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October 30, 1998

MEMORANDUM

TO: USAID/Bosnia-Herzegovina, Craig G. Buck

FROM: RIG/Budapest, James R. Bonnell

SUBJECT: Audit of USAID/Bosnia-Herzegovina's Bosnian Reconstruction Finance Facility Program for the Period October 1, 1997 through March 31, 1998

This is our final report on the subject audit. In preparing the report, we considered your comments on the draft and included them in Appendix II. Based on the results of our audit, we found that the loan volume during this six month period increased significantly—$54.5 million in loans recommended—representing 91 percent of the targeted amount. However, the $120.5 million in recommended loans from the inception of the program was short of the targeted amount of $195 million due to a slow start as discussed in our earlier audit reports of this program. During the period covered by the audit, we noted that extensive resources were applied to generating a greater volume of loans. In the coming months, the loan portfolio and the number of problem loans should continue to grow. We believe that USAID and the implementing contractor will need to build upon their initial efforts at loan monitoring and restructuring and focus additional attention on these areas.

This report makes no new recommendations. Thank you for the assistance and courtesies extended to my staff during the audit.

Background

Bosnia-Herzegovina declared its independence from the former Socialist Republic of Yugoslavia in March 1992, following the lead of Slovenia and Croatia which declared independence in 1991. The move to independence precipitated a war in Bosnia-Herzegovina that lasted from 1992 until the signing of the Dayton cease-fire agreement on October 10, 1995. Following the cease-fire, Bosnia-Herzegovina was faced with consolidating the peace and restructuring its war-torn economy. The Dayton Agreement viewed economic rehabilitation and reconstruction as an essential element to achieving peace. The Agreement negotiators believed that the people must have an economic stake in the process; therefore, economic reconstruction, economic institution building, and promotion of a market economy were deemed to be major factors to ensure lasting peace.

In 1996, there were signs of economic recovery such as repairs to basic infrastructure. However, many key economic institutions and businesses were not fully functioning. The country's banking system was technically insolvent and burdened with nonperforming loans. To address some of these concerns, House Joint Resolution 170 (Public Law 104-122) appropriated $198 million for assistance to Bosnia-Herzegovina on March 29, 1996. These funds are to be used for economic revitalization ($145 million), police training and monitors ($45 million), demining ($5 million), and operating expenses ($3 million).

USAID became involved in May 1996 when the Assistant Administrator for the Bureau of Europe and the New Independent States authorized the five-year $278 million Bosnian Reconstruction Finance Facility (BRFF) program. These funds are to be used for financial support of post war reconstruction and economic revitalization, as well as for increasing employment of the general population, refugees, and demobilized soldiers. On May 7, 1996, a grant agreement was signed between the United States and Bosnia-Herzegovina to obligate the program's initial $27.5 million. This amount was transferred by USAID to Bosnia-Herzegovina in July 1996. As shown in the following table, USAID has transferred a total of $99.5 million to Bosnia-Herzegovina.

SUMMARY OF OBLIGATIONS AND FUNDS TRANSFERS
AS OF MARCH 31, 1998

OBLIGATING DOCUMENT	AMOUNT (millions)	DATE OF FUNDS TRANSFER
Grant Agreement	$27.5	July 1996
Amendment #1	12.5	November 1996
Amendment #2	19.5	May 1997
Amendment #3	40.0	September 1997
Total Obligated and Transferred	$99.5	

Audit Objective

The objective of this concurrent audit was to determine whether USAID/Bosnia-Herzegovina and the implementing contractors used economic revitalization assistance funds designated for the Bosnian Reconstruction Finance Facility Program for the purposes authorized under the Grant Agreement and Public Law 104-122.

The Office of the Inspector General has issued periodic reports on the Bosnian Reconstruction Finance Facility Program. This is the sixth report on the program.[1] Appendix I contains a discussion of the scope and methodology for the audit.

Audit Findings

Did USAID/Bosnia-Herzegovina and the Implementing Contractors Use Economic Revitalization Assistance Funds Designated for the Bosnian Reconstruction Finance Facility Program for the Purposes Authorized Under the Grant Agreement and Public Law 104-122?

For the items tested, USAID/Bosnia-Herzegovina and the implementing contractors were using the economic revitalization assistance funds designated for the Bosnian Reconstruction Finance Facility (BRFF) program for the purposes authorized under the grant agreement and Public Law 104-122.

BRFF Program–What can funds be used for?

Bosnia-Herzegovina's physical infrastructure sustained extensive damage during the war. Reconstructing the infrastructure requires financial resources and long-term credit to rehabilitate and revitalize Bosnian businesses which then could offer sustainable employment opportunities for the general population, especially demobilized soldiers and refugees. In response to this requirement, USAID designed the BRFF program, a $278 million balance-of-payments initiative intended to "jump-start economic growth and generate employment opportunities for the general population". The program was officially initiated with the signing of the grant agreement on May 7, 1996. Through fiscal year 1998, it is planned that $278 million will be available for the BRFF program, with $256 million allocated for the loan program and $22 million for technical assistance, training, and support costs.

[1] See Audit Report Nos: B-168-97-002-P, dated March 26, 1997; B-168-97-006-P, dated June 27, 1997; B-168-98-001-P, dated October 10, 1997; and B-168-98-004-P, dated March 26, 1998. Also, Memo Report No.: B-168-98-003-S, dated July 21, 1998.

Loan Program. To implement the BRFF program, USAID signed a task order with Development Alternatives, Inc., (hereafter referred to as Development Alternatives) on May 16, 1996, to establish and operate Business Finance.[2]

As the primary implementor of the BRFF loan program, Business Finance, with offices in Sarajevo, Tuzla, Banja Luka, and Brcko, recommends loans to USAID/Bosnia-Herzegovina for approval. The task order set targets of $45 million in loan recommendations which were expected to create 6,750 jobs through December 31, 1996. Although not specified in the order, USAID/Bosnia-Herzegovina expected that Business Finance would recommend $10 million in loans per month (generating 1,500 jobs per month) after December 31, 1996. These targets were formalized with Development Alternatives in a task order modification effective May 1, 1997. The loan volume and job targets were continued in a subsequent contract with Development Alternatives which will expire on September 30, 1998. Through March 31, 1998, USAID expected that a cumulative total of $195 million in loans would have been recommended by Business Finance which would have resulted in 29,250 new jobs.

Technical Assistance. Development Alternatives' task order also provides for training of Bosnian commercial bankers to help strengthen the Bosnian banks' ability to meet the credit requirements of the emerging private commercial sector.

In addition to creating Business Finance, USAID signed a task order on June 28, 1996, with The Recovery Group to provide assistance to businesses seeking loans from the BRFF and World Bank credit programs and to assist enterprises in achieving long-term viability. To implement its objectives, The Recovery Group established Business Consulting[3] which now has offices in Sarajevo, Tuzla, Banja Luka, and Brcko.

BRFF Status–What were funds used for?

Loan Program. Generally, borrowers are financing building reconstruction, equipment purchases, raw material acquisitions, and some operational expenses with the loan proceeds. Since the program's inception through March 31, 1998, USAID/Bosnia-Herzegovina has approved 257 loans (totaling $110 million) out of the 270 loans (amounting to $120.5 million) that Business Finance has recommended. USAID/Bosnia-Herzegovina has obligated and disbursed $99.5 million to the Government of Bosnia-Herzegovina to assist with their balance of payment needs. (See Appendix V for detail on budgeted, obligated and disbursed amounts.) Bosnia-Herzegovina has disbursed $70.2 million for 161 of these loans.

Regarding the achievement of loan targets, the $120.5 million in loans that Business Finance recommended to USAID/Bosnia-Herzegovina since the beginning of the program fell short of the

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[2] Formerly known as the On-Lending Management Unit.

[3] Formerly known as the Bosnia Business Assistance Center.

targeted amount of $195 million. This loan volume shortfall also resulted in over 12,000 fewer estimated loan-generated jobs than expected.

During this six month period, Business Finance recommended 129 loans valued at $54.5 million with a corresponding anticipated increase in employment of about 5,400 jobs. These figures fell short of the expected six month targets by approximately $5.5 million and 3,600 jobs.

In previous reporting periods, shortfalls were attributed to a systems and personnel restructuring intended to streamline loan production and a shortage of lending officers to analyze and process applications. During this reporting period, Business Finance made significant progress towards increasing loan volume. Although slightly short of the six month target, loan volume increased from about $25.9 million in the previous six months to $54.5 million for this six month period. According to program personnel, this progress was accomplished as a result of various factors such as:

- Additional program personnel, especially short-term technical assistance.
- Increased experience of program personnel and lenders.
- Expansion of program activities within the Brcko and Banja Luka areas of the Republika Srpska.
- Greater allocation of resources to loan volume rather than to loan monitoring although there was an increasing focus on monitoring by the end of this reporting period.

(See Appendix III for detailed information on the status of the BRFF program.)

Technical Assistance. Business Finance stated in its March 31, 1998, training report that, during this six month period, its training division sponsored 28 seminars and work shops in Tuzla, Sarajevo, and Banja Luka with a total attendance of 602 bankers, prospective borrowers, consultants and Business Finance staff. Since the beginning of the program, Business Finance has sponsored 89 events with a total of 2,382 participants. The seminars included such courses as Counting on Your Banker, Managing the Loan Portfolio, and Financing the Small Business. In March 1998, the Training Unit also conducted the first "Senior Lending Associate Program" for in-house staff which covered advanced credit analysis and loan structuring.

Business Consulting reported that since the inception of the program through March 31, 1998, it had prepared 367 diagnostics (formerly known as loan application supporting documentation). It has also completed 260 performance improvement projects which are designed to help enterprises restart and strengthen operations and establish initial viability and direction. Business Consulting has been achieving the targets for diagnostics in its latest task order but is still lagging behind the targets for projects. However, some progress was noted in their performance after USAID's proactive demands for improvements in the areas of impact reporting, recruiting, and communications. Also, at the end of the reporting period, Business Consulting initiated a turnaround consulting practice which will

be developed in close coordination with Business Finance. We will continue to monitor these areas of concern.

Results of Audit Tests

Our audit work during this reporting period focused on obtaining information on the status of loan activities and visiting a sample of agent banks and borrowers in the Sarajevo, Tuzla, and Brcko areas. (Appendix I contains a more detailed description of our audit scope and methodology.)

We visited 38 borrowers this period, bringing our total visits to 67 out of the 161 borrowers who have received loan disbursements. When appropriate, we inspected reconstruction work and equipment purchases funded by the loan proceeds at the borrowers' place of business. This period, we also visited 7 agent banks through which loans were disbursed. To date, we have visited 18 of the 24 agent banks. When appropriate, we tested compliance with the loan procedures and the agreements with agent banks.

Some problems were noted with the borrowers and agent banks visited and are briefly highlighted below. (Appendix IV contains more detail on the results of our site visits.)

Borrowers. Problems experienced by the borrowers in prior periods have continued to expand. Eighteen of the 38 borrowers visited are considered to be problem loans by Business Finance's internal auditors. Certain borrowers were experiencing problems such as delayed or reduced production, anticipated market demand not materializing, and having to resort to barter arrangements due to difficulties in collecting receivables. Borrower problems are being aggravated by a general lack of liquidity in the country.

In addition, while not necessarily a problem, loan proceeds were sometimes used to pay existing short-term debts which were incurred while the borrower was awaiting the BRFF loan proceeds. Business Finance attributed these delays in loan disbursements to five factors: (1) internal confusion in communication, (2) a significant increase in loan volume, (3) the requirement to post a public collateral notice, (4) borrower delays in securing property registered for mortgage, and (5) increased and more complex demands on borrowers for pre-disbursement conditions. Business Finance has temporarily shifted resources to help accelerate the disbursement process.

At the end of this reporting period, Business Finance collected on two outstanding loans due to the borrowers' failure to respect the terms of the loan agreement. Each borrower had decided to use the loan to conduct a trading operation rather than use the funds for production, as approved. One borrower conducted its business imprudently and had no funds left. The Agent Bank repossessed the borrower's collateral and reimbursed Business Finance for the principal amount of the loan. The other borrower had prospered, partly due to the loan, and chose to pay off the loan balance within six weeks. The other actions being taken by program personnel to address the issue of problem loans are discussed in a subsequent section on "Delinquent Loans".

Agent banks. Several agent banks were engaged in questionable practices and were not effectively monitoring the borrowers. During the summer of 1998, Business Finance was conducting a comprehensive review of all agent banks, a review which should help screen out the banks which are not fulfilling the obligations of their agreements or are not actively participating in the program. Business Finance was also developing a training program to specifically correct deficiencies in the monitoring and reporting being carried out by the agent banks. The agent banks will receive additional coverage during our next audit.

In addition to the Borrower and Agent Bank problems discussed above, other significant problems and issues came to our attention which are highlighted below.[4] To the extent deemed appropriate, we will continue to monitor these issues during our next audit.

Delinquent Loans. Delinquent loans are a growing problem and USAID was not fully aware of the complete picture due to incomplete reporting. Business Finance prepares a monthly report containing loans delinquent for at least 31 days (the full report). Instead of providing this full report to USAID, it provided an abbreviated report which only contained loans delinquent for at least 61 days and, thus, did not present a complete picture of delinquencies. To illustrate, the full report showed a delinquency rate about 50 percent higher than the abbreviated report provided to USAID. USAID took immediate action after we brought this matter to their attention. At USAID's request, Business Finance agreed to provide the full report.

The delinquency rate has been rising, from about 18 percent six months ago to over 30 percent as of March 31, 1998. According to a Business Finance delinquency report, as of March 31, 1998, 46 borrowers were delinquent— about triple the number as of September 30, 1997. Business Finance and Business Consulting have begun to provide resources to address this problem but additional and sustained efforts will be needed in the coming months. A Business Finance loan monitoring unit has been slow to get up and running. For example, plans called for 10 to 20 staff, but as of March 31, 1998, only three staff had begun some monitoring tasks. With the coming turnover in contractors (see below), there will be additional changes in the monitoring process which we will follow in subsequent audits.

Business Finance has also formed a loan restructuring and workout group and has already restructured some loans to facilitate repayment. Furthermore, at the end of the reporting period, Business Consulting initiated a turnaround consulting practice which will be developed in close coordination with Business Finance. According to program personnel, the typical loan period of three years has proven to be insufficient when proceeds are used for equipment and buildings, items which typically require a longer payback period. USAID also intends to pursue foreclosure actions in the most serious cases. During the next audit period, we will carefully monitor actions being taken by USAID, Business Finance, and Business Consulting to address problem loans. If the delinquency rate continues to grow, we will recommend additional actions to alleviate this problem.

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[4] Some of these matters were also discussed in our interim memorandum report (see Report No. B-168-98-003-S, dated July 21, 1998).

A New Implementing Contractor. Development Alternatives has been the primary implementor of the BRFF program since May 1996. USAID decided to compete their contract and, in late 1997, requested any and all interested parties to submit a proposal. After an extensive evaluation process, the Barents Group was selected. In April 1998, Development Alternatives filed a protest, but a General Accounting Office ruling denied the protest in August 1998. As a result, Development Alternatives will be replaced by the Barents Group. The transition should be completed by September 30, 1998.

Investigations. During the reporting period, there was extensive coordination with the RIG/Budapest investigator as allegations of fraud and abuse surfaced. Various matters have been pursued, some of which have resulted in personnel changes. The most significant action occurred in July 1998, when a Foreign Service National serving as the USAID manager for the BRFF program was terminated for inappropriate conduct.

Business Finance's Internal Audit Unit. We found that the internal audit unit has developed into an effective team and proven its value to the loan program. Additional staff added to this unit, perhaps on a rotational basis, would assist in the overall program monitoring and oversight process.

Security of Records. Original loan documents were not kept in a fireproof cabinet and backup copies of these documents and computer files were not maintained at a secure offsite location. Business Finance was working on a plan for better safeguards.

Management Comments and Our Evaluation

USAID/Bosnia-Herzegovina officials agreed with the content of the report and their comments are included as Appendix II to this report. In its response, USAID/Bosnia-Herzegovina noted that the program activities have been periodically adjusted to adapt to changing circumstances. The Mission expects additional program enhancements to be carried out by the new Business Finance contractor.

Scope and Methodology

Scope

The Office of the Regional Inspector General/Budapest is conducting a concurrent audit of USAID's Bosnian Reconstruction Finance Facility (BRFF) program activities in Bosnia-Herzegovina in accordance with generally accepted government auditing standards. For this reporting period, we conducted the audit from December 4, 1997, through May 30, 1998, at the USAID office in Sarajevo, and at the Development Alternatives' Business Finance offices and The Recovery Group's Business Consulting offices in Sarajevo and Tuzla. We visited 38 borrowers and 7 agent banks, some more than once, in these same areas.

During this reporting period, we did not audit the three BRFF program bank accounts maintained by the Central Bank of Bosnia-Herzegovina (formerly the National Bank). Also, we did not audit the program's financial statements shown in Appendix V. We performed limited work on The Recovery Group's Business Consulting activities.

Methodology

Audit methodology included file reviews, interviews, field visits and data analysis. We reviewed House Joint Resolution 170 (Public Law 104-122) dated March 29, 1996; the Foreign Operations, Export Financing, and Related Programs Appropriations Act of 1996 (Public Law 104-107), dated February 12, 1996; the Grant Agreement Between Bosnia-Herzegovina and the United States of America for Reconstruction Finance Facility; program documents; and contracts to determine BRFF program objectives and restrictions. We reviewed accounting records and tested compliance with the loan procedures and the agent bank agreements to assess whether internal control procedures were adequate and being followed. We interviewed USAID, contractor, and agent bank officials as well as borrowers to obtain their views on problems being experienced in the program and the adequacy of actions taken to address these problems.

We judgmentally selected 38 borrowers to visit, bringing our total visits to 67 out of the 161 borrowers who have received loan disbursements. Some borrowers were visited more than once. Our visits were conducted to verify the existence of the borrowers' businesses and their use of the loan proceeds. We observed equipment and raw material purchases and reconstruction efforts which

were funded by the loan proceeds. We visited 7 agent banks resulting in one or more visits to 18 of the 24 agent banks through which loans were disbursed. When appropriate, we reviewed documentation to determine how the banks were monitoring the use of the proceeds and the agent banks' internal records tracking the receipt and disbursement of loan proceeds for each borrower. We also selectively reviewed invoices submitted by the borrowers for purchases made using the proceeds of the loans.

Our test results have included testing performed by Business Finance's internal auditors. In order to rely on their work, we reviewed the generally accepted government auditing standards pertaining to an auditor's reliance on the work of other auditors. In accordance with those standards, we satisfied ourselves as to their competence and objectivity and also evaluated and tested the work they performed.

United States Agency for International Development
Sarajevo, Bosnia-Herzegovina

MEMORANDUM

Date: October 22, 1998

To: James R. Bonnell, RIG/A/Budapest

From: Craig G. Buck, Director /s/

Subject: Audit of USAID/Sarajevo's Bosnian Reconstruction Finance Facility Program for the Period October 1, 1997 through March 31, 1998

Our Mission continues to appreciate the RIG's intensive efforts to probe new areas of potential concern, to confirm and precisely define issues of mutual concern to the Mission, and to recommend sound measures to ameliorate problems.

From the beginning, the design of the Bosnia Reconstruction Finance Facility (BRFF) program (now Business Development Program) anticipated that the first few years would be roughly analogous to an emergency lending program like FEMA's in the U.S. Specifically, in a formerly socialist country in the aftermath of a genocidal war during which no audited financial statements were kept, we expected there would be a significant number of problem loans and eventual losses. That expectation notwithstanding, from day one every effort has been made to base each loan on commercially viable criteria to the fullest extent possible, and to rigorously monitor them after disbursement. With the constructive advice of the RIG, we have been adjusting both the Business Finance (BF) and Business Consulting (BC) contract activities to help fix the operations of individual borrowers and to tighten the loan monitoring activities of all three participants: the BC as well as the BF and agent banks.

This draft audit report touches on all key concerns and many of the remedial adjustments being implemented by the Mission. We believe there will be continuous and noticeable improvement in the handling of the expected increase in problem loans in this challenging environment of economic transition. The new BF contractor (Barents) formally took over on October 1, 1998, and has fielded a team of highly experienced international commercial bankers who are reviewing every single

aspect of the program's lending and monitoring operations. Based on their own fresh perspectives and the benefit of lessons learned by the original contractor, Barents is quickly developing a series of BF proposals to:

(1) tighten up lending policies and operations,

(2) increase control of the disbursement of loans (by tranching more precisely and introducing working capital facilities like revolving lines of credit used in commercial banking elsewhere),

(3) introduce a loan risk rating system with greater predictive value (like an early warning system) to facilitate preventive interventions to minimize the number of turnaround problem loans (after a borrower is already in serious trouble),

(4) reorienting the Field Associates hired by the previous contractor into a more aggressive loan monitoring unit (instead of serving as junior loan officers in training), and

(5) significantly reducing the number of agent banks to only the most active and reliable over the past two years of experience.

Of equal importance is the way the new BF contractor and the more tightly structured BC contractor are now actively integrating their operations at all levels, exclusively focused on helping each BF borrower be as successful a business as it can be in this environment.

Audited Status of the Bosnian Reconstruction Finance Facility *as of March 31, 1998*

The Bosnian Reconstruction Finance Facility (BRFF) program, a five-year, $278 million balance-of-payments initiative, approved by the Assistant Administrator for the Bureau of Europe and the New Independent States on May 3, 1996, is intended to "jump-start economic growth and generate employment opportunities for the general population, including refugees and demobilized soldiers." The BRFF grant agreement, signed on May 7, 1996, provides balance-of-payments assistance to Bosnia-Herzegovina to aid postwar reconstruction, provide credit to the industrial and commercial sectors, and generate employment.

On May 16, 1996, USAID signed a task order with Development Alternatives to establish and operate Business Finance[5] and provide intensive, in-country commercial banker training. Development Alternatives' team arrived in Sarajevo on June 13, 1996, to begin implementing the program and they had an expatriate staff of 21 assigned to the program as of March 31, 1998.

Business Finance, composed of a team of experienced U.S. bankers, accountants, and Bosnian staff with headquarters located at the Central Bank of Bosnia-Herzegovina, is the primary implementor of the BRFF program. Some of Business Finance's responsibilities include reviewing and recommending loan applications for approval; managing BRFF's lending operations; and monitoring and managing the flow of funds between the BRFF program, the borrowing enterprises, and the agent Bosnian commercial banks. Agreements with Bosnian commercial banks licensed by the Central Bank allow these banks to function as agents for Business Finance by submitting client loan applications. Business Finance also works with the Bosnian commercial banks to help educate them in market-oriented lending policies and credit evaluation techniques to assist in developing a capable financial sector.

In addition to creating Business Finance, USAID signed a task order on June 28, 1996, with The Recovery Group to help Bosnian businesses prepare and present proposals to Business Finance and to assist enterprises in restarting and strengthening their operations. To implement its objectives, The Recovery Group established Business Consulting[6] with headquarters located in Sarajevo.

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[5] Formerly known as the On-Lending Management Unit.

[6] Formerly known as the Bosnia Business Assistance Center.

BRFF Program Plan

Although the BRFF program is a five-year program, its planned budget is $278 million for a three-year period. According to the BRFF program authorization document, $278 million was budgeted through fiscal year 1998—$256 million for the lending program and $22 million for technical assistance and implementation costs.

The BRFF program also provides training for Bosnian commercial bankers concentrating on loan structuring and risk assessment. This training is intended to strengthen market-oriented Bosnia commercial banks' ability to meet the credit requirements of the emerging private commercial sector.

BRFF Program Status

From the program's inception, $128.6 million of the budget had been obligated and $117.9 million had been disbursed. Of the $128.6 million obligated, $99.5 million was for loans with the remaining $29.1 million allocated for technical assistance and program implementation. (See Appendix V.)

Loan Program. Business Finance is responsible for reviewing and assessing credit risk on all loan applications and recommending viable loans to USAID/Bosnia-Herzegovina for approval. After USAID/Bosnia-Herzegovina approves the loan, it can be disbursed by the Central Bank of Bosnia-Herzegovina with USAID's approval. During the six month period ended March 31, 1998, Business Finance recommended 129 loans, valued at $54.5 million, to USAID/Bosnia-Herzegovina. These recommendations anticipate an increase of approximately 5,400 new jobs. The Central Bank disbursed funds for 68 loans valued at $24.9 million.

From the beginning of the BRFF program, USAID/Bosnia-Herzegovina approved 257 loans totaling $110 million and the Central Bank disbursed $70.2 million for 161 of them. Loan proposals classified as "prospective" can potentially be recommended to USAID/Bosnia-Herzegovina for approval. Business Finance's cumulative lending activity is shown as follows:

BRFF LOAN SUMMARY AS OF MARCH 31, 1998

Status of Loans	Number of Loans	Amount[7] (millions)
Applications		
Recommended by Business Finance[8]	280	$130.7
Prospective[9]	116	31.9
Rejected[9]	307	113.5
TOTAL	703	$276.1
Recommended by Business Finance		
Approved by USAID/B-H	257	$110.0
Awaiting approval by USAID/B-H	13	10.5
	270	$120.5
Not Approved by USAID/B-H	10	10.2
TOTAL	280	$ 130.7
Approved by USAID/B-H		
Disbursed	161	$ 70.2
Not Yet Disbursed	96	39.8
TOTAL	257	$ 110.0

[7] Loan amounts are recorded and disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. Loan totals were converted using a weighted average exchange rate of 1.6764 Deutsche Marks to $1.

[8] For discussion purposes in our report, we have considered loan recommendations by Business Finance to consist of those recommended loans which were approved or are awaiting approval. We have presented the loans not approved for information purposes only.

[9] Information obtained from Business Finance's March 31, 1998, report.

Development Alternatives' task order set targets of $45 million in loan recommendations which were expected to create 6,750 jobs through December 31, 1996. Although not specified in the order, USAID/Bosnia-Herzegovina expected that Business Finance would recommend $10 million in loans per month (generating 1,500 jobs per month) after December 31, 1996. These loan volume and job targets were formalized with Development Alternatives in a task order modification effective May 1, 1997. These targets were continued in a subsequent contract with Development Alternatives which will expire on September 30, 1998. Through March 31, 1998, USAID expected that a cumulative total of $195 million in loans would have been recommended by Business Finance which would have resulted in 29,250 new jobs.

A comparison of these agreed upon and expected targets to actual results from inception through March 31, 1998 is shown in the following table.

	Targeted	Actual	Shortfall
Recommended Loans	$195 million	$120.5 million	$74.5 million
Associated Jobs	29,250	16,634	12,616

Business Finance recommended the approval of $120.5 million in loans—achieving 62 percent of the targeted amount of $195 million, or a shortfall of 38 percent. It is expected that 16,634 jobs will be generated by the disbursed loans—achieving 57 percent of the targeted 29,250 jobs, or a shortfall of 43 percent.

In previous reporting periods, shortfalls were attributed to a systems and personnel restructuring to streamline loan production and a shortage of lending officers to analyze and process applications. During this reporting period, Business Finance has made significant progress towards increasing loan volume. Although slightly short of the six month target, loan volume has increased from about $25.9 million in the previous six months to $54.5 million for this six month period. According to program personnel, this progress was accomplished as a result of various factors such as:

- Additional program personnel, especially short-term technical assistance.
- Increased experience of program personnel and lenders.
- Expansion of program activities within the Brcko and Banja Luka areas of the Republika Srpska.
- Greater allocation of resources to loan volume rather than to loan monitoring although there was an increasing focus on monitoring by the end of this reporting period.

Business Finance sends monthly bills to both the borrowers and the agent banks. Borrowers make interest and/or principal payments to their agent bank which then wires the money to the Central Bank's Bank of America repayment account. The funds in the repayment account have been used for future lending. The interest and/or principal repayments are tracked and recorded by Business Finance. According to a Business Finance delinquency report as of March 31, 1998, 46 borrowers are delinquent— about triple the number as of September 30, 1997. Business Finance will review each borrower's situation and attempt to work out a solution or restructure the loan. Business Finance has formed a loan restructuring and workout group and has already restructured some loans to facilitate repayment.

Technical Assistance. Business Finance reported that a cumulative total of 89 seminars and workshops had been completed in Sarajevo, Tuzla, and Banja Luka with a total attendance of 2,382 bankers, prospective borrowers, consultants, and internal staff. Courses offered included:

- Counting on Your Banker.
- Advanced Credit Seminar.
- Managing the Loan Portfolio.
- Financial Analysis and Business Planning.
- Financing the Small Business.

These and other courses will continue to be offered during 1998.

Audit
Test Results

Loan Program. USAID/Bosnia-Herzegovina has approved the disbursement of $70.2 million through 24 agent banks to 161 borrowers since the beginning of the program. The majority of the loans are financing building repairs and reconstruction, machinery and equipment purchases, raw material purchases, and working capital. During this reporting period, we visited 7 agent banks which handle 157 loans in the BRFF program. In general, we found that the banks are maintaining the necessary paperwork required by the BRFF program but are not always effectively monitoring the borrowers. Some banks are more competent and diligent in fulfilling their responsibilities under the BRFF program than other banks.

We also visited 38 borrowers to verify the existence of the business and the use of the loan proceeds. Problems experienced by the borrowers in prior periods have continued to expand. Eighteen of the 38 borrowers visited are considered to represent significant problem loans by the internal auditors of Business Finance. Certain borrowers were experiencing problems such as delayed or reduced production, anticipated market demand not materializing, and having to resort to barter arrangements due to difficulties in collecting receivables. Borrower problems are being aggravated by a general lack of liquidity in the country. In addition, while not necessarily a problem, loan proceeds were sometimes used to pay existing short-term debts which were incurred while the borrower was awaiting the BRFF loan proceeds.

Shown below are additional details on these visits to the agent banks and borrowers.

Visits to Agent Banks[10]

Agent Bank	No. Of Loans	Total Loan Amount (millions)	Comments, if applicable
1	23	$ 13.9	This bank is being closely watched as it has engaged in deceptive practices.
2	4	$ 1.1	
3	19	$ 5.9	
4	62	$ 19.4	A bank official involved with the program, suspected of inappropriate behavior, has been removed from his position.
5	24	$ 11.7	
6	2	$ .8	This bank is having financial difficulties and may not continue in the BRFF program.
7	23	$ 10.9	

[10] Actual records and documents reviewed did not always total the loan amount as many borrowers had not used all of the loan proceeds.

Visits to Borrowers

Borrower	Agent Bank	Loan Amt. ($)	Purpose of Loan	Comments/Exceptions Noted
1	Tuzlanska Bank	835,123	Purchase of equipment for asphalt production.	Equipment bought before loan was disbursed; proceeds used to pay existing indebtedness.
2	Tuzlanska Bank	596,516	Purchase of production machinery and laboratory equipment for the manufacture of detergents, soap and related products.	Barter arrangements made as regards certain customers due to the general non-liquidity of the Bosnian economy.
3	Komercijalna Bank	387,736	Purchase of equipment for a sawmill and a wood processing facility.	Awaiting delivery of equipment.
4	Export Bank	178,955	Purchase of oil-driven oven for a bakery; for construction works.	Problem noted on disbursement procedures for in-country payments.
5	Komercijalna Bank	71,582	Purchase of equipment for chicken farm; for working capital.	No problems noted.
6	Tuzlanska Bank	611,429	Purchase of equipment for shoe production; for repair of factory; and for working capital.	Major production and market problems; all signed deals are coming to an end with no new contracts; no market in Bosnia.
7	SAB Bank	322,119	Purchase of equipment in the production of metal road signs and vehicle plates; for repair of building.	No problems noted.
8	Union Bank	596,516	Purchase of equipment for the manufacture of clothing; for building repairs; and for working capital.	Past due on principal and interest payments; requesting extension of grace period; cash flow problem due to lack of market demand, low profit margins, and taxes.

Borrower	Agent Bank	Loan Amt. ($)	Purpose of Loan	Comments/Exceptions Noted
9	Privredna Banka	596,516	Purchase of machinery for carpet production; for raw materials; and for start-up costs.	Problem noted on loan repayment; 80% of revenue are paid through compensation deals; no contracts signed for the year; no strong demand for products in Bosnia.
10	Market Bank	596,516	Purchase of equipment for tar cardboard and water insulation tape production.	No problems noted except competition posed by companies importing insulation tapes from abroad.
11	Ljubljanska Banka	596,516	Purchase of equipment for wood products manufacturing plant.	Needs additional funds to complete production line; production level far behind projections; past due in principal and interest payments.
12	BH Bank	596,516	Purchase of raw materials and equipment for furniture manufacturing; for repairs and renovation of plant.	Problem exists in collection of receivables; resorts to short-term loans.
13	BH Bank	298,258	Purchase of machinery for construction; for transport and installation costs.	No problems noted but a portion of loan proceeds was used to pay off debt incurred prior to disbursement of the loan.
14	BH Bank	363,875	Purchase of equipment for wood processing; for working capital.	Production not yet started; part of loan proceeds appears to have been used to repay a short-term loan.
15	BH Bank	566,160	Purchase of equipment for saw mill; for working capital.	No problems noted.
16	BH Bank	745,645	Purchase of equipment for saw mill; for building reconstruction; and for working capital.	Proceeds used to pay off short-term loans obtained for working capital prior to disbursement of loan; ceiling of funds for working capital already exceeded; majority of loan proceeds has been reclaimed by BF until the company situation stabilizes.

Borrower	Agent Bank	Loan Amt. ($)	Purpose of Loan	Comments/Exceptions Noted
17	BH Bank	1,371,988	Purchase of machinery and equipment for construction; for spare parts and equipment for workshop.	No problems noted but a portion of loan proceeds was used to pay off debt incurred prior to disbursement of the loan.
18	BH Bank	1,789,549	Purchase of machinery and equipment for sawmill; for working capital.	Loan proceeds have been used for working capital, equipment, and to pay off short-term loans.
19	BH Bank	116,321	Purchase of equipment for collecting eggs in chicken farm; for working capital.	No problems noted.
20	BH Bank	894,775	For working capital in the production of construction materials.	Loan proceeds used for repayment of short-term loans.
21	BH Bank	1,133,381	Purchase of equipment for fruit processing; for working capital.	Loan proceeds for working capital used to pay off existing indebtedness.
22	BH Bank	596,516	Purchase of equipment and fruit seedlings for fruit berry production; for working capital.	Loan proceeds used partially to pay off short-term loans for equipment and seedlings; poor bookkeeping records.
23	BH Bank	268,432	Purchase of parts for computer assembly; for electronic devices; and for working capital.	All inventory is in the possession of banks which extended loans to the borrower before disbursement of the loan; retail outlets are closed; ability to continue operations is uncertain.
24	BH Bank	399,666	Purchase of equipment for concrete blocks and paving tile manufacturing plant; for working capital.	Loan recently funded; equipment not procured yet.
25	UPI Bank	954,426	Purchase of machines for the manufacture of shoes, boots, and other leather accessories; for roofing of production building; and for working capital.	Has difficulty meeting requirements of loan repayment; obtained a short-term loan to pay off first installment; requesting extension of grace period; has signed three export production contracts.

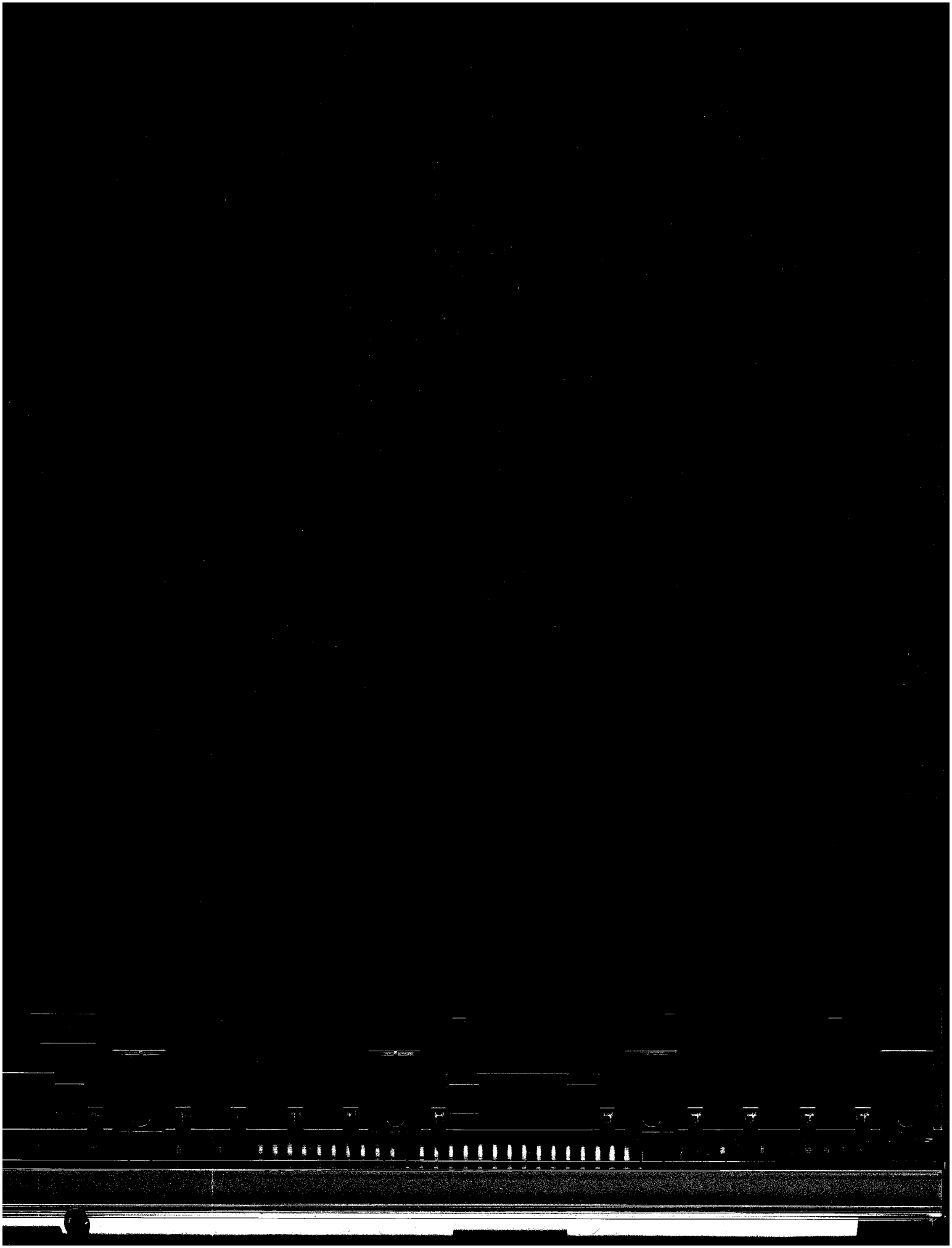
Borrower	Agent Bank	Loan Amt. ($)	Purpose of Loan	Comments/Exceptions Noted
26	Tuzlanska Bank	238,607	Purchase of equipment for production of concrete blocks and reinforced concrete beams; for new production facility; and for working capital.	No problems noted.
27	Tuzlanska Bank	1,491,291	Purchase of equipment for manufacture of dining room, office and school furniture; for working capital.	Portion of loan proceeds was used to pay off a short-term loan.
28	Tuzlanska Bank	715,820	Purchase of equipment for production of construction materials; for building of production facility; for working capital.	No problems noted.
29	Tuzlanska Bank	894,775	Purchase of machinery for industrial crane manufacturing; for working capital.	Past due on principal payments; pressure on cash flow leads to short-term loans; borrower is shareholder and founder of agent bank.
30	Tuzlanska Bank	596,516	Purchase of machinery for timber logging and milling; for working capital.	Loan proceeds used in part for financing existing debt; logs, fuel and other working capital items are being purchased from entities related to the borrower.
31	Tuzlanska Bank	178,955	For working capital in the remanufacture, rebuilding, and repair of all types of electric motors and pumps.	No problems noted.
32	Tuzlanska Bank	357,910	Purchase of equipment in the assembly of motors for heaters and fans; for working capital.	Past due on principal and interest payments; future debt service uncertain due to seasonal dependency; portion of loan proceeds used to pay off existing debt.
33	Tuzlanska Bank	585,421	Purchase of equipment in the quarrying and processing of gravel and sand for construction; for working capital.	Past due on principal and interest payments; future debt service uncertain due to liquidity problem.

Borrower	Agent Bank	Loan Amt. ($)	Purpose of Loan	Comments/Exceptions Noted
34	Komercijalna Bank	721,785	Purchase of equipment in the production of building materials and concrete blocks and roof tiles for houses.	Past due on principal and interest payments; financed fixed assets with short-term loans creating pressure on cash flow; sales and market problems; borrower is a shareholder of the agent bank.
35	Tuzlanska Bank	542,830	Purchase of equipment for the manufacture and installation of marble and granite; for working capital.	Current on loan but internal record keeping is poor.
36	Tuzlanska Bank	149,129	Purchase of equipment in the manufacture of willow furniture products; for working capital.	Past due on principal and interest payments; difficulty with liquidity due to problems in collecting receivables; borrower has been approved short-term loans by another bank which is in violation of loan agreement with BF.
37	Gospodarska Bank	184,920	Purchase of equipment for printing and publishing; for working capital.	Problem with collection of accounts receivable due to general non-liquidity of Bosnian economy; short-term loan being requested from agent bank to make next BF payment.
38	Gospodarska Bank	298,258	Purchase of equipment for the manufacture of building products in concrete plant; for working capital.	Most loan proceeds spent according to plan but production not started yet.

Unaudited Bosnian Reconstruction Finance Facility Fund Accountability Statement *as of March 31, 1998*

The amounts that USAID/Bosnia-Herzegovina budgeted and obligated for the five-year Bosnian Reconstruction Finance Facility program are shown below; however, the program has a three-year budget. The amount obligated for the On-Lending Program represents the balance-of-payments support to Bosnia-Herzegovina. Of the $99.5 million transferred to Bosnia-Herzegovina, $70.2 million[11] has been transferred as loans to borrowers. The disbursed implementation costs are amounts paid by USAID.

	3-Year Program Budget	Amount Obligated	Amount Disbursed
On-Lending Program	$256,000,000	$99,540,000	$99,540,000
Implementation Costs:			
Contractors	17,500,000	27,589,199	17,259,754
Audit, Program and Evaluation	1,500,000	0[12]	0[12]
Environmental Monitoring	600,000	0	0
USAID Program Management	0	290,990	290,990
Contingencies	2,400,000	0	0
Totals	$278,000,000	$127,420,189	$117,090,744

[11] Loans were disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. A total of 117.7 million Deutsche Marks were disbursed and converted using a weighted average exchange rate of 1.6764 Deutsche Marks to $1.

[12] In previous audit reports, the amounts shown as obligated and disbursed for this budget line were taken from the Mission's Audit, Evaluation and Program Support project. According to the Mission Controller, this project has taken on additional contents that are irrelevant to the BRFF program. Therefore, as of this reporting period, obligated and disbursed amounts are from BRFF program funds.