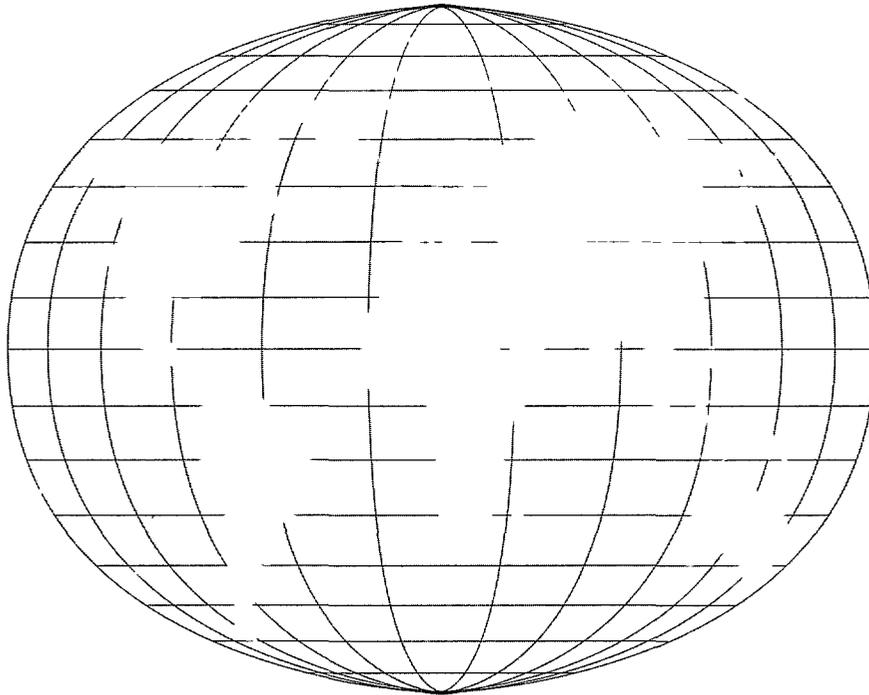


Report of Audit

AUDIT ON USAID'S CREDIT PROGRAMS AND RELATED INTERNAL CONTROLS FOR FISCAL YEAR 1999

Report No. 0-000-00-002-F
February 1, 2000



Financial Audit

**OFFICE OF INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**



U S AGENCY FOR
INTERNATIONAL
DEVELOPMENT

FEB 1 2000

MEMORANDUM FOR CFO, Michael T Smekovich

FROM IG/A/FA, Bruce N Crandlemire

SUBJECT Audit on USAID Credit Programs and Related Internal Controls for
Fiscal Year 1999

This memorandum audit report is our report on Credit Programs. This report is part of our review of the U S Agency for International Development (USAID) consolidated financial statements as required by the Government Management and Reform Act of 1994. This act requires USAID to prepare and submit a financial statement audit for the preceding fiscal year that covers all accounts and associated activity of the agency.

In previous years, the Office of Inspector General's (OIG) ability to express an opinion was impaired by an inadequate financial accounting and performance measurement systems, and related material weaknesses in internal controls. The OIG concluded that these deficiencies in the financial accounting systems¹ 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 the Office of Management and Budget (OMB). Accordingly, the OIG did not express an opinion on the fairness of the financial statements.

As a result of problems noted in previous years' audits, the OIG agreed with USAID to focus our fiscal year 1999 efforts on the material line items on its balance sheet. 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 1999 balance sheet. This report makes three recommendations to improve USAID's accounting for its loan portfolio and strengthen related internal controls. Based on discussions with M/FM officials, there is substantial agreement with the findings and recommendations.

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.

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

Background

USAID was created in 1961 to advance the United States' foreign policy interests by promoting broad-based sustainable development and providing humanitarian assistance. USAID has an overseas presence in over 70 countries, 42 of which have operational and formal USAID missions. As of September 30, 1999, USAID credit programs had total net receivables of about \$6.9 billion. Of the net receivables amount, direct loans accounted for about \$6.6 billion and receivables on guaranteed loans accounted for the remainder. The direct loans program is authorized under the Foreign Assistance Act, various predecessor agency programs, and other foreign assistance legislation. Direct loans are issued in both U.S. dollars and the borrower's currency. The following lists the loan programs that are included in USAID credit programs' net receivable balances:

Direct Loan Program - \$6.6 billion
Guaranteed Loan Programs² - \$289 million

In July 1998, USAID signed a contract with Riggs National Bank to provide accounting and collections services for USAID credit programs. In April 1999, Riggs National Bank began issuing notices of payment due to borrower countries for USAID's loans. USAID expects that Riggs National Bank's loan accounting and collection services will reduce vulnerability in and streamline the management of the credit program.

Audit Objective

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

Were USAID Credit Programs' Account Balances Accurate as of September 30, 1999?

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

² The guaranteed loan programs included above consist of Urban and Environmental Program and the Micro and Small Enterprise Development Program.

Audit Findings

Were USAID Credit Programs' Account Balances Accurate as of September 30, 1999?

Overall the OIG determined that USAID September 30, 1999 credit programs' account balances were reasonably accurate. After receiving confirmation² valuing about \$8.7 billion from 40 of the 68 borrower countries, the OIG statistically selected and reviewed 60 loan accounts. The OIG found that the individual loan account balances tested were accurate. The OIG also found that USAID financial managers were responsive to our previous audit recommendations³ to improve the internal controls over the credit program portfolio. However, during this review the OIG noted certain areas within USAID credit program that need improvements. The OIG does not consider these conditions to be material weaknesses, but rather reportable conditions⁴. Accordingly, the OIG has included recommendations for corrective actions to USAID management to strengthen the internal controls related to its credit programs. Our review of USAID's 1999 credit program account balances identified the following improvements:

- (1) USAID's loan information maintained by Riggs National Bank has not been reconciled with the information contained in USAID's legacy loan accounting systems – Loan Accounting and Information System (LAIS), and the Housing Guaranty Payment Management System (HGPMS),
- (2) USAID has not provided the most updated information to Riggs National Bank on rescheduled loans, and
- (3) USAID did not research and promptly resolve unapplied loan collections from borrower countries.

USAID Loan Information Needs to Be Reconciled with the Riggs National Bank's

The Office of Financial Management did not ensure that the information used to generate its September 30, 1999 credit programs' account balances was based on the same records used to account for and service USAID loans. The credit program financial information in USAID's statements was based on information obtained from its legacy systems even though Riggs

OIG sent out confirmation requests to 68 borrower countries having outstanding loan balances of about \$23 billion. The requests solicited confirmation of outstanding loan account balances as of June 30, 1999.

Report to USAID Managers on Selected USAID Internal Controls (Audit Report No. 0-000-99-002-F, March 31, 1999)

⁴ Under the auditing standards published by the American Institute of Certified Public Accountants, reportable conditions are matters coming to the auditor's attention that should be communicated to the auditee because they represent significant deficiencies in the internal controls that could adversely affect the ability to record, process, and report financial data. A material weakness is a reportable condition in which the internal control does not reduce to a relatively low risk the possibility that material misstatements may occur in the financial statements.

National Bank began providing loan accounting and billing services for USAID's major credit programs on April 1, 1999. USAID did not use the information maintained in Riggs National Bank's system because this information had not been completely reconciled with the original loan documents and records. This condition occurred because the transition from USAID's legacy systems to the Riggs National Banks System was still underway and a complete reconciliation had not been performed. Consequently, USAID credit programs' account balances recorded in Riggs National Bank's system may have been overstated by an undeterminable amount on loans having an outstanding balance of \$23 billion.

Because USAID loan information is currently maintained in Riggs National Bank and USAID's legacy systems, a reconciliation of the information among the systems is necessary to develop more accurate and reliable the financial statements.

Recommendation No. 1 We recommend that the Office of Financial Management

- 1.1 Ensure that a complete reconciliation is performed between USAID's legacy credit programs accounting systems and the Riggs National Bank's system**
- 1.2 Use the information contained in the Riggs National Bank to prepare future USAID financial statements**

Loan Balances Needs Adjustments for Rescheduled Loans

In the 1998 audit⁵ of USAID's financial statements, the OIG made a recommendation to eliminate the backlog of loan rescheduling calculations. Since then, USAID completed the rescheduling calculations for 381 loans, however, the updated rescheduling information developed during the recalculations was not provided to Riggs National Bank as of September 30, 1999. Since April 1, 1999, Riggs National Bank began providing loan accounting services for USAID's loan portfolio, including the 381 loans that were being rescheduled.

In the process of verifying loan balance information, Riggs National Bank officials were directed by USAID to make adjustments of about \$21.5 million for 175⁶ of the 381 rescheduled loans to account for the effect of the rescheduling calculations. The adjustments were necessary because Riggs National Bank did not have the benefit of the updated rescheduling information. USAID officials were aware of the proposed adjustments to the loan balances maintained in Riggs National Bank's system. However, USAID officials have not validated the proposed adjustments.

Until the updated rescheduling information is provided to Riggs National Bank, USAID's loan balances at September 30, 1999 for these 175 loans, may not be accurate by as much as

⁵ Report to USAID Managers on Selected USAID Internal Controls (Audit Report No. 0-000-99-002-F March 31, 1999)

⁶ These 175 loans had an outstanding balances of about \$657 million.

\$21.5 million. In addition, by not having the most current reschedule information for the 175 loans in Riggs National Bank's System, USAID's accrued interest at September 30, 1999 was impacted by the adjustments made to the loan balances.

Recommendation No. 2 We recommend that the Office of Financial Management

- 2.1 Complete the rescheduling and forward updated information on rescheduled loans to Riggs National Bank and ensure that the bank's system reflects this information**
- 2.2 Research and make a determination about whether the adjustments recorded by Riggs National Bank were needed**
- 2.3 Direct Riggs National Bank to correct all adjustments that were not needed to the September 30, 1998 USAID Loan Accounting Information System (LAIS) loan balances**

USAID Needs to Resolve the Unapplied Collection Account Balance

During the course of day-to-day operations, the USAID Office of Financial Management occasionally receives payments from borrowing countries that are not readily identifiable to a particular loan agreement. These payments are credited to an unapplied collections account. As of September 30, 1999, the unapplied collections account balance was \$25.7 million. The \$25.7 million represents \$19.6 million in direct loan principal payments, \$4.2 million in direct loan interest payments, and \$1.9 million in guaranty loan payments. The 1999 balance was 87 percent less than the \$187 million balance at September 30, 1996.

While the amount of the unapplied collections account balance has been significantly reduced in recent years, USAID financial managers have not placed a priority on eliminating the account balance. Consequently, USAID's borrowers are being billed on outstanding balances that are overstated and will require future research and adjustments. Additionally, interest accrued on outstanding balances that did not reflect those repayments, was overstated.

Recommendation No. 3 We recommend that the Office of Financial Management research and resolve on a timely basis payments posted to the unapplied collections account.

Management Comments and Our Evaluation

USAID's Management agreed with the findings and recommendations made in this report. The Chief Financial Officer said that Management was delighted to know that the September 30, 1999 credit program account balances were reasonably stated. Management also provided information regarding actions planned for addressing each recommendation.

With regard to audit recommendation No 1 1, management reported that Riggs National Bank has completed the reconciliation of the data contained in the M&I Data System and the two USAID credit legacy systems – Loan Accounting Information System (LAIS) and Housing Guaranty Payments Management System (HGPMS) as of June 30, 1999. Copies of the reconciliation spreadsheets have been provided to us. Management will be working with Riggs National Bank to resolve the reconciling differences, a large number of which are related to the balance adjustments discussed as part of Recommendation No 2 of the draft report. Management should have resolved all of the reconciling items by June 30, 2000.

On audit recommendation No 1 2, management reported that the system operated by Riggs National Bank is now the official subsidiary credit system for the Agency. The LAIS and HGPMS systems were turned off after September 1999 processing was completed. These two USAID legacy systems will not be used for FY 2000 and after. The M&I Data System will be used for preparation of the FY 2000 financial statements.

Concerning audit recommendation No 2 1, management said that the workpapers have been completed for all direct loan debt rescheduling in effect at this time. The FM/LM staff will be forwarding them to Riggs National Bank for recording as soon as all the legal documents associated with each rescheduling has been completed. In addition, with the assistance of contractors, management will complete the Urban and Environmental Program (UE) rescheduling and forward them to Riggs National Bank also. All debt rescheduling in effect today should be recorded by Riggs before March 31, 2000.

For audit recommendation Nos 2 2 and 2 3, management planned to have the work completed by June 30, 2000 and will provide Riggs National Bank with appropriate instructions as Management resolves each adjustment. Again, this work should be completed by June 30, 2000.

On audit recommendation No 3, management explained that an analysis of the direct loan unapplied collection account determined that \$8.4 million or 35.4 percent of the \$23.8 million had actually been applied to loan 512L141R as of October 1, 1998. The collection was left on the unapplied list in error. Of the remaining \$15.4 million, \$12.9 million related to loans being rescheduled, \$1.1 million are current items and \$1.4 million are old items which must be researched. These collections related to debt rescheduling will be applied when the backlog of rescheduling transactions are recorded. The current items of \$1.1 million have been applied as have \$0.4 of the old items. We will address the remaining unapplied direct loan items as well as the \$1.9 million guaranty items by June 30, 2000.

We appreciate the management comments. Based on management's acceptance of the audit recommendations, we are accepting the management decisions for audit recommendation Nos 1 2 through 3. For audit recommendation No 1 1, management did not provide comments on its planned actions to perform a reconciliation of the data contained in the M&I Data System and the two USAID's credit legacy systems (LAIS and HGPMS) as of September 30, 1999. Because the LAIS and HGPMS systems were turned off after September 1999 processing was completed we believe that completing a reconciliation of the information among the systems as of September 30, 1999 is necessary. In addition, completing a reconciliation as of September 30, 1999 ensures that the information used to generate the Agency's FY 1999 financial statements is consistent with the information to be used to generate the Agency's FY

2000 financial statements As a result, we do not accept the management decision for audit
recommendation No 1 1

SCOPE AND METHODOLOGY

Scope of Our Consideration of USAID's Credit Programs

For fiscal year 1999, USAID Office of Inspector General agreed with the Office of Financial Management that it would be advantageous for the 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, 1999. Therefore, this report does not contain an opinion about the fairness of the statements taken as a whole.

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 1999 balance sheet. We determined whether the amounts were accurate, whether applicable policies and procedures were established, and whether they had been placed in operation to meet the objectives of the FASAB and other regulations. We considered all reasonable efforts made by USAID management 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 1998 Net Cost of Operations, any amount over \$360 million will be considered material and included in our review of USAID's fiscal year 1999 financial statements. USAID credit programs' net receivables for fiscal year 1998 totaled about \$6.6 billion. Accordingly, the material level for this audit of the credit programs was \$33 million (5 percent of \$6.6 billion).

Methodology

In accomplishing our audit objective, we reviewed significant line items related to USAID's fiscal year 1999 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 credit programs for the period ended September 30, 1999. This report specifically addresses the issues identified in our review of the credit program on the fiscal year 1999 balance sheet for which USAID management corrective actions are needed.

To accomplish our credit programs specific 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 programs,
- Reviewed the contract between USAID and Riggs National bank for the servicing of USAID loans,
- Reviewed Riggs National Bank's policies and procedures for servicing USAID loans,
- Conducted meetings with USAID/LMD and Riggs Bank officials,
- Confirmed USAID loan account balances with all 68 borrower countries,
- Statistically selected and reviewed 60 loan account balances. The sample was evenly distributed among countries that responded to our loan confirmation request and those that did not respond, and
- Discussed the confirmed differences with USAID Loan Management Division and Riggs National Bank, and conducted allowance determination meeting with the Office of Management and Budget

USAID MANAGEMENT COMMENTS



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JAN 10 1999

MEMORANDUM FOR IG/A/FA Bruce N Crandlemire

FROM CFO Michael T Smokovich

SUBJECT Audit on USAID Credit Programs and Related Internal Controls for Fiscal Year 1999

Thank you for your memorandum dated December 23, 1999 on the above subject. I am delighted that you were able to determine that the September 30, 1999 credit program account balances are reasonably stated. As you know, the Agency's staff responsible for credit programs has put forth a significant effort over the past two years to address the financial management weaknesses related to USAID's credit programs. Your recognition of their effort is greatly appreciated.

As regards the findings and recommendation, we are in complete agreement. Following is our management decision and planned actions for each.

Recommendation No. 1.1 - Riggs National Bank has completed the reconciliation of the data contained in the M&I Data System and the two USAID credit legacy systems (LAIS and HGPMS) as of June 30, 1999. Copies of the reconciliation spreadsheets have been provided to your staff. We will be working with Riggs to resolve the reconciling differences, a large number of which are related to the balance adjustments discussed as part of Recommendation 2 of the draft report. We should have resolved all of the reconciling items by June 30, 2000.

Recommendation No. 1.2 - The M&I Data System operated by Riggs National Bank is now the official subsidiary credit system for the Agency. The LAIS and HGPMS systems were turned off after September 1999 processing was completed. These two USAID legacy systems will not be used for FY 2000 and after. The M&I system will be used for preparation of the FY 2000 financial statements.

Recommendation No. 2.1 - The workpapers have been completed for all direct loan debt rescheduling in effect at this time. The FM/LM staff will be forwarding them to Riggs National Bank for recording as soon as all the legal documents associated with each rescheduling has been completed. In addition, with the assistance of contractors, we will complete the UE credit program rescheduling and forward them to Riggs also. All debt rescheduling in effect today should be recorded by Riggs before March 31, 2000.

Recommendation No. 22 - We plan to have this work completed by June 30, 2000.

Recommendation No. 23 - We will provide Riggs with appropriate instructions as we resolve each adjustment. Again, this work should be completed by June 30, 2000.

Recommendation No. 3 - An analysis of the direct loan unapplied collection account determined that \$8.4 million or 35.4% of the \$23.8 million had actually been applied to loan 5121141R as of October 1, 1998. The collection was left on the unapplied list in error. Of the remaining \$15.4 million, \$12.9 million related to loans being rescheduled, \$1.1 million are current items, and \$1.4 million are old items which must be rescheduled. The \$12.9 million in collections related to debt rescheduling will be applied when the backlog of rescheduling transactions is recorded. The current items of \$1.1 million have been applied as have \$4 of the old items. We will address the remaining unapplied direct loan items as well as the \$1.9 million in guaranty items by June 30, 2000.

I would like to thank you for the professional and cooperative manner that the auditors conducted their work.

cc: MCF/O J Cully
M/C/O S Owens
M/M/M J King
M/M/LM M Washington
MCF/O/MPI S Malone Gilmer
M/M/MPI C Turner