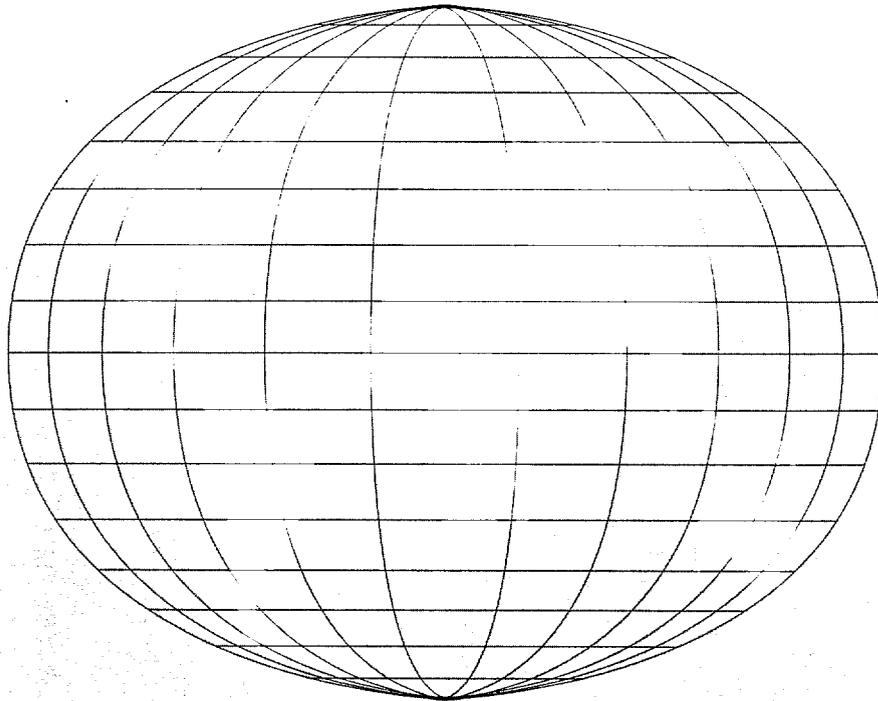


Report of Audit

**Audit of USAID/Sarajevo's
Bosnia Reconstruction Finance Facility Program
for the Period
May 7, 1996 to December 31, 1996**

**Audit Report No. B-168-97-002-P
March 26, 1997**



**Regional Inspector General
Budapest, Hungary**

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



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March 26, 1997

MEMORANDUM

TO: USAID/Sarajevo, Craig Buck
FROM: RIG/Budapest, *James R. Bonnell* James R. Bonnell
SUBJECT: Audit of USAID/Sarajevo's Bosnian Reconstruction Finance Facility Program for the Period May 7, 1996 to December 31, 1996

This is our final report on the subject audit. In preparing the report, we considered your comments on the draft and included them in Appendix II. The audit found that the \$24.3 million in recommended loans was short of the targeted amount of \$45 million primarily because of a lack of On-Lending Management Unit credit officers to analyze and process loan applications. No other major problems were identified in the Bosnian Reconstruction Finance Facility Program as of December 31, 1996.

Six preliminary audit findings were issued during the reporting period (see Appendix V for a summary). The Mission took corrective action on all of the preliminary findings and recovered \$14,053 in an unauthorized use of loan proceeds. This report makes no new recommendations.

Thank you for the assistance and courtesies extended to my staff during the audit.

Background

Bosnia-Herzegovina declared its independence from the former Socialist Republic of Yugoslavia in March 1992, following the lead of Slovenia and Croatia which declared independence in 1991. The move to independence precipitated a war in Bosnia-Herzegovina that lasted from 1992 to the cease-fire agreement of October 10, 1995. Bosnia-Herzegovina was one of six republics in ex-

Yugoslavia, with a prewar population of 4.4 million. Of these, 43.7 percent were Muslim Slavs, 31.4 percent were Bosnian Serbs, and 17.3 percent were Bosnian Croats. Per capita income was \$1,900.

After the cease fire agreement, Bosnia-Herzegovina was faced with consolidating the peace and reconstructing its war-torn economy, an enormous task as evidenced by the following problems:

- At least 2.4 million people needed assistance out of Bosnia-Herzegovina's population of three million. There were more than 300,000 pensioners, 120,000 disabled, 140,000 orphans and widows, 800,000 displaced persons, and more than one million returning refugees.
- The country's banking system was technically insolvent and burdened with nonperforming loans.

In addition to the financing needed to repair the infrastructure and provide social services, the government faced large private claims and large wage and pension arrears. The economy was demonetized during the war when doctors, teachers, and other public sector professionals did not receive wages for three years.

House Joint Resolution 170 (Public Law 104-122) appropriated \$198 million for assistance to Bosnia-Herzegovina on March 29, 1996. These funds are to be used for economic revitalization (\$145 million), police training and monitors (\$45 million), demining (\$5 million) and operating expenses (\$3 million).

In early May 1996, the Assistant Administrator for the Bureau of Europe and the New Independent States authorized the five-year \$278 million Bosnian Reconstruction Finance Facility (BRFF) program. These funds are to be used for financial support of post war reconstruction and revitalization, as well as to increase employment of the general population, refugees, and demobilizing soldiers. On May 7, 1996, a grant agreement was signed between the United States and Bosnia-Herzegovina to obligate the initial \$27.5 million for this program. In early July 1996, USAID transferred the \$27.5 million to Bosnia-Herzegovina. Additional funding of \$12.5 million was provided in November 1996.

Audit Objective

The objective of this ongoing audit was to answer the following question:

Did USAID/Sarajevo and the implementing contractors use economic revitalization assistance funds designated for the Bosnian Reconstruction Finance Facility Program for the purposes authorized under the Grant Agreement and Public Law 104-122?

The Office of the Inspector General plans to issue quarterly reports on the Bosnian Reconstruction

Finance Facility Program with this being the first one. Appendix I contains a discussion of the scope and methodology for the audit.

Audit Findings

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

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

BRFF Program—What can funds be used for?

Bosnia-Herzegovina's physical infrastructure sustained extensive damage during the war. Reconstructing the infrastructure requires financial resources and long-term credit to rehabilitate and revitalize Bosnian businesses which then could offer sustainable employment opportunities for the general population, especially demobilized soldiers and refugees. In response to this requirement, USAID designed the BRFF program, a \$278 million balance-of-payments initiative intended to "jump-start economic growth and generate employment opportunities for the general population." The grant agreement was signed on May 7, 1996, and, on May 16, USAID signed a task order with Development Alternatives, Inc., (a U.S. firm) to establish and operate the On-Lending Management Unit (OMU) which would be the primary implementor of the BRFF program.

For the first year of operations, it is planned that \$68 million will be available for the BRFF program, with \$60 million allocated for the loan program and \$8 million for technical assistance and support costs. USAID expected that \$45 million in loans would be disbursed, which would generate 6,750 jobs, during the six-month period ended December 1996.

BRFF Status—What were funds used for?

During the reporting period, USAID/Sarajevo obligated and disbursed \$40 million to Bosnia-Herzegovina to assist with their balance of payment needs and obligated \$11.9 million for program implementation costs. USAID/Sarajevo had approved 43 loans totaling \$24.3 million and the National Bank of Bosnia-Herzegovina disbursed \$20.4 million for 39 of these loans. Generally, borrowers have been financing building reconstruction, equipment and raw material acquisitions and some operational expenses with the loan proceeds. An additional 96 loan proposals were classified as "prospective" meaning that they could be recommended to USAID/Sarajevo for approval.

The \$24.3 million in loans which OMU recommended to USAID/Sarajevo was short of the targeted amount of \$45 million for the six-month period from July to December 1996. According to the

OMU, this shortfall resulted primarily from too few credit officers to analyze and process loan applications. This shortfall in loans also resulted in 722 fewer loan-generated jobs than planned. We did not make a recommendation concerning this shortfall because USAID/Sarajevo and OMU are reviewing alternatives to remedy this situation. (See Appendix III for detailed information on the BRFF's status and Appendix VI for details on budgeted, obligated and disbursed amounts).

In addition to the lending program, the BRFF program has sponsored 20 seminars and work shops in Tuzla and Sarajevo with a total attendance of 582 bankers, prospective borrowers, and consultants. The seminars included such courses as Role of the Agent Bank, Managing the Loan Portfolio, and Financing the Small Business.

Results of Audit Tests

Since this was the first period covered by our audit, much of our audit work was focused on obtaining an understanding of lending procedures and controls for the program and obtaining information on the status of loan activities. Appendix I contains a more detailed description of our audit scope and methodology.

During this period we tested compliance with loan procedures and the agreement with agent banks. These tests disclosed one major control weakness—two agent banks disbursed loan proceeds without obtaining invoices or supporting documentation, resulting in the potential for borrowers to use loans for purposes other than stipulated in the loan agreement. We also identified an unauthorized use of loan proceeds in the amount of \$14,053. Based on these audit test results, we issued six preliminary audit findings to USAID/Sarajevo. The Mission took corrective action on all of the preliminary findings and recovered the \$14,053 used without authorization from the borrower. Since the Mission has taken final actions with respect to our preliminary findings, we are not making any formal recommendations in this report. (Appendix V contains a summary of the audit findings reported to USAID/Sarajevo during this period.) For tracking purposes and to comply with the Inspector General Act of 1978, as amended, we have included a list of recommendations and their status (see Appendix VII) that were submitted with the preliminary findings.

During this period we also visited 19 of the 39 borrowers who had received loan disbursements as of December 31, 1996. When appropriate, we inspected the reconstruction and equipment purchases funded by the loan proceeds at the borrower's place of business. No major problems were identified at the 19 borrowers visited. However, in several cases, machinery and equipment purchased by the loan proceeds had not yet arrived. We plan to revisit some of the borrowers at a later date to verify that the machinery and equipment has been installed and is being used.

We also visited all 13 agent banks through which loan disbursements had been made as of December 31, 1996, and found several instances of noncompliance with loan procedures and the agent bank agreement. We plan to revisit some of these banks at a later time to verify that they are complying with procedures and the bank agreement. Appendix IV contains more details on the results of our site visits.

Management Comments and Our Evaluation

USAID/Sarajevo officials agreed with the content of the report and their comments are included as Appendix II to this report. In its response, USAID/Sarajevo stated that since the period of the audit about \$7.7 million in new loans have been disbursed with an anticipated creation of over 1,100 jobs. The Mission also stated that it is focusing on removing obstacles to reviewing and recommending loan applications for approval in order to meet or exceed program targets.

<p style="text-align: center;">Scope and Methodology</p>

Scope

The Office of the Regional Inspector General/Budapest is conducting a concurrent audit of USAID's Bosnian Reconstruction Finance Facility (BRFF) program activities in Bosnia-Herzegovina in accordance with generally accepted government auditing standards. The report cut off for this phase of the audit was December 31, 1996. The audit was conducted from October 29, 1996 through January 29, 1997. We conducted our audit at the USAID office in Sarajevo and Development Alternatives, Inc.'s On-Lending Management Unit offices in Sarajevo and Tuzla. We examined whether selected internal controls were implemented as designed, and also visited 19 borrowers and 13 agent banks located in the Sarajevo and Tuzla areas.

During this reporting period, we did not audit the BRFF program bank accounts maintained by the National Bank of Bosnia-Herzegovina. Also, we did not audit the program's financial statements that are shown in Appendix VI, nor the activities of The Recovery Group's Bosnia Business Assistance Center.

Methodology

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

We judgmentally selected 19 of the 39 borrowers to whom loans had been disbursed to verify the businesses' existence and the use of the loan proceeds. We were not able to visit three of the borrowers because of the unavailability of armored vehicles required for travel outside of Tuzla and Sarajevo. Instead, we relied on reports of visits from the On-Lending Management Unit's Internal

Auditor and the USAID/Sarajevo BRFF Program Assistant for these three borrowers. We observed equipment and raw material purchases and reconstruction efforts funded by the loan proceeds. We visited all 13 agent banks through which loans had been disbursed and reviewed documentation to determine how the banks were monitoring the use of the loan proceeds. We reviewed the agent banks' internal records tracking the receipt and disbursement of loan proceeds for each borrower. We also reviewed invoices submitted by the borrowers for purchases made using loan proceeds.



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM

DATE: March 14, 1997

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

FROM: Craig G. Buck, Director

SUBJECT: Audit of USAID/Sarajevo's Bosnian Reconstruction Finance
Facility Program for the Period May 7, 1996 to
December 31, 1996

We have reviewed the subject draft audit report and are pleased to see that the on-going audit activities have not uncovered any unforeseen problems with implementation of the program. We are also pleased that implementation of this program is moving forward as intended.

The report notes that the program is behind in reaching targets for loans given and jobs created which were established in the ambitious program design. Since the period of this review, DM 11,556,000 in new loans have been disbursed with an anticipated creation of over 1,100 new or reactivated jobs. Our Mission is focusing intense efforts to remove any and all obstacles to meet, if not exceed, established targets in this program, which is of critical importance to our goals in Bosnia and the effective support of Dayton objectives for peace and economic recovery.

USAID had originally planned to contract with an outside CPA firm to perform the on-going audit coverage of this program. However, this program got underway very quickly in spite of our concerns about working in the unknown environment in Bosnia. We were therefore pleased that the RIG decided to assign its own personnel to keep up with the fast pace of resource disbursement and activity. We fully appreciate the objectivity and professionalism of that staff in the course of their work. Observations made by the RIG audit team have identified and

clarified issues before they became problems. Their commitment to offer solutions to correct the direct causes of potential problem areas identified has added significantly to the program's success to date. We would like to take this opportunity to express our appreciation to RIG/A/Budapest for their participation in and contribution to these efforts.

**Audited Status of the
Bosnian Reconstruction Finance Facility
*as of December 31, 1996***

Bosnia's physical infrastructure sustained extensive damage during the war, its industrial production is less than 5 percent of prewar levels, and employment has plummeted to less than 20 percent of prewar employment, or approximately 190,000. Reconstruction of Bosnia requires financial resources and long-term credit to rehabilitate and revitalize Bosnian businesses which then could offer sustainable employment opportunities for the general population, especially demobilized soldiers and refugees.

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

On May 16, 1996, USAID signed a task order with Development Alternatives, Inc. to establish and operate the On-Lending Management Unit (OMU) and provide intensive in-country commercial banker training. Development Alternatives' team arrived in Sarajevo on June 13, 1996, to begin implementing the program and as of December 31, they had an expatriate staff of nine assigned to the program.

The OMU, composed of a team of experienced U.S. bankers, accountants, and Bosnian staff located at the National Bank of Bosnia-Herzegovina, is the primary implementor of the BRFF program. Some of the OMU's responsibilities include reviewing and recommending loan applications for approval; managing BRFF's lending operations; and monitoring and managing the flow of funds between the BRFF program, the borrowing enterprises, and the agent Bosnian commercial banks. Agreements with Bosnian commercial banks licensed by the National Bank allow these banks to function as agents for the OMU by submitting client loan applications. OMU also works with the Bosnian commercial banks to help educate them in market-oriented lending policies and credit evaluation techniques to assist in developing a capable financial sector. Also, on June 28, 1996, USAID signed a task order with The Recovery Group, to help Bosnian businesses prepare and present proposals to the OMU.

BRFF Program Plan

The total 3-year planned BRFF program budget is \$278 million. According to the BRFF grant agreement, \$68 million of the planned budget was to be used during the first year of operations—\$60 million for the lending program and \$8 million for implementation costs.

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

BRFF Program Status

As of December 31, 1996, \$51.9 million of the budget had been obligated and \$21 million had been disbursed. Of the \$51.9 million obligated, \$40 million was for loans.

OMU is responsible for reviewing and assessing credit risk on all loan applications and recommending viable loans to USAID for approval. After USAID approves the loan, it can be disbursed by the National Bank of Bosnia-Herzegovina. As of December 31, 1996, USAID had approved 43 loans totaling \$24.3 million and disbursed \$20.4 million for 39 of these loans. Loan proposals classified as "prospective" have the potential to be recommended to USAID for approval. The OMU's lending activity through December 31, 1996, is shown below:

Status of Loan Application	Number of Loans	Loan Totals¹
Disbursed	39	\$20,443,413
Approved by USAID but not yet disbursed	4	3,904,000
Prospective	96	43,515,833
Rejected by the OMU	82	30,657,408
Totals	<u>221</u>	<u>\$98,520,654</u>

¹ Loan amounts are recorded and disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. The loan totals in this column were converted at a rate of 1.5 Deutsche Marks to \$1.

A comparison of the targets established by Development Alternatives' task order to actual results for the six-month period from July to December 1996 follows:

	Targeted	Actual	Variance
Recommendations	\$45,000,000	\$24,347,413	(\$20,652,587)
Associated Jobs	6,750	6,028	(722)

The OMU recommended the approval of \$24.3 million in loans—short of the targeted amount of \$45 million. This shortfall was primarily due to a lack of credit officers to analyze and process loan applications. It is expected that 6,028 jobs will be generated by the disbursed loans compared to the targeted 6,750 jobs, a shortfall of 722. We did not make a recommendation concerning this shortfall in the number and amount of approved loans because USAID/Sarajevo and OMU are reviewing alternatives to remedy this situation, such as increasing the number of credit officers.

Examples of disbursed loans are presented below:

- *Fabrika Obuće I Galanterije*, a footwear and leather accessory manufacturer, received \$1,066,667 for building and roof repairs, upgrading and repair of equipment, and raw materials which will enable it to increase its production capacity. The company expects to reactivate 199 employees, 85 percent of which are women.
- *TEPPSA HOLDING, doo*, a manufacturer of carpets and ladders, received \$666,667 to reestablish its carpet production lines and start up production of wooden ladders. The loan proceeds will be used for equipment and raw material purchases for both production lines as well as funding some of the salaries and start up operation costs. Approximately 97 demobilized soldiers and 58 women are expected to be employed.
- *BOSNALJEK*, a manufacturer of pharmaceuticals, received \$666,667 to reestablish production of liquid medicines which will be placed in glass ampules. The loan proceeds will fund plant reconstruction, new equipment, raw materials, and some start up operation expenses. The company anticipates hiring 70 new employees.

In addition to the lending program, as of December 31, 1996, Development Alternatives, Inc., had completed 20 seminars and workshops in Tuzla and Sarajevo with a total attendance of 582 bankers, prospective borrowers, and consultants. Courses offered included:

- BRFF Introduction.
- Role of the Agent Bank.

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- Managing the Loan Portfolio.
- Financial Analysis and Business Planning.
- Financing the Small Business.

These and other courses, such as "Commercial Loan Monitoring" and the "Bank Executive Simulation" will continue to be offered through May 1997.

<p>Audit Test Results</p>

As of December 31, 1996, USAID/Sarajevo had disbursed \$20,443,413 in loans through 13 agent banks to 39 borrowers. The majority of the 39 loans are financing building repairs and reconstruction, machinery and equipment purchases, raw material purchases, and working capital. In November 1996 and January 1997, we visited all 13 agent banks through which loans had been disbursed and reviewed documentation to determine how they were monitoring the use of the loan proceeds.

The agent banks appeared to be adequately monitoring the use of loan proceeds by borrowers with the exception of two banks, Hippo Banka in Zenica and Kreditna Banka in Tuzla. Neither of these two banks had complete documentation supporting the borrowers' use of loan proceeds and one of them had allowed a borrower to make a payment not authorized by the loan agreement. Also, two banks were applying a National Bank of Bosnia-Herzegovina requirement for foreign purchases from which, according to the Bilateral Treaty, BRFF loan proceeds were exempted. Preliminary audit findings were issued regarding these matters (see Appendix V).

We also visited 19 borrowers to verify the existence of the business and the use of loan proceeds. We did not find any major problems with the borrowers. The results of our audit tests are detailed below.

Visits to Agent Banks²

Agent Bank	Borrower	Loan Amount
Hippo Banka d.d., Zenica	BEST PRODUKT	\$176,000
	MAKOM	666,667
	FIMEX	184,667
	SITEX	666,667
	LADY A	320,333
Privedna Banka, Sarajevo	SPORTFORM	660,400

² Actual records and documents reviewed did not always total the loan amount as many borrowers had not used all of the loan proceeds.

Agent Bank	Borrower	Loan Amount
Privedna Banka, Sarajevo (cont.)	MILCOS	\$637,333
	TEPPSA HOLDING	666,667
Market Banka d.d., Sarajevo	UGARAK PRODUCTS	666,667
UPI Banka d.d., Sarajevo	FABRIKA OBUCE I GALANTERIJE	1,066,667
	KLAS	666,667
Central Banka d.d., Sarajevo	ALHOS	600,000
	VITEX	666,667
	BOSNALIJEK	666,667
Union Banka d.d., Sarajevo	KRAS	666,667
Universal Banka, Sarajevo	BMP	665,413
	KLJUC	400,000
BH Banka d.d., Sarajevo	ZGP	333,333
	POLJOPROMET	666,667
	STANDARD	666,667
Kreditna Banka d.d., Tuzla	SOKOLINA	666,667
	BOSNA PLET	166,667
	FINALIST-BRCKO	606,667
	SIPOREX	806,667
	MMR	533,333
Tuzlanska Banka d.d., Tuzla	ELEKTROREMONT	200,000
	TMB	400,000
	TRGOINEX	654,267

Agent Bank	Borrower	Loan Amount
Investiciono-Komercijalna Banka d.d., Zenica	BORAC	\$666,667
	UNIS-TADIV	666,667
Gospodarska Banka, Sarajevo	MULLER D.J.L.	206,667
Ljubljanska Banka d.d., Sarajevo	D.J.L. OHRAN	413,333
	SIPAD dd ENTERIJERI	666,667

Visits to Borrowers

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
MAKOM	Hippo Banka d.d., Zenica	\$666,667	Finance construction of a building, equipment purchases, operating expenses, and working capital to expand production of paints and glues. Expected to generate 36 jobs.	The borrower delayed the start of construction of the building as the Municipality of Zenica imposed unexpected taxes for the use of the land. The borrower is negotiating with the Municipality to resolve this issue.
BEST PRODUKT	Hippo Banka d.d., Zenica	176,000	Purchase a new building and equipment to expand its juice manufacturing production. Expected to generate 15 new jobs.	Borrower had not purchased the building or equipment. Loan subsequently suspended as Municipality of Zenica imposed DM 110,000 in taxes. The loan was reinstated in January 1997.
MILCOS	Privedna Banka, Sarajevo	637,333	Fund equipment repairs, building construction, working capital, and equipment purchases to reestablish an ice cream production line. Expected to generate 62 jobs.	Loan proceeds had not been used yet; however, a compressor had been ordered and received.

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
UGARAK	Market Banka, Sarajevo	\$666,667	Funding for construction of a small warehouse, equipment and vehicle purchases, and raw materials for the manufacturing of door and window frames. Expected to generate 107 jobs.	The factory is producing door and window frames and is hiring additional employees.
SPORTFORM	Privedna Banka, Sarajevo	130,000	Funding to reestablish a handmade knitwear division through purchases of raw materials, vehicles and equipment. Expected employment of 500 multiethnic rural women to knit sweaters in their homes.	Approximately 200 women have been hired.
SPORTFORM	Privedna Banka, Sarajevo	530,400	Finance the purchase of machinery, equipment and working capital to reestablish sportswear production line. Expected to generate 280 jobs.	None.
FABRIKA OBUCE I GALANTERIJE	UPI Banka dd, Sarajevo	1,066,667	Funding for roof repairs, repair and upgrading of equipment and working capital for reconstruction and expansion of shoe manufacturing plant. Expected to reactivate 199 prewar employees.	Production has started, roof repairs are underway and some equipment has been received.
KLAS	UPI Banka dd, Sarajevo	666,667	Fund purchase of equipment to expand wafer production. Expected to generate 53 jobs.	Equipment has been ordered but not yet received.
ALHOS	Central Banka d.d., Sarajevo	600,000	Finance building reconstruction, equipment repairs and purchases, and working capital to expand production of the women's clothing line. Expected to generate 70 new jobs.	Building reconstruction is underway, equipment has been purchased and production of clothing is underway.

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Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
SIPOREX	Kreditna Banka d.d., Tuzla	\$806,667	Fund equipment repairs and raw materials to restart production of concrete blocks and concrete roof tiles. Expected to generate 300 jobs immediately and an additional 150 within a year.	Equipment repairs are underway and production has started. May have some difficulty selling the products as the construction season slows down during the winter months.
KRAS	Union Banka d.d., Sarajevo	666,667	Fund reconstruction, equipment and start up operational expenses for a new production line for men's shirts. Expected to generate 92 new jobs.	Reconstruction is underway but equipment has not yet been purchased.
VITEX	Central Banka d.d., Sarajevo	666,667	Finance reconstruction, equipment and raw material purchases to restart the sheepskin slipper production line. Expected to reactivate 90 prewar employees.	Reconstruction is underway and raw materials have been purchased; however, equipment has not been bought. The factory was closed until mid-February.
BOSNALIJEK	Central Banka d.d., Sarajevo	666,667	Fund plant reconstruction, equipment and raw material purchases, and some start-up operation expenses for the reestablishment of a liquid medicine production line. Expected to generate 70 jobs.	Production has not started as equipment is specially designed and takes time to build. Reconstruction of the plant is anticipated to start soon.
TEPPSA HOLDING	Privedna Banka, Sarajevo	666,667	Finance the purchase of equipment and raw materials, some of the start up operation costs and salaries for the reestablishment of a carpet production line and the start up of a wooden ladder production line. Expected to generate 155 jobs.	Ladder production is expected to start when equipment that has been ordered arrives. Carpet production is expected to start when the equipment is installed and raw materials have been purchased.

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
STANDARD	BH Banka d.d., Sarajevo	\$666,667	Fund reconstruction of the factory buildings, equipment repairs and purchases and working capital to rehabilitate and equip a part of a furniture factory. Expected to generate 135 jobs.	Most building reconstruction is complete and equipment has been purchased but not all has been received.
SOKOLINA	Kreditna Banka d.d., Tuzla	666,667	Finance purchase of equipment for timber logging and milling. Expected to generate 420 jobs.	In the process of acquiring equipment.
BOSNA PLET ³	Kreditna Banka d.d., Tuzla	166,667	Fund purchase of raw materials and new equipment for expansion of wicker ware and wicker furniture manufacturing. Expected to generate 200 jobs for weavers.	None.
MMR ³	Kreditna Banka d.d., Tuzla	533,333	Finance purchase of raw materials and equipment for the start up of a lightweight, insulated aluminum roofing plates production line. Expected to generate 28 jobs.	Equipment has been purchased but not yet received. Funds allocated for raw materials were used for equipment purchase without authorization.
FINALIST-BRCKO ³	Kreditna Banka d.d., Tuzla	606,667	Fund the purchase of equipment, raw materials and vehicles for the expansion of the manufacture and installation of marble and granite building materials. Expected to generate 43 jobs.	None.

³ We relied on reports of visits from the OMU's Internal Auditor and USAID/Sarajevo's BRFF Program Assistant for these borrowers. We were unable to visit these borrowers as planned because of the unavailability of an armored vehicle as required for travel outside of Tuzla.

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
TRGOINEX	Tuzlanska Banka d.d., Tuzla	\$654,267	Finance equipment and working capital to increase quarrying and processing of gravel and sand. Expected to generate 81 jobs.	Have not purchased equipment yet. Expect to start production in March 1997.

**Summary of Audit Findings
Reported to USAID/Sarajevo**

Finding No. and Date Issued	Summary of Audit Finding	Management Decision/Action
BRFF-1 11/19/96	Four borrowers entered into contracts with a company for "services" in exchange for a contingent fee of approximately 10 percent of the loan proceeds. As a result, loan proceeds may have been used for purposes other than the rehabilitation and/or reconstruction of the borrower's business.	USAID/Sarajevo took corrective action. It directed the On-Lending Management Unit (OMU) to insert language in the loan application documents and agreement prohibiting the payment of finder's fees. As a result, OMU now requires borrowers to sign a certification that they have not and will not pay unreasonable brokerage fees. In addition, the borrower must disclose any reasonable fees paid to any individual or institution.
BRFF-2 11-19-96	Two agent banks deposited 10 percent of foreign currency payments made by borrowers outside of the country in the National Bank of Bosnia-Herzegovina (NBBH) which reduced the borrowers' ability to use those funds to make necessary foreign purchases. As a result, two agent banks reduced the effectiveness of the Bosnian Reconstruction Finance Facility (BRFF) loan by decreasing funds available to the borrower to make necessary foreign purchases.	USAID/Sarajevo took corrective action. It requested OMU to provide all agent banks with a letter from a senior level official in the NBBH emphasizing that BRFF loan proceeds are exempt from this deposit requirement. OMU obtained such a letter from the Vice Governor of the NBBH and sent it to the two agent banks.

Finding No. and Date Issued	Summary of Audit Finding	Management Decision/Action
BRFF-3 11/19/96	Two agent banks disbursed loan proceeds without obtaining invoices or supporting documentation. Banks cannot monitor and report on the use of loan proceeds received by borrowers without submitting invoices. As a result, the potential exists for borrowers to use the funds for purposes other than stipulated in the loan agreement.	USAID/Sarajevo took corrective action. It directed that OMU require the two agent banks to obtain copies of invoices for all payments made by the borrower using loan proceeds. As a result, OMU requested in writing that one bank obtain copies of invoices for payments from loan proceeds by 1/15/97. OMU verbally requested the other agent bank to obtain invoices by 1/31/97.
BRFF-4 11/19/96	Loan proceeds were used for an unauthorized payment. BRFF funds were diverted from their intended uses.	USAID/Sarajevo took corrective action. It recovered the unauthorized payment of DM 21,080 (\$14,053) from a borrower which was used to reimburse the loan.
BRFF-5 11/19/96	OMU did not have an internal auditor to review and evaluate OMU's internal controls, accounting, and loan tracking systems, and to perform audits of agent banks and borrowers. As a result, there is an increased risk of misuse of BRFF funds.	USAID/Sarajevo took corrective action. It requested Development Alternatives, Inc., to expedite the hiring of an internal auditor. The auditor was hired and arrived in Sarajevo in January 1997.

Finding No. and Date Issued	Summary of Audit Finding	Management Decision/Action
BRFF-6 11/19/96	<p>OMU did not have written policies and procedures for the handling and disposition of the agent banks' quarterly monitoring reports. Without written guidelines, OMU may not receive quarterly monitoring reports in a timely fashion which would lessen their effectiveness as a monitoring device. Another possible effect is that quarterly monitoring fees could be paid without proper approval.</p>	<p>USAID/Sarajevo took corrective action. It requested that OMU develop and implement formal written policies and procedures for the quarterly monitoring reports to include (a) a tickler system to track report due dates and their receipt; (b) establishment of responsibility and guidelines for the initial review of the report; (c) establishment of responsibility and guidelines for the final review of the report; (d) follow up and feedback to the agent banks and/or borrowers; and, (e) approval for payment of quarterly monitoring fees. As a result, OMU adopted a written policy for Agent Bank Quarterly Monitoring which defines procedures for tracking, reviewing, providing feedback to Agent banks, and approving payment of the quarterly monitoring fees.</p>

**Unaudited Bosnian Reconstruction Finance Facility
Fund Accountability Statement
as of December 31, 1996**

The amounts that USAID/Sarajevo has budgeted and obligated for the Bosnia Reconstruction Finance Facility program are shown below. The amount obligated for the On-Lending Program represents the balance-of-payments to Bosnia-Herzegovina. Disbursements for the On-Lending Program are loans transferred by the National Bank of Bosnia-Herzegovina to borrowers. The disbursed implementation costs are amounts paid by USAID.

	3 Year Program Budget	Amount Obligated	Amount Disbursed
On-Lending Program	\$256,000,000	\$40,000,000	\$20,443,413 ⁴
Implementation Costs:			
Contractors	17,500,000	10,860,000	not available
Audit, Program and Evaluation	1,500,000	729,579 ⁵	461,069
Environmental Monitoring	600,000	0	0
USAID Program Management	0	286,131	93,197
Contingencies	2,400,000	0	0
Totals	<u>\$278,000,000</u>	<u>\$51,875,710</u>	<u>\$20,997,679</u>

⁴ Loans were disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. A total of 30,665,119 Deutsche Marks were disbursed which were converted at the rate of 1.5 Deutsche Marks to \$1.

⁵ The total amounts obligated (\$1,459,157) and disbursed (\$922,138) were equally divided between the Bosnian Reconstruction Finance Facility and the Municipal Infrastructure and Services programs (see Audit Report No. B-168-97-003-P).

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Listing of Audit Recommendations for Tracking Purposes

Rec. No.	Description	Status
We recommend that USAID/Sarajevo:		
1.1	direct the On-Lending Management Unit to insert language in the loan application documents and agreement prohibiting the payment of finder's fees;	Final action
1.2	request the On-Lending Management Unit to provide all agent banks with a letter from a senior level official in the National Bank of Bosnia-Herzegovina stating that loan proceeds are exempt from the 10 percent foreign currency deposit requirement;	Final action
1.3	direct the On-Lending Management Unit to require the two agent banks to obtain copies of invoices for all payments made by the borrowers using loan proceeds;	Final action
1.4	recover DM 21,080 (approximately \$14,000) in loan proceeds used for unauthorized purposes;	Final action—Mission recovered \$14,053
1.5	request Development Alternatives, Inc. to expedite the hiring of an internal auditor; and,	Final action
1.6	require the On-Lending Management Unit to develop and implement formal written policies and procedures for the quarterly monitoring reports.	Final action

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