Office of Inspector General

November 13, 2012

MEMORANDUM

TO: USAID/Serbia Mission Director, Susan Fritz
USAID/Kosovo Regional Contracting Officer, Brian Aaron
USAID/E3/MPEP Director, Shari Berenbach

FROM: IG/A/PA, Director, Steven Ramonas /s/

SUBJECT: Review of USAID/Serbia's Opportunity Bank Project
(Report No. 9-000-13-001-S)

USAID's Office of Inspector General (OIG), Performance Audits Division conducted a review in response to an inquiry from the regional contracting officer in Budapest. The officer asked for a review of USAID/Serbia's Opportunity Bank project to determine whether it was designed and implemented to meet the dual objectives of issuing loans to the underserved population of Serbia and providing for funds to be paid back to USAID at the end of the project. Based on our review, we made the following conclusions.

- Opportunity International (OI) created and developed a microfinance institution in Serbia to issue loans to the underserved population of Serbia, but the project was not designed, from the outset, to require funds to be paid back to USAID at the end of the project.

- The repayment requirement in Modification 2 of the agreement is legally binding.

- USAID lacks clear guidance for disposition of funds at the end of microfinance type awards.

The mission's original cooperative agreement with OI dated September 29, 2003, included an initial equity investment of $8 million, but it did not outline repayment requirements clearly. Subsequently, in Modification 2 dated December 8, 2005, the mission added language that required OI to repay the entire equity investment amount, plus 3 percent interest, at the end of the project.

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Even though OI signed the modification in December 2005, the $8 million was not recorded as a liability by OI until 2010. The 2010 A-133 financial audit report[1] stated that, during OI's negotiations with USAID to extend the Serbia grant agreement, "it became apparent to [OI] management in late 2010 that USAID was expecting repayment from its initial equity investment made in 2005; however, management did not perform or document an analysis to determine the appropriate accounting treatment of the transaction until September 9, 2011." An OI official said they did not record the $8 million as a liability at the time because they interpreted the language in Modification 2 to mean one of three things: (1) OI would repay USAID when it sold Opportunity Bank Serbia, (2) OI would repay USAID in 2011, or (3) the agreement officer could decide to forgive the debt altogether because of the language in the modification stating "except as agreement officer may otherwise direct." Equivocal language around a financial transaction of this nature does not seem appropriate; OI interpreted this language to be a loophole.

The OI official said other similar agreements OI had in place at the time with USAID in Albania and Montenegro did not have a repayment requirement. USAID/Washington staff confirmed that the Agency historically has given funds to organizations to establish microfinance institutions without stating clearly in the award document what would happen to those funds at the end of each project.

OI has since agreed to repay the funds, and Modification 5, dated September 24, 2012, includes a disposition plan with a timeline and milestones. However, the project was not designed originally to require that OI repay the funds to USAID.

OIG asked the USAID Office of the General Counsel to review the agreement and the repayment provision in Modification 2 and to provide a legal opinion on whether the repayment requirement is legally binding. Officials in that office determined that the provision is valid and binding and provided guidance for how the Agency should enforce the terms of repayment. Therefore, we make the following recommendations.

> ***Recommendation 1:*** *We recommend that USAID/Serbia and the regional contracting officer[2] responsible for the agreement follow the guidance provided by the USAID Office of the General Counsel regarding how USAID should enforce the terms of repayment.*

> ***Recommendation 2:*** *We recommend that USAID/Serbia report in writing on the progress against each of the milestones outlined in the disposition timeline contained in Modification 5 to the regional contracting office, and provide an explanation and any associated mitigating circumstances for milestones that are not met.*

During the review, we learned about other USAID-funded projects where the lack of clear disposition requirements at the outset caused misunderstandings at the end over whether or not—or how—Agency funds were to be repaid, turned over to the supported organization, or applied to a new activity. ADS Chapter 219, Microenterprise Development, contains no disposition guidelines. According to USAID's Europe and Eurasia Enterprise Oversight Team, their past experiences with investment funds have showed that clear expectations and guidance on how to use assets remaining at the end of activities should be defined at the outset. Though investment funds and microfinance institutions are different types of organizations, similar

[1] Annual financial audits are required by the Office of Management and Budget Circular A-133.
[2] As of October 2012, USAID/Kosovo's regional contracting office provides acquisition and assistance coverage for USAID/Serbia.

complications can arise when the rules governing the disposition of funds are not stated clearly up front.

Based on the above, we make the following recommendation.

> ***Recommendation 3:*** *We recommend that USAID's Office of Microenterprise and Private Enterprise Promotion work with other offices in USAID to develop microfinance institution disposition guidance for existing agreements as well as future agreements and document the results.*

cc: USAID/M/CFO/APC, Gloria White
USAID/Serbia Controller, Rebecca Krzywda
USAID/GC/A&A Attorney Advisor General, Linda Leonard

EVALUATION OF MANAGEMENT COMMENTS

On December 13, 2012 and January 18, 2013, USAID/Serbia and USAID's Office of Microenterprise and Private Enterprise Promotion (MPEP) provided responses to our management letter. On the basis of information provided by USAID/Serbia and MPEP, we determined that management decisions have been reached on all three recommendations.

In their response, USAID/Serbia included details regarding a meeting that took place with Opportunity International (OI) on November 16, 2012. During this meeting, OI expressed concerns about being able to meet their liability to USAID. OI subsequently submitted a revised proposal and business plan on December 5, 2012 with a commitment for OI to return to USAID a portion of the proceeds from the sale of Opportunity Bank Serbia (OBS). The amount proposed to be returned to USAID is significantly less than the amount currently required by the cooperative agreement. USAID/Serbia is currently analyzing OI's proposal and business plan, and is working with the regional contracting officer and regional legal advisor on a response.

Recommendation 1. USAID/Serbia and the regional contracting officer agree to follow the guidance provided by USAID's Office of the General Counsel (according to which Modification No. 02 is a binding modification) regarding how to enforce the terms of repayment. The mission plans to come to an agreement with OI for re-programming the funds for purposes and activities consistent with the cooperative agreement and issue a new modification setting forth the terms for the reprogramming. The details of this will be negotiated with OI as part of USAID/Serbia's response to the December 5, 2012 proposal from OI. Accordingly, a management decision has been reached.

Recommendation 2. USAID/Serbia agrees to report in writing on the progress against each of the milestones outlined in the disposition timeline contained in Modification No. 05 to the regional contracting office, and provide an explanation and any associated mitigating circumstances for milestones that are not met. This shall be in addition to - and in response to - the monthly updates that OI is required to provide to USAID on the status of the disposition plan milestones. Accordingly, a management decision has been reached.

Recommendation 3. MPEP agrees to develop microfinance institution disposition guidance for existing and future agreements by July 8, 2013. For existing agreements, they will determine if the appropriate disposition language is already contained in the agreement. If not, they will assist with drafting appropriate language to be incorporated into the agreement through a modification. MPEP will also draft standard language to be incorporated into any new agreements under which direct support will be provided to microfinance institutions. This language will provide clear guidance and draft agreement language that can be used in the future for the support of microfinance institutions.

While this recommendation is not an action for USAID/Serbia, USAID/Serbia noted that its Economic Growth Office has been in contact with MPEP to provide updates regarding the issues surrounding OI and OBS and will continue to do so in order to inform their guidance.

Accordingly, a management decision has been reached.