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UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT

AREA AUDITOR GENERAL - LATIN AMERICA (NORTH)

PANAMA CITY, R.P.

REPORT OF AUDIT

PRIVATE INVESTMENT FUND - LOAN No. 514-L-057

USAID/COLOMBIA

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AUDIT REPORT No. 1-514-71-157

DATE ISSUED: JUNE 30, 1971

USAID MISSION TO COLOMBIA

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I. SCOPE OF AUDIT

Under authority of M.O. 203.5, the Area Auditor General for Latin America (North), AAG/LA (N), performed an audit of the Private Investment Fund (Loan 514-L-057) signed on December 22, 1969, for the amount of US $10.0 million.

An exit conference was held with representatives of the Capital Resources Development Office on June 23, 1971, and the report was discussed at a meeting of the Mission Implementation and Evaluation Committee held on July 8, 1971. The Mission's comments have been included to the extent considered appropriate.

This examination performed between April 1 and May 31, 1971, covers the period December 22, 1969 through May 31, 1971, and includes obligations totaling $10,000,000 and disbursements totaling $1,240,700*.

The audit was performed primarily to:

A. Determine the extent of compliance with the Loan Agreement.

B. Ascertain the propriety of expenditures.

C. Determine the utilization of AID's contribution, and

D. Review and evaluate, to the extent possible, the progress and accomplishments of the program.

Accordingly, we reviewed the Loan Paper, the Loan and Payment Agreements, Implementation Letters, correspondence files and other records and documents of the Mission. We also reviewed and analyzed the records and files of the Bank of the Republic (BOR), selected Intermediary Credit Institutions (ICI's), and certain of the private industries receiving the loans. In this connection, we visited the offices of the Private Investment Fund (PIF), related Sections of the BOR, and certain ICI's and private companies in Bogota, Cali, Palmira, Medellin and Barranquilla.

* In accordance with BOR records.

II. BACKGROUND INFORMATION

A. Project Information

Under Resolution No. 11, the Bank of the Republic (BOR) established the Private Investment Fund (PIF) for purposes of financing industrial and agro-industrial projects in the Colombian private sector. As a part of the BOR, the PIF assisted the Intermediary Credit Institutions (ICI's) to make loans for the following purposes:

1. Diversification and promotion of exports.

2. Elimination of production bottlenecks, and

3. Import substitution.

These ICI's process, service and are otherwise responsible for the subloans approved by PIF.

The purpose of Loan 057 (and previously audited Loan 040) was to make U. S. dollars available to finance the U. S. dollar costs of industrial and agro-industrial projects in the private sector.

In making $10,000,000 available under Loan 057, AID, considering its experience with Loan 040 (and Audit Report No. 69-08), included the following conditions:

a. The BOR will provide evidence that PIF has implemented organizational changes to enable it to carry out the program more efficiently.

b. The interest rates to sub-borrowers will range from 15 1/2% to 18% per year.

c. The private borrowers will pay a commitment fee of 3/4 of 1% per annum on the committed but undisbursed portion of the sub oan.

d. The GOC is required to exercise its option to use the two-step Special Payment Procedure "prior to the day on which the first interest payment is due" on the loan, and

e. Excess of the funds received by the GOC over the amounts necessary to service the loan, will be used by the GOC for purposes beneficial to the economic and social development of Colombia, and as agreed to by the GOC and by AID.

As in the case of Loan 040, the GOC elected to use the two-step Special Payment Procedure. This meant that the GOC would assume the loan. As a result, the GOC will collect interest from the BOR at the rate of 5 1/2% per annum on the outstanding balance, the Principal being repayable over 15 years, including a 5-year grace period. In turn, the GOC will pay AID interest at the rate of 2% per annum, on the unpaid balance for the first 10 years, and 3% per annum thereafter. In addition, Principal is repayable by the GOC over a 40-year period, including a 10-year grace period.

Other pertinent restrictions included in Loan 057 are:

(1) PIF will not finance more than 70% of any project (regardless of source of funds).

(2) Proposed subloans in excess of $500,000 will be referred to the Export-Import Bank for possible financing by that Bank.

(3) The term of Project Loans may range from 5 to 10 years, and

(4) ICI's will retain a uniform 3% interest margin.

B. Funds Authorized and Released

Under Loan 057, AID obligated $10.0 million and the Mission has received AID/W Disbursement Reports totaling $1,102,000 through May 31, 1971. The records of the BOR reflect that the $10.0 million has been committed in total by AID through two Letters of Commitment of $5.0 million each with the Bank of America and the Chase Manhattan Bank of New York respectively. Through May 31, 1971, the BOR has approved $4.1 million in subloans and has reimbursed U. S. Banks $1,240,700 covering payments to suppliers.

III. SUMMARY

The Private Investment Fund (PIF) Loan has been successful in that:

A. It has made a substantial contribution to the economic development of Colombia, by providing financial assistance on favorable terms for projects involving:

  1. Diversification and promotion of exports.

  2. Elimination of production bottlenecks, and

  3. Substitution of imports.

B. It has been successful in attracting and receiving financial assistance for similar purposes from other sources, and

C. It has strengthened the private commercial sector.

The problem and/or potential problem areas encountered were:

1. Utilization of funds provided by the Loan has been slow, primarily due to the Borrower not making pesos available promptly as required by Section 4.02 of the Loan Agreement. (Recommendation No. 1, page 8)

2. The Mission does not have specific written monitoring policies and/or procedures for monitoring the Loan nor is the reporting by PIF to the Mission adequate or timely. (Recommendation No. 2, page 9)

3. The Mission has not clarified in writing its position with regard to subloan applications of over $500,000. (Recommendation No. 3, page 9)

4. The PIF appears to have shown preference to finance corporations over commercial banks, and a majority of the funds have been approved for subloans to companies that are major shareholders of the finance corporations. (Recommendation No. 4, page 10)

5. There has been a concentration of funds lent to large companies. No recommendation necessary since corrective action has been taken by the Mission.

6. Commitment fees have not been collected by PIF partly due to a misunderstanding by PIF of the wording of the Loan Agreement. Since corrective action to clarify this situation has been taken by both the Mission and the Borrower, no recommendation is considered necessary.

7. PIF has not been reorganized as required by Section 3.01(d) of the Loan Agreement. Since they are presently in the process of reorganizing and the Mission has requested the necessary information to satisfy itself that the reorganization will be effective, no recommendation is considered necessary.

8. Waivers of the "Small Business Notification Requirement" has taken an inordinately long time. The Mission has plans to reduce this substantially, therefore no recommendation is considered necessary.

IV. FOLLOW-UP ON PRIOR AUDITS

Audit Report 69-08 (issued May 28, 1969) covered AID Loans 514-L-040, 514-G-042 and related Counterpart Funds for the period February 28, 1963 (the date PIF was created) through December 31, 1968. The audit was performed during the period November 15, 1968 through May 10, 1969.

Our follow-up indicated that all recommendations had been cleared. Recommendation No. 7 suggested that the Mission request "the GOC to complement from its own funds Ps. 7.9 million." On September 24, 1969, the Assistant Director for Development Policy wrote the Controller that since the shortfall occurred as a result of the U..S. Government's inability to meet its commitments under P.L. 480 "it would seem reasonable to make up the difference from Counterpart generations rather than requesting the GOC to make it up from its own funds." On the basis of the above memorandum the auditors agreed to clear Recommendation No. 7.

On February 1, 1971, the Mission wrote the GOC Planning Department recommending that certain transfers be made to PIF. As of May 31, 1971, these transfers had not been made, thereby contributing to PIF's shortage of pesos as described in Section V,B,1 of this report.

V. AUDIT FINDINGS AND RECOMMENDATIONS

A. Overall Program Implementation Performance

The main objectives of Loan 057 as stated in the Loan Paper and the Loan Agreement are being achieved in varying degrees. The PIF is an effective tool of the GOC in channeling funds to the private sector for projects to:

1. Diversify and promote exports.

2. Eliminate production bottlenecks, and

3. Substitute imports.

It has also been able, as required, to attract and receive financial assistance for this purpose from other sources, to strengthen the private commercial and industrial sectors, and to assist in increasing and diversifying minor exports from $62.3 million in 1963 to $221.0 million in 1970. In addition to approximately $59.3 million (Ps. 588,259,000) contributed by the GOC in the financing of PIF projects, PIF has received:

From	Date	Amount U.S. Dollars	Term	Interest Rate
I.D.B.	10-30-63	$ 3,000,000	12 years	5.75% p.a.
Holland	03-05-64	1,382,642	15 years	5.5% p.a.
K.F.W.				
AL-292	10-10-66	5,000,000	15 years	5.5% p.a.
AL-494	June 71	3,415,300	25 years	5.5% p.a.
F.N.C.B.	05-22-71	5,000,000	5 years	6.5% p.a.
Total Other Sources		$17,797,942		

B. Findings Requiring Corrective Action

1. Utilization of Funds

Utilization of funds under Loan 057 has been slow and it appears that the funds will not be fully disbursed by the Final

Contribution Date (July 1, 1972). It also appears highly unlikely that the full $10.0 million will be approved for subloans by July 1, 1972, unless corrective action is taken by the Mission and/or the Borrower.

The Agreement was signed on December 12, 1969, at which time Section 7.04 provided that "no Letter of Commitment or other commitment documents which may be called for by another form of disbursement .... shall be issued in response to requests received by A.I.D. ..... after July 1, 1971." This Section also provided that "no disbursement shall be made against documentation received by A.I.D. ..... after July 1, 1972."

As of March 31, 1971, the PIF had approved 14 subloans, committing $5.1 million of the $10.0 million available under Loan 057. A follow-up review of PIF records made on June 15, 1971, showed:

Total approved by BOR on 03-31-71		$5,045,000
Less:		
(1)	Reduction of Loan to Peldar from $1,137,000 to $500,000	(637,000)
(2)	Cancellation by Abonos Colombianos	(387,000)
(3)	Probable cancellation by INGRAL*	(368,000)
		$3,653,000

In effect then, in 18 of the 30 months during which the $10.0 million was expected to be fully committed and disbursed, only $3.7 million has been committed and $1.2 million disbursed. Further, during the last 2 1/2 months, no further subloans had been approved.

A major reason for this slow utilization was a shortage of pesos for PIF loans. Each project involved payment of the dollar costs from AID Loan 057, and payment of peso costs by the GOC. Section 4.02 of the Loan Agreement specifies: "Borrower shall provide promptly as needed all funds (pesos) required for the punctual and effective carrying out of the Program."

* Simultaneous request to Banco Ganadero for this amount will be approved.

The GOC did make pesos available for relatively large subloans during the first half of 1970, but by the end of the year there was a shortage of pesos for this purpose, and on December 4, 1970, the BOR issued Circular No. 2,862 advising all banks and financial corporations that approval of subloans under PIF had been suspended pending availability of further peso resources. The Borrower, therefore, has not complied with Section 4.02 of the Loan Agreement.

To assist the GOC in complying with this requirement, the USAID agreed with the GOC to furnish (in addition to other pesos provided) Ps. 125.0 million from Counterpart Funds generated under Program Loan 049, and Ps. 70.0 million from Program Loan 044. Of this, only Ps. 62 million under Loan 044 was furnished to PIF, leaving a shortfall of Ps. 133 million. (This shortfall was due to an over-estimate of the expected peso generation under the two loans mentioned.) On February 1, 1971, the Mission wrote the GOC Planning Department that Ps. 65.3 million delivered by the BOR for projects other than those authorized under Counterpart Agreements must be reprogrammed for mutually agreed upon activities, and suggested that it be allocated to PIF to partially make up for the shortfall of Ps. 133 million. The Mission also suggested that an additional Ps. 45 million expected to be generated under Loan 049 be transferred for the use of PIF. As of May 31, 1971, these transfers had not been made.

Recommendation No. 1

USAID/Colombia should request that the BOR furnish the Mission its plan for: (1) the generation of the local currency requirements, and (2) the utilization of the rest of the Loan (approximately $6.3 million).

2. Mission Monitoring

The Mission does not have specific written monitoring policies and/or procedures for Loan 057. Conversations with the Capital Development Office indicate that the Mission considers the BOR capable of conducting the program on its own. Since this is in accord with the overall worldwide policy of the Agency, the Mission has decided to allow the BOR to operate the Program with very little monitoring. We believe that if the Mission had monitored this Loan more closely and had required the BOR to furnish more information on a timely basis, many of the deficiencies listed in this report would not have occurred. Although we agree that ideally the BOR should conduct the program independently, we also feel that the Mission should have certain minimum requirements. The USAID Capital Development Office advised us that the Mission has prepared formats for monthly reports that PIF will be requested to furnish the Mission. We feel that this will be helpful for the Mission to determine timely utilization, borrower concentration, purpose of subloans, compliance with pertinent sections of the Loan Agreement, etc.

Recommendation No. 2

USAID/Colombia should consider issuing written policies and procedures for monitoring Loan 057.

3. Subloans Over $500,000

Section 5.01(a) of the Loan Agreement states that Loan applications over $500,000 will be referred through AID to the Export-Import Bank of Washington, D. C. for possible financing by that Bank. However, the Agreement is silent on what AID would do if the Export-Import Bank expressed interest or non-interest. In a memo to the Mission Director dated February 1, 1971, the Capital Development Office indicated that problems might arise due to the Mission not stating its policy clearly, and recommended that Mission policy be clearly communicated to PIF officials. However, this has not been done.

The Mission, therefore, has not made its position clear, although in a recent case (which the BOR may use as a precedent) where the Export-Import Bank had expressed interest, the Mission has required that the sub-borrower reduce its application to $500,000. Because the Mission has not clearly stated its position on this matter, there has been a resulting confusion on the part of PIF in administering the Loan. The Agreement is also silent as to whether one company is limited to $500,000, or whether the same company may apply for several loans of $500,000 provided they are for different projects.

Recommendation No. 3

USAID/Colombia should: (1) clarify, in writing, its policy on Loan applications over $500,000, and (2) be more specific in this respect in the preparation of future similar Loan Agreements.

4. Subloans Concentrated in Large Corporations

PIF has been especially lenient in granting large amounts in subloans to large corporations, with the result that a disproportionate amount of the Loan has been approved for large corporations. Also, except for one small loan of $21,000, all subloans were channeled through finance corporations, of which the sub-borrowers are large shareholders. In addition, of the $5.1 million approved through March 31, 1971, $3.3 million has been submitted for approval by one finance corporation, Financiera Nacional.

The funneling of almost 100% of PIF funds through finance corporations was largely due to commercial banks having been advised that due to a shortage of pesos, loan applications to PIF requiring substantial amounts of pesos would not be considered. The commercial banks were also not kept advised on as current a basis as were the finance corporations.

Recommendation No. 4

USAID/Colombia should request that the BOR disseminate information, particularly to commercial banks, on a more timely and detailed basis.

In spite of several requests, PIF officials have not furnished us details on the ownership of the finance corporations. All except one (unconfirmed) of the large companies that received loans through Financiera Nacional are shareholders, but we have not been able to determine to what extent.

In each case where subloans had been approved for large amounts (over $300,000) we were advised by the sub-borrowers that:

a. They (the sub-borrowers) would have qualified for, and had access to other than PIF financing, but on less favorable terms, and

b. They would have proceeded with the project even if PIF financing had not been made available.

In confirmation of the fact that other financing was available, as stated by the sub-borrowers, we determined that the World Bank since 1966 has made available to the BOR $60.0 million at comparatively favorable terms. The only restriction was that the money could be lent only through the finance corporations.

On March 27, 1971, AID/W advised the Mission that the GAO Auditors criticized the PIF Loans because:

1. Credit was extended to the bank's biggest and best customers and only if a high percentage of collateral was available, and

2. Most of these customers could have obtained the financing elsewhere although not on similar terms.

AID/W found the criticism (1) "bothersome" to the extent "the Bank in question actually rejected applications which represented sound projects from a financial stand point, but were being sponsored by investors not in the so-called "in-group." AID/W went on to state that they were concerned if "such financing was available from other in-country sources on similar or reasonable terms thus indicating that the credit service being provided by the AID-supported bank was no longer necessary or institutionally unique."

We suggest that Mission officials determine whether financing other than PIF had indeed been available to these large companies. If this financing had been available as stated above, then Loan 057 was not necessarily an additive, nor did it contribute to the economic development of Colombia to the extent it would have, had the funds been restricted to companies that did not have access to other financing.

Finance corporations concentrated on large borrowers because the risks on larger loans are generally less (since larger companies with better collateral tend to ask for larger loans), the work involved is less, and the profit is greater. In a meeting with the USAID Capital Development Office we were advised that the Mission is considering incentives for smaller loans. We are entirely in accord with this, but suggest also that future Loan Agreements of this type include a section restricting a large percentage for use by only smaller to medium-sized companies.

Mission officials advised the auditors that they were aware of this problem, and as a result the Urban Regional Sector Loan in the amount of approximately $28.0 million is restricted to financing projects for the smaller to medium-sized companies (total assets no more than Ps. 15 million). Therefore, we do not consider that any recommendation is necessary.

5. Commitment Fees

Section 3.01(g),(iv) requires that the Borrower collect a commitment fee of 3/4 of 1% per annum on the "committed but undisbursed balance of the Project Loan." The ICI's have collected this commitment fee in each instance 120 days after approval of the subloans by PIF, but since PIF has not charged them this fee, they have not remitted it to PIF. When we brought this to the attention of PIF officials, debit notes were issued by PIF charging these amounts to the accounts of the ICI's. In a subsequent discussion with the USAID Capital Development Office we were advised that the Mission considered funds "committed" as of the date a Letter of Credit is issued against a Letter of Commitment Bank in favor of a supplier. This is apparently not the definition used by the BOR nor does this appear to be the intent of the Loan Agreement. The word "committed" has been used in at least two different places in the Loan Agreement to mean two entirely different dates and it appears that this apparent ambiguity has been at least partly responsible for misunderstanding on the part of the Borrower.

The Capital Development Office advised us that the Mission has now agreed with the BOR charging the commitment fee 120 days after the approval of the subloan by the BOR. Therefore we do not consider that any recommendation is necessary.

6. Reorganization of PIF

Section 3.01(d) of the Loan Agreement included as a Condition Precedent that the Borrower furnish the Mission evidence that "PIF has implemented organizational changes sufficient to enable it more efficiently to carry out the Program."

However, in Implementation Letter No. 2, dated March 29, 1970, the Mission waived compliance with the above with the understanding that "the question of improvement in the operations of the PIF" be included "in the first consultation held pursuant to Section 4.03 ...." and "would expect the PIF at that time to submit" to the Mission "the kind of information set forth in Paragraph I(A), (2) of Implementation Letter No. 1," dated January 5, 1970. As of May 31, 1971, this information had not been furnished to the Mission.

During our discussions with officials of PIF we were advised that they have been provided with more spacious offices and with additional staff by the BOR. In addition, the Mission advised us that PIF has been requested to furnish "the new organizational chart and a write-up on key personnel." Therefore no recommendation is considered necessary.

7. Small Business Notification Requirement

Like most AID Loan Agreements, Loan Agreement 057 requires that all potential U.S. suppliers be given an opportunity to bid on the furnishing of supplies for projects financed under this Loan. Sub-borrowers throughout the country complained of the problems and the delay involved in complying with this requirement. Since this is a problem which all Missions face, we feel that this should be resolved on a worldwide basis by AID/W.

However, importers complained also of an inordinate amount of time required for approval of waivers of this requirement by the USAID. Since the Mission has advised that it is aware of both problems and is in the process of setting up procedures for expediting the issuance of waivers, no recommendation is considered necessary.

C. Other Findings

1. Opportunities for Improvement in the Language of the Loan Agreement

The Mission has had problems in the implementation of the Loan Agreement primarily because certain sections of the Loan Agreement were indefinite, lacking or not written clearly.

For instance:

a. The words "committed" and "commitment" have been used at leat 14 times in the Loan Agreement and could often have been interpreted differently. Section 3.01(g),(iv) states that the private borrower will pay PIF a commitment fee on the "committed but undisbursed balance of the Project Loan." Neither the Loan Agreement nor the Implementation Letters define when the funds become "committed."

b. Section 5.01(a) states that proposed Project Loans in excess of $500,000 will be referred through AID to the Export-Import Bank of Washington, D. C. for possible financing by the Bank. It fails to state what AID would do if the Bank expresses interest, or no interest, and

c. Although the above section provides that proposed subloans in excess of $500,000 be submitted through AID to the Export-Import Bank, no maximum was set on the amount that may be financed for one project or for one company. It is also possible for one project or one company to receive several subloans of less than $500,000 thereby bypassing the requirement that the Export-Import Bank have an opportunity to consider the project for financing.

LISTING OF RECOMMENDATIONS

Clearance Date

Recommendation No. 1

USAID/Colombia should request that the BOR furnish the Mission its plan for: (1) the generation of the local currency requirements, and (2) the utilization of the rest of the Loan (approximately $6.3 million).

ACTION OFFICE: ________________

Recommendation No. 2

USAID/Colombia should consider issuing written policies and procedures for monitoring Loan 057.

ACTION OFFICE: ________________

Recommendation No. 3

USAID/Colombia should: (1) clarify, in writing, its policy on Loan applications over $500,000, and (2) be more specific in this respect in the preparation of future similar Loan Agreements.

ACTION OFFICE: ________________

Recommendation No. 4

USAID/Colombia should request that the BOR disseminate information, particularly to commercial banks, on a more timely and detailed basis.

ACTION OFFICE: ________________