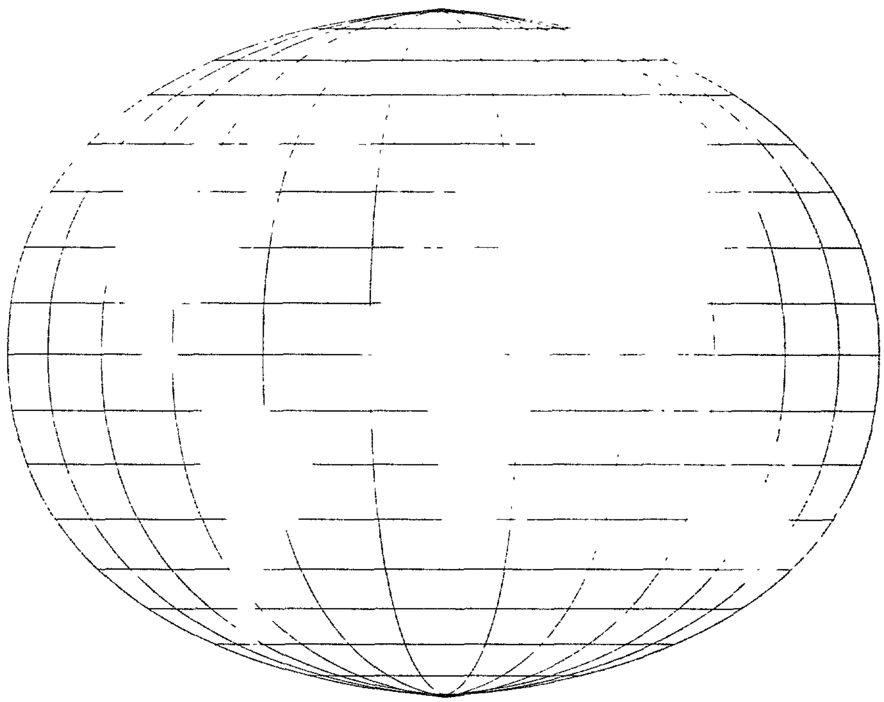
Report of Audit

Audit of USAID'S
Micro and Small Enterprise
Development Program
Financial Statements for the Year Ending
September 30, 1995

Report No. 0-000-96-018
July 1, 1996



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

USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

July 1, 1996

MEMORANDUM

TO: CFO, Donald K. Charney

FROM: Director, IG/A/FA, Bruce N. Crandlemire

SUBJECT: Audit of USAID's Micro and Small Enterprise Development Program for the Years Ended September 30, 1995 and 1994

This is our final report on the audit of the financial statements for the U.S. Agency for International Development's (USAID) Micro and Small Enterprise Development for fiscal years 1995 and 1994.

The Chief Financial Officers (CFO) Act of 1990 requires the U.S. Agency for International Development to prepare annual financial statements for the Micro and Small Enterprise Development (MSED) Program. Office of Management and Budget (OMB) Bulletin No. 93-18 established March 1, 1996 as the date by which these financial statements were to be submitted. However, in a March 13, 1996 letter to OMB from USAID's Chief Financial Officer and Inspector General, OMB was advised that the audited financial statements would be delayed until June 30, 1996.

The USAID Office of Inspector General (OIG) is responsible for auditing the financial statements. To fulfill this responsibility, the OIG contracted with the independent certified public accounting firm of Deloitte and Touche, LLP to perform the audit under the oversight of the OIG. In addition, the OIG reviewed the presentation of management's performance information contained in the Program Overview section of the report in accordance with OMB requirements.

Audits under the CFO Act are to be performed in accordance with generally accepted government auditing standards and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require the audit to provide reasonable assurance that the financial statements are free of material misstatement. The auditors are to obtain an understanding of the relevant internal control policies and procedures designed to achieve control objectives; determine whether the controls have been placed in operation; and assess the control risk. The audit also is to include tests of USAID's compliance with certain laws and regulations.

MSED is a credit-financed program with the primary goal of promoting the private sector in developing countries by increasing sustainable access to credit for small and micro enterprises. The Bureau for Global Programs, Center for Economic Growth, Credit and Investment Staff is responsible for designing, implementing and monitoring the MSED program. The Division of Loan Management, Office of Financial Management, is responsible for processing and recording MSED accounting activity for the Program.

As a result of its audit, Deloitte & Touche concluded that adequate accounting records and sufficient evidential matter supporting account balances were unavailable for the audit. Moreover, because the missing information was considered material to the financial statements and the auditors were unable to apply alternative procedures, the auditors were unable to express an opinion on the financial statements of MSED for the year ended September 30, 1995.

The auditors' report identified as a material weakness that MSED did not maintain an adequate internal control structure. As reported in their prior audit report on MSED for fiscal year 1994 (Report No. 0-000-95-036 dated June 28, 1995) the auditors expressed concern that accounting activity for fiscal year 1995, which had been performed subsequent to year end, had not been recorded on a timely basis throughout the year, reportedly because the individual responsible was transferred to another program. Responding to that report, the Office of Financial Management provided OIG with a written plan for keeping MSED accounting activity current. However, although MSED program management maintained information on fiscal year 1995 financial transactions, the Office of Financial Management did not process and record the MSED financial transactions during fiscal year 1995. Subsequent to September 30, 1995 efforts were made to reconstruct the 1995 MSED accounting records; however, this process did not result in the production of complete, reliable, timely and consistent financial information for the program.

The independent auditors concluded that USAID has not complied with the Budget and Accounting Procedures Act of 1950, as amended and the Federal Managers' Financial Integrity Act of 1982 that apply to the aforementioned inadequate internal control structure. These Acts require that USAID establish and maintain systems of accounting and internal control designed to provide effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit.

<u>Recommendation No. 1</u>: We recommend that USAID's Chief Financial Officer ensure that financial management staff receive adequate training and sufficient supervisory oversight to process and record MSED financial transactions within the framework of an internal control structure that permits the preparation of financial statements in accordance with Office of Management and Budget Bulletin No. 94-01.

USAID management is also responsible for providing reasonable assurance that data which support performance measures reported in the Program Overview are properly recorded and accounted for to permit preparation of complete and reliable performance information. The Overview contains a wide range of data, some of which are not directly related to the financial statements. We do not express an overall opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with management. Based on this limited work, we found no material inconsistencies with the financial statements or non-conformance with OMB guidance.

<u>Management Comments and Our Evaluation</u>

We provided a copy of our draft report to USAID's Chief Financial Officer and other USAID Management officials. Appendix I contains USAID management's response to our draft audit report.

I appreciate the courtesy and cooperation extended to both the staffs of the USAID Office of Inspector General and Deloitte and Touche, LLP during the course of this audit.

Office of the Inspector General

Office of the Inspector General
July 1, 1996

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Financial Statements for the Years Ended September 30, 1995 and 1994, and Independent Auditors' Report

Deloitte &
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INDEPENDENT AUDITORS' REPORT

To the Administrator
and the Inspector General of the
U. S. Agency for International Development:

Summary

We were engaged to audit the financial statements, listed in the table of contents, of the Micro and Small Enterprise Development Program (MSED) administered by the U. S. Agency for International Development (USAID) as of and for the year ended September 30, 1995. We have audited the similarly listed financial statements as of and for the year ended September 30, 1994.

We are unable to express an opinion on the financial statements of MSED as of and for the year ended September 30, 1995, due to a lack of adequate accounting records and sufficient evidential matter supporting account balances that are material to the financial statements. We were unable to apply alternative auditing procedures to satisfy ourselves as to such account balances.

In our opinion, the financial statements as of and for the year ended September 30, 1994, are presented fairly, in all material respects.

We noted deficiencies in internal controls that we consider to be reportable conditions under established standards, which are also considered material weaknesses.

We identified material instances of noncompliance with selected provisions of applicable laws and regulations tested.

These conclusions and the scope of our work are discussed in more detail below.

Disclaimer of Opinion on 1995 Financial Statements

Because we were unable to apply alternative auditing procedures to satisfy ourselves regarding account balances that are material to the financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the 1995 financial statements of MSED referred to above.

Opinion on 1994 Financial Statements

In our opinion, the 1994 financial statements referred to above present fairly, in all material respects, MSED's:

- Financial position as of September 30, 1994;
- Results of operations and changes in net position;
- Cash flows; and
- Budgetary resources and actual expenses for the year then ended;

in conformity with the basis of accounting prescribed in Office of Management and Budget (OMB) Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. As discussed in Note 1 to the financial statements, OMB Bulletin No. 94-01 is a comprehensive basis of accounting other than generally accepted accounting principles.

Report on Internal Control Structure

The management of USAID is responsible for establishing and maintaining the internal control structure of MSED. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with the basis of accounting prescribed in OMB Bulletin No. 94-01;

- Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition; and

- Transactions, including those related to obligations and costs, are executed in compliance with:

    - Laws and regulations that could have a direct and material effect on the financial statements; and

    - Any other laws and regulations that the OMB, entity management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning our engagement to audit the financial statements of MSED, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of attempting to express our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted a certain matter, which is discussed below, involving the internal control structure and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matter involving the internal control structure and its operation that we consider to be a material weakness as defined above.

MSED DID NOT MAINTAIN AN ADEQUATE INTERNAL CONTROL STRUCTURE

In our Independent Auditors' Report related to the MSED financial statements as of and for the year ended September 30, 1994, dated June 8, 1995, we noted that subsequent to year-end the individual responsible for processing and recording MSED accounting activity on behalf of the Office of Financial Management (FM) transferred to a different program with USAID with the result that accounting activity subsequent to September 30, 1994, was not recorded.

We understand that, subsequent to the issuance of the 1994 report, FM provided a written plan to the USAID Office of Inspector General (OIG) including a detailed approach to assure that MSED accounting activity would be kept current. MSED program management maintained information on fiscal year 1995 financial transactions from which FM could have processed and recorded MSED accounting records. We noted, however, that such processing and recording by FM did not occur during fiscal year 1995.

Subsequent to September 30, 1995, efforts were made to reconstruct the 1995 MSED accounting records utilizing contractual services personnel. However, this process was not adequate for the production of complete, reliable, timely, and consistent financial information of the program.

As stated in our 1994 report, FM should process, record, and verify accounting information on a timely basis, and with an appropriate monitoring and review by FM and program management.

Compliance with Laws and Regulations

Compliance with laws and regulations applicable to MSED is the responsibility of USAID's management. During our engagement to audit the financial statements, we performed tests of MSED's compliance with certain provisions of laws and regulations. However, the objective of our engagement to audit the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Laws and regulations applicable to MSED include:

- Eligibility provisions of Title III of the Foreign Assistance Act of 1961, as amended;
- The Chief Financial Officers Act of 1990;
- The Budget and Accounting Act of 1950, as amended;
- The Federal Managers Financial Integrity Act of 1982; and
- The Federal Credit Reform Act of 1990.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions contained in statutes or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations may be material to the financial statements, or if the sensitivity of the matter would cause it to be perceived as significant by others. The material weaknesses in internal control discussed above indicates that management is not in compliance with certain provisions of the following laws and regulations:

- The Federal Managers Financial Integrity Act of 1982; and
- The Budget and Accounting Procedures Act of 1950, as amended.

These instances of noncompliance are required to be reported herein under *Government Auditing Standards*.

Management's Responsibilities

Management has responsibility for:

- Preparing the financial statements in accordance with the comprehensive basis of accounting described in Note 1 to the financial statements;
- Establishing and maintaining an internal control structure; and
- Complying with applicable laws and regulations.

Management is also responsible for obtaining audit coverage that is broad enough to help fulfill the reasonable needs of potential users of the audit report. With respect to audit coverage of internal controls and compliance with laws and regulations, we were engaged to perform those procedures required in a financial statement audit conducted in accordance with generally accepted government auditing standards. Those procedures were not sufficient to provide a basis for expressing an opinion on internal controls or compliance. Had we been engaged to apply additional agreed-upon procedures or perform an examination of controls or compliance with laws and regulations, we might have discovered and reported deficiencies in internal controls or instances of noncompliance in addition to those reported above.

Independent Auditors' Responsibilities

Except as discussed in the following paragraph, we were engaged to audit the financial statements in accordance with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*.

Also, as requested by the USAID Office of the Inspector General, the procedures we conducted did not address the requirement in OMB Bulletin No. 93-06 to obtain an understanding of the internal control structure and to assess risk with respect to management's policies and procedures for the preparation of performance information. This audit requirement was addressed by the OIG.

Distribution

This report is intended for the information of the U. S. Congress, the management of USAID, and the Office of the Inspector General for USAID. This restriction is not intended to limit distribution of this report when it becomes a matter of public record.

Deloitte & Touche LLP

June 21, 1996

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 1995 AND 1994
(In Thousands)

ASSETS	1995	1994
ENTITY ASSETS:		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 7)	$ 6,527	$ 4,246
Restricted Fund Balance with Treasury (Note 7)	5,362	5,362
Fund Balance with USAID	12	12
Accounts Receivable	5	67
Governmental Assets:		
Accounts Receivable - Net (Note 5)	280	117
Loans Receivable, Pre-Credit Reform - Net (Note 4)	3,402	4,137
Loans Receivable, Credit Reform - Net (Note 4)	895	910
Total Entity Assets	16,483	14,851
NON-ENTITY ASSETS	3	3
TOTAL ASSETS	$ 16,486	$ 14,854

LIABILITIES AND NET POSITION	1995	1994
LIABILITIES COVERED BY BUDGETARY RESOURCES:		
Intragovernmental Liabilities:		
Other Funded Liabilities (Note 6)	$ 1,546	$ 1,175
Accrued Payroll and Benefits	79	-
Governmental Liabilities:		
Liabilities for Loan Guarantees - Pre-Credit Reform (Note 3)	817	1,079
Liabilities for Loan Guarantees - Credit Reform (Notes 2 and 3)	936	693
Accounts Payable	111	139
Deferred Revenue	285	233
Total Liabilities Covered by Budgetary Resources	3,774	3,319
Liabilities not Covered by Budgetary Resources - Accrued Leave	37	25
Total Liabilities	3,811	3,344
NET POSITION:		
Appropriated Capital, Pre-Credit Reform	407	1,252
Appropriated Capital, Credit Reform	8,170	6,941
Cumulative Results of Operations	4,135	3,342
Future Funding Requirements	(37)	(25)
Total Net Position	12,675	11,510
TOTAL LIABILITIES AND NET POSITION	$ 16,486	$ 14,854

The accompanying notes are an integral part of these financial statements.

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

STATEMENTS OF OPERATIONS
YEARS ENDED SEPTEMBER 30, 1995 AND 1994
(In Thousands)

	1995	1994
REVENUES AND FINANCING SOURCES:		
Appropriated Capital Used	$ 1,516	$ 2,049
Interest and Penalties, Governmental	272	197
Interest, Intragovernmental	45	76
Other Revenues and Financing Sources	284	314
Total Revenues and Financing Sources	2,117	2,636
EXPENSES:		
Operating Expenses (Note 8)	1,029	1,528
Interest, Intragovernmental	57	103
Lender Training Expenses (Note 9)	214	261
Provision for Subsidy Expense - Guarantees (Note 3)	275	174
Provision for Subsidy Expense - Loans (Note 4)	-	116
Provision for Uncollectible Loans and Interest - Pre-Credit Reform	(251)	953
Total Expenses	1,324	3,135
EXCESS (DEFICIENCY) OF REVENUES AND FINANCING SOURCES OVER EXPENSES	$ 793	$ (499)

The accompanying notes are an integral part of these financial statements.

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

STATEMENTS OF CHANGES IN NET POSITION
YEARS ENDED SEPTEMBER 30, 1995 AND 1994
(In Thousands)

	Appropriated Capital				
	Pre-Credit Reform	Credit Reform	Cumulative Results of Operations	Future Funding Requirement	Net Position
BALANCE AT OCTOBER 1, 1993	$ 7,119	$ 6,516	$ 6,890	$ (24)	$ 20,501
Unobligated Funds Returned to Treasury	(4,672)	-	(3,228)	-	(7,900)
Appropriations Received	-	1,000	-	-	1,000
General USAID Appropriations	-	1,474	-	-	1,474
Appropriations Expensed	-	(2,049)	-	-	(2,049)
Masstock Loan Transfer - Net (Note 4)	(1,125)	-	-	-	(1,125)
Deficiency of Revenues and Financing Sources over Expenses	-	-	(498)	(1)	(499)
Other	(70)	-	178	-	108
BALANCE AT SEPTEMBER 30, 1994	1,252	6,941	3,342	(25)	11,510
Unobligated Funds Returned to Treasury	(845)	(385)	-	-	(1,230)
Appropriations Received	-	2,000	-	-	2,000
General USAID Appropriations	-	-	-	-	-
Appropriations Expensed	-	(386)	-	-	(386)
Excess of Revenues and Financing Sources over Expenses	-	-	793	(12)	781
BALANCE AT SEPTEMBER 30, 1995	$ 407	$ 8,170	$ 4,135	$ (37)	$ 12,675

The accompanying notes are an integral part of these financial statements.

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U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 1995 AND 1994
(In Thousands)

	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (Deficiency) of Revenues and Financing Sources over Expenses	$ 793	$ (499)
Adjustments Affecting Cash Flows:		
Provision for Subsidy Expense - Guarantees	275	174
Provision for Subsidy Expense - Loans	-	116
Provision for Uncollectible Loans and Interest - Pre-Credit Reform	(251)	953
Claim Losses Realized - Credit Reform	(61)	(80)
Claim Losses Realized	(63)	(130)
Changes in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable, Governmental	(256)	33
Decrease (Increase) in Accounts Receivable, Intragovernmental	62	(16)
Decrease in Other Assets	-	125
Increase in Other Liabilities	371	927
Increase (Decrease) in Accrued Payroll and Benefits	79	(3)
(Decrease) Increase in Liabilities for Loan Guarantees - Credit Reform	31	162
(Decrease) in Accounts Payable, Governmental	(28)	(173)
Increase in Deferred Revenue, Governmental	52	91
Increase in Liabilities not Covered by Budgetary Resources	12	1
Net Cash Provided by Operating Activities	1,016	1,681
CASH FLOWS FROM FINANCING ACTIVITIES:		
Unobligated Funds Returned to Treasury	(1,230)	(7,900)
Appropriations Received	2,000	1,000
General USAID Appropriations	-	1,474
Loan Disbursements and Capitalization of Interest - Pre-Credit Reform	-	(1,288)
Loan Disbursements - Credit Reform	-	(1,000)
Loan Principal Repayments	881	3,042
Appropriations Expensed	(386)	(2,049)
Decrease (Increase) in Restricted Fund Balance at Treasury	-	171
Net Cash Provided by (Used in) Financing Activities	1,265	(6,550)
NET CASH PROVIDED BY (USED IN) OPERATING AND FINANCING ACTIVITIES	2,281	(4,869)
FUND BALANCE WITH TREASURY, BEGINNING OF YEAR	4,246	9,115
FUND BALANCE WITH TREASURY, END OF YEAR	$ 6,527	$ 4,246

The accompanying notes are an integral part of these financial statements.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

STATEMENTS OF BUDGETARY RESOURCES AND ACTUAL EXPENSES
YEARS ENDED SEPTEMBER 30, 1995 AND 1994
(In Thousands)

	1995	1994
Budget Resources	$ 11,253	$ 4,338
Budget Obligation	2,077	2,615
Total Unobligated Balance	$ 9,176	$ 1,723

Budget Reconciliation:		
Total Expenses	$ 1,324	$ 3,135
Budget Resources Expended That Are Not Included in Actual Expenses:		
Loan Disbursements and Capitalization of Interest	-	2,288
Expenses Not Covered by Budgetary Authority:		
Increase in Payables	(453)	(913)
Decrease (Increase) in Deferred Revenue	52	(91)
(Decrease) Increase in Receivables	(194)	17
Items not requiring outlays:		
Provision for Subsidy Expense - Guarantees	(275)	(174)
Provision for Subsidy Expense - Loans	-	(116)
Provision for Uncollectible Loans and Interest	251	(953)
Claim Losses Realized	124	210
Less Reimbursements:		
Loan Principal Repayments	(881)	(3,042)
Revenues and Financing Sources	(2,117)	(2,636)
Accrued Expenditures, Direct	$ (2,169)	$ (2,275)

The accompanying notes are an integral part of these financial statements.

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
MICRO AND SMALL ENTERPRISE DEVELOPMENT PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 1995 and 1994

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Micro and Small Enterprise Development Program (MSED), formerly the Private Sector Investment Program (PSIP), is administered by the Bureau for Global Programs of the U. S. Agency for International Development (USAID), an agency of the U. S. Government. MSED operates with funding provided by (a) MSED's subsidy appropriation; (b) MSED's administrative expense appropriation; (c) The Private Sector Revolving Fund; (d) the Functional Development Assistance Fund; (e) USAID's operating expenses appropriation; and (f) Guarantee budget authority. USAID's Loan Management Division of the Office of Financial Management performs the accounting functions for MSED.

In 1983, a Private Sector Revolving Fund was established to promote economic growth led by the private sector by increasing the flow of credit and cooperatives in developing countries. The Revolving Fund was authorized by the International Security and Development Assistance Authorization Act of 1983, which added Section 108 to the Foreign Assistance Act of 1961, as amended. Provisions of the legislation state that funded loans should:

- Have a demonstration effect;
- Be innovative;
- Be financially viable;
- Support enterprise that will maximize the development impact on the host country;
- Provide support and services not generally available to small business enterprise; and
- Provide capital at or near the interest rate available to the recipient.

In addition, the legislation provides that not more than $3 million may be available for any one project and, further, that not more than 20 percent of the assets may be dedicated to any one country.

The Omnibus Trade and Competitiveness Act of 1988 added Loan Guarantee Authority to the Direct Lending Authority of the Revolving Fund. Congress intended that loan guarantees, backed by the full faith and credit of the U. S. Government, would help mobilize credit in developing country financial markets for private sector growth. Because MSED shares the risk associated with lending in the small business sector, private lending institutions operating in developing countries are encouraged to extend more market rate financing to small businesses.

MSED is subject to the Federal Credit Reform Act of 1990 (PL 101-508) (Credit Reform), which became effective as of October 1, 1991. The primary objective of Credit Reform was to identify the costs inherent in federal credit programs so that they may be compared more easily with the costs of other federal spending.

In fiscal year 1993, a comprehensive phase-out plan for PSIP was approved by USAID's senior management. However, recognizing the importance of micro and small businesses to economic growth and desiring to increase the access of micro and small enterprises to financial markets, USAID's senior management instructed the unit to preserve and repackage the "best elements" of PSIP for use in efforts to encourage broad-based, economic growth. Commencing in fiscal year 1994, MSED was formed for this purpose. The PSIP portfolio is now incorporated into MSED.

B. Basis of Presentation

The financial statements have been prepared to report the financial position and results of operations of MSED as required by the Chief Financial Officers Act (CFO Act) of 1990. They have been prepared from the books and records of MSED, in accordance with the Office of Management and Budget's (OMB) Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, and the Program's accounting policies, which are summarized in this Note. These statements are therefore different from the financial reports also prepared by MSED pursuant to OMB directives that are used to monitor and control MSED's use of budgetary resources. OMB Bulletin 94-01 is considered to be a comprehensive basis of accounting other than generally accepted accounting principles (GAAP). The principal difference between GAAP and OMB Bulletin 94-01 as it applies to MSED is in the accounting for the effects of the Credit Reform Act (Note 2).

C. Basis of Accounting

Transactions are recorded on a accrual accounting basis and on a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

D. Fund Balance with Treasury

Cash receipts and disbursements are processed by the U. S. Treasury. Fund Balance with Treasury is available to pay current liabilities and to finance authorized purchase commitments.

E. Restricted Fund Balance with Treasury

Restricted unobligated balance amounts relate to expired authority, and holdings which have not been transferred into the general fund as of September 30, 1995, but are unavailable for use. The expired unobligated balances retain their fiscal year identity for five fiscal years. At the end of the five-year period, the unobligated balances are closed.

F. Fund Balance with USAID

USAID holds funds with the U. S. Treasury from which it pays operating expenses that are not paid by MSED's operating expenses fund. At year-end, amounts remaining, which are obligated by USAID to pay for the MSED's accounts payable and accrued payroll and benefits, are reflected on the statement of financial position as the fund balance with USAID.

G. Loans Receivable - Pre-Credit Reform

Loans Receivable Pre-Credit Reform consist of direct loans made to developing country borrowers and to other foreign institutions to increase the flow of credit to individuals and entities in developing countries. In addition, MSED makes loans to U. S. institutions, which then issue standby letters-of-credit to banks in developing countries to help increase the flow of credit to indigenous small businesses in the developing country.

These loans are recorded net of an allowance for uncollectible loans and interest (Note 3). The estimated amount for the allowance for uncollectible loans and interest is based upon past experience, present market conditions, and an analysis of the outstanding balance.

Loan set-offs occur when a developing country bank draws on a standby letter-of-credit as a result of defaults by their borrowers. In this instance, the amount drawn down on the standby letter-of-credit will not be repaid to MSED by the U. S. institution and the balance of loans receivable is reduced by the amount of the set-off. Any future loan recoveries are recorded in the period received.

Loan balances which are delinquent for 90 days or more are placed in a nonaccrual status. Any accrued but unpaid interest receivable on such loan balances is eliminated through an adjustment against current period interest income.

MSED did not make any new loans or modify any existing loans in fiscal year 1995.

H. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by MSED as a result of a transaction or event that has already occurred. However, no liability can be paid by MSED absent an appropriation. Liabilities for which an appropriation has not been enacted are therefore classified as Liabilities Not Covered by Budgetary Resources, since there is no certainty that the appropriation will be enacted.

I. Liabilities for Loan Guarantees

The Liabilities for Loan Guarantees - Pre-Credit Reform provide for losses inherent in the guarantee operation for pre-Credit Reform activity. These liabilities represent a general reserve, available to absorb losses related to loan guarantees on loans outstanding. The loan guarantees represent off-balance-sheet commitments (Note 3). The provision for losses on guarantees is based on management's evaluation of the participating financial institution, underlying transaction risk, as well as a review of the country risk.

The Liabilities for Loan Guarantees - Credit Reform is the estimated long-term costs to the Government of loan guarantees, calculated on a net present value basis, for post-Credit Reform activity. The subsidy is accrued once guarantee documents are signed and committed, and is reestimated annually. The liability is estimated based on a financial model developed by OMB.

J. Deferred Revenues

Origination fees and facility fees in excess of direct origination costs are deferred and recognized over the life of the guarantee as an adjustment to fee income.

K. Accrued Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rate. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of unvested leave are expended as taken.

L. Liabilities not Covered by Budgetary Resources and Future Funding Requirements

Future Funding Requirements consist of the outstanding balance of accrued leave at the end of the fiscal year. The balance of Liabilities not Covered by Budgetary Resources Expenses is comprised of the increase or decrease for the fiscal year in the accrued annual leave liability. These expenses will be funded through appropriations to USAID in the years in which the leave is taken by employees.

M. Other Revenues and Financing Sources

Other Revenues and Financing Sources represent fees earned on both direct loans and outstanding guarantee balances.

N. Statement of Cash Flows

Where operating activities are financed by non-cash transactions, they are not reflected in the Statement of Cash Flows. A portion of the Accounts Payable, is funded by the increase in Fund Balance with USAID. The increase in the Accrued Annual Leave Liability is funded by the increase in Future Funding Requirements.

2. CREDIT REFORM

The Federal Credit Reform Act of 1990, which became effective on October 1, 1991, has significantly changed the manner in which MSED finances its credit activities. The primary purpose of this Act is to more accurately measure the cost of Federal credit programs and to place the cost of such credit programs on a basis equivalent with other Federal spending. Consequently, commencing in 1992 MSED's activities were funded through direct appropriation provided for that year only, rather than through cumulative appropriations granted in prior years and accumulated under the Revolving Fund.

In fiscal years 1995 and 1994, the Program received appropriations totaling \$2 million and \$1 million, respectively. The appropriations were used to cover the estimated subsidy cost of new guarantee activity.

When guarantee commitments are made, MSED records a guarantee reserve in the program account (the budget account into which appropriations to cover the cost of MSED's credit programs are made). This guarantee reserve is based on the present value of the estimated net cash outflows (if any) to be paid by MSED as a result of the loan guarantees, except for administrative costs, less the net present value of all revenues to be generated from those guarantees. As discussed above, when the guarantee reserve is established, an obligation is recorded against budget authority (appropriation).

When the loans guaranteed by MSED are disbursed, MSED transfers from the program account to the financing account (a non-budget account that holds balances, receives the cost payment from the program account, and includes all other cash flows to and from the Government resulting from credit program commitments) the amount of the subsidy cost related to those loans. The amount of subsidy cost transferred, for a given loan, is proportionate to the amount of the total loan disbursed (Note 3).

3. COMMITMENTS AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

MSED is subject to risk for financial instruments not included in its Statement of Financial Position. These financial instruments are guarantees on loans which provide principal protection to lenders in developing countries against risks of lending to borrowers (Note 2). These guarantees may not exceed $3 million each, nor exceed 50 percent of the cost of the activity to be financed to any one borrower. MSED and the private lender share equally in the risk of default, and in any collateral or recoveries taken or realized by a lending bank. Total financial guarantees committed by MSED were $92.5 million and $81.6 million at September 30, 1995 and 1994, respectively.

A summary of guarantees committed and used, and related liability at September 30, 1995, is as follows (in thousands):

	USAID Guarantee Committed	USAID Guarantee Utilized	Liability
Pre-Credit Reform	$45,792	$10,331	$ 817
Credit Reform	46,750	13,204	936
	$92,542	$23,535	$1,753

The calculations of the Liability for Loan Guarantees - Credit Reform at September 30, 1995 and 1994, are as follows (in thousands):

	1995	1994
The present value of the cost of estimated defaults on guaranteed loans disbursed	$1,544	$739
The present value of the estimated fees to be collected on loans disbursed	(608)	(46)
Liabilities for Loan Guarantees - Credit Reform	$ 936	$693

The activity in the Liabilities for Loan Guarantees - Credit Reform account for each year is as follows:

	1995	1994
Beginning Balance	$693	$545
Provision for Subsidy Expense	275	174
Miscellaneous Fees	124	162
Subsidy Reestimate	(95)	(108)
Claims Losses Realized	(61)	(80)
Ending Balance	$936	$693

Guarantees committed prior to October 1, 1991, are not subject to Credit Reform. The activity in the Liabilities for Loan Guarantees - Pre-Credit Reform during fiscal years 1995 and 1994 is as follows (in thousands):

	1995	1994
Liabilities for Loan Guarantees - Pre-Credit Reform, Beginning of Year	$ 1,079	$ 1,096
Provision for Uncollectible Loans and Interest	(199)	113
Claim Losses Realized	(63)	(130)
Liabilities for Loan Guarantees - Pre-Credit Reform, End of Year	$ 817	$ 1,079

4. LOANS RECEIVABLE

Loans Receivable represents direct loans to borrowers. Loans are accounted for as receivable when funds are disbursed. Loans Receivable is reduced by an allowance for doubtful accounts. The estimate for the allowance for doubtful accounts for Pre-Credit Reform Loans is based upon past experience, present market conditions, and analyses of outstanding balances. Such loans receivable, net of allowance for doubtful accounts, by geographical area at September 30, 1995 and 1994, consist of the following (in thousands):

	1995	1994
Africa	$ 50	$ 100
Asia	2,262	2,694
Latin America & Caribbean	2,868	3,267
Multi-Regional/Country	1,562	1,562
Total Loans Receivable	6,742	7,623
Less: Allowance for Doubtful Accounts	(3,340)	(3,486)
Loans Receivable, Pre-Credit Reform - Net	$ 3,402	$ 4,137

Changes to the Allowance for Doubtful Accounts for the years ended September 30, 1995 and 1994, were as follows (in thousands):

	1995	1994
Allowance, Beginning of Year	$ 3,486	$ 4,578
Provision for Uncollectible Loans and Interest	(146)	835
Masstock Reserve Transfer	-	(1,858)
Loan Set-offs	-	(69)
Allowance, End of Year	$ 3,340	$ 3,486

MSED had a loan to Masstock, Zambia, recorded in the amount of $1.1 million, which represented the net of the original loan in the amount of $2.9 less a provision for uncollectible loans and interest of $1.8 million. This net loan was transferred to another government agency in fiscal year 1994.

During fiscal year 1994, the interest rate on the loan to Accion was modified. The loan to Accion was authorized prior to the Credit Reform Act. The loan was modified in accordance with Statement of Federal Financial Accounting Standard Number 2 (SFFAS No. 2), and it was recorded as the sole Credit Reform loan for MSED. The composition of the Accion loan and related allowance is as follows:

	1995	1994
Loan Receivable - Accion	$ 1,000	$ 1,000
Less: Provision for Subsidy Expense	(105)	(90)
Loan Receivable, Credit Reform - Net	$ 895	$ 910
Beginning Provision for Subsidy Expense	$ 90	$ -
Provision for Subsidy Expense	-	116
Subsidy Reestimate	15	(26)
Provision for Subsidy Expense	$ 105	$ 90

5. ACCOUNTS RECEIVABLE

Accounts receivable, Governmental, represents accrued interest earned on the loans receivable and accrued fees earned on both direct loans and outstanding guaranty balances. The balances at September 30, 1995 and 1994, are as follows (in thousands):

	1995	1994
Accounts Receivable	$ 404	$ 131
Less: Allowance for Doubtful Accounts	(124)	(14)
Accounts Receivable	$ 280	$ 117

6. OTHER FUNDED LIABILITIES

Other Funded Liabilities, Intragovernmental, are as follows at September 30, 1995 and 1994 (in thousands):

	1995	1994
Unobligated Funds - Transferrable to Treasury	$ 623	$ 252
Principal Payable to Treasury	923	923
Total - Other Funded Liabilities	$ 1,546	$ 1,175

7. FUND BALANCES WITH TREASURY AND NET POSITION

Appropriated capital is disclosed separately for Pre-Credit Reform and for Credit Reform to reflect the effects of Credit Reform on MSED's net position. Capital accumulated through September 30, 1991 can only be used to finance credit activities which were originated prior to September 30, 1991. Capital appropriated in fiscal years 1992 and beyond, under Credit Reform, is designated for specific years' credit activities. The fiscal year 1994 appropriated capital related to Credit Reform is $6.9 million. Of this amount, $5.3 million was appropriated for guarantee and lending activity, however, was not used for these purposes. $1.6 million was available for guarantee commitments. The fiscal year 1995 appropriated capital related to Credit Reform is $8.2 million. Of this amount, $5.3 million was appropriated for guarantee and lending activity, however, was not used for these purposes. $2.9 million was available for guarantee commitments.

Cumulative results of operations for MSED included the revenues and expenses of the Private Sector Revolving Fund since inception. As discussed above, the unobligated funds for MSED were transferred to Treasury in accordance with Credit Reform Act.

Fund Balance with Treasury represents undisbursed obligations for MSED's account with the U. S. Treasury. Prior to September 30, 1991, the Fund Balance with Treasury also included unobligated funds. As of September 30, 1991, all unobligated funds were transferred to the general fund, and there have been no further appropriations other than permanent indefinite appropriations for actual and estimated defaults on guarantees occurring prior to October 1, 1991, and for subsidy costs of Credit Reform Appropriations. Accordingly, $1.2 million and $7.9 million of unobligated funds for MSED were transferred to Treasury in fiscal years 1995 and 1994, respectively.

Because these unobligated funds were no longer available for use by MSED, the Fund Balance with Treasury, Appropriated Capital, and Cumulative Results of Operations have been reduced by these amounts at September 30, 1995 and 1994. The Fund Balances at September 30, 1995 and 1994 are as follows (in thousands):

	September 30, 1995			September 30, 1994		
	Available	Restricted	Total	Available	Restricted	Total
Revolving Funds	$3,621	$ -	$ 3,621	$2,670	$ -	$2,670
Appropriated Funds	2,906	5,362	8,268	1,576	5,362	6,938
Total	$6,527	$5,362	$11,889	$4,246	$5,362	$9,608

8. OPERATING EXPENSES

Operating Expenses by object classification for fiscal years 1995 and 1994 are as follows (in thousands):

Object Classification	1995	1994
Salaries and Benefits	$ 460	$ 670
Contractual Services	347	388
Operational Travel	63	69
Overhead	110	291
Rent	34	39
Audit Cost and Other Expenses	15	40
Loss on Accion Loan Modification	-	31
Total Operating Expenses	$ 1,029	$ 1,528

9. LENDER TRAINING EXPENSES

MSED contracts with a private firm to conduct a lender training program. This program is designed to enhance the skills of personnel in the financial services sector in developing countries. The lender training activity is the only function performed by MSED that does not pertain to providing credit, and as a result it is separately disclosed on the Statement of Operations.

10. RETIREMENT PLAN

MSED employees are covered by one of four retirement plans, the Civil Services Retirement System (CSRS), the Federal Employee Retirement System (FERS), the Foreign Services Pension System (FSPS), or the Foreign Services Retirement and Disability System (FSRDS). The Agency contributes approximately 7.5 percent of an employee's gross salary for CSRS and FSRDS, and approximately 24 percent of an employee's gross salary for FERS and FSPS.

In addition, employees may elect to participate in the Thrift Savings Plan (TSP). Under this plan, FERS and FSPS employees may elect to have up to 10 percent of gross earnings withheld from their salaries, and receive matching contributions from a minimum of 1 percent to a maximum of 5 percent. CSRS and FSRDS employees may elect to have up to 5 percent of gross earnings withheld from their salaries, but do not receive matching contributions.

Although MSED funds a portion of employee pension benefits and makes necessary payroll withholdings, it has no liability for future payments to employees under the programs, nor is it responsible for reporting the assets, actuarial data, accumulated plan benefits, or any unfunded pension liability of the retirement plan. Reporting of such amounts is the responsibility of the U. S. Office of Personnel Management and the Federal Retirement Thrift Investment Board. Data regarding actuarial present value of accumulated benefits, assets available for benefits, and unfunded pension liability are not allocated to individual departments and agencies.

11. INTRA-GOVERNMENTAL TRANSACTIONS

MSED is subject to the financial decisions and management and controls of USAID, which in turn is subject to the financial decisions and management controls of OMB. As a result of these relationships, MSED's operations may not be conducted nor its financial position reported as they would be if MSED were an autonomous entity.

MSED provides training in credit management to program participants. Program participants generally are selected employees of banking institutions in developing countries. This aspect of the Program provides a benefit not only to MSED but also to USAID Missions. MSED does not receive any reimbursements for this benefit.

As discussed in Note 10, MSED does not account for those aspects of the pension liability, assets, and expenses which are the responsibility of the Office of Personnel Management and the Federal Retirement Thrift Investment Board.

* * * * * *

Executive Summary

Fiscal Year 1995 was the second year of operation for the Micro and Small Enterprise Development Program (MSED), the successor to the Private Sector Investment Program (PSIP). Based on the decision of the USAID Administrator, the best elements of PSIP were retained and reformulated as MSED during FY 1993 to focus exclusively on addressing the financial needs of small and micro businesses. MSED uses a combination of training, partial loan guarantees, and direct loans to build long-term and sustainable links between formal financial institutions and micro and small enterprises otherwise lacking full access to formal credit markets.

The creation of MSED coincided with the Agency's reorganization. In that reorganization, the Private Enterprise Bureau was subsumed within the newly created Global Bureau, which serves as the home to USAID's technical staff. The Global Bureau is divided into five Centers, each of which are generally aligned with one of the Agency's strategic objectives. The Office of Investment, which manages MSED, was renamed the Office of Credit and Investment Staff (CIS), and is part of the Economic Growth Center.

The Overview and Program Performance sections describe the events of FY 1995 in greater detail. These sections summarize MSED's FY 1995 operations, and highlight significant subsequent events.

The Micro and Small Enterprise Development Program

MSED is a credit-financed program which seeks to promote the private sector in developing countries by increasing the access to bank credit for small and micro enterprises. FY 1995 funding for MSED was provided by the FY 1995 Foreign Operations, Export Financing, and Related Programs Appropriations Act, which appropriated $1.5 million to cover the subsidy costs of direct loans and loan guarantees, as authorized by section 108 of the Foreign Assistance Act of 1961 (Public Law 87-195) and the Foreign Assistance Appropriations (Public Law 103-87) dated January 1994. Section 108 was enacted in 1983 in recognition of the pivotal role of private enterprise in fostering broad-based economic growth.

MSED's portfolio is administered by the U.S. Agency for International Development (USAID). Its programs and activities are managed through USAID's Credit and Investment Staff, located within the Global Bureau's Center for Economic Growth.

Legislative Mandate and Mission of MSED

With its primary focus on micro and small business development, MSED is designed to: (1) stimulate the growth and expansion of private enterprise activity in Less Developed Countries (LDCs) by facilitating access to credit for micro and small businesses; (2) develop innovative financing mechanisms that address imperfections in the credit markets which inhibit micro and small business development; and (3) strengthen the capacity of indigenous financial institutions to engage in micro and small business lending through targeted training programs. Section 108 (c) (2) of the enabling legislation stipulates that assistance should be provided at or near market rates of interest, to support private sector activities which:

- have a demonstration effect;
- are innovative;
- are financially viable;

- maximize development impact appropriate to the host country; and
- are primarily directed to making support and services available to small business enterprises.

MSED Facilities

In response to its legislative mandate to support small and micro enterprise development, MSED operates a number of direct loan and guarantee vehicles in an effort to meet the changing needs of the small and micro entrepreneurs in the developing world. While direct loans continued to be part of the portfolio for select development purposes, guarantees comprise the majority of MSED program activity. Types of MSED facilities include:

Guarantees

- Loan Portfolio Guarantees (LPG) -- the primary tool of the program, designed to share risk with financial institutions to encourage them to increase credit flows to micro and small businesses.

- Bond Guarantees -- designed to help introduce an important financial instrument to LDC financial markets and expand the capital available for micro and small business lending.

- Resource Mobilization Guarantees -- designed to redirect liquidity from companies, pension funds and the insurance industry to the small business sector.

- Privatization Guarantees -- designed to support privatization, particularly through employee/management buy-outs, in USAID-assisted countries.

- Term Loan Portfolio Guarantees -- designed to extend the maturity of loans to small businesses through partial guarantees of term loans (loans of greater then two years).

Direct Loans

- Direct Project Loans -- used to finance developmentally desirable private sector projects in LDCs.

- Bridge loans -- used to foster the sustainability of Private Voluntary Oganizations (PVOs) and Non-Govermental Organizations (NGOs) engaged in micro-finance through their overseas affiliates. The loans are used by MSED borrowers as collateral for letters of credit issued to banks overseas. The letters of credit guarantee commercial-rate loans made to the borrower's affiliates.

- Loan Backed Guarantees/Letters of Credit (To be phased out) -- used before MSED and PSIP had the authority to issue guarantees directly, these loans secured letters of credit in favor of LDC financial institutions making loans to indigenous small businesses.

Graphic A summarizes the number and type of facilities in the MSED portfolio.

Graphic A - MSED Portfolio Summary*
as of September 30, 1995

Authority Type	Project Type	No. of Projects	Obligated Amount ($ millions)	% of Portfolio (based on $)
Guarantee				
	Bond (BND)	4	$8.5	9.6%
	Privatization (PRV)	3	15.0	17.0%
	Franchising (FRA)	0	0.0	0.0%
	Resource Mobilization (RMG)	1	1.2	1.4%
	Small Business Loan Portfolio (LPG)	41	61.6	69.7%
	Term Loan Portfolio Guarantee (TRM)	3	2.0	2.3%
	Subtotal - Guarantees:	52	$88.3	100.0%
Direct Loan				
	Direct Project (DIL)	5	7.1	62.4%
	Letter of Credit/Guarantee (LNG)	3	4.3	37.6%
	Subtotal - Direct Loans:	8	$11.3	100.0%
TOTAL		60	$99.6	

* Includes active facilities as of 09/30/95, not including grant of $517,000 to ACCION.

The Credit and Investment Staff works in conjunction with USAID Missions in all geographical regions, as well as with other USAID Bureaus and Offices, primarily to address the credit needs of micro and small enterprises in the private sector in developing countries. Graphic B illustrates the regional scope of MSED's activities on September 30, 1995.

Graphic B - Summary by Geographic Region*

Region	Total Obligations ($ Millions)	% of Portfolio	No. of Projects
Africa & Near East	$30.3	30.4%	22
Asia	35.5	35.6%	23
Latin America & Caribbean	26.2	26.3%	10
Europe	5.0	5.0%	2
Worldwide	2.6	2.6%	3
TOTAL	$99.6	100.0%	60

* Includes active facilities as of 09/30/95, not including grant of $517,000 to ACCION.

Bank Training Program

Supplementing MSED's loan guarantee and direct loan programs is a Bank and Borrower Training Program. This program, which is performed by a private firm under contract to USAID, was designed to complement the loan/guarantee program with a two-fold purpose: 1) to work with intermediary financial institutions to improve their capacity to evaluate, structure and manage micro and small business loans, emphasizing cash-flow based lending techniques to counter the traditional LDC bank requirement for high collateral; and 2) to help small business owners improve their financial management techniques, as well as increase their knowledge of how to obtain and repay loans successfully. Because of the importance of combining training with partial guarantees, the Bank and Borrower Training Program has been continued and expanded under MSED.

Credit Reform

Funding for MSED is subject to the Credit Reform Act of 1990 (Public Law 101-508). Prior to Credit Reform, funding for the Private Sector Investment Program began with annual direct appropriations to a revolving fund beginning in FY 1984 and ending in FY 1989. These totalled $76.0 million. With the enactment of Credit Reform legislation, which governs all U.S. Government loan and guarantee programs, prior Revolving Fund assets were no longer available for new PSIP activities. Under the rules and principles of credit reform, first effective in FY 1992, budget authority is appropriated for the estimated "true cost" (also referred to as the "subsidy" cost) of new loan and guarantee projects. The estimated true cost is calculated for each project based on the present value of the estimated net cash outlays over the project's life.

In FY 1995 CIS obligated a total of $1,416,300 in appropriated budget authority to support both new and modified guarantees, and a direct loan. Of the total subsidy obligated, $1,240,200 was used to establish $20.25 million in new guarantees, $74,100 was used to increase two existing guarantee by $3.5 million, and $102,000 in subsidy was used to provide a $1.0 million direct loan. Thus, the total amount of credit mobilized in FY95 under the program was $48.5 million (two times the guaranteed amount plus the direct loan). FY 1994 commitments resulted in the obligation of $992,900 in budget authority, FY 1993 projects utilized $743,000 in budget authority, and FY 1992 projects utilized $588,000 in budget authority. As required by Credit Reform, in addition to USAID general appropriations, administrative operations, e.g., overhead, audit and travel costs, were funded by appropriations to the MSED program.

PROGRAM PERFORMANCE

Operational Summary

During FY 1995, a total of $1.31 million in guarantee authority was committed to support thirteen new facilities in nine different countries, and to modify two existing facilities in South Africa (see table below). These included loan guarantee facilities to increase the flow of credit to small and micro enterprises in Africa, Asia, Latin America, and Eastern Europe. The total subsidy obligated for all project activities was $1,416,300, not including reestimates of previous facilities. In total, 60 facilities, to 56 separate financial institutions in twenty-one countries, had active MSED facilities at the end of 1995 (including three Private Voluntary Organizations or Non-Governmental Organizations).[1] This compares

[1]Excludes grant to Accion International.

with 59 financial institutions participating at the end of FY 1994.

In summary, the program's resources were used to:

- encourage Sri Lankan commercial banks to increase the maturity of loans made to Sri Lankan-owned small businesses through new Term Loan Guarantees;
- increase the level of capital available to a Bolivian bank for lending to microenterprises through the issuance of USAID guaranteed bonds;
- assist banks in Poland and Hungary to provide credit to indigenous small businesses; and
- encourage wider participation in the economy in Zimbabwe through small business guarantee facilities with two local financial institutions.

Africa

Barclays Bank of Zimbabwe -- Guarantee to Support Small & Micro Business Lending
Stanbic Bank -- Guarantee to Support Small & Micro Business Lending
Barclays Bank of Kenya -- Term Guarantee to Increase the Maturity of Small Business Loans
Nedcor -- Modification of Guarantee to Support Small & Micro Business Lending
First National Bank of South Africa -- Modification of Guarantee to Support Small & Micro Business Lending

Asia

Bank NISP -- Guarantee to Support Small & Micro Business Lending
Hatton National Bank -- Guarantee to Support Microenterprise Lending
Hatton National Bank -- Term Guarantee to Increase the Maturity of Small Business Loans
Seylan Bank Ltd. -- Term Guarantee to Increase the Maturity of Small Business Loans

LAC

Banco Sol -- Bond Guarantee
Bancasa -- Guarantee to Support Small & Micro Business Lending

Europe

Amerbank -- Guarantee to Support Small & Micro Business Lending
OTP -- Guarantee to Support Small & Micro Business Lending

Worldwide

FINCA International -- Bridge Loan to Increase Liquidity for Microenterprise Lending

Performance Review

Performance Measures

The CIS has established new performance indicators intended to provide a more accurate measurement of the program's impact upon its target sector of micro and small enterprises. The performance indicators are organized by program objective. These objectives are in three primary areas: Institutional and Financial Sector Development, Small Business Development, and Program Management. Some of the new indicators require the collection of baseline data from participating financial institutions over several years. That information is currently being collected.

Performance Monitoring and Control Information System (PMCIS)

Recognizing the need for a system to collect data and assist in performance measurement, the CIS, in August 1992, contracted for the design of an automated system - PMCIS - to organize previously collected data in a logical format. Because development of the automated system was suspended as a result of the 1992 phase out, the upgrading of PMCIS to allow for the full processing of relevant performance data was delayed. That upgrade, which includes the development of a module to generate the performance indicators discussed under the Small Business Development section, is now near completion. Among our efforts to speed data processing, is the upgrading of the PMCIS system to allow for the electronic transfer of data from participating banks.

Institutional and Financial Sector Development

Training

MSED supports small business lending in less developed countries with tools other than guarantees and loans. To augment the guarantees, the CIS contracts with a private firm to conduct a training program to educate bankers and entrepreneurs in less developed countries in analyzing, administering, and applying for small business enterprise loans. The training seeks to ensure the sustainability of the CIS loan guarantee programs by enhancing the capacity of participating financial institutions to provide credit to micro and small borrowers.

The training is funded by the Development Assistance Fund under the provisions of sections 103-106 of the Foreign Appropriation Act of 1961 (Public Law 103-87). During FY 1995, the existing training contract expired and was subsequently replaced with a training services from a new contractor. For this reason, MSED only conducted 2 training sessions in 2 countries during FY 1995, with 45 bankers participating. The total spent during FY 1995 was $214,290.54 with $92,901.05 spent on training and $121,290.54 spent on developing new microenterprise training modules. During FY 1994, CIS held training in 8 countries with 396 individuals (244 bankers and 152 business owners) attending at a total cost of $301,912.68.[2]

Types of Facilities

One strength of PSIP was its ability to provide new and innovative tools to support sustainable economic growth in less developed countries. The variety of guarantee or loan products indicated the flexibility of the program in reaching markets that could not be reached through conventional methods of assistance. For example, in response to the need for innovative facilities, the CIS developed the Bond Guarantee Program and targeted specific small business lending activities under the LPG such as micro-enterprise and franchise lending. Each of these facilities is intended to have a positive "demonstration effect" on the local market economy.

Innovation will continue to be important under MSED. But, rather than create new applications of the Guarantee for multiple development purposes (e.g., privatization), the CIS will strive to be creative in finding ways to use guarantees and loans to increase the flow of credit to micro and small businesses. That was the case during 1994, when CIS utilized Term Guarantees, Bond Guarantees, Loan Portfolio Guarantees and Bridge Loans to mobilize credit for micro and small borrowers.

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[2] FY 1994 figures have been revised to reflect the proper treatment of accruals.

Small Business Development[3]

The ÇIS performance indicators on small business development are most meaningful when applied to individual facilities, rather than to the portfolio as a whole. The baseline questionnaire distributed this year is designed to collect data annually on the bank's small and micro enterprise lending activities, both under and outside the MSED guarantee program. After data collections have taken place over several years, it will be possible to assess the impact of the MSED Guarantee on the each bank's small and micro enterprise lending practices. In the mean time performance results will be analyzed on the basis of the MSED portfolio as a whole.

The following performance indicators have been incorporated into PMCIS as part of the recent upgrade. However, because data is constantly being updated, the actual numeric figures may change as data is supplied by our participating financial institutions. Each of the performance indicators discussed below is designed to be calculated for every year in the life of the facility.

Number and Size of Small Business Loans

MSED seeks to increase the availability of formal sector credit to micro and small business borrowers. The best evidence of the Program's success is the number of loans made by participating financial institutions to micro and small businesses. Increased loans, in combination with a reduction in average loan size, would indicate greater accessibility to formal sector financing for the target sector.

The number of sub-loans made during FY95 was 3,340, an increase from the 2,694 loans made in FY94 and 3,203 in FY93. This increase can be attributed to the growth in the number of mature or seasoned facilities in the portfolio. While the average loan size has been decreasing steadily for the past seven years, this year it rose to $6,814.66 compared to an average loan size of $5,544 in FY94. The average loan size in FY93 was $8,560. This small increase reflects an increase in the number of mature facilities that have emphasized small business, as opposed to microenterprise, lending.

First-Time Borrowers

This indicator measures the percentage of loans that are made to first-time borrowers. A goal of MSED is to extend credit to borrowers with no previous exposure to formal credit markets. Borrowers who are introduced to formal credit markets through the program are more likely to continue to have access to those markets after the program ends. In FY95, 79.12% of entered loans were made to first-time borrowers, compared to 73.5% in FY94 and 36.7% in FY93.[4] The large increase in 1994 was, in part, attributable to the increase in loans made by Hatton National Bank, which makes nearly all of its loans to first-time borrowers. The overall trend is viewed as positive.

Collateral Requirements

This indicator reflects the perceived risk of lending to the small/micro sector. A consistent reduction in collateral requirements indicates that MSED training programs combined with guarantees, are having a

[3]Statistics in this section are based on PMCIS data in the system as of December 4, 1995.

[4]These figures exclude loans from the Standard Bank of South Africa (SBSA), which is not required to answer this question because of its loan volume.

positive impact by teaching the financial institution to rely more on cash-flow analysis techniques. In addition, a decrease in collateral requirements also shows that the financial institution is increasingly comfortable lending to the small/micro sector. The average collateral requirement as a percentage of loan amounts was 38.04% in FY95, 57.51% in FY94, and 46.5% in FY93.[5] The decrease can be explained, in part, by the two facilities that make the most loans - Standard Bank of South Africa (SBSA) and Hatton National Bank.

Borrower Size

By measuring the median and average net asset size of borrowers over the life of the facility, it is possible to profile the beneficiaries of the guarantee program. Lower asset sizes are consistent with MSED's objectives and indicate a change in attitude of bankers towards small and micro enterprises. Generally, the average asset size of borrowers has decreased significantly over the past seven years. However, in FY95, the average net asset size was $20,407.80, up from $16,931 in FY94. In 1993 average asset size was $21,897.[6] Again, this increase can be attributed to the increase in the number of mature facilities lending primarily to small businesses, as opposed to microenterprises.

Majority Women-Owned/Managed Businesses

This indicator measures the percentage of loans under guarantee coverage that are made to majority women-owned or women-managed businesses.[7] In FY95, 27.92% of loans were made to majority women-owned or managed businesses, as compared to 24.2% in FY94 and 37.5% in FY93[6].

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[5] All loans made by SBSA are assumed to have an average 20% collateral requirement. SBSA requires borrowers to hold deposits, of approximately this amount, at the bank in lieu of collateral. Because the PMCIS defaults to 0, any other loans (not from Hatton or SBSA) listing 0 collateral were not included.

[6]The two primary microenterprise facilities, Hatton National Bank and Standard Bank of South Africa list the asset sizes of their borrowers as 0 because the asset sizes are negligible. Because PMCIS defaults to 0, these figures exclude all 0 asset sizes other than those from Hatton and SBSA, assuming that the question was not answered for those loans.

[7]Hatton answers the question on the Transaction Report about ownership composition, but does not answer the question about management composition. Consequently, it is only possible to determine the number of women-owned borrowers for Hatton.

[6]SBSA is not required to report on the gender of owners or managers. Thus, the 346 loans made by SBSA in FY 1995 were not included in the calculation.

Program and Risk Management

Internal management and risk indicators seek to measure the effectiveness with which management has utilized appropriated credit subsidy to establish its facilities and promoted utilization of facilities once established.

Utilization

The effectiveness of the program is represented, in part, by its utilization (i.e., total amount of direct loans disbursed compared to amount obligated, and outstanding sub-loan balances compared to maximum covered portfolio amounts for guarantees). Graphic C shows the amount of FY95 year-end assistance compared to outstanding obligations. Utilization in FY95 was 29.54% a decrease from 36.12% in 1994. The utilization level in 1993 was 31.69%. The FY 1995 utilization percentage includes all active facilities (except grants), including new facilities just signed at the end of the year. If unseasoned facilities are not included, FY 1995 utilization is 37.97%, down slightly from 40.90% in 1994.

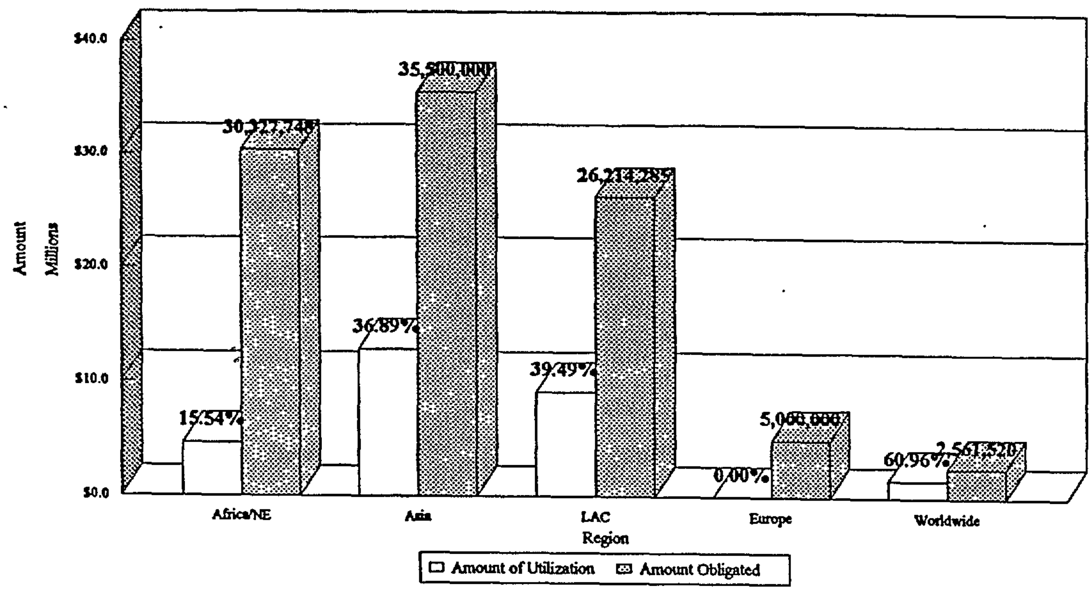
The total amount of credit mobilized under guarantees and the balance of direct project loans on September 30, 1995 was $52,798,281. This reflects only the outstanding balances of loans under coverage (guarantees) or receivable (direct loans) *on that date*, which actually understates the use of the guarantee facilities: the guarantee facilities are designed to permit banks to place loans under coverage, remove them as they are repaid or otherwise deemed not to need coverage, and place *other* loans under the guarantee. Thus, while the outstanding balances of the loans under coverage on any given date may be low, the *cumulative use* over the life of the facility may be significantly higher. Cumulative credit mobilized for currently active facilities, excluding grants, on September 30, 1995 was $104,884,547. The ratio of cumulative credit mobilized to amount obligated (cumulative utilization) for active facilities was 105.3%.

Risk of Facilities

Prior to authorizing any project, CIS reviews the project proposal with respect to both risk and development impact. The risk assessment includes a review of the capacity of the Intermediary Financial Institution (IFI) to make and administer loans, the country risk and the risks associated with the underlying loans. This assessment results in a Weighted Average Risk Factor (WARF) for each facility. Under the requirements of Credit Reform, the WARF is one input for calculating the estimated cost (or "subsidy") of the project to the U.S. Government.

The facilities are classified into three risk categories - low, medium, and high. For pre-Credit Reform projects, the risk ratings are determined by the Investment Officers. For post-Credit Reform projects, the risk rating is based on the WARF. The facilities are reviewed on a quarterly basis thereafter to identify any financial or performance issues that might change the risk of that project. As of September 30, 1995, 55% of project dollars are in the medium risk category, 28% are in low risk projects, and 17% of project dollars are in the high risk category. Of the eleven new facilities committed during FY94, eight were rated high risk and three were medium risk.

Graphic C - Utilization by Region*
as of September 30, 1995



* Current utilization for active facilities as of Sept. 30, 1995. Does not include grants.
** Utilization % = current amount utilizated/(total obligation-claims-principal repaid)

LIMITATIONS OF FINANCIAL STATEMENTS

1) The financial statements have been prepared to report the financial position and results of operations pursuant to the requirements of the Chief Financial Officers Act of 1990.

2) While the statements have been prepared from MSED's books and records in accordance with the formats described by OMB, the statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

3) The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

JUN 28 1996

MEMORANDUM

TO: Bruce Crandlemire, IG/A/FA

FROM: Donald K. Charney, Chief Financial Officer

SUBJECT: Draft Report - FY 1995 Year End Financial Audit of the M.S.E.D. Program

The Chief Financial Officer (CFO) does not agree with the opinion of the auditor that the financial statements do not fairly represent the financial position of the USAID M.S.E.D. Program. The CFO does not believe that the audit was performed in a fair and impartial manner. The Office of the Inspector General (OIG) has presented audit reports to the CFO in prior years. OIG had detailed knowledge of the exact operation of this program.

It is a material fact that the OIG and AA/M are not working together in a cooperative manner. Management feels that this situation is not conducive to the performance and review of the financial statements prepared by the Office of Financial Management in a fair and impartial manner. The fact that the CFO was requested to present a management response to an audit report of this complexity in less than 24 hours is additional evidence of the type of working relationship that exist between the OIG and the CFO.

The lack of internal controls inherent in the systems and the process are present, but in the opinion of the CFO are not so onerous as to be the cause for the financial statements to be misleading.

It is the opinion of the CFO that unless the above conflicts are presented the reader of the auditor's opinion cannot obtain a true presentation in the manner in which the auditor's work was carried out and the basis used to form an opinion as to the fairness and impartiality of the financial statements.

Our comments relating to the internal control weakness identified in the audit report are as follows:

-- We concur the adequate accounting records were unavailable for the audit. A special task force was immediately formed by the CFO to provide the missing information and to prepare accurate financial statements. This was accomplished within thirty days of being notified by the auditors of this situation.

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In response to recommendation one, we concur and have taken the following steps:

-- We have completely reorganized the Loan Management Division to include professionally trained accountants with sufficient supervisory oversight.

The CFO does not feel that the internal control examples presented in the audit report were material enough in nature to render a disclaimer.