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AUDIT OF THE LOCAL CURRENCY-FINANCED CENTRAL BANK CREDIT LINE PROGRAM

Audit Report No. 1-519-89-17
March 31, 1989

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March 31, 1989

MEMORANDUM

TO: Director, USAID/El Salvador, Henry Bassford

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

SUBJECT: Audit of the Local Currency-Financed Central Bank Credit Line Program, Audit Report No. 1-519-89-17

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of the Local Currency-Financed Central Bank Credit Line Program. Five copies of the audit report are enclosed for action.

The draft audit report was submitted to you for comment on February 27, 1989. Since we did not receive your written comments on the draft report in 30 calendar days, the report is being published without them. We did however consider the written comments you gave us following the exit conference.

The report contains six recommendations. The six recommendations remain open pending Mission action. Please advise me within 30 days of any actions taken to implement these recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

EXECUTIVE SUMMARY

In 1984, USAID/El Salvador contracted for a study of the Central Bank's credit program for the private sector. The objective of the study was to design new lines of credit and/or modify the existing ones with the intention of promoting investment and increasing production. The credit lines were to give special emphasis to activities which generate non-traditional exports outside the Central American area. In response to this study USAID/El Salvador and the Government of El Salvador programmed $150 million in local currencies made available under the Economic Support Fund program for ten different lines of credit during a three year period ending December 31, 1987.

The Regional Inspector General for Audit, Tegucigalpa performed a program results and compliance audit of the local currency-financed credit line program. Specific audit objectives were to determine whether the: (1) program objectives were being achieved, (2) the Central Bank had complied with selected requirements of GOES laws, credit regulations, and agreements, (3) intermediate credit institutions had adequately adhered to program eligibility criteria and were processing loans in an efficient and effective manner, and (4) loan recipients had used program resources for agreed upon purposes.

The audit could not determine whether program objectives were being fully achieved because the Central Bank had not developed indicators to measure the accomplishment of objectives. Although the Central Bank had generally complied with selected requirements of GOES laws, credit regulations, and agreements, the intermediate credit institutions had not always adhered to program eligibility criteria, and loan recipients had not always used program resources for agreed upon purposes.

Despite these weaknesses, the local currency-financed credit line program had provided much needed liquidity to El Salvador's nationalized banking system. As of December 31, 1987 the credit line program had funded 3,413 loans totaling $120.8 million in local currency. The audit showed that the majority of these loans were approved and were being used for eligible purposes and that loan recipients were generally satisfied in the manner in which the program was being implemented.

The report contains six findings. The Central Bank had not developed indicators to measure the accomplishment of objectives; the program had not fully used the funds made available; intermediate credit institutions and final borrowers did not always use loan funds for eligible purposes; the program's loan approval process was slow and cumbersome; the program did not have adequate information on the status of loan payments; and loan interest reflows were not being returned to the program.

Generally accepted management principles as well as the Foreign Assistance Act dictate that program managers develop quantitative indicators that measure progress toward achieving objectives. Quantitative indicators were not established for the Central Bank credit line program. Apparently neither USAID/El Salvador nor the Central Bank considered these factors important at the program's outset. As a result, program managers had less information to gauge program accomplishments and to make program management decisions. The report recommends that USAID/El Salvador and the Central Bank develop quantitative indicators to measure progress towards accomplishing objectives.

Sound banking principles dictate that banks fully use credit line funds to maximize their potential economic benefits. Of the 10 local currency-financed credit lines, six lines had funds that intermediate credit institutions were not fully using. These lines had limited activity because of a lack of information on the availability of funds, competition from other credit sources, and expiration of a credit line eligibility period. The limited use of these particular lines had resulted in $15.7 million in local currency remaining idle instead of being fully utilized to assist in El Salvador's economic recovery efforts. The report recommends that USAID/El Salvador and the Central Bank reprogram expired or unrequired funds.

Regulations and loan contracts governing the credit program specify the eligible purposes of funds. Both the intermediate credit institutions and loan recipients had not used some credit funds for eligible loans. In the first case, credit institutions occasionally did not make the loans as approved by the Central Bank and retained the funds because the loan contracts between the intermediate credit institutions and the Central Bank did not explicitly require the return of the funds. In the second case, final borrowers did not use loan funds for eligible purposes partly because the credit institutions did not make all field inspections as required. As a result, our sample showed credit funds totaling $1,576,664 in local currency were not used for purposes approved by the Central Bank and may not have contributed toward achieving the program's objectives. The report recommends that the credit institutions reimburse the Central Bank for ineligible loans or substitute eligible loans for the ineligible loans.

An effective and efficient credit program would require that normal loan processing not take an excessive amount of time. The Central Bank took more than a reasonable amount of time to approve loans and disburse loan funds to the intermediate credit institutions. Processing delays were caused primarily by the absence of mandatory processing timeframes and numerous documentation and loan approval requirements. Unnecessary delays in the delivery of credit could reduce the demand for credit and hurt the attainment of economic objectives by delaying resources to productive activities. The report recommends that the Central Bank establish reasonable processing times and eliminate unnecessary loan documentation and approval requirements.

Good banking practices require that lending institutions maintain adequate information on the status of loan payments in order to identify and correct potential recovery problems. Fourteen intermediate credit institutions did not maintain adequate loan payment status information by the individual credit lines. According to a USAID/El Salvador official this situation existed in part because the credit institutions were not required to report such information to the Central Bank. As a result, program managers had inadequate information to identify and correct loan payment problems in a timely manner. The report recommends that the intermediate credit institutions maintain adequate loan payment status information and report the same to the Central Bank.

The value of a credit fund is better maintained against depletion from bad loans, inflation, and devaluation by returning interest reflows to the program. All credit line interest reflows were not returned to the program for expenses or relending. Part of interest reflows went for the expenses of the Secretariat for External Financing, which was not directly involved with the program. As a result, the amount of funds available for program expenses or relending was reduced, which could result in the need for additional funding. The report recommends USAID/El Salvador and Government of El Salvador use all interest reflows for program expenses or relending.

Office of the Inspector General

AUDIT OF
THE LOCAL CURRENCY-FINANCED
CENTRAL BANK CREDIT LINE PROGRAM

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AUDIT OF
THE LOCAL CURRENCY-FINANCED
CENTRAL BANK CREDIT LINE PROGRAM

PART I - INTRODUCTION

A. Background

In 1984, USAID/El Salvador contracted for a study of the Central Bank's credit program for the private sector. The objective of the study was to design new credit lines and/or modify the existing ones with the intention of promoting investment and increasing production. The credit lines were to give special emphasis to activities which generate non-traditional exports outside the Central American area. In response to this study USAID/El Salvador and the Government of El Salvador (GOES), through its Central Bank, programmed $156 million in local currency made available under the Economic Support Fund program for ten different lines of credit during a three year period ending December 31, 1987. During this same period $120.8 million was expended. See exhibit 1 for the amounts programmed under the ten lines of credit.

Some of the responsibilities of the Central Bank as the implementing GOES agency are promoting the credit lines, establishing the procedures and conditions that intermediate credit institutions (ICI) are to follow in processing and approving loans, and monitoring ICI and credit line performance.

The Central Bank loaned funds to the ICIs who relent the funds to the final borrowers. The ICIs assumed full risk for bad loans and in return earned a portion of the interest spread equal to the difference between what the Central Bank charged the ICIs and what the ICIs charged their final borrowers. A Central Bank official stated that the Central Bank automatically deducts from each ICI account the predetermined amount of principal and interest due regardless of whether the ICIs have collected the principal and interest payments from their borrowers. The Central Bank used principal reflows for relending purposes. The memorandums of understanding allowed the Central Bank to use interest reflows for its own administrative expenses and those of the Secretariat for External Financing. Additionally some interest reflows went to a Central Bank loan guaranty fund and to the credit analysis and supervision departments of intermediate credit institutions as applicable.

USAID/El Salvador's Office of Private Sector is responsible for A.I.D.'s management of the credit line program which includes ensuring that it provides program resources as agreed upon and properly accounts for them.

B. Audit Objectives and Scope

The Regional Inspector General for Audit, Tegucigalpa (RIG/A/T) performed a program results and compliance audit of the local currency-financed credit line program. Specific audit objectives were to determine whether the: (1) program objectives were being achieved, (2) the Central Bank had complied with selected requirements of GOES laws, credit regulations, and agreements, (3) intermediate credit institutions had adequately adhered to program eligibility criteria and were processing loans in an efficient and effective manner, and (4) loan recipients had used program resources for agreed upon purposes.

The audit covered 10 credit lines financed by USAID/El Salvador during 1985, 1986, and 1987. The amount audited was $120.8 million while the amount tested was $27.2 million (see exhibit 1). USAID/El Salvador financed and contracted the local auditing firm of Price Waterhouse to assist in this audit. Price Waterhouse auditors worked under the supervision of the RIG/A/T auditors.

To accomplish audit objectives, RIG/A/T reviewed records and interviewed officials of USAID/El Salvador and the Central Bank. With Price Waterhouse we selected a random sample by credit lines of 498 loans at 15 ICIs to assess the performance of the program (see exhibits 2 and 3). Price Waterhouse interviewed officials and reviewed records of the loan sample at the Central Bank and intermediate credit institutions. They also performed field visits to interview the loan recipients of the sample. The audit field work took place from May 26 to December 13, 1988. RIG/A/T limited review of internal controls and compliance to the findings in this report and performed the audit in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit could not determine whether program objectives were being fully achieved because the Central Bank had not developed indicators to measure the accomplishment of objectives. Although the Central Bank had generally complied with selected requirements of GOES laws, credit regulations, and agreements, the intermediate credit institutions had not always adhered to program eligibility criteria, and loan recipients had not always used program resources for agreed upon purposes.

Despite these weaknesses, the local currency-financed credit line program had provided much needed liquidity to El Salvador's nationalized banking system. As of December 31, 1987 the credit line program had funded 3,413 loans totaling $120.8 million in local currency. The audit showed that the majority of these loans were approved and were being used for eligible purposes and that loan recipients were generally satisfied in the manner in which the program was being implemented.

The report contains six findings. The Central Bank had not developed indicators to measure the accomplishment of objectives; the program had not fully used the funds made available; intermediate credit institutions and final borrowers did not always use loan funds for eligible purposes; the program's loan approval process was slow and cumbersome; the program did not have adequate information on the status of loan payments; and loan interest reflows were not being returned to the program.

The report recommends that USAID/El Salvador in consultation with the Central Bank: develop quantitative indicators to measure program progress, reprogram funds to accelerate the movement of funds, require intermediate credit institutions to reimburse the Central Bank or substitute eligible loans for ineligible loans and report loan delinquency information to the Central Bank, eliminate unnecessary loan documentation and approval requirements, and modify program procedures to retain future interest reflows for program purposes.

A. Findings and Recommendations

1. Performance Indicators Needed To Be Established To Effectively Measure Program Accomplishments

Generally accepted management principles as well as the Foreign Assistance Act dictate that program managers develop quantitative indicators that measure progress toward achieving objectives. Quantitative indicators were not established for the Central Bank credit line program. Apparently neither USAID/El Salvador nor the Central Bank considered these factors important at the program's outset. As a result, program managers had less information to gauge program accomplishments and to make program management decisions.

Recommendation No. 1

We recommend that USAID/El Salvador in cooperation with the Central Bank develop quantitative indicators to measure progress toward accomplishing program objectives.

Discussion

Generally accepted management principles as well as the Foreign Assistance Act establish that program objectives be defined and indicators be developed that measure progress toward achieving objectives. Section 621A of the Foreign Assistance Act requires a management system that includes:

> ...the definition of objectives and programs for United States foreign assistance; the development of quantitative indicators of progress toward these objectives; the orderly consideration of alternative means for accomplishing such objectives; and the adoption of methods for comparing actual results of programs and projects with those anticipated when they were undertaken....

The local currency-financed credit line program may not technically be subject to the Foreign Assistance Act requirements. In our opinion however, the principles of defining objectives and establishing quantitative indicators of progress toward objectives are basic to sound management and apply to all developmental programs regardless of their funding source.

The 1985 credit program study stated that the basic objectives of the credit program were to promote non-traditional product exports and encourage productive investments in the industrial and agricultural sectors. In another part of the same study the long term objective of the program was to assist in the economy's reactivation and to reestablish political and economic stability in El Salvador. The 1985 and 1986 Economic Support Fund memoranda of understanding (MOU) also defined the credit program's purpose as economic stabilization and reactivation. Elsewhere in the same 1986 MOU, it was stated that the credit program was to improve exports of non-traditional products. Also, the regulations covering three of the ten credit lines indicated that their objectives were to promote or refinance traditional exports such as coffee, cotton and sugar. The regulations covering two credit lines also indicated that the programs were to support increased employment and/or production.

An analysis of pertinent program documents indicated that the credit program's long term objectives were economic stabilization and reactivation and its short-term objectives were to increase production and exports of both traditional and non-traditional crops as well as to increase employment. But these documents were not supplemented with quantitative indicators to enable management to ascertain how well they were doing. However, USAID/El Salvador and the Central Bank did not establish quantitative indicators to measure the accomplishment of those objectives.

The general cause for this condition was apparently that neither USAID/El Salvador nor the Central Bank had made establishing quantitative indicators a priority. As a result of not establishing indicators, neither USAID/El Salvador nor the Central Bank had information on whether or not the lines of credit were achieving their intended objectives.

In conclusion, to make sound programming decisions USAID/El Salvador and the Central Bank needed to develop indicators to measure progress toward accomplishing the credit line program objectives.

2. Several Credit Lines Were Not Fully Utilized

Sound banking principles dictate that banks fully use credit line funds to maximize their potential economic benefits. Of the 10 local currency-financed credit lines, six lines had funds that intermediate credit institutions were not fully using. These lines had limited activity because of a lack of information on the availability of funds, competition from other credit sources, and expiration of a credit line eligibility period. The limited use of these particular lines had resulted in $15.7 million in local currency remaining idle instead of being fully utilized to assist in El Salvador's economic recovery efforts.

Recommendation No. 2

We recommend that USAID/El Salvador obtain evidence that the Central Bank has addressed those factors adversely affecting the movement for funds of the six credit lines identified in this finding by either obtaining and providing improved information on the availability of funds to Intermediate Credit Institutions or reprogramming funds underutilized for any reason.

Discussion

Sound banking principles dictate that intermediate credit institutions fully use credit line funds to maximize their potential economic benefits. Credit funds that remain idle are subject to economic losses due to inflation and currency devaluation. Also, idle funds represent lost opportunity to earn interest or to make profits.

As of June 30, 1988, 6 of the 10 credit lines had available balances totaling $15.7 million in local currency which represented 16 percent of original principal balances for the six lines (see exhibit 5 for further details).

Credit Line	Date First Loan Contracted	Amount Funded	As of June 30, 1988 Balance a/ Available	Percent b/
Coffee Refinancing	09/06/85	$69,600,000	$ 6,748,374	10
Reconstruction Industrial Enterprises Damaged by Earthquake	06/23/87	4,689,724	3,075,716	66
Agrarian Reform Sector Refinancing	11/06/84	8,000,000	847,558	11
Special Fund for National Reconstruction	03/24/86	4,000,000	511,329	13

Credit Line	Date First Loan Contracted	Amount Funded	As of June 30, 1988 Balance a/ Available	Percent b/
Coffee Replanting 1985	12/18/85	800,000	93,018	12 c/
Coffee Replanting 1986	05/29/87	4,689,724	2,295,218	49 c/
Economic Development Fund	10/06/87	6,331,127	2,080,414	33
		$98,110,572	$15,651,627	16

a/ The balance available for lending is composed of original principal and/or reflows of principal.
b/ The percentage is of the balance available compared to the original amount funded.
c/ These two credit lines are the same line but have been split for comparison purposes.

According to a Central Bank official, the banks had used these credit lines less than anticipated for several reasons. Following are the six credit lines and his reasons for this inactivity:

1) Coffee Refinancing - ICIs did not use this credit line because it had terminated April 30, 1986.

2) Reconstruction of Industrial Enterprises Damaged by the Earthquake - ICIs did not use this credit line because it did not become available until nearly 8 months after the October 1986 earthquake and because it had less favorable terms and conditions than other competing lines.

3) Reform Sector Refinancing - ICIs did not use this credit line since October 1985 because the Central Bank did not generally inform the ICIs that funds were still available.

4) Special Fund for National Reconstruction - ICIs did not use this credit line because of inadequate publicity of its availability. Also Central Bank officials were not fully aware of balances still available for lending.

5) 1985 and 1986 Coffee Replanting - ICI's did not use these lines because they were now using a 1987 Coffee Replanting line not part of this program. The last loan made for the 1985 line was in March 1986, and for the 1986 line in February 1988. Central Bank and ICIs were not fully aware that balances remained for lending.

6) Economic Development Fund - ICIs did not use this line because Central Bank officials were not aware of how much was actually available in the line for further lending. They therefore did not inform ICIs of funds availability for lending from original principal or reflows.

In addition to these six credit lines, there were two relatively new credit lines established in June 1987 (the Eastern Region Refinancing and Reactivation lines) that a Central Bank official stated were not being used very fast. According to this official, these lines lacked sufficient margins for ICIs to actively pursue and involved excessive documentation.

As a result of these inactive credit lines, as much as $15.7 million in local currency was not available to assist in El Salvador's economic recovery efforts. We estimated that the Central Bank lost interest earnings totaling almost $954,000 over a one year period because these funds remained idle.

3. Some Credit Program Funds Were Not Used for Eligible Loans

Regulations and loan contracts governing the credit program specify the eligible purposes of funds. Both the intermediate credit institutions and loan recipients had not used some credit funds for eligible loans. In the first case, credit institutions occasionally did not make the loans as approved by the Central Bank and retained the funds because the loan contracts between the intermediate credit institutions and the Central Bank did not explicitly require the return of the funds. In the second case, final borrowers did not use loan funds for eligible purposes partly because the credit institutions did not make all field inspections as required. As a result, our sample showed credit funds totaling $1,576,664 in local currency were not used for purposes approved by the Central Bank and may not have contributed toward achieving the program's objectives.

Recommendation No. 3

We recommend that USAID/El Salvador obtain evidence that:

a. the intermediate credit institutions have reimbursed the Central Bank for ineligible loans or have substituted eligible loans for the ineligible loans;

b. the Central Bank has established procedures to require intermediate credit institutions to immediately refund monies not used for approved loans to final borrowers; and

c. the intermediate credit institutions are making field inspections as required.

Discussion

Regulations and loan contracts governing the credit program specify eligible purposes of funds. The Central Bank loaned monies to the ICIs for relending to final borrowers only after approving loan applications for specific final borrowers and uses (see appendix 1 for a detailed description of each credit line and its regulations).

The audit reviewed a statistically valid sample of 498 loans from 3,413 loans made under the 10 credit lines. As shown in the following table, 42 of the 498 loans or 8.4 percent were not eligible. Of the 42 ineligible loans, the ICIs did not make 29 of the loans approved by the Central Bank nor did the ICIs return the funds to the Central Bank; in the other 13 cases, final borrowers used the funds for ineligible purposes. Based on the results of the audit sample, we are 90 percent confident that the true error rate of the population is 8.4 percent plus or minus four percent. By applying this sample to the loan universe of 3,413 loans, the projection showed 288 ineligible loans with range of 151 to 424 loans. In all, seven of the ten lines sampled had ineligible loans.

Credit Line	Sample Size	Total Ineli-gible Loans	Percent Ineli-gible	Uni-verse Size
Coffee Replanting	55	0	0	183
Eastern Region Refinancing	3	0	0	3
Reform Sector Refinancing	15	0	0	15
Economic Development Fund	68	10	15	439
Eastern Region Reactivation	35	5	14	66
Manufacturing Industry	65	6	9	329
Industry/Agro industry	74	10	14	1092
Earthquake a/	41	4	10	41
Coffee Refinancing	70	4	6	529
National Reconstruction	72	3	4	716
	498	42	8	3413

a/ The full name of this line is Reconstruction of Industrial Enterprises Damaged by Earthquake.

Of the 42 ineligible loans, the ICIs did not make 29 of the approved loans totaling $80,615 nor did they return the funds to the Central Bank (see exhibit 6 for further details). We were not able to determine for what purposes the ICIs used these monies. However, one ICI official stated that funds to the loan applicants were not used because the funds arrived late and/or the plans of these borrowers changed. A Central Bank official stated that the ICIs did not return the funds to the Central Bank because the loan contracts between the Central Bank and ICIs lacked specific instructions to do so. The contracts did not require the identification, notification and return of funds when ICIs did not make the approved loan by a specific date. However, the contracts did indicate that the funds were to be used exclusively by the approved final borrower for the purposes stated in the approved contract and the ICI was to provide all information relative to the use of the loan to the Central Bank.

Final borrowers did not use the proceeds of 13 loans totaling $1,496,049 for eligible purposes (see exhibit 7 for further details). The reasons for these ineligible loans varied. For example, an earthquake loan was ineligible because the location of the property repaired was not in an area reportedly affected by the October 10, 1986 earthquake. Visits to various loan recipients indicated that a loan for planting a non-traditional crop (loofah = a cucurbitacious plant sold as sponges when dried) was used for other purposes; that another coffee refinancing loan was given to a farmer that was not producing coffee and the farm was subdivided to pay off outstanding debts; and that a loan was given a student who apparently had the capacity to pay for his education (see exhibit 7 for more details).

These irregularities partly occurred because in many cases the ICIs did not make the required field inspections. Regulations governing the majority of the credit lines, explicitly or implicitly, required on-site verification before and/or after the loans were made to ensure that funds were used as intended. Field inspections were not made as required in the credit lines for Coffee Refinancing, Coffee Replanting, Industry/Agro-Industry, Economic Development Fund, Eastern Region Reactivation, and Reconstruction of Industrial Enterprizes damaged by earthquake. There were 40 loans in which explicit pre-inspections were not made and 27 where explicit post inspections were not made. Additionally, there were five loans where implicit pre-inspections and 147 loans where implicit post-inspections were not made.

As a result of Central Bank and ICI loan management weaknesses, credit funds totaling $1,576,664 in local currency were not used for purposes approved by the Central Bank and may not have contributed towards achieving the program's objectives.

In our opinion, to ensure the use of funds for intended purposes, the Central Bank should establish procedures to require ICIs to immediately refund monies not used for approved loans. Also, the Central Bank should recover ineligible loans from the ICIs.

4. Unnecessary Loan Processing Delays Needed To Be Eliminated

An effective and efficient credit program would require that normal loan processing not take an excessive amount of time. The Central Bank took more than a reasonable amount of time to approve loans and disburse loan funds to the intermediate credit institutions. Processing delays were caused primarily by the absence of mandatory processing timeframes and numerous documentation and loan approval requirements. Unnecessary delays in the delivery of credit could reduce the demand for credit and hurt the attainment of economic objectives by delaying resources to productive activities.

Recommendation No. 4

We recommend that USAID/El Salvador obtain evidence that the Central Bank has:

a. established reasonable timeframes for loan processing; and

b. eliminated unnecessary loan documentation and approval requirements.

Discussion

In order to have a program that is effective and efficient in the delivery of credit, the length of time from application to initial disbursement should not be excessive. A January 1985 credit program study identified loan processing time as an impediment to the effective and efficient delivery of credit. This study mentioned that users considered the main obstacle in using the credit lines was the slow and cumbersome processing of transactions by the ICIs and Central Bank. As a result, the study recommended improvements be made in the time required to process loans. The study noted that the length of time from application to initial disbursement should not be excessive. The intent that loan processing was not to be excessive was also indicated in some of the Economic Support Fund Memoranda of Understanding (ESF MOU). For example, the 1986 ESF MOU, Annex 3 required the Central Bank to establish the maximum time in which its operational departments must process credit applications presented by the intermediate credit institutions (ICI) for the Manufacturing Industry, Reconstruction Industrial Enterprises Damaged by Earthquake, Economic Development Fund, and Coffee Replanting credit lines.

The audit disclosed that, based on data in 483 of the 498 loans in the audit sample, the average length of time from the date of loan application until the Central Bank made the initial disbursement to the ICI was 197 days. The average times varied among credit lines from a low of 120 days to a high of 465 days (see exhibit 8 for details).

Delays in the loan approval and disbursement process occurred principally in two phases. The first delay occurred at the ICIs in preparing the loan package for the Central Bank. Generally after an applicant applies for a loan, the Central Bank requires the ICI to submit the individual application with all required documentation for Central Bank approval.

This documentation was numerous and took a substantial amount of time to process. In some cases, however the Central Bank required the ICI to send loans to it in group packages. For example, if the ICI was the Federacion de Cajas de Credito (FEDECREDITO) or Fondo de Financiamiento y Garantia Para La Pequena Empresa (FIGAPE) or if the loan line was the Economic Development Fund, it submitted a loan group package. This first phase took an average of 118 days. The second significant delay occurred at the Central Bank in reviewing the loan package and arranging disbursements to the ICI. The second phase averaged 79 days. See exhibit 8 for the variance in delays among credit lines.

Unnecessary loan processing delays have occurred in part because the Central Bank required numerous documentation and loan approval requirements and USAID/El Salvador did not enforce the agreement requirement that the Central Bank establish maximum processing times for its operational departments.

The audit identified two changes that could be made in loan processing procedures to accelerate the delivery of credit. First, loan documentation requirements could be simplified. This would reduce the average time (118 days) necessary at the ICIs for preparing the loan application package for the Central Bank. Second, the Central Bank loan approval requirements could be modified to reduce or eliminate the average time required by the Central Bank (79 days) to review the loan package and to disburse funds to the ICIs. Currently, the Central Bank approves all loans in advance. One modification of this procedure could be to retroactively approve all loans or loans over a certain amount. Still another possibility would be to continue to approve loans in advance but limit approvals to loans over a certain amount. Another possibility (which would save the most time) would be to advance funds to ICIs and retroactively approve all loans or loans over a certain amount. If any loans were retroactively disapproved, the Central Bank could either charge the ICI's account or require the substitution of eligible loans for the disapproved loans.

The impact of the credit program is diminished to a certain degree as a result of unnecessary loan processing delays. Long and unpredictable loan processing may discourage businessmen from seeking loans altogether which would have a negative effect on achieving the economic objectives of the program.

5. Information On the Status of Loan Payments Could be Improved

Good banking practices require that lending institutions maintain adequate information on the status of loan payments in order to identify and correct potential recovery problems. Fourteen intermediate credit institutions did not maintain adequate loan payment status information by the individual credit lines. According to a USAID/El Salvador official this situation existed in part because the credit institutions were not required to report such information to the Central Bank. As a result, program managers had inadequate information to identify and correct loan payment problems in a timely manner.

Recommendation No. 5

We recommend that USAID/El Salvador obtain evidence that the Central Bank has required intermediate credit institutions to maintain adequate loan payment status information by credit line and to report this information to the Central Bank on a periodic basis.

Discussion

Good banking practices require that lending institutions maintain adequate information on the status of loan payments in order to identify and correct potential recovery problems in a timely manner. Adequate information requirements to be maintained simultaneously are loan delinquencies aged, on current basis, and by line of credit. Both aged 1/ and current loan delinquency information are necessary to promptly identify and correct potential recovery problems. Having information by lines of credit would permit USAID/El Salvador and the Central Bank to know which lines are having problems and which are not. An aged delinquency list which was not current would only give historical information on past delinquencies. On the other hand having current delinquency information which was not aged would not indicate to managers the seriousness of the problem. In other words, by having all three types of information available simultaneously, management could effectively monitor the recovery of loans.

Fifteen intermediate credit institutions (ICIs) participated in the credit line program. Fourteen of these ICIs did not maintain adequate loan payment information. Of the 14 ICIs, 13 did not maintain loan payment information by lines of credit; 4 did not have current loan payment information; and 3 did not age delinquent loans (for details see exhibit 9).

The causes for this deficient loan payment information varied. For example, the Banco de Fomento Agropecuario did not accurately classify current loans versus delinquent loans. Instead of classifying the loan as delinquent when payments fell due and were not paid, the loan was classified as delinquent upon expiration of loan term when payments were

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1/ Aged refers to the accounting practice of accumulating the number of days a loan has been delinquent.

still due. The Federacion de Cajas de Credito kept loan delinquency information by branch office but not by credit line, and the information at its central office was four months old. Also its 61 branch offices used different cut-off dates when reporting loan delinquency information. The Instituto Nacional del Cafe kept loan delinquency information by lines of credit but the delinquency amounts were not aged. Also, reported loan delinquencies were not supported by appropriate records as they were not posted in a timely manner.

A USAID/El Salvador official stated that the Central Bank had not required the ICIs to provide it with loan payment status information. As a result of inadequate loan status payment information and reporting requirements, program managers were less likely to identify and correct loan payment problems in a timely manner which could adversely affect the accomplishment of program objectives.

In our opinion, both the Central Bank and participating ICIs could better manage their loan portfolios if they had current information on the status of payments. Such information would be valuable in determining if interest rates being charged for the various lines of credit were appropriate, if appropriate reserves for bad debts were maintained, and if the enterprises receiving loans were successful as determined by their ability to repay loans.

6. Use of Interest Reflows Hurt Long Term Objectives of the Credit Program

The value of a credit fund is better maintained against depletion from bad loans, inflation, and devaluation by returning interest reflows to the program. All credit line interest reflows were not returned to the program for expenses or relending. Part of interest reflows went for the expenses of the Secretariat for External Financing, which was not directly involved with the program. As a result, the amount of funds available for program expenses or relending was reduced, which could increase the need for additional funding.

Recommendation No. 6

We recommend that USAID/El Salvador in consultation with the Government of El Salvador redirect the Secretariat for External Financing's portion of the credit line program's interest reflows to the credit line program for program expenses or relending.

Discussion

The value of a credit fund is better maintained against depletion from bad loans, inflation, and devaluation by returning all interest reflows to the program.

All credit line program interest reflows were not returned to the program for program expenses or relending. As of December 31, 1987, according to available Central Bank records as adjusted by the audit, interest totaling approximately the equivalent of $3.6 million had been earned by the intermediate credit institutions. The Central Bank was given about $1.8 million for its expenses in managing the credit program. The Secretariat for External Financing (SETEFE) was given about $1.7 million to augment its extraordinary budget. The loan guaranty fund was given about $26,000 1/ and the credit analysis and supervision program of the Central Bank about $52,000. 2/

Since the credit line program was initiated in 1985, SETEFE has earned the equivalent of $1.7 million of interest reflows from the program for its operating expenses. Although SETEFE received nearly the same amount of interest earnings as the Central Bank, it has no implementation

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1/ The 1986 MOU stated the ICIs would collect and send one interest point to the Central Bank for establishing and managing a guaranty fund for the Manufacturing Industry line. Additionally, this guaranty fund was to eventually receive any credit analysis and supervision funds not earned by the ICIs.

2/ The MOU for 1986 stated that ICIs could earn an additional two points of interest for the lines they administered if they had Central Bank approved credit supervision and analysis departments. This money had not been distributed because ICIs felt no financial incentive existed to set up these departments.

responsibilities for the credit program. SETEFE monitors and administers extraordinary budget funds given to various GOES agencies. The Central Bank and intermediate credit institutions (ICIs) jointly manage the program. The Central Bank's role is to allocate resources among the various credit lines, encourage the use of the credit lines, establish attractive conditions for users, regulate the use of certain lines, establish quotas for the ICIs, assure adequate use of resources by qualifying credit transactions to ensure the fulfillment of established conditions, and supervise the use of the credit lines. The ICIs make short, medium, and long-term loans to individuals and firms for financing all types of activities in various economic sectors. According to the Central Bank official in charge of the credit department, the ICIs assume all the risk for the loans as the Central Bank automatically reduces each ICI account for payment due regardless of whether the ICI was able to collect loan and interest payments when due.

Agreements between the Central Bank and the Governments of the United States and El Salvador provided that SETEFE, the Central Bank, and the ICIs would receive the following percentages of interest collected from the ten credit lines:

Breakdown of Credit Line Interest Percentage Allocations

	Credit Line	Percent to SETEFE b/	Percent to Central Bank b/	Percent to ICIs a/
1.	Special Fund for National Reconstruction	0	2	4
2.	Manufacturing Industry	5-14	2	2-3
3.	Coffee Refinancing	0-1	2	3
4.	Reform Sector Refinancing	2	2	2
5.	Coffee Replanting	3-13	2-3	2
6.	Industry/Agroindustry	5-12	3	3
7.	Reconstruction of Industrial Enterprises Damaged by Earthquake	6	3	3
8.	Economic Development Fund	0-3	1-3	2-3.5
9.	Eastern Region Refinancing	0	3	1
10.	Eastern Region Reactivation	4-6	3	3

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a/ Interest spread excluded Federacion de Cajas de Credito (Fedecredito), a credit union association, and cooperatives.

b/ The spreads changed from year to year depending on the governing memorandum of understanding.

A far better use of the interest reflows given to SETEFE would be to allow the ICIs to retain a greater portion of the reflows to cover the cost of bad loans and credit supervision. The 1985 credit program study indicated that the ICIs lacked interest in using the credit lines because of their low financial margins (spread) of between 2 and 3 percent compared to a spread of from 6 to 7 percent earned on loans made with their own funds. According to a Central Bank official, low margins have continued to impede ICI use of the credit lines. This is not surprising in a country such as El Salvador where, according to a USAID/El Salvador official, the banking system has bad debts of from 16 to 24 percent of their total loan portfolios.

In January 1986 the Government of El Salvador devalued its currency 100 percent from 2.5 to 5 colones for one United States dollar. The inflation rates as measured by the Consumer Price Index for 1985, 1986, and 1987 in El Salvador were 22.3, 31.9, and 24.9 percent respectively. These factors have lowered the real value of the fund's principal significantly.

As a result of reflows going to SETEFE the amount of funds available for program expenses or relending was reduced.

The audit concluded that the value of the credit fund would be better maintained against depletion from bad loans, inflation, and devaluation by returning SETEFE's designated part of the interest reflows to the credit lines for program expenses (such as increased interest spreads for the ICIs to cover the risk of bad loans and credit supervision) or for relending purposes. It is our opinion that the interest reflows should not be distributed to SETEFE for its operating expenses because it has no implementation or monitoring responsibilities for the Central Bank credit line program.

B. Compliance and Internal Control

1. Compliance

We limited review of compliance to the findings presented in this report. The audit disclosed the following compliance deficiencies.

First, there were 29 instances where loans were approved by the Central Bank but were not made by the ICIs as required (see Finding No. 3).

Second, in thirteen cases the loan recipients apparently used loan funds for unauthorized purposes. For example, one borrower was supposed to plant a crop (loofah) from which sponges are made but this crop was not planted (see Finding No. 3).

Third, at least two loans were granted by an ICI to ineligible loan recipients who received coffee refinancing loans although they were not growing coffee at the time (their farms were out of production). (See Finding No. 3.)

Fourth, in fifteen instances, loan files at certain ICI offices did not contain required loan application documents. For example, no signed loan contracts were located for four applicants and their respective lending institutions for coffee replanting, and five for coffee refinancing (Other Pertinent Matters).

Fifth, there were 36 deficient loan files at the Central Bank. The ESF Local Currency Agreements for 1985 through 1987 indicate that documentation relating to the local currency lines of credit program should be available for audit for three years after the date of the last disbursement (see Other Pertinent Matters).

Sixth, in many cases loans were made without required field inspections by ICIs before (10 loans) and after (27 loans) the loans were made to ensure that funds were used as intended (see Other Pertinent Matters).

Seventh, in two instances an ICI refinanced loans from the Coffee Refinancing lines at terms and conditions more favorable to itself (four years instead of 12 years) contrary to the terms and conditions governing this line. Additionally, we found five loans where grace periods were at variance with the governing regulations (see Other Pertinent Matters).

Eighth, there were seven cases where ICIs received advance payments but did not promptly remit such to the Central Bank. For example, one of the ICIs administering coffee lines of credit, was collecting accelerated principal and interest payments per the applicable loan clause but was not promptly remitting these advance payments to the Central Bank. Instead, the ICI was remitting the normal payment of principal and interest (see Other Pertinent Matters).

2. Internal Control

We limited review of internal controls to the findings presented in this report. The audit disclosed the following internal control deficiencies.

First, most of the ICIs participating in the credit program had inadequate loan repayment information. Without such information, the ICIs did not readily know which lines of credit were experiencing the most success as evidenced by their ability to timely repay loans (see finding No. 5 and appendix 2).

Second, in at least one occasion, procedures were not adequate to prevent the duplicate processing of an Economic Development Fund student loan by an ICI (see Other Pertinent Matters).

Third, five coffee replanting loans were contractually effected without the mandatory clause that requires the grower/producer to agree to make payments on any overdue or past refinanced loans with any remaining revenue proceeds from coffee crop sales after paying off crop loans and other mortgage payments (see Other Pertinent Matters).

Fourth, one ICI was about one year behind in posting loan accounting records relating to two lines of credit program purportedly because of delays in implementing a new computer system (see Other Pertinent Matters).

Fifth, 40 loan applications were approved although no prior on-site physical verification had been made as stipulated in the credit line regulations for coffee refinancing, Manufacturing Industry, Economic Development Fund, Eastern Region Reactivation, Coffee Replanting and Reconstruction of Industrial Enterprises damaged by earthquake. Also, 27 loans did not have inspections during the period of the loan as required (see Other Pertinent Matters).

Sixth, one of the ICIs had collected advance payments of principal and interest but had not remitted these advance payments to the Central Bank immediately. In five other cases loan recipients repaid loans in advance but the ICIs continued to remit payments to the Central Bank as if the loans were being repaid normally (see Other Pertinent Matters).

C. Other Pertinent Matters

Five of the ten lines of credit are already experiencing significant delinquency rates. In our opinion, for the credit program to reach its economic goals and objectives, loan delinquencies need to remain low reflecting the economic success of a business as measured by its ability to repay loans. The high rates of delinquency are attributed to the narrow profit margins in highly competitive industries, poor coffee harvests and prices, and a climate of violence and terrorism in many areas of El Salvador. The effect of significant delinquency rates is that economic goals and objectives such as economic recovery, increased employment, and foreign exchange generation may not be reached since the ability to repay loans is an indicator of whether such goals can be reached (see appendix 2 for further details).

Documentation and interviews indicated that less progress than planned has been made toward achieving the credit program objectives of increased employment and production (see exhibit 10 for further details).

We found seven loans where repayment or grace periods were at variance with the governing regulations. In two instances an ICI refinanced loans from the Coffee Refinancing lines at terms and conditions more favorable to itself (4 years instead of 12 years) contrary to the terms and conditions for this line. Also, the ICI shortened the grace period for five other loans previously approved by the Central Bank.

One of the ICIs administering coffee lines of credit was collecting accelerated principal and interest payments per the applicable loan clause in two cases but was not promptly remitting these advance payments to the Central Bank. Instead, the ICI was remitting the normal payment of principal and interest. The regulation for this line of credit does not specifically state how many days after collection these advance payments are to be remitted to the Central Bank. In five other uses, loan recipients repaid loans in advance but the ICIs continued to remit payments to the Central Bank as if the loans were being repaid normally. There is no specific requirement governing this situation. Retaining advance payments by ICIs reduces the amount of funds available to achieve the objectives of the program.

There were five coffee loans which were entered into without a mandatory clause to require the grower/producer to make payments on any overdue or past refinanced loans with any revenue remaining from coffee crop sales after paying off crop loans and other mortgage payments.

There were 31 loans for which an eligibility determination could not be made. These loans appeared in the Industry and Agroindustry, Reconstruction of Enterprises Damaged by Earthquake, National Reconstruction, Manufacturing Industry, Coffee Replanting, Coffee Refinancing and Economic Development Fund lines. The total amount of these loans was $527,988 (see exhibit 10).

There were many cases where loan files were deficient as certain loan documents were either not available for review or never executed. There were 36 deficient loan files at the Central Bank and 15 at the ICIs. The ESF local currency agreements for 1985 through 1987 indicate that documentation relating to the local currency lines of the credit program should be available for audit for three years after the date of the last disbursement.

One ICI was about one year behind in posting loan accounting records relating to two credit lines purportedly because of delays in implementing a new computer system.

On at least one occasion, procedures were not adequate to prevent the duplicate processing of an Economic Development Fund student loan by an ICI.

AUDIT OF
THE LOCAL CURRENCY-FINANCED
CENTRAL BANK CREDIT LINE PROGRAM

PART III - EXHIBITS AND APPENDICES

FINANCIAL STATUS OF
CENTRAL BANK CREDIT LINES
FINANCED WITH 1985, 1986 AND 1987 ESF FUNDS
AS OF DECEMBER 31, 1987 1/

Description of Credit Line	ESF Funds Received by Central Bank	Loans Approved No.	Loans Approved Amount	Loans Contracted No.	Loans Contracted Amount 3/	Loans Disbursed by Central Bank	Loans Repaid to Central Bank	Loans Outstanding	Cash Available	Year of Funding
Special Fund for Nat'l Reconstruction 4/	$ 4,000,000	725	$ 4,376,596	716	$ 4,299,196	$ 4,155,556	$ 1,199,119	$ 2,956,437	$ 1,043,563	1985
Manufacturing Industry	11,200,000	323	14,888,440	329	14,955,473	13,699,032	2,674,129	11,024,903	175,097	1985
Coffee Refinancing	69,600,000	543	83,444,961	529	78,235,634	78,018,820	18,618,870	59,399,950	10,200,050	1985
Reform Sector Refinancing	8,000,000	15	8,059,612	15	8,059,612	8,049,612	1,340,645	6,708,967	1,291,033	1985
Coffee Replanting	5,489,724	201	5,473,081	183	5,085,844	2,196,335	10,631	2,185,704	3,304,020	1985/86
Industry - Agroindustry 5/	17,117,492	1140	18,784,396	1092	13,569,033	11,264,072	558,225	10,705,847	6,411,645	1986
Reconstruction Industrial Enterprises damaged by earthquake 6/	4,689,724	46	1,219,099	41	867,370	785,299	29,212	756,087	3,933,637	1986
Economic Development Fund	6,331,127	105	6,200,669	439	5,236,657	2,350,365	57,733	2,292,632	4,038,495	1986
Eastern Region Refinancing 2/	20,945,061	3	259,731	3	259,731	220,971	-	220,970	20,724,091	1986/87
Eastern Region Reactivation	9,000,000	78	397,009	66	291,720	95,200	-	95,200	8,904,800	1987
Total	$156,373,128	3179	$143,103,594	3413	$130,840,270	$120,835,262	$24,488,564	$96,346,697	$60,026,431	

1/ The rate of exchange used in this exhibit to convert local currence (colones) to dollars was 2.50 colones to U.S.$1 for 1985, 4.264643408 colones to U.S.$1 for 1986 and 5.00 colones for U.S.$1 for 1987. 1986 ESF monies included 1985 funds reprogrammed in 1986, therefore a mixture of ¢2.5 to US$1.00 and ¢5.00 to U.S.$1.00 resulted.

2/ We use the 1986 exchange rate for funds received in 1986 ($15,945,061) and the 1987 exchange rate for funds received in 1987 ($5,000 000). For all other columns in this credit line except cash available we use the 1986 exchange rate. The cash availabie column is the difference between loans outstanding and amount received.

3/ Loans contracted may exceed loans approved due to inclusion of reflows (loan repayments which are made available for new loans).

4/ Memorandum of Understanding refers to this line of credit as Small Enterprises (PEMER).

5/ Memorandum of Understanding refers to this line of credit as Industry.

6/ Memorandum of Understanding refers to this line of credit as Industrial Reconstruction.

Exhibit 1
Page 1 of 2

FINANCIAL STATUS OF
CENTRAL BANK CREDIT LINES
FINANCED WITH 1985, 1986 AND 1987 ESF FUNDS
AS OF DECEMBER 31, 1987

Description of Credit Line	ESF Funds Received by Central Bank	Loans Approved		Loans Contracted		Loans Disbursed by Central Bank	Loans Repaid to Central Bank	Loans Outstanding	Cash Available	Year of Funding
		No.	Amount	No.	Amount 1/					
Special Fund for Nat'l Reconstruction 2/	C 10,000,000	725	C 10,941,491	716	C 10,747,991	C 10,388,891	C 2,997,797	C 7,391,094	C 2,608,906	1985
Manufacturing Industry	28,000,000	325	37,221,099	329	37,338,682	34,247,579	6,685,322	27,562,257	437,743	1985
Coffee Refinancing	174,000,000	543	208,612,403	529	195,589,085	195,047,049	46,547,174	148,499,875	25,500,125	1985
Reform Sector Refinancing	20,000,000	15	20,149,029	15	20,149,029	20,124,029	3,351,612	16,772,417	3,227,583	1985
Coffee Replanting	22,000,000	201	21,929,025	183	20,277,597	8,538,919	45,336	8,493,583	13,506,417	1985/86
Industry - Agroindustry 3/	73,000,000	1140	80,108,750	1092	57,867,086	48,037,250	2,380,630	45,656,620	27,343,380	1986
Reconstruction Industrial Enterprises damaged by earthquake 4/	20,000,000	46	5,199,022	41	3,699,022	3,349,022	124,578	3,224,444	16,775,556	1986
Economic Development Fund	27,000,000	105	26,443,644	439	22,332,475	10,023,470	246,212	9,777,258	17,222,742	1986
Eastern Region Refinancing 2/	93,000,000	3	1,107,660	3	1,107,660	942,360	-	942,360	92,057,640	1986/87
Eastern Region Reactivation	45,000,000	78	1,985,043	66	1,458,600	476,000	-	476,000	44,524,000	1987
Total	C512,000,000	3179	C413,697,166	3413	C370,567,227	C331,174,569	C62,378,661	C268,795,908	C243,204,092	

1/ Loans contracted may exceed loans approved due to inclussion of reflows (repayments which are made available for new loans).

2/ Memorandum of Understanding refers to this line of credit as Small Enterprises (PEMER).

3/ Memorandum of Understanding refers to this line of credit as Industry.

4/ Memorandum of Understanding refers to this line of credit as Industrial Reconstruction.

Exhibit 2

ANALYSIS OF UNIVERSE AND SAMPLES SELECTED OF CENTRAL BANK CREDIT LINES

Credit Lines	Loans Contracted (Universe)	Sample Size 1/ Selected	Start Point of Random Number	Selection Interval
- Special Fund National Reconstruction 2/	716	72	9	10
- Manufacturing Industry	329	65	2	5
- Coffee Refinancing	529	70	2	8
- Reform Sector Refinancing	15	15	1	-
- Coffee Replanting	183	55	2	3
- Industry-Agroindustry 3/	1,092	74	4	15
- Reconstruction Industrial Enterprises damaged by the Earthquake 4/	41	41	1	-
- Economic Development Fund	439	68	5	7
- Eastern Region Refinancing	3	3	2	-
- Eastern Region Reactivation	66	35	7	2
Total	3,413	498		

1/ Confidence level was set at 90 percent, the expected error rate at 5 percent and the sample precision size at plus or minus 4 percent. In other words, there is a 90 percent probability that the true error rate of the population will fall between 1 and 9 percent.

2/ Memorandum of Understanding refers to this line of credit as Small Enterprises (PEMER).

3/ Memorandum of Understanding refers to this line of credit as Industry.

4/ Memorandum of Understanding refers to this line of credit as Industrial Reconstruction.

Exhibit 3

SAMPLE OF LOANS FOR REVIEW SELECTED BY LINES OF
CREDIT AND INTERMEDIATE
CREDIT INSTITUTIONS

	Participating Intermediate Credit Institutions															
	Banco Agricola Comercial	Banco Capitalizador	Banco Comercio	Banco de Credito Popular	Banco Cuscatlan	Banco Hipotecario	Banco Salvadoreno	Banco Financiero	Banco Mercantil	Banco Desarrollo e Inversion	BANAFI 1/	BFA 2/	FIGAPE 3/	INCAFE 4/	FEDECREDITO	TOTAL
Manufacturing Industry	4	1	2	5	2		1			2	2		46			65
Economic Development Fund		25			25	1	1			5		3	4		3	68
Special Fund for National Reconstruction													13		59	72
Coffee Replanting	4	3	5	2	6	9	3		2	1		3		16	1	55
Coffee Refinancing	5	1	4	1	4	36	2	1		1		6		4	5	70
Reconstruction Industrial Enterprises Damaged by Earthquake					2	1				1			36		1	41
Eastern Region Reactivation				1						1					33	35
Eastern Region Refinancing					1		1								1	3
Industry/AgroIndustry	1		1	1		1					1		69			74
Reform Sector Refinancing												15				15
Total Loans	14	30	12	11	40	48	8	1	2	11	3	27	168	20	103	498

1/ Banco Nacional de Fomento Industrial
2/ Banco Fomento Agropecuario
3/ Fondo de Financiamiento y Garantia para la Pequena Empresa
4/ Instituto Nacional del Cafe
5/ Federacion de Cajas de Credito

DELINQUENCY ANALYSIS OF LOAN SAMPLE 4/

Lines of Credit	Total 3/ Loans	Number of Loans Reviewed	Number of Loans Delinquent	Percentage of Loans Delinquent	Amount of loans Delinquent 6/	Percentage Amount of Delinquent Loans: Less than 30 days	30 to 60 days	Over 60 days
Reconstruction Industrial Enterprises Damaged by Earthquake	41	41	16	39	$ 3,685	19	19	62
Manufacturing Industry	329	65	19	29	36,009	9	7	84
Special Fund for National Reconstruction	716	72	21	29	7,750	5	4	91
Industry-AgroIndustry	1,092	74	19	26	5,924	19	19	62
Coffee Refinancing	529	70	11	16	499,205	0	1	99
Eastern Region Reactivation	66	35	5	14	1,163	63	0	37
Economic Development	439	68	4	6	2,296	96	2	2
Eastern Region Refinancing	3	3	-	0	-	0	0	0
Coffee Replanting	183	55	- 1/	0	-	0	0	0
Reform Sector Refinancing	15	15	N/A 2/	N/A	N/A	N/A	N/A	N/A
Total	3,413	498 5/	95	19%	$ 556,032	2%	1%	97%

1/ These loans are still in their grace periods.

2/ No loan delinquency information was available at the Banco De Fomento which refinanced all 15 loans.

3/ Total loans contracted as of December 31, 1987.

4/ As shown by th's analysis, although the loan portfolios of these credit lines are very recent (the oldest loans were made approximately 3 1/2 years ago), 95 of our statistically valid sample of 498 loans were experiencing loan delinquency problems. Deliquencies were determined as the end of the month from June through September 1988. It was necessary to use these different end of month cut-off dates because the various ICIs making the loans provided deliqneuncy information as of these dates.

A summary by cut-off date follows:

As of End of Month	No. of Loans	Amount of Loans
June 1988	21	$ 40,443
July 1988	53	17,545
August 1988	11	14,490
September 1988	10	483,554
Totals	95	$556,032

5/ The sample represents 15 percent of loans contracted and 21 percent of total amount contracted.

6/ Amounts are delinquent principal not interest.

Exhibit 4

ANALYSIS OF MOVEMENT FOR LINES OF CREDIT
AS OF JUNE 30, 1988

Credit Line	Date of First Loan Contracted	Original Amount of Line	Percentage Projection of the Original Amount Which Would Be Used In One Year 2/	Balance Available For lending	Date of Last Loan	Factors Adversely Affecting 3/ Use of Credit Line
Special Fund for Nat'l Reconstruction	3/24/86	$ 4,000,000	54%	$ 511,329	6/14/88	Unknown; perhaps lack of publicity or demand. Central Bank unaware of available balance.
Manufacturing Industry	12/4/85	11,200,000	66%	444,450	12/9/87	Line terminated and reflows of principal are flowing into Industry/Agroindustry line per credit line agreements.
Coffee Refinancing	9/6/85	69,600,000	63%	6,748,374	6/16/87	This line terminated on April 30, 1986 by Central Bank Officials.
Coffee Replanting 1985	12/18/85	800,000	424%	93,018	3/13/86	ICIs now using 1987 Coffee Replanting line; Central Bank not aware of available balance.
Coffee Replanting 1986	5/29/87	4,689,724	134%	2,295,218	2/5/88	ICIs now using 1987 Coffee Replanting line; Central Bank not aware of available balance.
Reform Sector Refinancing	11/6/84	8,000,000	111%	847,558	10/3/85	Central Bank has not informed ICIs adequately that funds are still available.
Industry/Agroindustry	4/1/87	17,117,492	113%	(465,706)1/	6/21/88	Not applicable; no balance of principal conclusion or principal reflows left from this line.
Reconstruction Industrial Enterprises Damaged by Earthquake	6/23/87	4,689,724	34%	3,075,716	4/21/88	Other competing lines of credit available; line arrived relatively late after earthquake of October 1986.

1/ The Industry/Agroindustry line has loaned out more funds than were originally available because the Central Bank provided reflow funds from two other credit lines as required by the credit line agreement regulation.

2/ This is a projection for the first year of the loan based on data obtained as of June 30, 1988.

3/ According to a Central Bank official.

Credit Line	Date of First Loan Contracted	Original Amount of Line	Percentage Projection of The Original Amount Which Would Be Used In One Year	Balance Available For Lending	Date of Last Loan	Factors Adversely Affecting Use of Credit Line
Economic Development Fund	10/6/87	6,331,127	281%	2,080,414	2/5/88	Central Bank not aware of how much was actually available in the line for further lending.
Eastern Region Refinancing	12/28/87	20,945,061	57%	16,043,311	6/27/88	New line; small margin of profit for ICIs, and excessive documentation required.
Eastern Region Reactivation	12/29/87	9,000,000	59%	7,231,548	6/27/88	New line; small margin of profit for ICIs, and excessive documentation required.
		$156,373,128		$ 38,905,230		

LOAN APPROVED BY CENTRAL BANK BUT NOT USED
BY APPROVED LOAN APPLICANTS

Item No	Lending 2/ Institution	Line of Credit	Amount of Loan 1/ Colones	Amount of Loan 1/ Dollars	Purpose of Loan	Date Funds Received By Lending Institution From Central Reserve Bank
1	BANCO CUSCATLAN	Economic Development Fund	C 3,200	$ 640	Finance professional career	12/24/87
2	BANCO CUSCATLAN	Economic Development Fund	5,700	1,140	Finance professional career	12/24/87
3	BANCO CUSCATLAN	Economic Development Fund	2,400	480	Finance professional career	12/24/87
4	BANCO CUSCATLAN	Economic Development Fund	3,000	600	Finance professional career	12/24/87
5	FIGAPE	Economic Development Fund	3,825	765	Purchase of medical equipment	10/23/87
6	FEDECREDITO	Eastern Region Reactivation	7,000	1,400	Purchase of milk cows	12/18/87
7	FEDECREDITO	Eastern Region Reactivation	8,000	1,600	Purchase of milk cows	12/07/87
8	FEDECREDITO	Eastern Region Reactivation	15,000	3,000	Purchase of mixed breed cattle	01/04/88
9	FEDECREDITO	Eastern Region Reactivation	8,600	1,720	Purchase of three cows with calves	01/04/88
10	FEDECREDITO	Eastern Region Reactivation	25,000	5,000	Purchase of six cows with calves	01/12/88
11	FIGAPE	Manufacturing Industry	10,000	2,000	Working Capital	12/09/85
12	FIGAPE	Manufacturing Industry	10,000	2,000	Purchase of machinery	12/09/85
13	FIGAPE	Manufacturing Industry	10,000	2,000	Working Capital	01/03/86
14	FIGAPE	Manufacturing Industry	3,200	640	Working Capital	02/06/86
15	FIGAPE	Manufacturing Industry	5,000	1,000	Working Capital	02/18/86
16	FIGAPE	Manufacturing Industry	15,000	3,000	Purchase of Machinery	07/15/86
17	FIGAPE	Industry/Agroindustry	2,000	400	Purchase of raw materials	09/17/87
18	FIGAPE	Industry/Agroindustry	2,000	400	Purchase of raw materials	10/07/87
19	FIGAPE	Industry/Agroindustry	9,000	1,800	Working capital and machinery	10/09/87
20	FIGAPE	Industry/Agroindustry	2,000	400	Working capital	11/30/87
21	FIGAPE	Industry/Agroindustry	3,500	700	Working capital	12/08/87
22	FIGAPE	Industry/Agroindustry	3,000	600	Working capital	12/03/87
23	FIGAPE	Industry/Agroindustry	3,000	600	Working capital	12/16/87
24	FIGAPE	Industry/Agroindustry	5,000	1,000	Working capital	12/16/87
25	FIGAPE	Industry/Agroindustry	1,500	300	Working capital	12/16/87
26	FEDECREDITO	Coffee Refinancing	30,000	6,000	Refinance previous overdue loans	02/18/86
27	FIGAPE	Reconstruction Industrial Enterprises Damaged by Earthquake	20,000	4,000	Repair damage to property	09/04/87
28	FIGAPE	Reconstruction Industrial Enterprises Damaged by Earthquake	8,000	1,600	Replace raw materials	10/09/87
29	BANCO HIPOTECARIO	Coffee Refinancing	179,150	35,830	Refinance previous overdue loans	02/13/86
			C403,075	$80,615		

1/ Exchange rate used: US$1 to 5.0 colones

2/ FIGAPE = Fondo de Financiamiento y Garantia para la Pequena Empresa
FEDECREDITO = Federacion de Cajas de Credito

Exhibit 6

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LOANS USED BY BORROWERS FOR UNAUTHORIZED PURPOSES

Item No.	Lending Institution 2/	Line of Credit	Amount of Loan Colones	Amount of Loan Dollars 1/	Reason for Classification of Ineligibility
1	FEDECREDITO	National Reconstruction	C 11,000	$ 2,200	Field visit showed this loan refinanced personal rather than business debt.
2	FEDECREDITO	National Reconstruction	6,000	1,200	Field visit showed that loan given without required evidence that property was damaged from terrorist act; additionally was for personal debt of the FEDECREDITO branch accountant.
3	FEDECREDITO	National Reconstruction	15,000	3,000	Document review showed no certification that vehicle damages were suffered from war or terrorist act.
4	FIGAPE	Reconstruction Industrial Enterprises Damaged by Earthquake	12,000	2,400	Field visit and document review showed this area was not affected by earthquake.
5	FIGAPE	Reconstruction Industrial Enterprises Damaged by Earthquake	20,000	4,000	Field visit and document review showed business previously repaired with another loan.
6	BANCO HIPOTECARIO	Coffee Refinancing	6,763,175	1,352,635	Field visit showed farm out of production and was being divided up by the ICI and sold to pay off outstanding debts.
7	BFA	Coffee Refinancing	273,510	54,702	Field visit and document review showed farm out of production and partially sold off.
8	BANCO CREDITO POPULAR	Economic Development Fund	206,908	41,382	Field visit showed that contemplated assets not all purchased.
9	BANCO SALVADORENO	Economic Development Fund	112,850	22,570	Field visit and document review showed that paste plants were not purchased and planted as indicated in approved purpose for loan.
10	BANCO CAPITALIZADOR	Economic Development Fund	32,000	6,400	Document review showed pig breeding stock was sold after purchase and loan not paid off.
11	BANCO CUSCATLAN	Economic Development Fund	3,500	700	Field visit and document review showed the borrower was not eligible because his income was above required limits.
12	BANCO CUSCATLAN	Economic Development Fund	14,300	2,860	Field visit showed borrower possessed assets which disqualified her for this loan.
13	FIGAPE	Industry/Agroindustry	10,000	2,000	Document review indicated ratio of owner's equity to debt was 6 to 1; 4 to 1 was required.
			C7,480,243	$ 1,496,049 1/	

1/ Exchange rate used: US$1 TO 5.0 colones

2/ FEDECREDITO = Federacion de Cajas de Credito
- FIGAPE = Fondo de Financiamiento y Garantia para la Pequena Empresa
- BFA = Banco de Fomento Agropecuario

Exhibit 7

AVERAGE PROCESSING TIME FOR LOAN
AS OF JUNE 30, 1988

Step No.	Loan Processing Step	Average All Lines	National Reconstruction	Manufacturing Industry	Coffee Refinancing	Agrarian Reform Refinancing	Coffee Replanting	Industry-Agroindustry	Reconstruction Industrial Enterprises Damaged by Earthquake	Economic Development Fund	Eastern Region Refinancing	Eastern Region Reactivation
			CREDIT LINES									
1	Days between the date the loan application was submitted to the ICI and the date the application was received by the Central Bank	118	234	96	63	58	50	78	157	121	81	183
2	Days between receipt of loan application by Central Bank and its approval by the Central Bank credit committee.	15	8	32	11	9	10	12	23	16	40	8
3	Days between Central Bank loan approval and notification to the ICI	1	- 1/		1	2	3	1	2	2	3	2
4	Days between Central Bank notification to ICI and signing of the loan contract between the Central Bank and the ICI	26	15	18	56	168	33	9	7	19	9	8
5	Days between signing of loan contract between the Central Bank and the ICI and first disbursement of funds to the ICI by the Central Bank	37	16	18	28	228	62	20	19	63	152	22
	Total (Steps 1 to 5)	197	273	164	159	465	158	120	208	221	285	223
	Total (Steps 2 to 5)	79	39	58	96	407	108	42	51	100	204	40

Exhibit 8

1/ Not available.

2/ We were able to determine average processing time for 483 loans from our sample of 498 loans. 15 loans in our sample did not have the necessary information to determine the average processing time.

LOAN DELINQUENCY
INFORMATION MAINTAINED BY INTERMEDIATE CREDIT INSTITUTIONS

Intermediate Credit Institution	Delinquency Information		
	Aged Delinquencies	Provided by Line of Credit	Currently Maintained
Federacion de Cajas de Credito	Yes	No	No
Banco Hipotecario	Yes	No	Yes
Banco Cuscatlan	Yes	No	Yes
Instituto Nacional del Cafe	No	Yes	No
Fondo de Financiamiento y Garantia para la Pequena Empresa	Yes	Yes	Yes
Banco Fomento Agropecuario	No	No	Yes
Banco Nacional de Fomento Industrial	Yes	No	Yes
Banco de Desarrollo e Inversion	Yes	No	Yes
Banco Mercantil	Yes	No	Yes
Banco Financiero	Yes	No	Yes
Banco Salvadoreno	Yes	No	Yes
Banco de Credito Popular	Yes	No	No
Banco de Comercio	No	No	No
Banco Capitalizador	Yes	No	Yes
Banco Agricola Comercial	Yes	No	Yes

SUMMARY OF FIELD INTERVIEWS FOR PRODUCTION AND EMPLOYMENT INCREASES

	Credit Line	Interviews Made	Production Levels Increased Thoughts of Borrower			Employment Increased Thoughts of Borrower			Production Level Increased Supported by Documents			Employment Level Increased Supported by Documents		
1	Manufacturing Industry	48	Yes	40	83%	Yes	22	46%	Yes	2	4%	Yes	2	4%
			Same or No	1	2%	Same	17	35%	Same or No	0	0%	Same	0	0%
			No Info	7	15%	No	2	4%	No Info	46	96%	No	0	0%
				48		No Info	7	15%		48		No Info	46	96%
							48						48	
2	Reform Sector Re-financing	15	Yes	4	27%	Yes	7	47%	Yes	0	0%	Yes	5	33%
			Same or No	11	73%	Same	5	33%	Same or No	4	27%	Same	2	13%
			No Info	0	0%	No	3	20%	No Info	11	73%	No	1	7%
				15		No Info	0	0%		15		No Info	7	47%
							15						15	
3	Coffee Refinancing	53	Yes	1	2%	Yes	9	17%	Yes	0	0%	Yes	1	2%
			Same or No	49	92%	Same	35	66%	Same or No	3	6%	Same	6	11%
			No Info	3	6%	No	6	11%	No Info	50	94%	No	0	
				53		No Info	3	6%		53		No Info	46	87%
							53						53	
4	Coffee Replanting	44	Yes	0	0%	Yes	38	86%	Yes	0	0%	Yes	24	54%
			Same or No	44	100%	Same	6	14%	Same or No	44	100%	Same	3	7%
			No Info	0	0%	No	0	0%	No Info	0	0%	No	0	0%
				44		No Info	0	0%		44		No Info	17	39%
							44						44	
5	National Reconstruction	63	Yes	47	75%	Yes	15	24%	Yes	1	2%	Yes	3	5%
			Same or No	5	8%	Same	41	65%	Same or No	0	0%	Same	0	0%
			No Info	11	17%	No	1	2%	No Info	62	98%	No	0	0%
				63		No Info	6	9%		63		No Info	60	95%
							63						63	
6	Industry/Agro Industry	55	Yes	47	86%	Yes	15	27%	Yes	3	5%	Yes	1	2%
			Same or No	4	7%	Same	34	62%	Same or No	0	0%	Same	0	0%
			No Info	4	7%	No	2	4%	No Info	52	95%	No	1	2%
				55		No Info	4	7%		55		No Info	53	96%
							55						55	
7	Reconstruction of Industrial Enterprises Damaged by Earthquake	33	Yes	19	58%	Yes	5	15%	Yes	1	3%	Yes	1	3%
			Same or No	9	27%	Same	22	67%	Same or No	0	0%	Same	1	3%
			No Info	5	15%	No	1	3%	No Info	32	97%	No	0	0%
				33		No Info	5	15%		33		No Info	31	94%
							33						33	
8	Eastern Region Refinancing	1	Yes	0	0%	Yes	0	0%	Yes	0	0%	Yes	0	0%
			Same or No	1	100%	Same	1	100%	Same or No	0	0%	Same	0	0%
			No Info	0	0%	No	0	0%	No Info	1	100%	No	1	100%
				1		No Info	0	0%		1		No Info	0	0%
							1						1	

Credit Line	Interviews Made	Production Levels Increased Thoughts of Borrower			Employment Increased Thoughts of Borrower			Production Level Increased Supported by Documents			Employment Level Increased Supported by Documents		
9 Eastern Region Reactivation	22	Yes	21	95%	Yes	3	14%	Yes	0	0%	Yes	2	9%
		Same or No	1	5%	Same	19	86%	Same or No	0	0%	Same	0	0%
		No Info	0	0%	No	0	0%	No Info	22	0%	No	0	0%
			22		No Info	0	0%		22		No Info	20	91%
						22						22	
10a Economic Development Fund	13	Yes	9	69%	Yes	5	38%	Yes	0	0%	Yes	1	8%
		Same or No	2	16%	Same	7	54%	Same or No	0	0%	Same	0	0%
		No Info	2	15%	No	1	8%	No Info	13	100%	No	0	0%
			13		No Info	0			13		No Info	12	92%
						13						13	
10b Economic Development Fund (Education)	25 1/	N O T A P P L I C A B L E 3/											
Total interviews relative to production and employment generation	347	Yes	188	54% 2/	Yes	119	34% 2/	Yes	7	2%	Yes	40	12%
		Same Or No	127	37%	Same	187	54%	Same or No	51	15%	Same	12	3%
		No Info	32	9%	No	16	5%	No Info	289	83% 4/	No	3	1%
			347		No Info	25	7%		347		No Info	292	84% 4/
						347						347	

1/ We had 372 interviews from our 498 loan sample. 25 of the interviews pertained to student loans and were not applicable to employment generation and production increases. We therefore had 347 interviews from 473 loans or 73.4% of our sample. The rest of the 126 interviews were not made because the loan recipient: was in a conflictive zone; was inaccessible because of bad roads; was not home the day of the visit; the address location was unknown; or the business no longer existed.

2/ 54% of the 347 borrowers believed their production had gone up; 34% of the 347 borrowers believed their number of employees had increased.

3/ Not included in total because this type of loan does not generate production or increase employment. They are student loans.

4/ In many cases borrowers refused to show documentation. For increases in production we accepted sales reports and delivery reports. For increases in employment we accepted payroll information.

LIST OF 31 LOANS FOR WHICH AN ELIGIBILITY DETERMINATION COULD NOT BE MADE

Reason for Questioning/ Credit Line Name	Intermediary Credit Institution (ICI)	Sample No.	Loan Amount 1/	Loan Balance as of 6/30/88	Percentage in arrears 2/	Economic Activities	Comments
1. The business closed its operations.							
Industry/Agroindustry	FIGAPE	41	$1,000	$ 835	4	Clothing manufacturing.	The borrower could not provide documentation on use of loan.
Industry/Agroindustry	FIGAPE	44	400	84	29	Clothing manufacturing	Borrower stated that loan amount was insufficient. Borrower could not provide documentation on use of loan proceeds.
Industry/Agroindustry	FIGAPE	46	1,800	1,737	16	Furniture manufacturing	Borrower's whereabouts are unknown. Cosigner (guarrantor) is paying the loan.
Industry/Agroindustry	FIGAPE	72	600	588	19	Manufacturing of men's clothes	Borrower did not provide documentation on use of loan proceeds.
Reconstruction of Enterprises Damaged by the Earthquake	FIGAPE	10	2,600	2,595 3/	23	Manufacturing	Business is being liquidated. Machinery was sold and proceeds used for paying other loans. There is no production.
Reconstruction of Enterprises Damaged by the Earthquake	FIGAPE	26	4,000	3,651 3/		Briefcases and belts manufacturing	Loan was for repairing the business premises. This was done. Borrower did not have support documentation to prove costs.
Reconstruction of Enterprises Damaged by the Earthquake	FIGAPE	30	1,600	1,206 3/		Clothing manufacturing	Borrower did not provide documentation on use of loan proceeds.
National Reconstruction	FEDECCREDITO	14	600	550	100	Commerce	Borrower could not provide documentation on use of loan proceeds.
National Reconstruction	FEDECCREDITO	17	2,800	2,763	55	Commerce	Same as precedent. Same borrower. This credit was for refinancing other loans.
National Reconstruction	FEDECCREDITO	21	500	0		Commerce	The business was closed because the borrower, an employee of the ICI, did not have time for it. Loan balance was paid.
National Reconstruction	FEDECCREDITO	29	1,000	0		Poultry	The borrower provided conflictive information to the auditors regarding the purpose of the loan. Loan has been paid off.

Reason for Questioning/ Credit Line Name	Intermediary Credit Institution (ICI)	Sample No.	Loan Amount 1/	Loan Balance as of 6/30/88	Percentage in arrears 2/	Economic Activities	Comments
Manufacturing Industry	Banco de Credito Popular	10	$38,000	$ 0		Cardboard boxes manufacturing	Company assets were sold. Loan balance was paid off.
Manufacturing Industry	FIGAPE	20	2,450	0 3/		PVC products	Company assets were sold and loan paid.
Manufacturing Industry	FIGAPE	25	600	362 3/	58	Clothing manufacturing	Borrower left the country.
Manufacturing Industry	FIGAPE	44	320	94 3/		Carpentry	Business closed due to the high cost of materials and lack of workers.
Manufacturing Industry	FIGAPE	56	2,000	1,620 3/	56	Bakery	The business place was destroyed by the October 1986 earthquake.
2. Business/Assets financed were sold or lost							
National Reconstruction	FEDECREDITO	48	2,000	1,322	100	Agriculture	Borrower sold the cattle financed. He could not provide documentation on use of loan proceeds.
National Reconstruction	FEDECREDITO	59	4,000	3,084		Agriculture	Cattle was stolen from borrower who could not provide documentation on use of loan proceeds.
Coffee Refinancing	Banco Hipotecario	31	11,472	0 4/		Coffee Growing	Customer showed documents to evidence the sale of the land and the repayment of the loan.
3. Business has been abandoned							
Coffee Refinancing	Banco Hipotecario	33	20,094	19,678 4/		Coffee Growing	The farm is located in a conflictive area and was burned down by the guerrillas.
Coffee Refinancing	Banco Hipotecario	50	7,266	6,093 4/		Coffee Growing	Same as precedent.

Reason for Questioning/ Credit Line Name	Intermediary Credit Institution (ICI)	Sample No.	Loan Amount 1/	Loan Balance as of 6/30/88	Percentage in arrears 2/	Economic Activities	Comments
4. ICI did not have sufficient information for auditors to determine eligibility.							
Coffee Refinancing	Banco Salvadoreno	15	$ 71,524	$ 65,564	9	Coffee Growing	Physical inspection by auditors not made due to the deficient state of the road.
Coffee Refinancing	BFA	59	3,275	0		Coffee Growing	Loan recipient is out of the country. Physical inspection not made. Loan has been paid off.
Coffee Refinancing	Banco Hipotecario	23	47,748	19,988 4/		Coffee Growing	No evidence borrower complied with credit line requirements.
Coffee Refinancing	Banco Hipotecario	24	258,320	264,577 4/5/	19	Coffee Growing	Same as precedent.
Coffee Replanting	Banco Agricola	2	18,300	14,507 6/		Coffee Growing	Physical inspection by auditors not made due to severe climatological conditions (Hurricane Gilbert).
5. Other Reasons							
Economic Development Fund	FIGAPE	66	5,000	5,000 3/	5	Apiculture	Auditors were denied access to the project site. Borrower is the wife of the GOES Foreign Minister.
Industry and Agroindustry	FIGAPE	11	400	307	33	Clothing Manufacturing	Borrower was not home. Balance outstanding confirmed by his wife, but no documentation on use of loan proceeds was provided.
Industry and Agroindustry	FIGAPE	18	1,000	950	30	Manufacturing of gift boxe	Same as precedent.
Coffee Refinancing	Banco Hipotecario	16	14,219	0		Coffee Growing	Loan recipient stated the ICI acted on its own to get the loan refinanced. She was only told the interest rate had been decreased. Loan was paid off.
National Reconstruction	FEDECREDITO	54	3,000	1,395	0	Agriculture	Vehicle not physically present and loan borrower did not have a certification of damage due to terrorism.

DESCRIPTION OF PROGRAM COMPONENTS

Economic Support Fund (ESF) grant agreements and the associated memoranda of understanding for 1985, 1986, and 1987 established a credit program for the private sector. The program is financed with ESF local currencies and managed by the Salvadoran Central Reserve Bank (BCR). As a result of these agreements, ten credit lines were established as follows.

Special Credit Line for National Reconstruction

This credit line is intended to benefit participants living in El Salvador's central and eastern region which has been the most affected by the armed conflict. Its purpose is to provide funds to reconstruct, replace, or repair productive assets of businesses damaged or destroyed as a result of the armed conflict, to repair houses damaged by the same conflict, or to refinance past due loans which could not to be paid because of the damage caused to productive assets of such businesses. The equivalent of $4 million was provided on October 8, 1985, with no termination date specified. The BCR charges two percent interest to the credit institutions utilizing these funds for lending purposes while allowing them to charge six percent to customers utilizing such funds. In the case where Federacion de Cajas de Credito (FEDECREDITO) borrows these funds for lending to its affiliated credit unions, the BCR charges FEDECREDITO 2 percent but allows it to charge its affiliates 4 percent. The affiliated credit unions can charge customers receiving these funds 6 percent. Depending on the use of the loan, the maximum lendable amounts are $6,000 and $10,000, and the repayment period varies from 3 to 15 years with a grace period of 1 or 2 years.

Special Credit Line for the Manufacturing Industry

The objective of this credit line is to increase the ability of the manufacturing industry to export non-traditional products outside Central America and to reactivate the industrial sector. The equivalent of $11.2 million in ESF local currency was provided to this credit line on October 8, 1985; in addition, the BCR was to make available the equivalent of $5.2 million from its own resources, and the reflows from this and another credit line.

This line was to finance working capital needs, increases in installed capacity, the modernization of the industry, and the establishment of new enterprises whose production is destined primarily for exportation outside of Central America. Resources from this credit line can be used to construct or remodel new buildings or other installations and to acquire new machinery, spare parts, etc. The interest rate charged by

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the BCR to intermediary credit institutions (ICI) using these funds is 11 percent except for refinancing existing debt which has a rate of 16 percent. The ICIs are allowed to charge 13, 14, or 18 percent depending on the type of project and whether the entity being financed is a new enterprise, a small business concern, or other industrial concern. The maximum lendable amount is $1.2 million to an individual or sole corporation and $2.4 million to a pool of commonly-owned companies or multicorporations. The repayment period varies from 1 year for temporary working capital to 15 years for industrial installations with grace periods ranging from 1 to 4 years except for loans made for temporary working capital or for refinancing debt in which case there is no grace period. Commercial banks are required to present to the BCR thorough financial information for each loan application; this serves as the basis for approval by the BCR. According to BCR documents, these resources were also to be used to finance a special credit line for handicraft production and another special credit line for the purchase of stock in industrial concerns.

Special Credit Line for Coffee Refinancing

The objective of this credit line is to allow coffee producers with overdue loans (originally obtained for coffee production and related activities) to use these resources to pay off overdue principal and interest to participating ICIs and the BCR. The equivalent of $69.6 million was provided to this credit line on October 8, 1985. There is no termination date specified for this credit line. The BCR charged the participating ICIs an interest rate of 3 percent while the ICIs were allowed to charge the final borrowers 6 percent per annum to refinance their delinquent debt. In the case where FEDECREDITO obtains funds to lend through its affiliated credit unions, the BCR charges FEDECREDITO 2 percent, FEDECREDITO charges its affiliates 4 percent who in turn charge coffee producers 6 percent. In the case where final recipients receive the loan through a cooperative, the ICIs charge 5 percent to the cooperatives who in turn charge members 6 percent. The repayment period can be up to 12 years. There i no grace period allowed except for producers in the country's eastern region (armed conflict area) who were given up to two years in consideration of their financial situation. Requirements for the use of this credit line call for the participating ICIs to obtain evidence that: loan applicants are active coffee producers as certified by the agricultural department of the lending ICI; loan delinquency must not be due to misuse of prior loan resources by the farmer/producer and the borrower's coffee production for the last five crops has not been below a given level. There is also a clause which requires the loan recipients to use "the majority" of the revenues remaining from the sale of their coffee crop, after paying off other crop and mortgage loans, to pay the refinanced loan.

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Special Credit Line for Coffee Replanting

The purpose of this credit line is to finance the cost of planting new coffee plants. The equivalent of $5,489,724 had been provided by May 26, 1987 for this activity. The BCR charges ICIs 12 percent per annum while allowing them to charge coffee producers 14 percent. For loans placed through FEDECREDITO affiliates, the BCR charges 12 percent and allows FEDECREDITO to charge affiliated credit unions 13 percent; final customers pay 14 percent interest. Loan recipients can have up to six years to repay the loan, including a grace period of up to three years. The only special requirement of this credit line is to require loan recipients to use any excess revenue remaining after paying off annual coffee crop loans or mortgages to service this credit.

Special Credit Line for the Reform Sector Refinancing

The purpose of this credit line is to refinance loans made to the agrarian reform sector organizations for the production of coffee, cotton, sugar cane, basic grains, and other agricultural production activities. USAID/El Salvador authorized the use of $8 million equivalent for this credit line on October 8, 1985. Participating commercial banks pay the BCR 4 percent for using this line of credit and charge loan recipients 6 percent. The repayment period was up to four years. A special condition for this line was that loan recipients promised to accelerate payments on their loans if they received greater than expected revenues because of favorable prices, high yields, etc.

Special Credit Line for the Industry and Agroindustry

A USAID/El Salvador official stated that this credit line is basically an extension of the Manufacturing Industry Credit line. Its purpose is to develop the capacity of manufacturing and agricultural industries to primarily export non-traditional products outside the Central American area. The total funds received in ESF generated local currency was the equivalent of $17,117,492. In addition, the BCR was to provide the equivalent of up to $3.6 million from the reflows of two other credit lines for the short term financing of this credit line. The line started April 1, 1987 and has no specified termination date. The BCR charges participating ICIs an interest rate of 10 percent and allows them to loan out these funds at 13 percent. For refinancing credits of industrial concerns, the BCR charges ICIs 18 percent interest for the use of these monies and allows ICIs to lend funds at 19 percent. These resources can be loaned for the same uses as the loans in the Manufacturing Industry credit line. The repayment period is also the same as for the "Manufacturing Industry": from 1 to 15 years with grace periods ranging from 1 to 4 years except for loans made for temporary working capital and refinancing debt in which case there was no grace period. One of the special requirements of this credit line was that the repair of damages caused to the productive capacity by the October 10, 1986 earthquake was not eligible for financing under this line.

Special Credit Line for the Reconstruction of Industrial Enterprises Damaged by the October 10, 1986 Earthquake

The purpose of this credit line is to reconstruct or replace assets damaged by the October 10, 1986 earthquake. Specific eligible uses of funds were to: build, reconstruct, or repair buildings used for productive ends, replace or repair damaged machinery and equipment, and replace inventory or other items to the operation of the enterprise. The equivalent of $4,689,724 was received May 26, 1987. No termination date was established for this line. The BCR charges participating ICI funds an annual interest rate of 11 percent and allows them to charge customers 14 percent interest. Repayment periods ranged from 3 to 15 years with grace periods of 1 or 2 years. The maximum lendable amount to a borrower with assets worth up to $400,000 was $100,000 and for a borrower with assets greater than $400,000 it was $200,000. One of the requirements of this credit line was that the ICI had to verify the damages suffered by the applying business.

Economic Development Fund (EDF)

The objective of this fund is to provide financial resources for activities related to the economic development of El Salvador such as agricultural production and employment. Uses of EDF resources can be used for various activities such as: financing the cost of secondary, undergraduate, and graduate studies, promoting the tourism industry and financing animal production projects, agricultural equipment, and agricultural diversification projects. The total amount of resources made available to this fund as of December 31, 1987 was the equivalent of $6,331,127. The annual interest rates charged by the BCR to ICIs varies from 1 percent to 8 percent. The ICIs can charge borrowers from 4.5 percent to 10 percent. The repayment period ranges from 2 to 15 years (except for wood production loans which can range up to 25 years) with grace periods depending on the nature of the project. The ICIs are allowed to require the collateral they consider reasonable and necessary. This line started May 26, 1987, and no termination date is mentioned.

Special Credit Line for Eastern Region Refinancing

The objective of this credit line is to promote the reincorporation to productive activities of Eastern Region producers delinquent loans due to the armed conflict. Funds from this credit line are to be used for refinancing credits originally given for productive activities of the private sector in the Salvadoran departments of Usulutan, San Miguel, La Union, and Morazan. The equivalent of $20,945,061 in local currency was provided on June 11, 1987. No termination date is mentioned. ICIs using these funds are charged an annual interest rate of 5 percent by the BCR. They are allowed to charge 6 percent to the loan applicants. In the case of FEDECREDITO it is charged 4 percent by the Central Bank; it charges its affiliates five percent, who in turn charge customers 6 percent annual interest. The line is available until the original principal is expended. Some of the special conditions to receive resources from this credit line are that the loan recipient has to demonstrate an ability to repay the loan, has to capitalize any undistributed earnings, and must reach a liability/owner's equity ratio of no greater than two to one. The maximum amount of a loan is the equivalent of $1 million for an individual proprietorship or partnership, and $1.6 million for a group of corporations or companies owned by the same group of stockholders. The repayment period is up to 20 years with 2 years of grace period.

Eastern Region Reactivation Credit Line

This credit line's objective is to provide financial resources to establish, extend, or rehabilitate medium and long-term productive projects in El Salvador's Eastern Region. This line will be focused on financing the manufacturing, livestock, and artisan sectors. The line was established June 11, 1987, when the local currency equivalent of $9 million was provided to the BCR. The BCR charges lending institutions using this credit line an annual interest rate of 11 percent, while the ICIs are allowed to charge users 14 percent interest. The BCR charges FEDECREDITO 9 percent, who charges its affiliates 11 percent who in turn charge loan recipients 14 percent annual interest. Repayment periods vary from 2 to 15 years with grace periods ranging from 1 to 4 years except for loans made to purchased small livestock in which case there is no grace period. Special requirements are that the user prove he will implement the project in the Eastern Region and that the ICIs verify that the funds have been invested in the Eastern Region for the purposes originally intended.

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LOAN DELINQUENCY RATES MAY THREATEN GOALS OF THE LOCAL CURRENCY PROGRAM

Five of the ten lines of credit are already experiencing significant delinquency percentages. In our opinion, for the credit program to reach its economic goals and objectives, loan delinquencies need to remain low reflecting the economic success of a business as measured by its ability to repay loans. The high rates of delinquency are attributed to the narrow profit margins, the highly competitive industries, poor coffee harvests and prices, and a climate of violence and terrorism in many areas of El Salvador. The effect of significant delinquency rates is that economic goals and objectives such as economic recovery, increased employment and foreign exchange generation may not be reached since the ability to repay loans is an indicator of whether such goals can be reached.

The lines of credit program ($156.4 million equivalent) was established from local currencies made available under the 1985, 1986, and 1987 ESF programs. Ten different lines of credit were established as part of this local currency program.

To determine the extent of loan delinquencies between the intermediate credit institutions (ICIs) and the borrowers, we selected a statistical sample of 198 loans from the credit lines to allow projection of sample results (see exhibits 2 and 3). As can be seen in Exhibit 11, the results of our sample showed that:

- 19 percent of the total number of loans were delinquent.
- 97 percent of the amount of these loans were delinquent for more than 60 days.
- Five of the ten credit lines were already experiencing substantial loan delinquency problems.
- Information was not available to determine delinquencies for one of the credit lines.
- There were no loan delinquencies for another credit line because the loans were still in its grace periods.

Five of the ten credit lines were already experiencing substantial loan delinquency trends even though these loan portfolios were still relatively young. In our opinion, higher rates of loan delinquency might be expected with more mature loan portfolios. We consider the ability to repay loans on a timely basis as an accurate barometer of how well a business is succeeding. A substantial delinquency rate in repayment of loans would indicate that businesses are experiencing financial problems and are unlikely to generate new employment or to sustain current employment as well as generate more foreign exchange or sustain current earnings. 1/ This could mean that economic recovery will be delayed and that economic stabilization is failing.

The five credit lines with significant delinquency problems are discussed below. Our sample of 41 loans in the Reconstruction of Industrial Enterprises Damaged by Earthquake Line of Credit were experiencing a 39 percent delinquency rate (16 loans). The Central Bank official administering this program attributed the high delinquency rate in this line to the small profit margins for most of these small businesses, receiving this type of credit. Our sample of 65 manufacturing loans had 19 loans or 29 percent experiencing delinquency. This same Central Bank official described this line's loan recipients as pertaining to small highly competitive industries with small profit margins. The National Reconstruction Line had 21 delinquent loans in our sample of 72 loans, or 29 percent. This Central Bank official stated these industries were in conflictive zones where normal business operations were disrupted, making it difficult to operate a profitable business. The Industry/Agro-Industrial credit line sample had 19 of 74 loans delinquent, or 26 percent. The Central Bank official also described these loan recipients as pertaining to small highly competitive industries with small profit margins. The coffee refinancing line had 11 delinquent loans in our sample of 70, or 16 percent. This Central Bank official stated world prices for coffee were low and climatic conditions for coffee growers in El Salvador had not been favorable for the last two years.

The effect of these significant loan delinquencies, in five of the ten lines of credit, may indicate that the economic goals and objectives of the credit program are less likely to be achieved by investing monies into these types of activities.

1/ We are defining a substantial loan delinquency rate as a rate of delinquency higher than interest rates being changed on the loan line meaning the line is decapitalizing itself.

4/

List of Report Recommendations

Recommendation No. 5 15

We recommend that USAID/El Salvador obtain evidence that the Central Bank has required intermediate credit institutions to maintain adequate loan payment status information by credit line and to report this information to the Central Bank on a periodic basis.

Recommendation No. 6 17

We recommend that USAID/El Salvador in consultation with the Government of El Salvador redirect the Secretariat for External Financing's portion of the credit line program's interest reflows to the credit line program for program expenses or relending.

Appendix 4

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