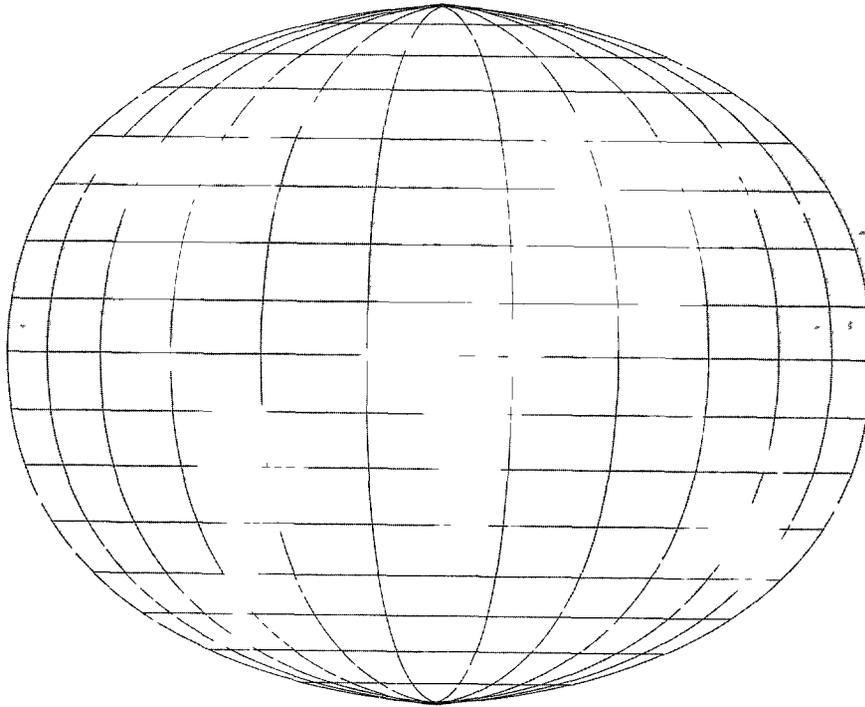


- PD-ABQ-366

Report of Audit

**Audit of USAID/Bosnia-Herzegovina's
Bosnian Reconstruction Finance Facility Program
for the Period
July 1 through September 30, 1997**

**Audit Report No. B-168-98-004-P
March 26, 1998**



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

**Audit of USAID/Bosnia-Herzegovina's
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**United States Agency for International Development
Office of the Regional Inspector General**

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March 26, 1998

MEMORANDUM

TO: USAID/Bosnia-Herzegovina, Craig G. Buck
FROM: RIG/Budapest, *James R. Bonnell* James R. Bonnell
SUBJECT: Audit of USAID/Bosnia-Herzegovina's Bosnian Reconstruction Finance Facility Program for the Period July 1 through September 30, 1997

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 although loan volume almost doubled this quarter, the \$69.6 million in recommended loans from the inception of the program was short of the targeted amount of \$135 million. Various factors such as the difficulty in recruiting/retaining contractor personnel, removal of an agent bank from the program, and expansion of activities to the Brcko and Banja Luka areas of the Republika Srpska hampered efforts to reach the targeted volume.

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.

The war in Bosnia-Herzegovina was fought between three major ethnic/religious groups—Bosniacs (Muslims), Serbs (Eastern Orthodox Christians), and Croats (Roman Catholics) The 1995 Dayton Agreement defined Bosnia as a single state consisting of two entities

- The Federation of Bosnia joining together Bosniacs and Bosnian Croats, and
- The Republika Srpska comprising the Bosnian Serbs

Bosnia remains both politically and ethnically divided with freedom of movement across ethnic boundaries still constrained.

The Dayton Agreement viewed economic rehabilitation and reconstruction as an essential element to achieving peace The Agreement negotiators believed that the people must have an economic stake in the process, therefore, economic reconstruction, economic institution building, and promotion of a market economy were deemed to be major factors to ensure lasting peace In 1996, 59 donor countries and organizations pledged \$1.9 billion to the reconstruction program and by the end of the year there were many signs of economic recovery For example, road and rail links were being restored, housing repaired, and basic services such as water and heating were reestablished However, many key national and Federation economic institutions, such as Bosnia's central bank, were not yet fully functioning

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 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 economic 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 program's initial \$27.5 million which was transferred by USAID to Bosnia-Herzegovina in early July 1996. In November 1996, May 1997, and September 1997, USAID transferred another \$12.5 million, \$19.5 million, and \$40 million, respectively, to Bosnia-Herzegovina.

Audit Objective

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

The Office of the Inspector General has issued periodic reports on the Bosnian Reconstruction Finance Facility Program with this being the fourth one.¹ Appendix I contains a discussion of the scope and methodology for the audit.

Audit Findings

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

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

BRFF Program—What can funds be used for?

Bosnia-Herzegovina's physical infrastructure sustained extensive damage during the war. Reconstructing the infrastructure requires financial resources and long-term credit to rehabilitate and

¹ See Audit Report Nos B-168-97-002-P for the period May 7 through December 31, 1996, B-168-97-006-P for the period January 1 through March 31, 1997, and B-168-98-001-P for the period from April 1 through June 30, 1997.

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" and signed the grant agreement on May 7, 1996. Through fiscal year 1997, it is planned that \$173 million will be available for the BRFF program, with \$158 million allocated for the loan program and \$15 million for technical assistance, training and support costs.

Loan Program. On May 16, 1996, USAID signed a task order with Development Alternatives, Inc., (hereafter referred to as Development Alternatives) to establish and operate Business Finance². With offices in Sarajevo and Tuzla, it would be the primary implementor of the BRFF loan program. Activities have also begun in the Brcko and Banja Luka areas of the Republika Srpska. Business Finance recommends loans to USAID/Bosnia-Herzegovina for approval. The task order set targets of \$45 million in loan recommendations which were expected to create 6,750 jobs through December 31, 1996. Although not specified in the order, USAID/Bosnia-Herzegovina expected that Business Finance would recommend \$10 million in loans per month (generating 1,500 jobs per month) after December 31, 1996. This expectation was formalized with Development Alternatives in a task order modification effective May 1, 1997. Through September 30, 1997, USAID expected that a cumulative total of \$135 million in loans would be recommended by Business Finance resulting in 20,250 new jobs.

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

On June 28, 1996, USAID signed a task order with The Recovery Group to provide assistance to businesses seeking loans from the BRFF and World Bank credit programs and to assist enterprises in achieving long-term viability. The Recovery Group established the Business Consulting³ offices in Sarajevo and Tuzla to implement its objectives. Activities have also begun in the Brcko and Banja Luka areas of the Republika Srpska.

BRFF Status—What were funds used for?

Loan Program. Since the program's inception, USAID/Bosnia-Herzegovina obligated and disbursed \$99.5 million to Bosnia-Herzegovina to assist with their balance of payment needs. (See Appendix V for detail on budgeted, obligated and disbursed amounts.) USAID/Bosnia-Herzegovina approved 124 loans totaling \$63.3 million and the Government of Bosnia-Herzegovina disbursed \$49 million for 92 of these loans. Generally, borrowers are financing building reconstruction, equipment purchases, raw material acquisitions, and some operational expenses with the loan.

² Formerly known as the On-Lending Management Unit

³ Formerly known as the Bosnia Business Assistance Center

proceeds. The \$69.6 million in loans which Business Finance recommended to USAID/Bosnia-Herzegovina since the beginning of the program fell short of the targeted amount of \$135 million. This loan volume shortfall also resulted in about 9,000 fewer estimated loan-generated jobs than planned.

During this quarter, Business Finance recommended 41 loans valued at \$17 million with a corresponding anticipated increase in employment of about 1,900. This fell short of the expected quarterly targets by approximately \$13 million and 2,600 jobs.

In previous reporting periods, shortfalls were attributed to a systems and personnel restructuring to streamline loan production and a shortage of lending officers to analyze and process applications. During this reporting period, Business Finance has made some progress towards increasing loan volume. Although still short of quarterly targets, loan volume has increased from about \$9 million in the previous quarter to \$17 million this quarter.

Various factors have contributed to the difficulty of Business Finance in achieving their targets such as

- Recruitment and retention of program personnel. The primary contractor's contract ended on September 30, 1997, and the contractor is operating on short-term bridge contracts while the main contract is being competed. The short term nature of the bridge contracts and the uncertainty as to their extension has made personnel recruitment and retention difficult.
- Removal of an agent bank from the program in September 1997 for suspected misuse of funds. This action entailed considerable staff time which otherwise could have been used for making loans.
- Expansion of program activities to the Brcko and Banja Luka areas of the Republika Srpska. Over the next year, this action should increase the loan volume, but the initial start-up requires a shifting of resources.

Technical Assistance. Business Finance stated in its September 30, 1997, report that its training division sponsored 16 seminars and work shops in Tuzla, Sarajevo, and Banja Luka with a total attendance of 549 bankers, prospective borrowers, and consultants during this quarter. Since the beginning of the program, Business Finance has sponsored 62 events with a total of 1,815 participants. The seminars included such courses as Role of the Agent Bank, Managing the Loan Portfolio, and Financing the Small Business.

Business Consulting reported that since the inception of the program through September 30, 1997, it had prepared 185 diagnostics (formerly known as loan application support) and completed 65 performance improvement projects, designed to help enterprises restart and strengthen operations and establish initial viability and direction. Business Consulting has begun to achieve the targets

for diagnostics in its new task order (signed on September 22, 1997) but is falling behind the targets for projects. We will monitor the new targets as the next reporting period progresses.

Results of Audit Tests

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

We visited 16 additional borrowers for a total of 42 borrowers visited, some multiple times, out of the 92 borrowers who received loan disbursements. When appropriate, we inspected reconstruction work and equipment purchases funded by the loan proceeds at the borrower's place of business. Some potential problems were noted at the borrowers visited which should be closely monitored. These potential problems include production not yet started or less than planned and a lack of anticipated markets. (Appendix IV contains more detail on the results of our site visits.)

We also visited two of the 18 agent banks through which loans were disbursed. To date, we have visited most of the active agent banks, some multiple times. During this period we tested compliance with loan procedures and the agreements with agent banks. Possible violations of the agent bank agreement by one of the agent banks (Hippo Banka) in late August 1997 were noted as loan documentation was missing or inadequate.

Since late 1996, Hippo Banka and its borrowers were visited repeatedly by Business Finance and USAID staff and auditors concerning delayed disbursements and borrower performance. Between June and August of 1997, concerns mounted and the Federation Banking Agency (FBA) of the Federation of Bosnia-Herzegovina became involved. Subsequently, Business Finance reviewed the bank's BRFF loan documentation and found numerous problems and irregularities. Consequently, Business Finance removed Hippo Banka from the BRFF program and demanded that all undisbursed loan proceeds be returned to the Government of Bosnia-Herzegovina. Hippo Banka returned a small portion of the proceeds. USAID requested the FBA to take control of the situation in order to salvage resources and protect the credibility of the program. The FBA proceeded to perform a bank examination. Technical assistance on this examination with its unique requirements was provided by the Barents Group, banking advisors to the FBA.

The FBA report was quite thorough with regards to possible criminal activities. Criminal reports have been filed on eight insiders with more possible as the investigation is ongoing. As of January 1998, Business Finance had determined that Hippo Banka had failed to disburse almost DM 1.3 million (over \$700,000) to borrowers for approved loans. These funds should be returned by Hippo to the Government of Bosnia-Herzegovina so that the funds can be used again in the BRFF program. The full extent of losses resulting from Hippo's actions cannot be determined until the matter is fully investigated and prosecuted by the appropriate Bosnia-Herzegovina authorities and courts.

While the above scenario has been playing out, USAID and Business Finance have been coordinating efforts to tighten up the agent bank selection process. All current agent banks are being evaluated for continued inclusion in the program. A new agent bank agreement is being drawn up by Business Finance which will be put into use in 1998 when renewal of agreements will be subject to approval by the USAID Mission Director. The renewal process will be similar to the process in which Business Finance recommends loans for concurrence by the Mission Director. In addition, a monitoring unit will be created within Business Finance. An estimated 10 to 20 monitors will be responsible for frequent visits to borrowers and agent banks to verify compliance with loan agreements and check on performance. With the increasing loan volume, this type of screening and proactive monitoring becomes a necessity.

Management Comments and Our Evaluation

USAID/Bosnia-Herzegovina officials agreed with the content of the report and their comments are included as Appendix II to this report. In its response, USAID/Bosnia-Herzegovina noted that the project has begun to achieve the lending target but not the employment target in the months subsequent to this reporting period. USAID/Bosnia-Herzegovina also supports the RIG's audit approach of focusing on the project's internal audit capability and monitoring procedures.

<p>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. We conducted the audit from August 25 through November 26, 1997, at the USAID office in Sarajevo, and the Development Alternatives' Business Finance offices and The Recovery Group's Business Consulting offices in Sarajevo and Tuzla. We visited 16 borrowers and two agent banks in the Sarajevo and Tuzla areas.

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

Methodology

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

We judgmentally selected 16 additional borrowers, bringing to a total 42 borrowers visited, some multiple times, of the 92 borrowers who received loan disbursements. Our visits were to verify the businesses' existence and their use of the loan proceeds. We observed equipment and raw material purchases and reconstruction efforts funded by the loan proceeds. We visited two agent banks resulting in one or more visits to most of the 18 agent banks through which loans were disbursed.

We reviewed documentation to determine how the banks were monitoring the use of the proceeds and the agent banks' internal records tracking the receipt and disbursement of loan proceeds for each borrower. We also selectively reviewed invoices submitted by the borrowers for purchases made using the proceeds.



United States Agency for International Development
Sarajevo, Bosnia-Herzegovina

MEMORANDUM

Date March 18, 1998

To James R. Bonnell, RIG/A/Budapest

From Craig G. Buck, Director /s/

Subject Audit of USAID/Sarajevo's Bosnian Reconstruction Finance Facility Program for the Period July 1 through September 30, 1997

As always, we appreciate the way the RIG has worked with the Mission as a part of a team dedicated to successful implementation of this project - which is a major program in its own right. This teamwork was especially evident in the case of Hippo bank where the collaboration was tight and effective between the RIG, Business Finance and USAID as each institutional actor, in its way, but in a highly coordinated manner, attacked this problem. The losses could have been much worse had not all three organizations shared critical information to the maximum possible extent.

The audit's observations regarding the shortfall in meeting project targets are correct, although we are pleased to report that during the Bridge contract period that followed this reporting period (Oct. 1, 1997 - Jan. 31, 1998) the lending target was met although the employment target was not fully achieved. We believe that for the future, we have conquered this particular shortcoming.

Our only suggestion at this point relates to future methodology. As the portfolio grows, we note that the RIG has been taking more of a systems approach by focusing on BF internal audit capability and monitoring procedures. We believe this is the correct strategy and want to encourage its continuing implementation with an increasing focus on all monitoring and remedial action systems (internal and external). We urge that this be extended to BC as well, as we have been pushing the business group to work closely with BF's workout division in a cooperative program aimed at resolving past due and problem loans.

USAID/Bosnia-Herzegovina, AmEmbassy Sarajevo, Dept. Of State, Washington DC 20521-7130
Phone Number: 387-71-66-79-00

**Audited Status of the
Bosnian Reconstruction Finance Facility
*as of September 30, 1997***

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

On May 16, 1996, USAID signed a task order with Development Alternatives to establish and operate Business Finance⁴ and provide intensive, in-country commercial banker training Development Alternatives' team arrived in Sarajevo on June 13, 1996, to begin implementing the program and they had an expatriate staff of 16 assigned to the program as of September 30, 1997

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

Also, on June 28, 1996, USAID signed a task order with The Recovery Group to help Bosnian businesses prepare and present proposals to Business Finance and to assist enterprises in restarting and strengthening their operations A new task order was signed on September 22, 1997.

⁴ Formerly known as the On-Lending Management Unit

BRFF Program Plan

Although the BRFF program is a five-year program, its planned budget is \$278 million for a three-year period. According to the BRFF program authorization document, \$173 million was budgeted through fiscal year 1997—\$158 million for the lending program and \$15 million for technical assistance and implementation costs.

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

BRFF Program Status

From the program's inception, \$123.4 million of the budget had been obligated and \$111.8 million had been disbursed. Of the \$123.4 million obligated, \$99.5 million was for loans with the remaining \$23.9 million allocated for technical assistance and program implementation. (See Appendix V.)

Loan Program. Business Finance is responsible for reviewing and assessing credit risk on all loan applications and recommending viable loans to USAID/Bosnia-Herzegovina for approval. After USAID/Bosnia-Herzegovina approves the loan, it can be disbursed by the Central Bank of Bosnia-Herzegovina with USAID's approval. During the quarter ended September 30, 1997, Business Finance recommended 41 loans, valued at \$17 million, to USAID/Bosnia-Herzegovina. These recommendations anticipate an increase of approximately 1,900 new jobs. The Central Bank disbursed 9 loans valued at \$6 million.

From the beginning of the BRFF program, USAID/Bosnia-Herzegovina approved 124 loans totaling \$63.3 million and the Central Bank disbursed \$49 million for 92 of them. Loan proposals classified as "prospective" can potentially be recommended to USAID/Bosnia-Herzegovina for approval. Business Finance's cumulative lending activity is shown on the following page.

Status of Loan Application	Number of Loans	Loan Totals⁵
Disbursed	92	\$49,023,180
Approved by USAID/Bosnia-Herzegovina but not yet disbursed	32	14,258,598
Recommended by Business Finance but not yet approved by USAID/Bosnia-Herzegovina	17	6,357,631
Prospective ⁶	64	26,661,339
Not Approved by USAID ⁶	5	6,089,718
Rejected by Business Finance ⁶	269	94,205,073
Totals	<u>479</u>	<u>\$196,595,539</u>

Development Alternatives' task order set targets of \$45 million in loan recommendations creating 6,750 jobs through December 31, 1996. Although not specified in the order, USAID/Bosnia-Herzegovina expected that Business Finance would recommend \$10 million in loans per month (generating 1,500 jobs per month) after December 31, 1996. This expectation was formalized with Development Alternatives in a task order modification effective May 1, 1997. Through September 30, 1997, USAID anticipated that a cumulative total of \$135 million in loans would be recommended by Business Finance, resulting in 20,250 new jobs. A comparison of these agreed upon and expected targets to actual results from inception through September 1997 is shown in the following table:

⁵ Loan amounts are recorded and disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. Disbursed, approved and recommended loans were converted at the exchange rates of the four tranches using the first-in, first-out approach. Prospective, not approved and rejected loans were converted at a rate of 1.7711 Deutsche Marks to \$1.

⁶ Information obtained from Business Finance's September 30, 1997 report.

	Targeted	Actual	Shortfall
Recommended Loans	\$135,000,000	\$69,639,409	\$65,360,591
Associated Jobs	20,250	11,214	9,036

Business Finance recommended the approval of \$69.6 million in loans—achieving 52 percent of the targeted amount of \$135 million, or a shortfall of 48 percent. It is expected that 11,214 jobs will be generated by the disbursed loans—achieving 55 percent of the targeted 20,250 jobs, or a shortfall of 45 percent.

In previous reporting periods, shortfalls were attributed to a systems and personnel restructuring to streamline loan production and a shortage of lending officers to analyze and process applications. During this reporting period, Business Finance has made some progress towards increasing loan volume. Although still short of their quarterly targets, loan volume has increased from about \$9 million in the previous quarter to \$17 million this quarter.

Various factors have contributed to the difficulty of Business Finance in achieving their targets such as:

- Recruitment and retention of program personnel. The primary contractor's contract ended on September 30, 1997, and the contractor is operating on short-term bridge contracts while the main contract is being competed. The short-term nature of the bridge contracts and the uncertainty as to their extension has made personnel recruitment and retention difficult.
- Removal of an agent bank from the program in September 1997 for suspected misuse of funds. This action entailed considerable staff time which otherwise could have been used for making loans.
- Expansion of program activities to the Brcko and Banja Luka areas of the Republika Srpska. Over the next year, this action should increase the loan volume, but the initial start-up requires a shifting of resources.

Business Finance sends monthly bills to both the borrowers and the agent banks. Borrowers make interest and/or principal payments to their agent bank which then wires the money to the Central Bank's Bank of America repayment account. The funds in the repayment account have been used for future lending. The interest and/or principal repayments are tracked and recorded by Business Finance. According to a Business Finance delinquency report as of September 30, 1997, 16 borrowers are delinquent. Business Finance will review each borrower's situation and attempt to

work out a solution or restructure the loan. A loan restructuring and work out specialist has been hired to focus full time on the problem loans.

Technical Assistance. Business Finance reported that a cumulative total of 62 seminars and workshops had been completed in Sarajevo, Tuzla, and Banja Luka with a total attendance of 1,815 bankers, prospective borrowers, and consultants. Courses offered included:

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

These and other courses will continue to be offered through December 1997.

<p>Audit Test Results</p>

Loan Program. USAID/Bosnia-Herzegovina approved the disbursement of \$49 million through 18 agent banks to 92 borrowers since the beginning of the program. The majority of the loans are financing building repairs and reconstruction, machinery and equipment purchases, raw material purchases, and working capital. This reporting period, we visited two agent banks which handle 53 loans in the BRF program. Although one agent bank appeared to be adequately monitoring the use of loan proceeds by borrowers, the other (Hippo Banka) has been removed from the program by Business Finance due to a lack of sufficient and qualified management and the apparent misuse of funds.

We also visited 16 borrowers to verify the existence of the business and the use of loan proceeds. Some potential problems were noted at the borrowers visited which should be closely monitored. These potential problems include production not yet started or less than planned and a lack of anticipated markets. The results of our audit tests are detailed below.

Visits to Agent Banks⁷

Agent Bank	No. of Loans	Total Loan Amount
Hippo Banka , Zenica (Removed from program subsequent to visit. Loans have been reassigned to other banks)	16	\$6.9 million
Komercijalna Banka d d , Tuzla	37	\$11.2 million

⁷ Actual records and documents reviewed did not always total the loan amount as many borrowers had not used all of the loan proceeds.

Visits to Borrowers

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
1	Hippo, Zenica	\$594,270	Build auto parts facility and purchase equipment Expected to generate 92 jobs	Facility not built yet, awaiting building permit Equipment has been purchased but not delivered Agent bank delayed disbursements
2	Hippo, Zenica	\$658,025	Purchase wood processing and tool and maintenance equipment Expected to generate 85 jobs	Equipment has been purchased but not completely mounted and installed yet Business operating according to plan Agent bank delayed disbursements
3	Market, Sarajevo	\$443,384	Purchase equipment, tools and raw materials for dumpster production line Expected to generate 98 jobs	Equipment has been purchased but has not been installed yet However, dumpsters have been produced using old equipment Ability to sell those dumpsters is a concern as organizations donating dumpsters was not anticipated
4	IKB, Zenica	\$658,328	Purchase equipment and raw materials for the clothing production line Expected to generate 669 jobs	Equipment and raw materials purchased but funded through a bridge loan, loan proceeds were used to pay off the bridge loan Production better than planned
5	Market, Sarajevo	\$987,037	Purchase production equipment and raw materials for a telephone wire cable production line Expected to generate 130 jobs	Equipment has been purchased but not delivered and installed, thus production has not started yet but should start in late 1997

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
6	Market, Sarajevo	\$658,328	Purchase equipment and raw materials for a publishing and printing facility Expected to generate 70 jobs	Equipment has been purchased Production has started but is not working at full capacity
7	Ljubljanska, Sarajevo	\$408,163	Build a cattle feed barn and purchase 2 trucks for beef operation Expected to generate 60 jobs	Construction of barn is near completion Trucks have been purchased Cattle processing has not yet begun Borrower wants longer term loan
8	Komercijalna, Tuzla	\$535,173	Purchase equipment for a poultry and beef facility Expected to generate 71 jobs	Equipment has been purchased Production began but is lower than expected
9	Komercijalna, Tuzla	\$526,662	Purchase equipment and raw materials for aluminum roof production Expected to generate 12 jobs	Equipment has been purchased Production started but slow Due to depressed market for construction and roofing materials, principal and interest payments were not met, loan restructured - the first in the program
10	Vakufska, Sarajevo	\$855,735	Build and equip a new fruit and vegetable processing plant Expected to generate 51 jobs Also, significant indirect employment (400 farm families)	Plant is constructed and equipment has been purchased Production started but has not reached projections Construction plans were changed to meet int'l standards which required more time and money than originally planned
11	Komercijalna, Tuzla	\$180,957	Repair building and purchase equipment for table eggs production Expected to generate 10 jobs	Building has been repaired and equipment has been purchased but some more installation work has to be done Production should start within a week
12	Komercijalna, Tuzla	\$208,123	Repair building and purchase equipment for broiler chicken operation Expected to generate 16 jobs	Repair work on building was underway and equipment has been purchased Production has not started yet

Borrower	Agent Bank	Loan Amount	Purpose of Loan	Comments/Exceptions Noted
13	Tuzlanska, Tuzla	\$658,328	Purchase equipment and parts for a state-owned farm Expected to generate 97 jobs	Equipment has been purchased but of a different make than planned Production is less than planned
14	Hippo, Zenica	\$658,328	Purchase equipment for wood parquet processing facility Expected to generate 81 jobs	Machines have been purchased but other equipment to complete the process has not been bought due to shortage of funds Production has not started as the facility is incomplete Agent bank delayed disbursements
15	Hippo, Zenica	\$658,328	Construct a new building and purchase equipment for a paint and glue factory Expected to generate 20 jobs	Construction of production facility has not been completed, building site is different from original plan Equipment has been purchased but has not been delivered Production has not started in new facility, however, paints and glues continue to be produced in old plant Agent bank delayed disbursements
16	Universal, Sarajevo	\$657,090	Purchase 2 complete production lines for tiles and set up a roof tile manufacturing plant Expected to generate 47 jobs	Production lines have been purchased and plant has been set up Facility is now in production Vast quantity of roof tiles in inventory, has not been able to generate the sales targeted in the plan due to illegal import of tiles that sell for less Borrower formed assn and is lobbying Gov't for assistance

Unaudited Bosnian Reconstruction Finance Facility Fund Accountability Statement <i>as of September 30, 1997</i>

The amounts that USAID/Bosnia-Herzegovina budgeted and obligated for the five-year Bosnian Reconstruction Finance Facility program are shown below, however, the program has a three-year budget. The amount obligated for the On-Lending Program represents the balance-of-payments support to Bosnia-Herzegovina. Of the \$99.5 million transferred to Bosnia-Herzegovina, \$49 million⁸ has been transferred as loans to borrowers. The disbursed implementation costs are amounts paid by USAID.

	3 Year Program Budget	Amount Obligated	Amount Disbursed
On-Lending Program	\$256,000,000	\$99,540,000	\$99,540,000
Implementation Costs:			
Contractors	17,500,000	22,552,097	11,354,405
Audit, Program and Evaluation	1,500,000	1,067,331 ⁹	646,169 ⁹
Environmental Monitoring	600,000	0	0
USAID Program Management	0	290,990	236,599
Contingencies	2,400,000	0	0
Totals	<u>\$278,000,000</u>	<u>\$123,450,418</u>	<u>\$111,777,173</u>

⁸ Loans were disbursed in Deutsche Marks, the medium of exchange in Bosnia-Herzegovina. A total of 75,991,231 Deutsche Marks were disbursed and converted at the exchange rates of the four tranches using the first-in, first-out approach.

⁹ The total amounts obligated (\$2,134,662) and disbursed (\$1,292,338) were equally divided between the Bosnian Reconstruction Finance Facility and the Municipal Infrastructure and Services programs (see Audit Report No. B-168-98-003-P).