggregate) Loan Recipients	Loan Amount ($000)	Job Impact (# of new jobs)
14	3,395	206

1/ Loans which had qualified for AID reimbursement.

2/ Though CFSC had financed this loan using RDO/C advances, RDO/C had yet to receive full loan-related documentation and thus recover its advance(s). These advances have been outstanding almost a year.

3/ While CFSC had approved or financed the loans under this category, some did not qualify or had not yet qualified for AID reimbursement. In order to reflect current status we included loans subsequent to the March 31, 1986 out-off date. CFSC had dropped two of the approved loans subsequent to March 31, 1986.

CFSC needs to develop specific criteria on investments, working capital, lower loan limits, and use of its funds for financing purposes. Also, CFSC needs to ensure that each loan approval will generate a significant number of jobs to effectively impact on the regional labor market and meet established project targets. Unless CFSC adjusts its investment policy and effectively uses project funding, this project will continue to achieve less than planned results.

Management Comments

CFSC advised RDO/C that a General Operations and Policy Statement was in preparation, and expected to meet the requirements of Recommendation No. 4 within 30 days of receipt of the audit report.

Inspector General Comments

All parts [a) through e)] of Recommendation No. 4 remain open until such time as management fully responds.

5. Potential Self-Dealing Could Harm CFSC's Image

Several past and present Board members of the Caribbean Financial Services Corporation (CFSC) could potentially benefit from CFSC's operations and investments. Board members' influence or relationship with other Board members could benefit themselves, their relatives, or the companies they either represented or with which they were associated. CFSC had been expected to observe ethical business standards in order to establish its reputation as an independent, private sector financing resource, and carry out its tasks with credibility and effectiveness. Although the Corporation addressed such standards in its General Policy and Operations Statement, its ambiguous wording afforded, Board members ample flexibility to be involved in potential self-dealing situations. Unless this situation is corrected, the Corporation's program is vulnerable to waste, abuse, and mismanagement which can damage the program's credibility and overall effectiveness.

Recommendation No. 5

We recommend that the AID Regional Development Office/ Caribbean:

a) have the Caribbean Financial Services Corporation amend its Acts, By-Laws, and General Policy and Operations Statement to include firm criteria covering the qualifications for membership on the Corporation's Board of Directors, and to include safeguards which preclude members, their relatives, and the companies they either represent or are associated with, from benefiting from CFSC's operations and investments; and,

b) review and document those instances where cases of self-dealing have developed, and have the Caribbean Financial Services Corporation take corrective action.

Discussion

The issue of potential self-dealing within the Caribbean Financial Service Corporation arises from the fact that several past and present CFSC's Board Directors, through their influence or relationship with other Board members, have been in a position to derive benefits from CFSC operations and investments for themselves, relatives, and the companies or institutions they either represented or with which they were associated. Several companies which service and provide outside support to CFSC operations either have or have had representatives on the Corporation's Board of Directors; in some instances, those companies have been major shareholders of the Corporation as well. CFSC's General Policy and Operations Statement (# 7 Ethical Standards) addresses the issue of potential self-dealing and conflict of interest. It states that "the Corporation shall not make any investment in any enterprise in which the Directors, officers and/or employees of the Corporation hold an interest directly or indirectly...." Yet, that same section contains provisions that provide ample flexibility for CFSC's Directors to be involved in situations of potential self-dealing. For example, the caption "Use of Corporate Resources" first prohibits "the use of the Corporation's resources for the personal benefit of any Directors/Officer/employee ...." only to be reversed by stating ".... unless authorized by the Directors whose discretion may be exercised in such decisions." (underline added). Therefore, CFSC Board members, at their own discretion, may be able to benefit from CFSC's resources, operations, and investments. To illustrate:

CFSC's Board Member	Indicators of Potential Self-Dealing
"X" (Chairman)	Head of "X" Enterprises Ltd., which owns 502 shares (1.8%) of CFSC stock. Without using competitive bids, CFSC subscribed a comprehensive insurance policy (employer's liability, consequential loss, etc.) with ____ Insurance Co. Ltd., associated with "X" Enterprises Ltd.
	CFSC responded that quotes from competing insurance companies were prohibitive, and the CFSC Managing Director's acquaintance with the General Manager of the insurance company enabled CFSC to negotiate a reasonable premium with more comprehensive coverage.
"Y" (Managing Director)	Worked eight years for the ____ Bank, which invested in 1,500 shares (5.6%) of CFSC stock, before joining CFSC. CFSC has a U.S. dollar account with this bank.
	CFSC responded that it opened the account at the bank's New York office; the bank's office in Bridgetown facilitated use of the New York account; the account was not subject to service charges or minimum balance, and that such terms could not be bettered. They also noted that the bank was not represented on the CFSC Board of Directors.
"Z"*	Senior Vice President/General Manager, ____ Bank, which invested in 2,400 shares (9.0%) of CFSC stock. CFSC has an account with this bank.
	CFSC responded that this bank was not represented on the CFSC Board of Directors at the time the account was opened.
"A"*	Senior Vice President, ____ Bank, which owns 2,500 shares (9.4%) of CFSC stock. CFSC has an account with this bank.

* No longer serving on the Board, although CFSC still did business with the corresponding institution.

CFSC responded that the account for this bank, too, was opened prior to its representation on CFSC's Board of Directors.

"B" Representing ____ Bank, "B" filled the vacancy left by A's resignation from the Board. *

"C" Recently appointed to the Board (on June 27, 1986) "C" represents ____ Bank, previously represented on the Board by Mr. "Z". CFSC always kept its account with this bank.

CFSC pointed out that commercial banks were CFSC's largest shareholders; that they would hold two seats on the CFSC Board to be rotated among them every three years; and that the rotation represented by B and C above was normal turnover.

"D" His nephew received a $50,000 loan from CFSC for an activity which CFSC defined as not falling within its lending strategy. Also had an interest (disclosed) in the ____ Hotel, Antigua. CFSC approved a $250,000 loan for the hotel.

CFSC responded that its Board members were often holders of shares in companies with which the institution proposes to do business; that Board members were required to declare their interest; and that Board member "D" made no input into either of the proposals, disclosed his association with both, and did not participate in the approval process.

"E" Had an interest (disclosed) in ____ Manufacturers Co., St. Lucia. CFSC lent $350,000 to this company.

CFSC responded that Board member "E" explained his indirect interest and was not involved in the approval process.

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* No longer serving on the Board, although CFSC still did business with the corresponding institution.

Based on the foregoing relationships, it is our opinion that the CFSC program was vulnerable to self-dealing and abuse which could subject the Corporation to criticism, and therefore affect its credibility and overall effectiveness.

Management Comments

CFSC took issue with the entire presentation on potential self-dealing. They termed the above summary "innuendo-laden." RDO/C generally supported CFSC's response. They said that the specific examples were misleading since all cited indicators were apparently those relating to potential conflicts of interest in situations in which the CFSC standards specifically, and without exception, operated to prevent self-dealing. They concluded that the established CFSC standards have worked, and suggested that the basic concerns reflected by audit may be worthy of prospective Agency-wide attention as to whether in the future uniform standards for AID-financed private sector activities should be developed. The entire RDO/C response is attached as Appendix 1.

Office of the Inspector General Comments

Based on RDO/C's confidence in CFSC's standards relevant to potential self-dealing, Recommendation No. 5 is closed effective the date of this report.

However, we wish to note certain dissent from the cognizant AID regional legal advisor's opinion when he states: "We submit that the record shows CFSC Board members/officers, in fact, have acted responsibly in a fashion which, consistent with USG standards of conduct for its own officers, has seen them removing themselves from all decisions in which their personal financial interests may be affected." (Appendix 1, page 2, top paragraph.) An officer of the USG has no discretion (as permitted in CFSC's ethical standards) as to whether or not s/he may participate in decisions of the type mentioned in this report; they simply cannot and should not.

Moreover, CFSC's protestations to the contrary notwithstanding, the fact that questionable and/or inconsistent loan award decisions were in fact made, regardless of who actually voted on them, is something which we believe should give RDO/C pause. Again, to cite the USG's standards for the conduct of its own employees: not only must they ensure that they do not engage in any wrongdoing, but they must also safeguard against even the appearance of wrongdoing.

While we would not urge so strict a standard for the conduct of commerce, in our opinion, any commercial enterprise, and especially one that is attempting to break into a traditional, conservative financial marketplace as is the case with CFSC, must exercise prudence in considering the image its lending decisions will create among members of the local financial community and, in this case, how they may also affect AID's image in the region.

6. Mission Reporting on Project Status Was Inaccurate

Two AID Regional Development Office/Caribbean reports on advances and disbursements, and on major outputs of the Caribbean Financial Services Corporation Project were inaccurate and therefore misleading to recipients. AID Handbook 3, 11-F, describes project officers' responsibilities, and the standards to be followed regarding project status reporting. Inaccurate Mission reporting was caused by ineffective project management which led to overstatements of figures and facts in both financial and project progress reports. Inaccurate reporting was detrimental: management was not able to effectively assess project implementation or take corrective actions.

Recommendation No. 6

We recommend that the AID Regional Development Office/Caribbean develop a Mission Order which, among other safeguards, requires its project officers to periodically verify the base data to support figures and facts that appear in project-related reporting, thereby ensuring the accuracy and reliability of RDO/C reporting to AID/Washington.

Discussion

In our review of the March 31, 1986 RDO/C financial and project progress reports, we found discrepancies between significant, reported, project-related figures and facts and those contained in the RDO/C Controller's and CFSC's files. To illustrate:

	Cumulative Obligations ($000)	Cumulative Expenditures ($000)	% Obligations Expended	Pipeline ($000)
RDO/C				
Financial Status ("Pipeline") Report	17,335	5,016	29%	12,319
Controller's Office Records	17,335	1,940 *	11%	15,395

	Major Project Outputs (No. of Loans)
RDO/C Project Status Report	24 **
CFSC Records	8

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* Includes advances and direct payments.

** While CFSC had approved 24 loans, eight (including two for which advances were outstanding) had received AID funds at the time of the reporting, and only these could be considered project-related.

Moreover, the progress report under the caption "Other Accomplishments and Overall Status" stated "CFSC is in good financial and operational shape." Contrary to that statement, however, CFSC could not have been in good financial shape when, at the time, it had committed itself to finance 17 loans valued at $4,251,000 with $2,732,691 in cash represented by its own funds, and unsure prospects of RDO/C financial support. The Mission Director's Assessment favorably graded the project "(A) No major implementation problems." This assessment differed the findings presented in this audit report.

Management Comments

RDO/C responded that it was taking action to meet the requirements of Recommendation No. 6.

Office of Inspector General Comments

Recommendation No. 6 remains open until resolved by RDO/C.

B. Compliance and Internal Controls

Compliance

Other than the conditions noted in this report, nothing came to our attention as a result of specified procedures that caused us to believe that untested items were not in compliance with applicable laws and regulations.

Internal Controls

There were three internal control exceptions:

-- $550,000 in advances had been outstanding almost a year (Finding 4).

-- Past and present Board members of the Caribbean Financial Services Corporation had an opportunity to benefit from the Corporation's operations and investments (Finding 5).

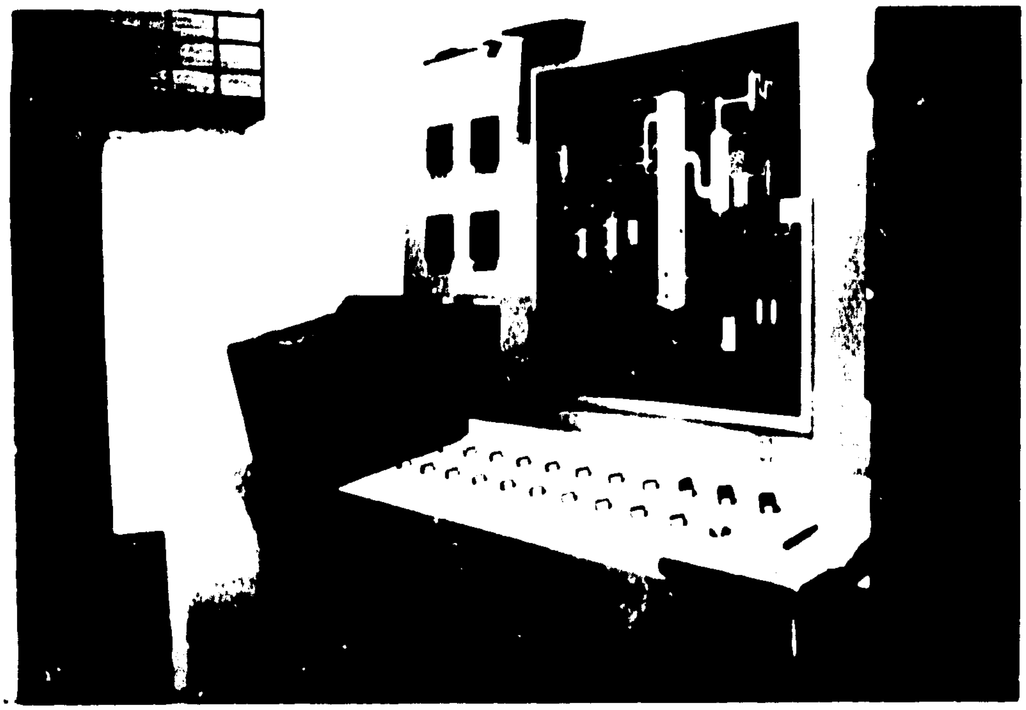
-- Two AID Regional Development Office/ Caribbean reports on advances and disbursements, and on major outputs of the project were inaccurate due to ineffective project management (Finding 6).

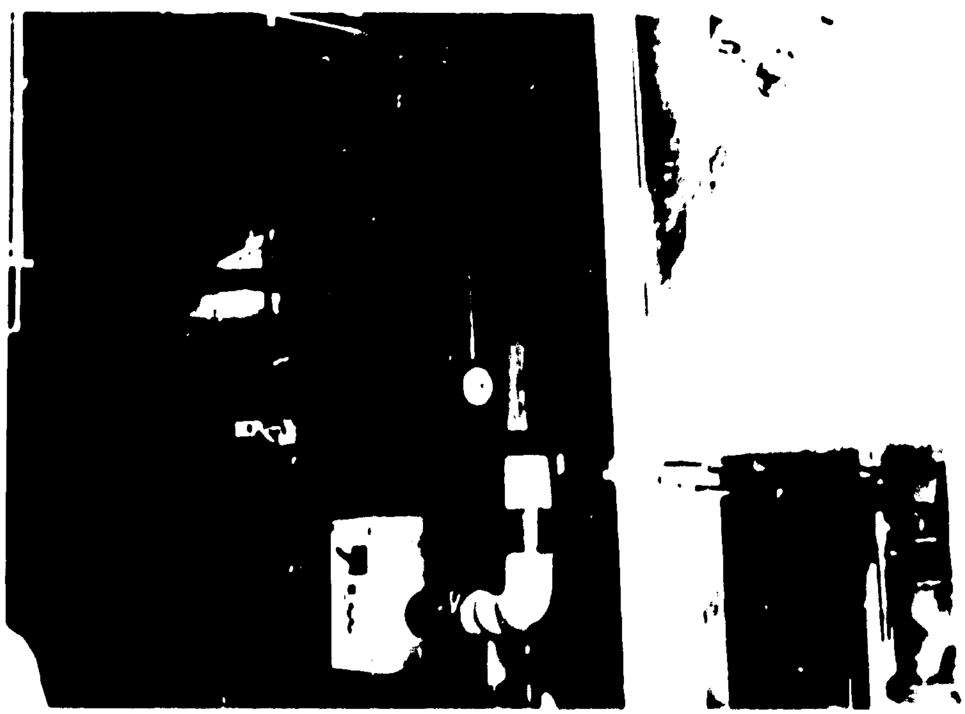
AUDIT OF
CARIBBEAN FINANCIAL SERVICES CORPORATION
PROJECT NO. 538-0084
AID REGIONAL DEVELOPMENT OFFICE/CARIBBEAN

PART III - EXHIBITS AND APPENDICES

Illustrative Examples of
Corporation-Funded Projects

Manufacturing
(Equipment for Edible Oil Plant Expansion)





Tourism
(Water Desalinization Plant for Hotel Expansion)

Tourism
(Equipment for Water Sports Business Start)

CFSC lent $50,000 to a relative of a Board member to finance equipment for water sports while rejecting a similar loan application on the basis that the line of business was not identified as falling within CFSC's lending strategy. The borrower told us that he would soon be going out of business. We noted that his headquarters (above) was without a telephone, a necessary tool in the tourist trade.

$35,000 of the $50,000 was used to purchase the speedboat shown above.

ACTION: RIG-3 INFO: AMB DCM/5

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VZCZCTG0264
OO RUEHTG
DE RUEHWN #8169/01 3011537
ZNR UUUUU ZZH
O 281535Z OCT 86
FM AMEMBASSY BRIDGETOWN
TO RUEHTG/AMEMBASSY TEGUCIGALPA IMMEDIATE 0382
INFO RUEHC/SECSTATE WASHDC 2247
BT
UNCLAS BRIDGETOWN 08169

28-OCT-86 TOR: 15:3
CN: 10947
CHRG: AID
DIST: RIG

AIDAC

PASS TO RIG/A/T, C. N. GOTHAGE

E.O. 12356: N/A
TAGS: NONE
SUBJECT: DRAFT AUDIT REPORT, PROJECT 538-0084, CFSC

REF: (A) BRIDGETOWN 7679, (B) TEGUCIGALPA 15772

1. WE AGREE THERE ARE SIMILARITIES BETWEEN THE CFSC COMMENT AND REF (A). THIS IS BECAUSE MISSION'S GENERAL VIEWS OF SUBJECT DRAFT REPORT ARE SIMILAR TO CFSC'S. AS REPORTED REF (A) MISSION AND CFSC STAFF REVIEWED THE DRAFT AUDIT REPORT TOGETHER AND REVIEWED EACH OTHER'S RESPONSES. SECTIONS OF THE CFSC COMMENT WERE REPEATED IN THE RDO/C CABLE TO MAKE IT A MATTER OF RECORD THAT THE IDEAS EXPRESSED WERE HELD ALSO BY RDO/C.

2. OUR CABLE IDENTIFIES THREE ERRORS OF FACT. THE FIRST, EQUITY PAY-IN, CAN BE VERIFIED BY READING THE LOAN AGREEMENT, AMENDMENT 2, SIGNED AUGUST 29, 1985. THE EQUITY PAY-IN UP TO DOLS3 MILLION IS A CONDITION PRECEDENT TO DISBURSEMENT OF THE FUNDS MADE AVAILABLE UNDER AMENDMENT NO. 2, AND NEED NOT BE MADE UNTIL CFSC WISHES TO DRAW DOWN THOSE FUNDS. THE SECOND, LOAN CEILING, IS VERIFIED BY THE DATE OF AN OCTOBER, 1984 EQUITY PAY-IN FROM IFC AND THE SUBSEQUENT DATE OF THE OFFERING LETTERS. WE HAVE INSPECTED CFSC RECORDS OF THESE SEQUENTIAL EVENTS. THE THIRD, EQUITY DEPLETION, IS APPARENTLY EITHER MISUNDERSTANDING OR MISUSE OF ACCOUNTING TERMINOLOGY AND CONCEPT. THIS POINT WAS DISCUSSED DURING THE RAF REVIEW, AND WE WERE SURPRISED TO SEE IT REAPPEAR IN THE DRAFT REPORT.

3. RIA HOLDS OPINION THAT ANY POSSIBILITY OF SELF-DEALING IN INSTANCES CITED IN REPORT IS NEGATED BY PLAIN FACT OF CONSCIENTIOUS, APPARENTLY SUCCESSFUL, EFFORTS OF CFSC OFFICIALS TO ABSENT THEMSELVES FROM DECISION-MAKING PROCESSES OF CFSC IN WHICH THEIR PERSONAL FINANCIAL INTERESTS MIGHT BE EFFECTED. TO INTIMATE OR CONCLUDE THAT AN OFFICER WHO DOES NOT PARTICIPATE IN A DECISION-MAKING PROCESS

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NEVERTHELESS CONTROLS OR INFLUENCES THAT PROCESS CAN BE NOTHING MORE THAN SPECULATION. WE SUBMIT THAT RECORD SHOWS CFSC BOARD MEMBERS/OFFICERS, IN FACT, HAVE ACTED RESPONSIBLY IN A FASHION WHICH, CONSISTENT WITH USG STANDARDS FOR CONDUCT OF ITS OWN OFFICERS, HAS SEEN THEM REMOVING THEMSELVES FROM ALL DECISIONS IN WHICH THEIR PERSONAL FINANCIAL INTERESTS MAY BE EFFECTED.

4. SPECIFICALLY, OF THE SUMMARIZED SITUATIONS RAISED IN THE DRAFT REPORT, X, D, AND E ALL INVOLVED TRANSACTIONS IN WHICH RDO/C HAS LEARNED THAT PERSONS INVOLVED DID NOT PARTICIPATE IN THE DECISION-MAKING PROCESS AFFECTING HIS INTEREST. ALSO, A, B, C, AND Z, INVOLVE INSTANCES IN WHICH THE PARTICULAR BOARD MEMBER, AT THE TIME HE BECAME A BOARD MEMBER, WAS AN OFFICER OF A BANK HOLDING STOCK SHARES IN CFSC. WE SUBMIT THIS SITUATION, IN AND OF ITSELF, IS NOT A CONFLICT SITUATION AND THAT A PARTICULAR BOARD MEMBER, BY NOT PARTICIPATING IN A DECISION-MAKING PROCESS AFFECTING HIS FINANCIAL INTERESTS AFTER HIS APPOINTMENT TO CFSC BOARD, AVOIDS A CONFLICT OF INTEREST SITUATION. CASE Y, IS A SITUATION IN WHICH OFFICER, BEFORE TAKING CFSC CHIEF EXECUTIVE POSITION, WORKED FOR A BANK WHICH PRESENTLY HOLDS CFSC STOCK SHARES. THIS OFFICER IS NO LONGER WITH SAID BANK AND HAS NO DISCERNIBLE FINANCIAL INTEREST IN CARRYING OUT BOARD APPROVED, CFSC TRANSATIONS WITH CHASE BANK.

5. DRAFT AUDIT REPORT, BY NOT FULLY QUOTING THE CFSC ETHICAL STANDARDS, CREATES UNWARRANTED IMPLICATIONS. IT IS CLEAR THAT THE CFSC ETHICAL STANDARDS IN ALL CASES WHERE THE BOARD IS DETERMINING TO INVEST IN AN ENTERPRISE REQUIRE THAT ANY DIRECTOR/OFFICER HAVING A FINANCIAL INTEREST ANNOUNCE THAT INTEREST AND NOT PARTICIPATE IN THE DECISION. THIS, INCIDENTALLY, IS CONSISTENT WITH THE COVENANT OF THE PROJECT AGREEMENT (SECTION 6.2 (Q)) WHICH REQUIRES SUCH A STANDARD OF CONDUCT TO BE OBSERVED. RDO/C ANALYSIS, AS SET FORTH ABOVE, SHOWS THAT THIS NON-PARTICIPATORY STANDARD HAS BEEN SCRUPULOUSLY OBSERVED BY CFSC. THE CAPTION QUOTE USE OF CORPORATE RESOURCES UNQUOTE IS NOT A LOOPHOLE WHICH PERMITS OFFICERS TO VIOLATE THE

PRESCRIBED CFSC CONFLICT OF INTEREST STANDARD. RATHER THE CORPORATE RESOURCES SECTION IS INTENDED AS A PROHIBITION TO ANY OFFICER MAKING USE OF CFSC PROPERTY OR FUNDS FOR HIS PERSONAL BENEFIT. FOR INSTANCE THIS WOULD BE A SITUATION SUCH AS PERSONAL USE OF A CFSC OWNED VEHICLE, MATERIALS, EQUIPMENT OR DRAWING ON CFSC'S FUNDS. THE CONFLICT OF INTEREST STANDARD IS AN ABSOLUTE BAR TO DECISION-MAKING PARTICIPATION AND IS NOT ALTERED BY THE CORPORATE RESOURCES PROVISION. EVEN THE CORPORATE RESOURCES PROVISION, IF INVOKED, WOULD REQUIRE AN OFFICIAL WITH A FINANCIAL INTEREST NOT TO PARTICIPATE IN A DECISION-MAKING PROCESS.

6. THE DRAFT REPORT, IN USING SPECIFIC EXAMPLES TO ILLUSTRATE THE QUOTE FLEXIBILITY UNQUOTE OF THE CORPORATE RESOURCES PROVISION AS INDICATORS-OF POTENTIAL SELF-DEALING IS MISLEADING SINCE ALL CITED INDICATORS ARE APPARENTLY THOSE RELATING TO POTENTIAL CONFLICTS OF INTEREST IN SITUATIONS IN WHICH THE CFSC STANDARDS SPECIFICALLY, AND WITHOUT EXCEPTION, OPERATED TO PREVENT SELF-DEALING. WE WOULD SUGGEST THAT THE BASIC CONCERNS REFLECTED IN THE DRAFT AUDIT REPORT MAY BE WORTHY OF PROSPECTIVE AGENCY-WIDE ATTENTION AS TO WHETHER IN THE FUTURE UNIFORM STANDARDS FOR AID-FINANCED PRIVATE SECTOR ACTIVITIES SHOULD BE DEVELOPED. WITH REGARD TO THIS PROJECT HOWEVER, THE ESTABLISHED CFSC STANDARDS HAVE WORKED, AND THE CONDUCT OF THE CFSC OFFICERS IN THE PROJECT HAS BEEN, AND IS, BEYOND REPROACH. IN SHORT, THE SYSTEM WORKS, AND THE POTENTIAL FOR CONFLICT OF INTERESTS IS BEING ADEQUATELY MET UNDER CFSC'S ESTABLISHED STANDARDS. WE WOULD HOPE THAT BEFORE ISSUANCE OF ANY RECOMMENDATION IN THIS PARTICULAR SUBJECT MATTER AND, GIVEN THE SEJITIVITY OF THE ISSUES, THAT YOUR AID/W RESOURCES BE CONSULTED. WE FEEL THIS POSITION IS MERITED BECAUSE THE DRAFT REPORT IS RECOMMENDING CFSC TAKE ACTION IN AN AREA WHERE THE FACTS INDICATE THAT, CONSISTENT WITH THEIR INTERNAL RULES, CFSC HAS TAKEN PAINS TO AVOID A CONFLICT OF INTEREST SITUATION FROM ARISING. THUS, WE AGAIN URGE YOU TO GIVE CAREFUL CONSIDERATION TO THE OBJECTIONS WE HAVE RAISED, AND IN THE MEANTIME WE ARE MOVING TO MEET RECOMMENDATIONS 1, 2, 3, 4, AND 6.

7. REF (A) WAS DULY REVIEWED AND CLEARED IN RDO/C AND WAS AUTHORIZED BY THE DIRECTOR AND HENCE REPRESENTS MISSION POSITION. THE FIRST DRAFT WAS READ AND COMMENTED UPON, IN PART, BY THE RLA, WHO WAS LEAVING ON TDY AND DID NOT HAVE TIME TO PARTICIPATE IN REVIEW PROCESS. RLA DID NOT CLEAR REF (A).
CARPENTER
BT
#8169

NNNN

ACTION: RIG-3 INFO: CHARGE/4

APPENDIX 1
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VZCZCTGC500
OO RUEHTG
DE RUEHWN #7679/01 2871413
ZNR UUUUU ZZH
O 141406Z OCT 86
FM AMEMBASSY BRIDGETOWN
TO RUEHTG/AMEMBASSY TEGUCIGALPA IMMEDIATE 0364
INFO RUEHC/SECSTATE WASHDC 1981
BT
UNCLAS BRIDGETOWN 07679

14-OCT-86 TOR: 14:11
CN: 07402
CHRG: AID
DIST: RIG

AIDAC

PASS TO RIG/A/T, C.N. GOTHARD

E.O. 12356: N/A
TAGS: NONE
SUBJECT: DRAFT AUDIT - PROJECT 538-0084, CFSC

REF: (A) RAFS 1,2,3,4 OF JULY 31, 1986; (B) HOLTAWAY-FIELDS MEMO OF AUGUST 6, 1986

1. DRAFT AUDIT RECEIVED SEPTEMBER 12, 1986. OUR RESPONSE WAS DELAYED TO ALLOW CFSC TO ANALYZE THE REPORT AND TO PRESENT THEIR COMMENTS AND SUPPORTING EVIDENCE. THEIR RESPONSE WAS RECEIVED ON OCTOBER 9. A COPY HAS BEEN QUICK-PACKED TO YOU. IN LIGHT OF THE ERRORS OF FACT THROUGHOUT THE REPORT, AS WELL AS QUESTIONABLE INTERPRETATIONS AND JUDGEMENTS, WE HOPE YOU WILL EXAMINE THIS CFSC DOCUMENT CLOSELY BEFORE ISSUING THE FINAL AUDIT REPORT.

2. ISSUES OF FACT.

(A) EQUITY PAY-IN. ON PAGES 5,6 AND 29 THE REPORT ASSERTS THAT CFSC IS NOT IN COMPLIANCE WITH THE EQUITY PAY-IN REQUIREMENT OF LOAN AGREEMENT AMENDMENT NO. 2. THIS REQUIREMENT IS A CONDITION PRECEDENT TO DISBURSEMENT OF THE FUNDS MADE AVAILABLE UNDER AMENDMENT NO. 2. CFSC HAS NOT DRAWNDOWN ANY OF THESE FUNDS, AND IS NOT REQUIRED TO MAKE THIS PAY-IN.

(B) LOAN CEILING. ON PAGES ITALIC 2, 3, 18, 19 AND 29 THE REPORT ASSERTS THAT ON TWO OCCASIONS CFSC VIOLATED THE LOAN CEILING WHICH LIMITS THE MAXIMUM CREDIT TO ANY ONE BORROWER TO 15 PERCENT OF CFSC'S PAID-IN EQUITY. THIS EQUITY WAS DOLS2 MILLION ON AUGUST 27, 1984 WHEN TWO DOLS350,000 PROPOSALS WERE REVIEWED BY THE BOARD. THE TWO LOANS WERE APPROVED SUBJECT TO RECEIPT OF AN IFC EQUITY PAY-IN WHICH WOULD RAISE THE CFSC EQUITY TO USDOLS2,350,000 AND THE SUBLOAN MAXIMUM TO US DOLS352,000. THE IFC PAY-IN WAS RECEIVED OCTOBER 24, 1984. OFFERING LETTERS COVERING THE TWO LOANS WERE ISSUED ON OCTOBER 31, 1984. THE LOANS WERE FORMALLY EXECUTED LATER.

(C) EQUITY DEPLETION. ON PAGES ITALIC 1, 1, AND 20 THE REPORT ASSERTS THAT BY USING PAID-IN EQUITY TO FUND LENDING, CFSC'S EQUITY HAS BEEN DEPLETED FROM DOLS2.7 MILLION TO DOLS900,000. IN THE LANGUAGE OF ACCOUNTING, THIS ASSERTION IS NONSENSE. FUNDING A LOAN DOES NOT DEPLETE EQUITY, BUT RATHER REDUCES CASH AND INCREASES LOANS RECEIVABLE. IF THE INTENTION IS TO CAUTION REGARDING THE VOLUME OF LOANS NOT ELIGIBLE FOR AID FINANCING, THE PRESENT SCOPE OF PROBLEM SHOULD BE ACCURATELY DEFINED AS FOUR SUBLOANS TOTALLING DOLS445,000 WHICH WILL NOT BE PRESENTED FOR AID FINANCING, WITHOUT INCLUDING SEVEN OTHER SUBLOANS WHICH WILL BE AID-FINANCED. AID DISBURSEMENTS EXCEEDING DOLS1 MILLION HAVE BEEN MADE AGAINST THREE OF THESE OTHER SUBLOANS SINCE MARCH. PAGE 20, PARAGRAPH THREE IMPLIES SOME PARALLEL OR LINKAGE BETWEEN CFSC'S USE OF EQUITY FUNDS AND THE FATE WHICH HAS BEFALLEN THE BARBADOS DEVELOPMENT BANK (BDB). THE BDB HAS LEVERAGED ITS CAPITAL WITH BORROWED FUNDS TO FINANCE LOANS WHICH ARE NOW NON-PERFORMING AND PERHAPS NON-COLLECTIBLE TO THE POINT WHERE ITS ADMITTED LOSSES ARE EQUIVALENT TO ALMOST HALF ITS STATED EQUITY. THIS DOES NOT MEAN THE BDB USED EQUITY FUNDS TO FINANCE THESE LOANS. REGARDLESS OF THE SOURCE OF FUNDS, ALL LOSSES EXCEEDING INCOME EVENTUALLY ARE CHARGED AGAINST EQUITY. UNFORTUNATELY LEVERAGE WORKS BOTH WAYS, AND WHAT COULD HAVE BEEN A MULTIPLIER OF PROFITS HAS BECOME A MULTIPLIER OF LOSSES. THE SOURCE OF THE PROBLEM IS THE INSTITUTION'S LOAN REVIEW PROCESS. THE BDB MAY BE UNDER PRESSURE WHICH COULD INTERFERE WITH BUSINESS JUDGEMENT; IN CONTRAST, THE CFSC INTENDS TO CONTINUE TO MAKE SOUND, BUSINESSLIKE APPRAISAL THE BASIS OF ITS LOAN APPROVAL PROCESS. WHETHER BORROWED FUNDS OR STOCKHOLDER FUNDS ARE USED HAS NO BEARING ON THE SOUNDNESS OF THE PORTFOLIO CREATED.

3. ISSUES OF INTERPRETATION. THE MOST DISTURBING AREAS OF QUESTIONABLE INTERPRETATION ARE THE FINDINGS AS TO CONFLICTS OF INTEREST AND THE PAYMENT OF EMPLOYEE BENEFITS, DIRECTOR'S EXPENSES, AND ENTERTAINMENT COSTS.

4. CONFLICT OF INTEREST. THE CONFLICT OF INTEREST ISSUE, MENTIONED ON TWELVE OF THE DRAFT'S THIRTY

APPENDIX 1
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NAMES OF COMPANIES AND PERSONS DELETED BY OFFICE OF THE REGIONAL INSPECTOR GENERAL/TEGUCIGALPA.

GES, IS SUMMARIZED BY BRIEFS OF EIGHT CASES ON GES 25-26. IN EACH INSTANCE THE REPORT EITHER SUNDERSTANDS THE SITUATION, MISREPRESENTS OR NORES RELEVANT FACTS, OR ALL THE ABOVE. EACH B EF REPEATED BELOW WITH THE MISSING PERSONAL AND STITUTIONAL NAMES FILLED IN.

ITEM X BRIEF: BOARD CHAIRMAN [redacted] HEAD [redacted] ENTERPRISES LTD., WHICH OWNS 502 SHARES .8 PERCENT) OF CFSC STOCK. WITHOUT USING MPETITIVE BIDS, CFSC SUBSCRIBED A COMPREHENSIVE SURANCE POLICY (EMPLOYERS' LIABILITY, CONSEQUENTIAL SS, ETC.) WITH [redacted] INSURANCE CO. LTD. AN INSURANCE ASSOCIATE OF [redacted] ENTERPRISES LTD. SPONSE: CFSC CARRIES PUBLIC AND EMPLOYEE ABILITY, AUTOMOBILE, FIRE, AND OTHER GENERAL SURANCE ISSUED BY THE [redacted] INSURANCE ., THROUGH THEIR AGENTS [redacted] AND CO., A BSIDIARY OF [redacted] ENTERPRISES LTD. THE INSURANCE LICIES WERE INITIATED OVER THE PERIOD DECEMBER 1983 ROUGH APRIL 1984. CFSC MANAGING DIRECTOR [redacted] GOTIATED THE POLICIES WITHOUT ANY REFERENCE TO THE SC CHAIRMAN, WHO IS ALSO THE CHAIRMAN OF [redacted] TERPRISES LTD. THE REASON CFSC CHOSE THE MMERCIAL UNION POLICY WAS THAT CFSC WISHED TO DEAL TH AN INSURANCE COMPANY IN WHICH IT COULD HAVE MPLETE CONFIDENCE, PARTICULARLY WITH RESPECT TO THE NORING OF CLAIMS, AND THE PRICE WAS COMPETITIVE. SC USED THE [redacted] CO. LTD. AGENCY CAUSE THE MANAGING DIRECTOR OF CFSC KNOWS THE NERAL MANAGER OF THIS AGENCY AND WILL RECEIVE RVICE WHICH THE SMALL PREMIUM OTHERWISE WOULD NOT RANT. THE TOTAL ANNUAL PREMIUM IN 1986 WAS DOLS1,961.00. IN THESE NEGOTIATIONS CFSC'S QUIREMENTS WERE REVIEWED IN DETAIL, AS WERE ICES. [redacted] ALSO HAD DISCUSSIONS WITH INSURANCE OKERS [redacted] AND CO. AND [redacted] E A VIEW TO SECURING DIRECTORS' LIABILITY URANCE. [redacted] WOULD NOT OFFER THIS ERAGE, WHILE [redacted] INDICATED A PREMIUM THAT WOULD E BEEN PROHIBITIVE. NO DIRECTORS' LIABILITY URANCE WAS TAKEN, THE DIRECTORS ASSUMING THIS RISK JOINING THE BOARD. OF THE 1986 TOTAL PREMIUM OF . DOLS1,961, U.S. DOLS865 (44 PERCENT) COVERED HICLE INSURANCE. AT THE TIME THAT THE VEHICLE ICY WAS ACQUIRED, THE MANAGING DIRECTOR TELEPHONED TED INSURANCE FOR A QUOTATION WHICH WAS GIVEN FOR SAME COST. GIVEN THE SIZE OF THE OVERALL NSACTION, A REQUEST FOR FORMAL COMPETITIVE BIDS NOT NECESSARY. A GENERAL SURVEY OF PREMIUMS WAS ERTAKEN, AND PROPER BUSINESS PRACTICES WERE LOWED. MR [redacted] WAS NOT AWARE OF THE NTS SURROUNDING THE SELECTION OF THE INSURANCE PANY, AND THE AUDITOR WAS SO ADVISED.

ITEM Y BRIEF: CFSC MANAGING DIRECTOR [redacted] WORKED EIGHT YEARS FOR THE [redacted] E, WHICH INVESTED IN 1,500 SHARES (5.6 PERCENT) OF

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CFSC STOCK, BEFORE JOINING CFSC. CFSC HAS A U.S. DOLLAR ACCOUNT WITH THIS BANK. RESPONSE: ON APRIL 30, 1984 THE BOARD APPROVED THE OPENING OF A CURRENT ACCOUNT AT [redacted] IN NEW YORK. [redacted] HAS AN OFFICE IN BRIDGETOWN, WHICH FACILITATES USE OF THE NEW YORK ACCOUNT. THE ACCOUNT IS NOT SUBJECT TO SERVICE CHARGES, NOR ARE MINIMUM BALANCE REQUIREMENTS IMPOSED. SUCH TERMS CANNOT BE BETTERED, AND THE QUALITY OF SERVICE IS GOOD. TO IMPLY THAT THERE WAS POTENTIAL SELF-DEALING BY [redacted] IS INCORRECT, SINCE [redacted] WAS NOT ON THE BOARD WHICH AUTHORIZED OPENING THE ACCOUNT. THE IMPLICATION THAT [redacted] IS BENEFITTING IMPROPERLY CALLS FOR PROOF OR RETRACTION.

7. ITEM Z BRIEF: CFSC BOARD MEMBER [redacted], SENIOR VICE PRESIDENT/GENERAL MANAGER, [redacted] BANK OF CANADA, WHICH INVESTED IN 2,400 SHARES (9.0 PERCENT) OF CFSC STOCK. CFSC HAS AN ACCOUNT WITH THIS BANK. RESPONSE: THE DIRECTORS OF CFSC AUTHORIZED THE OPENING OF AN ACCOUNT AT [redacted] IN THE AUGUST 11, 1983 MEETING. MR. [redacted] WAS ELECTED TO THE BOARD ON FEBRUARY 24, 1984. [redacted] WAS NOT REPRESENTED ON THE BOARD WHEN THIS ACCOUNT WAS OPENED.

8. ITEM A BRIEF: CFSC BOARD MEMBER [redacted], SENIOR VICE PRESIDENT, [redacted], WHICH OWNS 2,500 SHARES (9.4 PERCENT) OF CFSC STOCK. CFSC HAS AN ACCOUNT WITH THIS BANK. RESPONSE: IN THE AUGUST 11, 1983 MEETING THE BOARD ALSO AUTHORIZED THE OPENING OF A CURRENT ACCOUNT AT [redacted]. CFSC WISHED TO MAINTAIN TWO ACCOUNTS IN NEW YORK. AS WITH [redacted], [redacted] HAD A BRIDGETOWN OFFICE, THE TERMS OF THE ACCOUNT WERE THE SAME, AND SERVICE IS GOOD. MR. [redacted] WAS ELECTED TO THE BOARD ON FEBRUARY 24, 1984. [redacted] BANK WAS NOT REPRESENTED ON THE BOARD WHEN THIS ACCOUNT WAS OPENED. IT SHOULD BE NOTED THAT CFSC ALSO HOLDS OR HAS HELD ACCOUNTS AT THE BANK OF [redacted] AND THE [redacted] BANK OF [redacted]

9. ITEM B BRIEF: [redacted] REPRESENTING [redacted] FILLED THE VACANCY LEFT BY RON [redacted] RESIGNATION FROM THE BOARD. RESPONSE: THE COMMERCIAL BANKS AS A GROUP ARE THE LARGEST SHAREHOLDERS (49 PERCENT) AND IT HAD BEEN AGREED THAT THEY WOULD HOLD TWO SEATS ON THE BOARD TO BE ROTATED AMONG THEM EVERY THREE YEARS. THE DIRECTORS HAVE THE AUTHORITY TO FILL ANY CASUAL VACANCY ARISING FROM DIRECTORS' RESIGNATIONS DURING THE YEAR. MR. [redacted] OF [redacted] WAS APPOINTED A DIRECTOR AT THE DIRECTOR'S MEETING OF 31 JANUARY, 1985 TO FILL THE PLACE OF [redacted] OF [redacted] WHO HAD RESIGNED. [redacted] WAS ELECTED A DIRECTOR BY THE SHAREHOLDERS AT THE SHAREHOLDERS' MEETING OF 20 JUNE, 1985. WHATEVER IS THE PROBLEM?

10. ITEM C BRIEF: [redacted], RECENTLY APPOINTED TO THE BOARD (ON JUNE 27, 1986) REPRESENTS THE [redacted] BANK [redacted], PREVIOUSLY REPRESENTED ON THE BOARD BY MR. [redacted]. CFSC ALWAYS KEPT ITS ACCOUNT WITH THIS BANK. RESPONSE: AS IN B ABOVE, WHAT IS THE PROBLEM?

11. ITEM D BRIEF: CFSC DIRECTOR [redacted] NEPHEW RECEIVED A DOLS50,000 LOAN FROM CFSC FOR AN ACTIVITY WHICH CFSC DEFINED AS NOT FALLING WITHIN ITS LENDING STRATEGY. ALSO HAS AN INTEREST (DISCLOSED) IN THE [redacted] HOTEL - ANTIGUA. CFSC APPROVED A DOLS250,000 LOAN FOR THE HOTEL. RESPONSE: IN LENDING INSTITUTIONS IN THE EASTERN CARIBBEAN, BOARD MEMBERS ARE OFTEN HOLDERS OF SHARES IN COMPANIES WITH WHICH THE INSTITUTION PROPOSES TO DO BUSINESS. CLEAR RULES HAVE BEEN ESTABLISHED IN THESE INSTANCES - THAT THE INTERESTED BOARD MEMBERS DECLARE THEIR INTEREST AND DO NOT PARTICIPATE IN THE DECISION PROCESS. CFSC SCRUPULOUSLY OBSERVES THIS PROCESS. MR. [redacted] IS A DIRECTOR OF CFSC AND A SHAREHOLDER IN THE [redacted] IN ANTIGUA. HIS NEPHEW [redacted] RUNS THE [redacted] SERVICE AT BLUEWATERS. BOTH THESE PROSPECTS WERE IDENTIFIED BY THE MANAGING DIRECTOR DIRECTLY. MR. [redacted] MADE NO INPUT INTO EITHER OF THE PROPOSALS, DISCLOSED TO THE BOARD HIS ASSOCIATION WITH BOTH, AND DID NOT PARTICIPATE IN THE APPROVAL PROCESS.

12. ITEM E BRIEF: CFSC DIRECTOR [redacted] HAD AN INTEREST (DISCLOSED) IN [redacted] MANUFACTURERS - ST. LUCIA. CFSC LENT DOLS350,000 TO [redacted] MANUFACTURERS. RESPONSE: [redacted] MFG. LTD. IS A PUBLICLY HELD ST. LUCIAN COMPANY. THE TOTAL ISSUED CAPITAL OF [redacted] IS 3,002,000 SHARES. [redacted] PRODUCERS LTD. HOLDS 500 SHARES (0.02 PERCENT OF THE TOTAL). MR. [redacted] IS THE MAJORITY AND CONTROLLING SHAREHOLDER IN [redacted] PRODUCTS. MR. [redacted] HAS NO DIRECT INTEREST IN [redacted]. THE PROSPECT AND LOAN PROPOSAL WAS DEVELOPED BY [redacted] WHEN THIS LOAN WAS DISCUSSED AT THE DIRECTOR'S MEETING MR. [redacted] EXPLAINED HIS INDIRECT INTEREST, AND WAS NOT INVOLVED IN THE APPROVAL PROCESS.

13. WE TAKE ISSUE WITH THE REPORT'S ENTIRE PRESENTATION ON POTENTIAL SELF-DEALING, AND IN PARTICULAR WITH THE INNUENDO-LADEN SUMMARY OF ISSUES ENUMERATED ABOVE. WE URGE THIS SECTION BE DELETED FROM THE FINDINGS AND FROM RECOMMENDATION NO. 5.

14. PAYMENTS FOR EMPLOYEE BENEFITS: IT IS STANDARD PRACTICE OF LENDING INSTITUTIONS IN THE CARIBBEAN (AND IN TEGUCIGALPA AND WASHINGTON AS WELL) TO PROVIDE AS PART OF EMPLOYEE COMPENSATION PERKS SUCH AS LOW COST HOUSING LOANS, AUTO LOANS, AND COMPANY CARS FOR PERSONAL USE. SUCH ARRANGEMENTS ARE FOUND HERE IN BOTH THE PRIVATE AND PUBLIC SECTORS, INCLUDING ALL LOCAL COMMERCIAL BANKS, THE BARBADOS DEVELOPMENT BANK, THE CENTRAL BANK OF BARBADOS AND THE MULTINATIONAL CARIBBEAN DEVELOPMENT BANK.

15. PAYMENTS FOR DIRECTORS EXPENSES: CFSC REIMBURSES AIRFARE AND ACCOMMODATION EXPENSES FOR OVERSEAS DIRECTORS AND THE REPRESENTATIVES OF IFC AND DEG. AFTER THE DIRECTORS' MEETINGS CFSC USUALLY HOSTS A LUNCHEON TO WHICH ARE INVITED LEADING MEMBERS OF THE FINANCIAL AND BUSINESS COMMUNITY. THERE IS A CLEAR PARALLEL HERE BETWEEN CFSC PRACTISE AND OUR OWN, WHEREBY AID STAFF AND OTHERS TRAVELLING ON USG BUSINESS ARE REIMBURSED FOR THEIR TRAVEL AND LODGING EXPENSES. DIRECTORS' EXPENSES DURING 1984-85 WERE DOLS3,949; AND IN 1985-86, DOLS4,486.

16. PAYMENTS FOR ENTERTAINMENT: ENTERTAINMENT AND SPECIAL EVENTS DURING 1984-85 INCLUDED CLIENT ENTERTAINMENT--DOLS2,923; THE C/CAA MIAMI CONFERENCE ON CBI, WHICH ALL INSTITUTIONAL USAID RECIPIENTS IN THE REGION WERE URGED TO ATTEND--DOLS1,500; AND A BUFFET DINNER FOR REP. DAN ROSTENKOWSKI--DOLS1,340, FOR A TOTAL OF DOLS5,763, EQUIVALENT TO LESS THAN 3 PERCENT OF ALL OPERATING EXPENSES. IN 1985-86, WITHOUT C/CAA AND ROSTENKOWSKI, THIS FIGURE FELL TO DOLS4,466, ABOUT 2 PERCENT OF OPERATING EXPENSES. CFSC'S OPERATING EXPENSES ARE NOT CHARGED AGAINST AID FUNDS. IT WOULD APPEAR DIFFICULT TO CRITICIZE EITHER THE PRINCIPAL OR THE SUMS INVOLVED HERE.

17. THE RECOMMENDATIONS. CFSC IS PREPARING PORTFOLIO DEVELOPMENT PLAN (REC. 1); A GRANT USE PLAN (REC. 2); A STAFF EXPANSION PLAN (REC. 3); AND A GENERAL OPERATIONS AND POLICY STATEMENT (REC. 4) REVISING THE MATERIALS SUBMITTED IN AUGUST, 1984 IN SATISFACTION OF THE CONDITIONS PRECEDENT 5.2(C) AND 5.3.(B) OF LOAN AGREEMENT 538-W-024. WITH REGARD TO RECOMMENDATION NO. 5, CFSC AS A BARBADIAN CORPORATION IS GOVERNED BY LOCAL LAW WHICH INCLUDES STATEMENTS OF GENERAL CRITERIA COVERING QUALIFICATIONS FOR CORPORATE DIRECTORS. AN AMENDMENT TO THE GENERAL OPERATIONS AND POLICY STATEMENT TO SPELL OUT THESE CRITERIA WOULD REQUIRE THE APPROVAL OF SHAREHOLDERS AT THEIR NEXT MEETING IN MID-1987, WHEN ALL DIRECTORS WILL BE UP FOR ANNUAL ELECTION. WE FEEL THAT LOCAL LAW, REINFORCED BY ANNUAL SHAREHOLDERS' ELECTIONS, IS ADEQUATE ON THIS POINT. CONSIDERING THIS AND PARA 13 ABOVE WE URGE THAT THIS RECOMMENDATION BE DELETED IN ITS ENTIRETY. RDO/C WILL IMPROVE ITS PROJECT REPORTING PURSUANT TO RECOMMENDATION 6.

18. WE EXPECT TO SEE RECOMMENDATIONS 1-4 AND 6 MET WITHIN 30 DAYS OF RECEIPT OF THE AUDIT REPORT.
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LIST OF RECOMMENDATIONS

Recommendation No. 1

We recommend that the AID Regional Development Office/ Caribbean:

a) assist the Caribbean Financial Services Corporation in either developing a specific plan for the effective use of project funds obligated under Project No. 538-0084; or,

b) deobligate and transfer idle funds to another eligible project if the development of such a plan is not feasible.

Recommendation No. 2

We recommend that the AID Regional Development Office/Caribbean deobligate $364,000 in funds granted to the Caribbean Financial Services Corporation under Project No. 538-0084, or amend the grant in accordance with a specific plan in order to effectively utilize grant resources.

Recommendation No. 3

We recommend that the AID Regional Development Office/Caribbean either:

a) ensure that the Caribbean Financial Services Corporation obtains sufficient personnel to effectively implement all the components of Project No. 538-0084; or,

b) reduce the components of Project No. 538-0084, and the associated project budget, to a level commensurate with the corporate strategy and level of operations of the Caribbean Financial Services Corporation.

Recommendation No. 4

We recommend that the AID Regional Development Office/Caribbean take action to have the Caribbean Financial Services Corporation:

a) establish targets regarding investments in business start-up and non-tourism projects;

b) determine a loan limit range, and formally document the lower loan limit in its policy and procedures;

c) develop and formally document its policy on loans to finance working capital;

d) clearly define, and submit to AID for approval, its policy for using its funds to finance non-AID-funded loans; and,

e) direct its policy and planning efforts to meet the objectives and targets of Project No. 538-0084, or otherwise the Regional Development Office/Caribbean should modify them to coincide with the Caribbean Financial Services Corporation's actual credit and investment policies.

Recommendation No. 5

We recommend that the AID Regional Development Office/ Caribbean:

a) have the Caribbean Financial Services Corporation amend its Acts, By-Laws, and General Policy and Operations Statement to include firm criteria covering the qualifications for membership on the Corporation's Board of Directors, and to include safeguards which preclude members, their relatives, and the companies they either represent or are associated with, from benefiting from CFSC's operations and investments; and,

b) review and document those instances where cases of self-dealing have developed, and have the Caribbean Financial Services Corporation take corrective action.

Recommendation No. 6

We recommend that the AID Regional Development Office/Caribbean develop a Mission Order which, among other safeguards, requires its project officers to periodically verify the base data to support figures and facts that appear in project-related reporting, thereby ensuring the accuracy and reliability of RDO/C reporting to AID/Washington.

APPENDIX 3

REPORT DISTRIBUTION

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