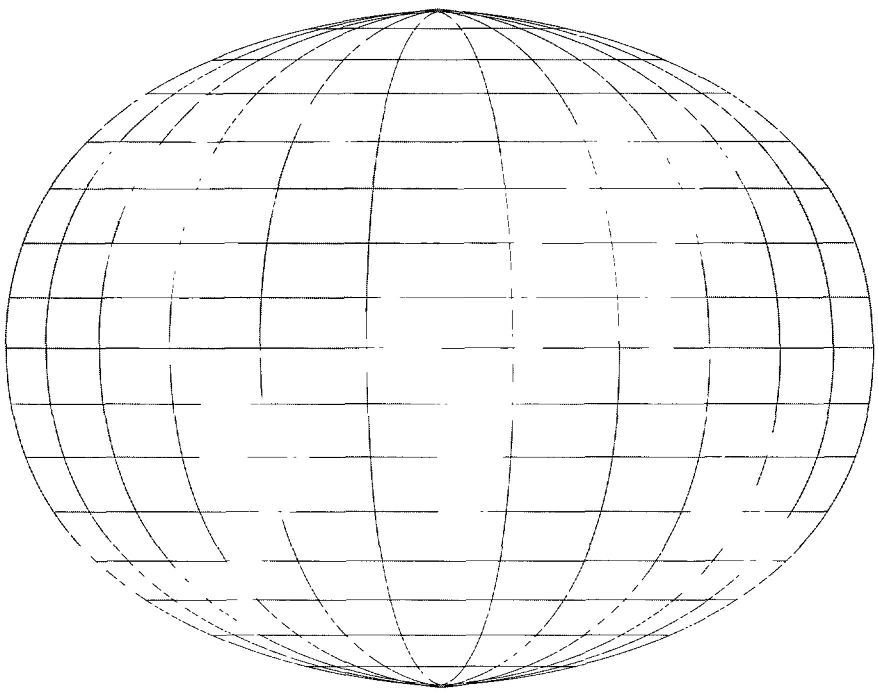
Report of Audit

Report on Agreed-Upon Procedures Related to the PCI Leasing and Finance (PCILF) Loan Portfolio Guarantee under the Microenterprise & Small Business Loan Portfolio Guarantee (LPG Activity No. 936-4216.5)

Report No. 5-492-01-001-D
January 26, 2001



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Manila, Philippines

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

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January 26, 2001

MEMORANDUM

TO: D/AA, Global Bureau, Barbara Turner

FROM: RIG/Manila, Paul E. Armstrong

SUBJECT: Report on Agreed-Upon Procedures Related to the PCI Leasing and Finance (PCILF) Loan Portfolio Guarantee under the Microenterprise & Small Business Loan Portfolio Guarantee (LPG Activity No. 936-4216.5) Report No. 5-492-01-001-D

The attached DCAA Report, transmitted to us by USAID/Philippines on July 26, 2000, presents the results of the application of agreed-upon procedures related to whether or not PCILF was adhering to the requirements of the Loan Portfolio Guarantee (LPG) funded under the Microenterprise and Small Business Loan Portfolio Guarantee (LPG Activity No. 936-4216.5). The DCAA review was done at the request of the Office of Credit and Investment of the Center for Economic Growth and Agricultural Development (G/EGAD/CI) in USAID/Washington through USAID/Philippines. It was intended to: i) evaluate the effectiveness of internal control systems in ensuring that PCILF adheres to the requirements of the Loan Portfolio Guarantee (LPG); ii) evaluate whether or not PCILF is following prudent leasing practices, and; iii) determine the extent to which reliance can be placed on external auditors, as it relates to compliance with the requirements of the LPG.

<u>Background:</u> The G/EGAD/CI has been operating the global loan guarantee program, now known as LPG, for about 15 years. A sub-activity, the Micro and Small Enterprise Development Program (MSED), is active in 22 countries, and banks and leasing companies in the Philippines have been among the most active users of the MSED program. PCILF has experienced higher than expected losses, and the level of claims submitted has increased dramatically over the period July 1998 to June 1999: loss claims submitted by PCILF had reached an alarming level -- over $800,000 -- prompting a review of its procedures by DCAA.

<u>Results of the DCAA review</u>: The DCAA auditors found that PCILF was not adhering to the requirements of the LPG or following the prudent lending practices required by the LPG. In particular, the auditors found:

✓ PCILF's practices result in premature loss claims to USAID and do not ensure compliance with the LPG requirement to have pursued all reasonable and diligent collection efforts at the time a claim was submitted to USAID for payment. DCAA observed that it was PCILF's practice to routinely submit a claim 90 days after demand for payment in full from the borrower.

- ✓ PCILF did not comply with the LPG requirement that it make certain certifications to USAID and establish a specific provision for possible loan losses when a loss claim is submitted. Instead PCILF perfunctorily certifies that it has met the requirement for establishing a specific provision for loss. The auditors state that there was inadequate documentation to support that a loss provision was established by PCILF.

- ✓ PCILF was not in compliance with the LPG requirement that all borrowers must be microenterprises or small businesses. There were, according to the auditors, instances where loans were made to construction companies whose total assets (excluding land, building and equipment) exceeded $250,000. The auditors noted four loans where the borrowers were already in delinquent status when the loans were brought into portfolio coverage. In one case, PCILF brought the delinquent loan under portfolio coverage and took almost immediate action to claim a loss to USAID. These loans do not comply with LPG requirements that loans should be an additional credit and not a renewal or extension of an existing credit. In all, the auditors listed ten loans totaling $278,327.51 that were made to businesses not eligible for coverage.

- ✓ PCILF did not update the status of recoveries for credit to USAID as required by the LPG. In four cases, recoveries from the borrower were made subsequent to the filing of a loss claim, which would have reduced the amount of the outstanding loan balance and the amount of the loan.

The DCAA auditors also noted that they were unable to accomplish one of the Agreed-Upon Procedures requested by the USAID/Philippines --to determine the extent to which reliance could be placed on the work of external auditors as it related to compliance with the requirements of the LPG. A review of the workpapers of PCILF's external auditors, Sycip Gorres Velayo & Co. (SGV), was not agreed to by SGV as they did not believe that there was any work in their files relevant to the DCAA's review. SGV stated that they were not aware of the specific requirements of the USAID program. They did agree to a release of a draft management letter for FY 1998, which was used by DCAA as part of its risk assessment. This draft management letter did contain several recommendations relevant to the DCAA review, including a recommendation that PCILF set up allowance for possible losses by performing specific account evaluation, and that PCILF follow up on long outstanding receivables and correct deficiencies in loan documentation.

PCILF, in its response to the DCAA draft report, indicated that it takes exception or disagrees with all the Statements of Conditions and Recommendations. The PCILF full written response of April 26, 2000 is provided in the Appendix of the DCAA report.

<u>Subsequent Events</u>

Since the DCAA Report has been issued we have been advised of the following actions being taken:

1. USAID/Manila attempted to follow-up on the DCAA findings and recommendations with PCILF officials but were not successful. The USAID wrote to PCILF on July 26, 2000 offering to work with them to avoid seeking a full refund, and requesting them to revisit the DCAA findings and send the USAID comments and documentation that would substantiate any of the cases where they disagreed with the auditors, giving an August 9, 2000 deadline for response. No response was received to this request. Instead, on September 5, 2000, PCILF wrote directly to Global Bureau asking to know the status of the twenty-five claims pending under the program. It did not make reference to the DCAA report or the USAID/Philippines request for information.

2. According to Global Bureau Development Credit staff responsible for the Loan Portfolio Guarantee Program, they have suspended payments of all pending claims filed by PCILF for this program, claims amounting to approximately $609,000.

3. Global Bureau staff also advised that the Bureau is currently consulting with USAID's General Counsel staff to determine whether and how USAID can recover approximately $803,000 in claims already paid to PCILF. Also, debarment action is being considered.

In view of the seriousness of the DCAA review findings concerning PCILF's implementation of the LGP program and actions being considered against PCILF as a result of these findings, we are making the following recommendation.

<u>Recommendation No. 1:</u> We recommend that the Deputy Assistant Administrator, Global Bureau, in consultation with USAID's General Counsel, initiate appropriate action to seek recovery of all ineligible claims included among the approximately $803,000 in claims already paid to PCI Leasing and Finance, Inc. and consider possible debarment of PCI Leasing and Finance, Inc. from future participation in USAID programs.

Please let us know within 30 days of the date of this report as to your management decision on these recommendations. Thank you for your cooperation with the audit process.

Cc: USAID/Philippines Director, Patricia K. Buckles

DEFENSE CONTRACT AUDIT AGENCY

REPORT NO. 4201-2000F17900001

30 June 2000

PREPARED FOR: Agreements Officer
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Philippines
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RECEIVED
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SUBJECT: Application of Agreed-Upon Procedures
PCILF Loan Portfolio Guarantee (LPG)

REFERENCES: PASA: 492-P-00-98-00041-00, Delivery Order No. 6
USAID: (LPG) Commitment No. 492-5G-10A, Project 936-4216.5
DCAA: Chronological Report No. 098

CONTRACTOR: PCI Leasing and Finance, Inc.
PCI Leasing Centre, Corinthian Gardens, Ortigas Avenue
Quezon City, MM, Philippines

REPORT RELEASE RESTRICTIONS: See Page 6

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Report No. 4201-2000F17900001

SUBJECT OF APPLICATION OF AGREED-UPON PROCEDURES

As requested in Participating Agency Service Agreement No. 492-P-00-98-00041-00, Delivery Order No. 6 of 30 September 1999, we applied agreed-upon procedures to determine if PCI Leasing and Finance, Inc. (PCILF) is in compliance with the requirements of Microenterprise and Small Business Loan Portfolio Guarantee (LPG) commitment No. 492-5G-10A, Project 936-4216.5.

SCOPE OF APPLICATION OF AGREED-UPON PROCEDURES

We have performed the mutually agreed upon procedures enumerated below solely to assist you in (i) evaluating the effectiveness of the internal control systems in ensuring that PCILF adheres to the requirements of the Loan Portfolio Guarantee (LPG), (ii) evaluating whether PCILF is following prudent leasing practices, and (iii) determining the extent to which reliance can be placed on the work of external auditors as it relates to compliance with the requirements of the LPG. This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards. The sufficiency of the procedures is solely the responsibility of the requestor. Consequently, DCAA makes no representation regarding the sufficiency of the procedures described below, either for the purpose for which this report has been requested or for any other purpose. The following agreed-upon procedures were applied:

<u>Procedure 1.</u> Review the accounting and lease management systems used by PCILF. Make recommendations regarding the effectiveness of these systems in ensuring that PCILF adheres to the requirements of the Loan Portfolio Guarantee (LPG).

<u>Procedure 2.</u> Determine whether PCILF is following prudent leasing practices focusing on the following areas:

- Determine if PCILF is properly recording leases.
- Determine if PCILF is complying with LPG requirements in placing loans in program coverage.
- Determine if PCILF has been capitalizing interest on loans.
- Determine if PCILF has complied with the requirements of USAID 19 March 1998 letter in placing restructured loans under program coverage.
- Identify any loans which do not qualify for coverage.

<u>Procedure 3.</u> To the extent reliance can be placed on the work of PCILF's external auditors use the work of these auditors to:

- Determine if PCILF's financial statements are fairly presented.
- Evaluate and report on PCILF's system of internal controls.
- Evaluate and report on PCILF's compliance with program requirements.
- Where applicable, determine if PCILF has taken adequate corrective action on prior audit recommendations.

RESULTS OF APPLICATION OF AGREED-UPON PROCEDURES

This report pertains only to the performance of agreed upon-procedures to (i) evaluate the effectiveness of the internal control systems in ensuring that PCILF adheres to the requirements of the Loan Portfolio Guarantee (LPG), (ii) evaluate whether PCILF is following prudent leasing practices, and (iii) determine the extent to which reliance can be placed on the work of external auditors as it relates to compliance with the requirements of the LPG. We were not engaged to and did not perform an audit, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that we would have reported to you.

<u>Procedure 1 – Compliance,</u> and
<u>Procedure 2 – Prudent Lending Practices</u>

The application of the agreed-upon procedures disclosed that PCILF is not adhering to requirements of the LPG or following prudent lending practices as required by the LPG. The Statements of Conditions and Recommendations presented in Appendix 1 show that:

- Condition 1: PCILF's practices result in premature loss claims to USAID and do not ensure compliance with the requirements of the Loan Portfolio Guarantee (LPG) Section 5.01[B] which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment.
- Condition 2: PCILF does not always adequately document compliance with (LPG) Sections 5.01[B] and 7.06 "Records, Inspections, and Audit". We do not believe that it is possible for PCILF management to make an adequate assessment of its collection effort at the time it places loss claims with USAID without sufficient documentation on hand. In response to our current review, PCILF did provide most of the necessary documentation after considerable additional research over an extended period of time.
- Condition 3: PCILF is not in compliance with LPG Section 5.01[C] which requires that PCILF has either (1) certified to USAID that it has written off the entire outstanding balance (including principal and interest); or (2) certified to USAID that it (A) is unable, because of a legal impediment or significant impracticality to take the action described in (1) above, and (B) has established a specific provision for possible loan losses. As a matter of practice, PCILF perfunctorily certifies that it has met the alternative requirement of establishing a specific provision for loss in lieu of a write off at the time a claim is submitted to USAID. However, there is inadequate documentation to support that a loss provision was established as presented in Appendix 2.
- Condition 4: PCILF is not in compliance in all cases with the requirements of LPG Section 2.01[a][4] which requires that borrowers must be microenterprises or small business. There are instances where loans were made to borrowers (primarily construction companies) exceeding the small business limitation of total assets (excluding

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land, building, and equipment) of $250,000 equivalent. We report these as non qualifying loans in Appendixes 2 and 3.

- Condition 5: PCILF has not followed prudent lending practices in bringing loans under portfolio coverage under the provisions of LPG Section 2.01(e) which requires that loans for existing customers must be an additional credit and not a renewal or extension of an existing credit. Further, PCILF has not complied with LPG Section 2.01[h] which requires that loans must be brought into coverage within 10 days of disbursement (term loans) or approval (lines of credit) as appropriate. We document instances where borrowers were in a delinquent status when loans were brought under portfolio coverage. We report these as non qualifying loans in Appendixes 2 and 3.
- Condition 6: PCILF must update the status of recoveries for credit to USAID as required by LPG Section 7.08. We document instances where recoveries have not been properly credited to USAID.

We present the detailed noncompliances upon which we base our conclusions in Appendix 2. We have identified $278,327.51 in questioned losses for loans which do not qualify for LPG coverage in Appendix 3. Also, in Appendix 3, we have identified losses which should be updated for additional recoveries to offset the losses.

<u>Procedure 3 – Reliance on Work of External Auditors.</u>

We were unable to fully apply the procedures. We did not place reliance on the work of the external auditors. Therefore, we did not reduce the scope of other procedures. We were unable to accomplish a review of the workpapers of PCILF's external auditors, SyCip Gorres Velayo & Co (SGV). SGV did not agree to a review of their workpapers as they do not believe there is any specific information in their files relevant to our review. SGV issues audit reports on the financial statements of PCILF taken as a whole. The financial statements do not readily identify USAID guaranteed loans. SGV was not aware of the specific requirements of the USAID program. There was no specific review of internal controls or compliance related to the USAID program. In addition there was no specific transaction testing of the USAID covered loans. SGV did agree to release of its *draft* fiscal year 1998 Management Letter concerning internal controls and compliance for our review. We reviewed the management letter as part of our risk assessment. SGV's draft management recommendations relevant to our review are as follows:

- SGV recommended that PCILF take steps to comply with the Philippine government's new Revised Financing Act of 1998 in setting up allowance for probable losses by performing specific account evaluation. *(Apparently this is a direct result of the Asian financial crisis.)* PCILF indicated it has policy guidelines in place.
- There is a recommendation to follow up on long outstanding receivables. PCILF indicated that it has procedures in place to monitor the receivables.
- There are deficiencies in loan documentation. PCILF indicated that the deficiencies were minor or corrected.
- PCILF overstated the value of repossessed property. PCILF indicated that it believes it follows Generally Accepted Accounting Principles, and updates valuation as information becomes available.

PCILF indicates in its response of 28 April 2000 (Appendix 4) that it strongly disagrees with a statement in the draft report that PCILF management apparently did not bring the USAID guarantee program to SGV's attention. We note that Mr. Marlo Cruz, Assistant Vice President, arranged and attended a meeting with Ms. Amy Cabal, SGV audit partner, on 8 October 1999. Ms. Cabal indicated that SGV was not aware of the specific USAID LPG requirements and did not perform any procedures to test for compliance. SGV was aware of the guarantee program but not the specific program requirements. Therefore we have deleted the statement previously appearing in our draft report that PCILF did not bring the USAID guarantee program to SGV's attention.

We discussed factual matters related to the noncompliances in Appendix 2 on 29 November 1999 with Mr. Manolo C. Arzadon, PCILF Senior Vice President; Mr. Roberto E. Lapid, PCILF Vice President; and Mr. Marlo R. Cruz, PCILF Assistant Vice President. USAID provided the draft results to PCILF on 22 March 2000. PCILF, in its response of 26 April 2000 received by USAID on 2 May 2000, indicates that it takes exceptions or disagrees with all the Statements of Conditions and Recommendations contained in Appendix 1. We summarize PCILF's responses and provide additional comments in Appendix 1. We include PCILF's full written response as Appendix 4.

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Report No. 4201-2000F17900001

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APPLICATION OF AGREED-UPON PROCEDURES REPORT AUTHORIZED BY:

/s/ June P. Francis
For JOHN H. GALIATSOS
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STATEMENT OF CONDITION AND RECOMMENDATIONS

Condition 1: PCILF's practices result in premature loss claims to USAID and do not ensure compliance with the requirements of the Loan Portfolio Guarantee (LPG) Section 5.01[B] which requires PCILF to have pursued all reasonable and diligent collection effort at the time a claim is submitted to USAID for payment. It is PCILF's practice to routinely submit a claim 90 days after demand for payment in full from the borrower. However, we found that PCILF's practice is perfunctory without an adequate assessment as to whether all reasonable and diligent collection efforts have, in fact, been made. PCILF has reduced the process of submitting a claim to one of waiting for the lapse of time without due consideration of the circumstances. In Appendix 2, we document excessive instances of ongoing payment and collection effort after the 90 day period.

Recommendations:

- PCILF should make a positive assessment as to whether it has pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID. The lapse of 90 days after a demand for payment in itself is not evidence of compliance.
- PCILF should consider following collection procedures consistent with its own internal policies and procedures. In the absence of more specific guidance in the LPG provisions, the policies and procedures which PCILF has established for itself are a valid and prudent source of guidance. PCILF has numerous formalized policies for (i) collection, (ii) classifying past due accounts, (iii) writing off losses and establishing loss reserves, and (iv) pursuing court cases and foreclosures.
- PCILF should document that it has pursued all reasonable and diligent collection effort. PCILF's documentation in compliance with internal policy for collection, classification of the loan, and the write off or establishment of a loss provision would be acceptable.

PCILF's Response: PCILF strongly disagrees that it routinely submits claims without pursuing diligent collection efforts. PCILF detailed its policies and procedures related to collection effort and submitting claims to USAID. PCILF did not address any of the specific noncompliances by borrower in Appendix 2. PCILF did not indicate that it would implement any of the recommendations. See Appendix 4 for PCILF's full response.

Auditor's Comments: Our evaluation consisted of obtaining an understanding of PCILF's policies and procedures and a review for compliance. The Statement of Condition results from noncompliances as a result of PCILF not following the stated policies, procedures, and LPG requirements. Our conclusions are supported by specific examples by borrower in Appendix 2. We cite where PCILF did not comply with LPG Section 5.01[B]. Further, we document excessive instances of ongoing payment and collection effort after the 90 day period. PCILF should address the specific noncompliances detailed in Appendix 2. We believe the Statement of Condition and Recommendations are valid.

Condition 2: PCILF does not always adequately document compliance with (LPG) Sections 5.01[B] and 7.06 "Records, Inspections, and Audit". We do not believe that it is possible for PCILF management to make an adequate assessment of its collection effort at the time it places loss claims with USAID without sufficient documentation on hand. In response to our current review, PCILF did provide most of the necessary documentation after considerable additional research over an extended period of time.

- There were instances where the loan files did not document the pursuit of appropriate court action in compliance with internal policy. This documentation is necessary (i) to show that all collection effort has been pursued, (ii) substantiates the amount of the loan loss claimed, and (iii) is critical to substantiating PCILF's certification of impracticality in writing off a claim at the time of submission of a loss to USAID due to pursuit of "*all judicial and extra judicial remedies*". The lack of court action may indicate PCILF considers further collection or restructuring of the loan to be possible. In Appendix 2, we document instances where PCILF did not pursue court action due to continuing discussions with the borrower.
- There were instances where there was no documentation that account officers made calls or visits to borrowers after a loan went past due as required by PCILF policy. Timely follow up on past due loans is critical to minimizing losses.
- There were instances where the requisite number of reminder and legal letters leading up to the demand for payment in full was not documented. Further, at times, the demand date for full payment that is reported to USAID is inaccurate. Timely follow up on past due loans is critical to minimizing losses.

Recommendation: We recommend that PCILF fully document collection activity in accordance with the requirements of its internal policies and procedures.

PCILF's Response: PCILF disagrees that its documentation is inadequate. PCILF indicates that its documentation satisfies internal requirements which are monitored and evaluated by internal and external auditors. PCILF did not indicate that it would implement any of the recommendations. See Appendix 4 for PCILF's full response.

Auditor's Comments: The Statement of Condition is based on an intensive review of loan files. At the completion of the review of each loan file we provided PCILF formal memoranda dated 14 October through 27 October 1999 citing numerous inadequacies and missing documentation. PCILF had to perform extensive additional research before submitting additional documentation and explanations on 29 November 1999. Also on 29 November 1999 we provided PCILF a comprehensive list of outstanding noncompliances. Appendix 2 details numerous instances of inadequate documentation. As stated above, we do not believe that it was possible for PCILF management to have made an adequate assessment of its collection effort at the time it placed loss claims with USAID without sufficient documentation on hand. We believe the Statement of Condition and Recommendations are valid.

<u>Condition 3:</u> PCILF is not in compliance with LPG Section 5.01[C] which requires that PCILF has either (1) certified to USAID that it has written off the entire outstanding balance (including principal and interest); or (2) certified to USAID that it (A) is unable, because of a legal impediment or significant impracticality to take the action described in (1) above, and (B) has established a specific provision for possible loan losses. As a matter of practice, PCILF perfunctorily certifies that it has met the alternative requirement of establishing a *specific* provision for loss in lieu of a write off at the time a claim is submitted to USAID. However, there is inadequate documentation to support that a loss provision was established as presented in Appendix 2.

- In the majority of cases there is no documentation to support that a *specific* loss provision was established. There is minimal documentation showing the extent to which management classified the loan as a loss. Further, there is no accounting documentation showing that a *specific* loss provision was established.
- When available, loan account statements in the majority of cases do not indicate a subsequent write off of the loan. This does not support that a loss provisions was previously established.
- In the few instances where there is documentation, a loss provision less than the full loss reported to USAID is evident.
- PCILF routinely reports the full outstanding balance as a loss to USAID instead of the "net loan balance" which should give consideration to net collateral and recoveries. The result is overstated losses.

<u>Recommendations:</u>

- PCILF should research its files for all loss claims and provide the documentation establishing the specific loss provision to substantiate its certifications and statement of losses. The documentation should be consistent with the certified date and amount.
- In future loss claims, PCILF should include copies of (i) management approval establishing the loss provision, and (ii) the accounting documentation actually recording the loss provision.
- PCILF should only claim the "net loan balance" giving due consideration to expected recoveries rather than claiming the total unadjusted outstanding loan balance.

<u>PCILF's Response:</u> PCILF disagrees that it is in noncompliance with LPG Section 5.01[C]. PCILF goes on to discuss the procedures for making general loss provisions. It is PCILF's position that the Statements of Loss submitted to USAID are evidence that a loss provision was made. PCILF did not address any of the specific noncompliances by borrower in Appendix 2. PCILF did not indicate that it would implement any of the recommendations. See Appendix 4 for PCILF's full response.

Auditor's Response: PCILF's comments are not responsive. The loss provisions discussed by PCILF are the very general loss provisions required for regulatory and financial statement purposes. PCILF certified in writing in the Statement of Losses submitted to USAID that it had made *specific* loss provision as of a specific date. However, as shown in Appendix 2, PCILF has; for the most part, not provided support for the loss provisions. We also identify in Appendix 2 the instances where documentation contradicts or is inconsistent with PCILF's written certification. We believe the Statement of Condition and Recommendations are valid. We further recommend that USAID disapprove any past or future loss claims where PCILF does not fully comply with the recommendations.

Condition 4: PCILF is not in compliance in all cases with the requirements of LPG Section 2.01[a][4] which requires that borrowers must be microenterprises or small business. There are instances where loans were made to borrowers (primarily construction companies) exceeding the small business limitation of total assets (excluding land, building, and equipment) of $250,000 equivalent. The problem arises from the fact that in the Philippines it is a common business practice for companies to significantly understate revenues and assets for tax purposes in *audited* financial statements. Therefore, businesses which appear to meet the small business criteria in fact do not. The weak financial condition presented in the audited financial statements in many cases do not support a prudent loan decision. Under the circumstances, it is PCILF's practice to request (i) audited financial statements (ii) *in-house confidential* financial statements and (iii) bank statements for cash flow analysis. Companies provide unaudited *in-house confidential* financial and bank statements to show a stronger financial position for loan purposes. PCILF then makes an informed loan decision as documented on the Credit Application (the document used to present a loan to PCILF management for approval). We report the non qualifying loans in Appendixes 2 and 3.

Recommendation: PCILF should use the best information available to determine whether borrowers qualify as small businesses or microenterprises. PCILF should report a business size to USAID consistent with the information it relies upon for its loan decision as documented in the Credit Application. In those cases where PCILF presents the strength of the in-house confidential statements and cash flows to justify approval of the loan, then PCILF should report a consistent business size to USAID.

PCILF's Response: PCILF indicates that loans are enrolled based on informed and prudent loan decisions. PCILF states that it relies on externally audited financial statements of the borrowers. PCILF did not address any of the specific noncompliances by borrower in Appendix 2. PCILF did not indicate that it would implement any of the recommendations. See Appendix 4 for PCILF's full response.

Auditor's Comments: PCILF does not directly address the issue. We have not taken issue on which financial statements PCILF should rely on in reaching an informed decision. We have left those judgements to PCILF. The issue is that PCILF does not present the same basis for its loan decisions to USAID as it has used itself. In Appendix 2 we have documented specific examples where PCILF has chosen to disregard the audited financial statements and bases its loan decision on the strength of the in-house confidential statements and cash flows. It is therefore improper and misleading for PCILF to present the audited financial statements, which it has itself disregarded, to USAID for the purpose of bringing loans under portfolio coverage. PCILF should address the specific examples we have presented in Appendix 2. We believe the Statement of Condition and Recommendations are valid.

Condition 5 PCILF has not followed prudent lending practices in bringing loans under portfolio coverage under the provisions of LPG Section 2.01(e) which requires that loans for existing customers must be an additional credit and not a renewal or extension of an existing credit. Further, PCILF has not complied with LPG Section 2.01[h] which requires that loans must be brought into coverage within 10 days of disbursement (term loans) or approval (lines of credit) as appropriate. We document instances where borrowers were in a delinquent status when loans were brought under portfolio coverage. We report these as non qualifying loans in Appendixes 2 and 3.

Recommendation: PCILF must strictly adhere to the requirements of the LPG in promptly bringing loans under coverage within the required time period. Further, for loans under annual review, PCILF should appraise the creditworthiness of the borrower by examining the repayment history and current financial condition. This will help to prevent loans for delinquent borrowers from being placed under portfolio coverage.

PCILF's Response: PCILF indicates that the loans in question are not renewal or extensions, but are rather, availments of credits on revolving lines. PCILF presents a discussion on the definition of lines of credits and availments on lines of credit. PCILF indicates that coverage requirements apply to the availment, not to the total line. PCILF emphasizes that it is following prudent lending practices in enrolling accounts. PCILF did not address any of the specific noncompliances by borrower in Appendix 2. PCILF did not indicate that it would implement any of the recommendations. See Appendix 4 PCILF's full response.

Auditor's Comments: Irregardless of PCILF's interpretation, it is not proper for PCILF to bring either a new availment or a new line of credit under portfolio coverage when the borrower is known to be in a delinquent status and in financial difficulty. Among others, we document an instance (Diagnostic Distributors) where PCILF brought a loan under portfolio coverage and then took almost immediate action to claim a loss to USAID. PCILF should address the specific examples presented in Appendix 2. We believe the Statement of Condition and Recommendations are valid.

Condition 6: PCILF should update the status of recoveries for credit to USAID as required by LPG Section 7.08. We believe the recoveries result from (i) premature loss claims, (ii) the fact that PCILF does not report the "net loan balance" to USAID and (iii) the lack of a formal follow up procedure to update and report recoveries. We document those instances where additional recoveries are due to USAID in Appendixes 2 and 3.

Recommendation: We recommend that PCILF undertake a 100 percent review of existing losses to review for additional recoveries. We also recommend that PCILF implement formal follow up procedures to identify recoveries on USAID losses. Adoption of the other recommendations should reduce recoveries due to premature and overstated loss claims.

PCILF's Response: PCILF indicates that it is continuously updating refunds which are remitted to USAID in batches. See Appendix 4 for PCILF's full response.

Auditor's Comments: Our recommendations are based on an intensive review of PCILF's loan files. In Appendix 2 and 3 we disclose recoveries which need to be credited to USAID. PCILF was not aware of those recoveries and was not actively monitoring those loans. PCILF agreed once we disclosed the information to them. We believe the Statement of Condition and Recommendations are valid.

SCHEDULE OF NONCOMPLIANCE BY BORROWER

We performed a detailed review of the larger losses for 21 borrowers amounting to approximately 80 percent of the total claimed. We incorporate the written responses provided by PCILF on 20 November 1999. We identify losses, which we believe are not eligible for coverage, in those cases where the cumulative noncompliances-are significant.

1. **Skeptron Marketing**
   USAID Share of Loss: P1,315,908 [$50,612]

There is no documentation that the entire loan balance was written off or that a specific loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response PCILF provided a list of "Allowance for Probable Losses". However, this is an "analysis" which compares the amount of USAID claimed losses against PCILF's total company wide loss provisions. There is no documentation to support a specific loss provision.

2. **Willsan Plastic Printing and Manufacturing**
   USAID Share of Loss: P1,483,204 [$57,046]

There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established.

3. **WKG Food Tech International Inc.**
   USAID Share of Loss: P1,713,033 [$65,886]

There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established.

4. **Carrandang, Spouses Jose and Corazon**
   USAID Share of Loss: P574,395 [$22,092]
   Recovery credited to USAID: P247,332 [$9,513]

   a. The claim to USAID was premature and not in compliance with LPG Section 5.01[B] which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment. The loss claim to USAID was filed based on a demand letter for payment in full dated 22 December 1997. However, there was a second demand letter for payment in full dated 12 May 1998 indicating continued payment and collection activity.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established. Further, PCILF claimed the total outstanding loan balance ignoring the value of equipment which had been repossessed at the time the loss was claimed to USAID. The result was that PCILF remitted the recovery on 11 May 1999 to USAID, seventeen months after the loss claim.

5. Giraffe-X Creative Imaging Inc.
USAID Share of Loss: P940,360 [$36,168]

a. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. Documentation contradicts a full write off provision. PCILF classified the loan as "Substandard", which requires a 25 percent loss provision at the time the claim was submitted to USAID. Further, the loan was classified "Doubtful" which requires a 50 percent loss provision over one year after the claim to USAID for a full loss. Finally, there is no documentation that the loan was ever classified "Loss" with a subsequent full write off.

b. As required by LPG Section 7.08 PCILF should update the status of recoveries based on its efforts to sell repossessed equipment.

6. Jampack Plastic Manufacturing
USAID Share of Loss: P580,407 [$16,664]
This loan should not be included under USAID LPG coverage.

a. PCILF has not complied with LPG Section 2.01(h) which requires that credit lines be placed under portfolio coverage within 10 days of approval. PCILF placed the loan under coverage on 21 November 1997 well after the renewal of the line of credit on 15 May 1997. Further, documentation indicates the borrower was *delinquent prior* to coverage as follows:

(1) Other loans of the borrower were classified "Substandard" from problems dating from at least 1 September 1997 which is prior to USAID coverage.
(2) There is a legal letter dated 24 July 1997 demanding payment on another note on the line of credit.

In response, PCILF indicates that it considers the new "availments" of the line of credit to meet the requirements of the LPG. We believe a strict interpretation is necessary to prevent the loans of delinquent borrowers from being brought under USAID coverage.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses". However, documentation contradicts a full write off provision. The loan was classified "Doubtful" requiring a 50 percent write off over one year *after* the claim for full payment to USAID. There is no documentation of a subsequent full write off.

7. Fiorelli Inc.
USAID Share of Loss: P1,084,695 [$26,232]
This loan should not be included under USAID LPG coverage.

a. PCILF has not complied with LPG Section 2.01(h) which requires that credit lines be placed under portfolio coverage within 10 days of approval. This loan was brought under coverage on 18 January 1998, well after the line of credit approval on 2 May 1997. In addition, there are indications that the borrower was *delinquent* on other loans prior to the subject loan being placed under USAID coverage as follows:

(1) At approximate time the subject loan was placed under USAID coverage, the account officer indicated discussions with the borrower related to other delinquent loans.

(2) There are demand letters on other delinquent loans prior to the subject loan.

In response, PCILF indicates that coverage was from date of disbursement of a draw on the line of credit in January 1998 when the borrower first utilized the credit. However, Section 2.01(h) states specifically, that on lines of credit, coverage should be from the approval date. Further, court documents indicate three loans were made from October to November 1997.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response, PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established.

8. Sonoray Medical Equipment, Inc.
USAID Share of Loss: P762,410 [$29,323]

There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses". However, documentation contradicts the analysis. PCILF classified the loan "Substandard" with no provision for loss on 30 November 1997, several months after the 21 February 1997 claim to USAID. There is no documentation of a subsequent full write off or loss provision.

9. BSL Construction
USAID Loss Share: P512,423 [$19,709]
This loan should not be included under USAID LPG coverage.

a. PCILF has not complied with the requirements of LPG Section 2.01[a][4] as the company is too large to meet the USAID definition of a small business. Total current assets (excluding land, buildings, and equipment) were the equivalent of $886,691, which exceeds the $250,000 limitation. In response, PCILF provided a 1993 audited financial statement which indicates current assets of P6,254,477 ($240,557). However, the loan was made and placed under USAID coverage based in part on the strength of PCILF's financial analysis in the Credit Application which indicates the current assets we have cited.

b. There is no documentation that the loan was written off or a loss provision was established at the time of the claim to USAID in accordance with Section 5.01[C]. The loan's account statement indicates the loan was written off in November 1997, well after the 15 April 1996 claim to USAID. In response, PCILF provided a 18 November 1997 memorandum from the President to the Board of Directors requesting write off of the loan and stating "Collection on these accounts have been extensively made including all possible legal remedies." This confirms that PCILF's practice of submitting loss claims is well in advance of internal policy in writing off loans.

10. Circulation Ent.
USAID Share of Loss: P1,872,077 [$71,672] (four loans)
Recovery credited to USAID: P323,610 [$12,389]

There is no documentation that the loan was written off or a loss provision was established on the USAID call date as required by Section 5.01[C]. The loan account statements indicate that loans were written off in November 1997, well after the claim to USAID on 22 April 1997. In response. PCILF provided a 18 November 1997 memorandum from the President to the Board of Directors requesting write off of the loan and stating "Collection on these accounts have been extensively made including all possible legal remedies." This confirms that PCILF's practice of submitting loss claims is well in advance of internal policy in writing off loans.

11. Jubilee Publishing
USAID Share of Loss: P774,905 [$29,804]

a. The claim to USAID was premature and not in compliance with Section 5.01[B] of the LPG which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment. The claim to USAID was based on a demand letter for payment in full dated 26 March 1998. However, there was a second demand letter for payment in full dated 12 October 1998, indicating continued payment activity. Further, PCILF provided an account officer call memo dated 3 April 1998 which indicates that the borrower had updated its account as of that date. Finally, a court case filed in 1999 indicates the borrower failed to make payments on 22 September 1998 and that a demand letter was sent on 14 October 1998.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses". However, the analysis is in contradiction to the continued payment activity discussed above.

c. Per Section 7.08, PCILF needs to update the status of recoveries. As discussed above, the loan account statement indicates further collections subsequent to payment of losses by USAID.

12. Hyroe Graphics and Prints
USAID Share of Loss: P1,197,831 [$46,070] (three loans)
Recoveries credited to USAID: P165,325 [$6,359]

a. The claim to USAID was premature and not in compliance with Section 5.01[B] of the LPG which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment. The claim to USAID was filed based on a demand letter for payment in full dated 5 February 1997. However, there was a second demand letter for payment in full dated 15 April 1998. There was continued payment activity by the borrower after USAID paid the loss claim. PCILF provided two account officer call memos dated 15 April 1997 and 24 June 1997 which indicate ongoing collection activity. PCILF acknowledges that USAID's share of recoveries due to subsequent collections amounted to P165,324.89. PCILF also indicates more recoveries may become due to USAID. Finally, PCILF confirms that a court case has been deferred as the borrower is updating its account.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response, PCILF provided a list of "Allowance for Probable Losses". However, documentation contradicts the analysis. PCILF classified the loan "Doubtful" which requires only a 50 percent loss provision on 15 April 1998, well after the 6 May 1997 claim to USAID. Further, the analysis contradicts the continued payment activity and recoveries discussed above. There is no documentation of subsequent full write off or loss provision.

13. Jose R. Ping-Ay Engineering and Associates
USAID Share of Loss: P545,597 [$20,985]

There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. Documentation does not support a full loss provision in the amount claimed. At the time of the claim to USAID the loan was classified "Doubtful" which requires only a 50 percent loss provision. There is no other indication the loan was subsequently classified "Loss" and written off in full.

14. TC Distributors
USAID Share of Loss: P630,127 [$24,236]
This loan should not be included under USAID LPG coverage.

a. PCILF has not complied with the requirements of LPG Section 2.01[a][4] as the company is too large to meet the USAID definition of a small business. Total assets (excluding land, buildings, and equipment) were the equivalent of P13,063,000 ($502,423) which exceeds the $250,000 limitation. PCILF verified the assets from in-house confidential financial statements and cash flow analysis from bank account statements. In response, PCILF provided a copy of the audited 1995 financial statements which shows current assets of P619,407 ($23,808) and net annual income of P121,536 ($4,674) to support that the borrower did not exceed size limitations. Further, PCILF indicates it did not rely on the in-house financial statements. However, we do not believe PCILF would provide a total of P1.659,706 in short term loans (less than 90 days) against the assets and income cited in the audited financial statements. PCILF cited the strength of the company's in-house financial statements and cash flow in approving the loan and placing that loan under USAID coverage.

b. In accordance with Section 7.08 PCILF should update recoveries from the proceeds of sales of P400,000 from seized vehicles. PCILF acknowledges recoveries are due to USAID.

c. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response, PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established.

d. PCILF has not complied with LPG to Section 10.01(H) which requires the exclusion of interest from loss claims. The total loss amount of P1,260,254.79 reported to USAID is overstated as it is the outstanding loan balance including both principal and interest as shown by various documents in the loan file. In response, PCILF indicates the principal amount is based on a lawyer's letter. We reviewed loan transaction documentation which we believe to be accurate. PCILF needs to correct the loss principal.

15. Goldenlite Philippines
USAID's Share of Loss: P1,307,241 [$50,279]
This loan should not be included under USAID LPG coverage.

a. Indications are that the company is too large to meet the USAID definition of a small business per Section 2.01(a)(4) and paragraph 5 of the 30 August 1995 commitment letter. The in-house financial statements show 1995 total assets of P27,013,000 ($1,038,962) and sales of P28,943,000 ($1,113,192). In response, PCILF provided the 1995 audited financial statements which show current assets of only P1,903,795 ($73,223), net income of P58,660. and cash flow of P173,450 to support that the borrower did not exceed size limitations. However, we do not believe PCILF would provide a three year loan of P3,899,000, requiring annual payments of P2,070,168, on the basis of the audited financial statements. PCILF cited the strength of the company's in-house financial statements and cash flow in approving the loan and placing that loan under USAID coverage.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. There is documentation that the loan was classified "Loss" by 30 May 1998, well after the 24 October 1997 claim to USAID, which is premature.

16. Begonsa Construction
USAID's Share of Loss: P673,259 [$25,895]
This loan should not be included under USAID LPG coverage.

a. PCILF has not complied with the requirements of LPG Section 2.01[a][4] as indications are that the company is too large to meet the USAID definition of a small business. The in-house financial statements show 1995 total assets of P62,330,000 ($2,397,307.77) and sales of P62,705,000 ($2,397,308). In response, PCILF provided 1995 audited financial statements showing current assets of P2,085,827 ($80,224) and net income of P3,662,987 to support that the borrower did not exceed size limitations. However, we do not believe PCILF would provide a loan to a construction company for one item of equipment requiring P1,298,112 in annual payments amounting to 35 percent of total annual income. Further, the total loan of P2,596,224 would be an additional 71 percent increase of the borrower's 1995 long term debt of P3,634,817. We do not believe it would have been prudent for PCILF to make the loan on the basis of the audited financial statements given the inherent risk of the construction industry. PCILF cited the strength of the company's in-house financial statements in approving the loan and placing that loan under USAID coverage.

b. There is no documentation that the loan was written off in full or a loss provision was established in the same amount as claimed against USAID as required by Section 5.01[C]. Documentation contradicts a full loss provision. PCILF classified the loan as "Doubtful" with a loss reserve for P379,181 on 9 February 1998, not the full loss claimed against USAID. There is no indication of a subsequent full write off of the loan. In response, PCILF indicates that the cited loss provision was a monthly amount. However, a loan progress report dated 31 May 1999 does not indicate any change in the loss provision or a subsequent write off.

17. Saladra, Spouses Ligaya and Balbino
USAID Share of Loan Losses: P507,515 [$12,761]
This loan should not be included under USAID LPG coverage.

a. PCILF has not followed prudent lending practices in bringing the loan under portfolio coverage under LPG Section 2.01(e). The loan was to restructure existing term loans which were delinquent at the time the loan was brought under USAID coverage. In response, PCILF indicates that the loan was restructured but that the client continuously made payments, and provided a real estate mortgage as collateral. However, we note that the first payment on the restructured loan was due on 17 January 1998 and shortly thereafter PCILF made a claim to USAID based on a demand letter dated 28 February 1998. The circumstances are that PCILF placed a restructured loan under USAID coverage and then took immediate action to claim a loss.

b. PCILF has not met the requirements of Section 5.01[A] as there are no demand letters for payment in full. There are only demand letters to bring past due amounts current. In response, PCILF provided a legal letter which demands an update of two months of payments in arrears. This is not a demand for payment in full.

c. The claim to USAID was premature and not in compliance with Section 5.01[B] of the LPG which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment. The claim to USAID on 29 April 1998 was premature as the borrower continued to make loan payments until 19 October 1998. In response, PCILF indicates that the branch office did not inform the home office of continuing payments. Further, PCILF indicates it has deferred filing a court case, since the client is still communicating with PCILF and exploring the possibility of settling their obligations in full.

d. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses" which is a listing of the losses claimed against USAID. The analysis contradicts the stated facts that the borrower continued to make payments as discussed elsewhere.

e. PCILF needs to update the status of recoveries due to USAID in accordance with Section 7.08. The total loss reported to USAID of P1,015,029.26 on 29 April 1998 was overstated as the outstanding loan balance had declined to P592,125 on 19 October 1998 shortly before USAID made payment on the loss. PCILF indicates it will provide a refund to USAID.

18. A.S. Topacio Construction
USAID Share of Loss: P1,493,544 [$56,918] (four loans)

a. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses". However, the loan account statements indicate full recovery on the loan including the portion of the loss paid by USAID and repossessed equipment. There is no documentation that a specific write off or loss provision was established.

b. In accordance with Section 7.08, PCILF should update the status of recoveries due to USAID. In response, PCILF indicates that it is having problems selling repossessed equipment.

19. Diagnostic Distributors
USAID Share of Loss: P941,764 [$36,222] (three loans)
This loan should not be included under USAID LPG coverage.

a. PCILF has not followed prudent lending practices in bringing the loan under portfolio coverage under LPG Section 2.01(e). The line of credit was originally granted in April 1994. An account officer's call memo of 27 November 1997 indicates the borrower had problems repaying existing notes on the line. Therefore, it is not appropriate to place the three new notes on the line under USAID coverage in March 1998. It is possible that the new loans were to restructure existing delinquent loans. In response, PCILF acknowledges that the borrower was looking at the possibility of restructuring the account but that payment experience was still good with no problems. However, we note that the first payment on the restructured notes were due from beginning15 April to 30 May 1998. PCILF made a claim to USAID for losses based on a demand letter dated 10 June 1998 based on the delinquency on the first two months payments. The circumstances are that PCILF placed the restructured notes under USAID coverage and then took almost immediate action to claim a loss.

b. There is no demand letter for full payment on file as required by Section 5.01[A]. In response, PCILF provided a legal letter date 10 June 1998. However, the demand is to bring payments current and is not a demand for payment in full.

c. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response, PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established. In addition, the loan account statements do not indicate a subsequent full write off of the loans to support a previous loss provision.

20. Northern Builders
USAID's Share of Loss: P949,706 [$36,527]
This loan should not be included under USAID LPG coverage.

a. This company is too large to meet the USAID definition of a small business as set by Section 2.01(a)(4) and paragraph 5 of the 30 August 1995 commitment letter. The company had 216 employees, a construction backlog of $3,933,944 in 1996, and monthly receipts of $593,791. The total current assets of P6,441,990 ($247,769) per the 1995 audited financial statements is likely understated. In response, PCILF provided a copy of the 1995 financial statements showing current assets of P6,441,990, current liabilities of P12,175,404, and net income of P922,100. We do not believe PCILF would provide a loan to the borrower requiring P3,777,552 in annual payments against the weak financial position shown in the audited financial statements. In the Credit Application PCILF cited the strength of the company's monthly cash receipts of P15,438,565 ($593,791) in approving the loan and placing that loan under USAID coverage.

b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date as required by Section 5.01[C]. In response, PCILF provided a list of "Allowance for Probable Losses". However, as discussed previously, this is an "analysis" with no documentation to support that a specific loss provision was established.

21. George Bian
USAID's Share of Loss: P1,834,491 [$70,557] (numerous notes)

a. The claim to USAID was premature and not in compliance with Section 5.01[B] of the LPG which requires PCILF to have pursued all reasonable and diligent collection efforts at the time a claim is submitted to USAID for payment. The demand date for payment in full is not 27 July 1998 as reported to USAID but begins on 24 November 1998. In addition, all demand letters for payment in full are not on file. In response, PCILF confirms the 27 July 1998 letter was used as the basis for submitting a claim to USAID. PCILF further indicates the 24 November 1998 letter was only against one account for the purposes of the external lawyer filing a complaint. However, we note that the 27 July 1997 letter is a reminder letter, not a demand for full payment. Further, we reviewed six November 1998 demand letters for full payment on various accounts. There are no letters for payment in full until November 1998.
b. There is no documentation that the loan was written off or that a loss provision was established in the same amount as reported to USAID as of the claim date, as required by Section 5.01[C]. PCILF provided a list of "Allowance for Probable Losses". However, this is an "analysis" which compares the losses claimed against USAID against PCILF's total company wide loss provisions. There is no documentation that a specific write off or loss provision was established.

SCHEDULE OF QUESTIONED - LOSSES NOT ELIGIBLE FOR COVERAGE and LOSSES REQUIRING AN UPDATE OF RECOVERIES

Appendix 2 Loan No.	Borrower	Pesos	USD	Comments
	Questioned Losses - Loans Not Eligible for Coverage:			
6	Jampack Plastic Manufacturing	P 580,406.77	$ 16,663.99	Borrower in delinquent status prior to USAID coverage.
7	Fiorelli, Inc.	1,084,695.24	26,232.05	Borrower in delinquent status prior to USAID coverage.
9	BSL Construction	512,422.98	19,708.58	Borrower exceeds size limitation for a small business.
11	Jubilee Publishing, Inc.	774,905.23	29,804.05	Loan exceeds the limitation for a Microenterprise.
14	TC Distributors	630,127.40	24,235.67	Borrower exceeds size limitation for a small business.
15	Goldenlite Philippines	1,307,241.22	50,278.51	Borrower exceeds size limitation for a small business.
16	Begonsa Construction	673,258.88	25,894.57	Borrower exceeds size limitation for a small business.
17	Saladra, Sps Ligaya & Balbino	507,514.63	12,761.24	Borrower in delinquent status prior to USAID coverage.
19	Diagnostics Distributor	941,763.82	36,221.69	Borrower in delinquent status prior to USAID coverage.
20	Northern Builders	949,706.20	36,527.16	Borrower exceeds size limitation for a small business.
		P7,962,042.37	$278,327.51	
	Losses Requiring an Update of Recoveries:			
5	Giraffe-X Creative Imaging Inc.	P940,360.00	$36,168.00	
11	Jubilee Publishing, Inc.	774,905.23	29,804.05	Also not eligible for coverage as stated above.
14	TC Distributors	630,127.40	24,235.67	Also not eligible for coverage as stated above.
17	Saladra, Sps Ligaya & Balbino	507,514.63	12,761.24	Also not eligible for coverage as stated above.

See Appendix 2 for a detailed discussion for each borrower.

FAA 8

PCI Leasing and Finance, Inc.

PCI Leasing Centre, Corinthian Gardens, Ortigas Avenue, Quezon City, P.O. Box 2768
Tel. No. 635-6416 Fax Nos. 635-5811 / 635-5805 / 635-3898

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26 April 2000

JAMES H. REDDER
Controller - USAID Philippines

Gentlemen:

Attached is our reply to each condition mentioned in the report of the DCAA Auditor dated 29 December 1999.

We wish to emphasize that in all the conditions mentioned, we made exceptions and/or disagreements. If the DCAA Auditor brought these conditions to our attention and discussed with us in the form and detail as the draft approved by USAID. PCI Leasing could have clarified and cleared all items.

We apologize, however for any adverse impression on PCI Leasing's credit and collection practices which the conditions seem to impress.

We assure you that our company has established credit policies and procedures that are among if not, the most comprehensive in the industry. Furthermore, we continually pride ourselves as the only finance company with a past due ratio of not more than 12% which is significantly low compared to the financing industry average past due ratio level of at least 25%.

We also emphasize that being the only listed financing company in the Philippines, we are audited year-round by the Philippine Stock Exchange, the Central Bank, Securities and Exchange Commission and the Bureau of Internal Revenue. This is in addition to our external auditor that audits PCI Leasing twice a year and the internal & credit policy auditors from our parent company. All of them concentrate on our receivables which as of December 1999 comprise 84% of our total assets. We have managed to pass all of these audits.

We look forward to a continuing relationship with the USAID through its LPG program.

Very truly yours,

MARIO R. CRUZ
Assistant Vice President - Credit

ROBERTO E. LAPID
Vice President - Marketing

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