

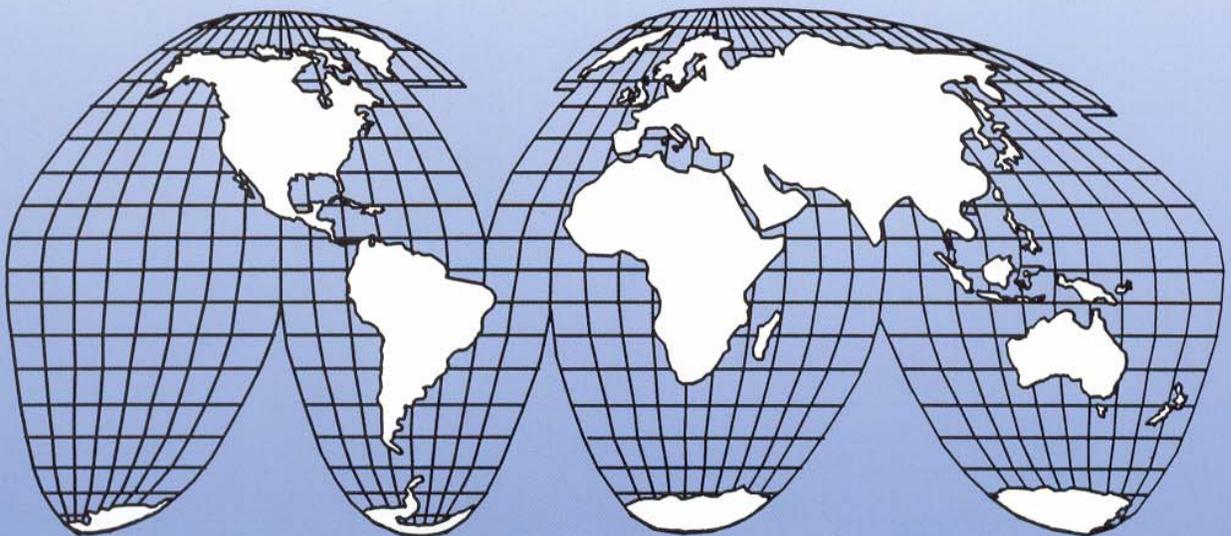
USAID

OFFICE OF INSPECTOR GENERAL

Audit of USAID/Bosnia-Herzegovina's Business Development Program

Audit Report No. B-168-03-003-P

June 26, 2003



**U.S. Agency for International Development
Budapest, Hungary**



June 26, 2003

MEMORANDUM

FOR: USAID/Bosnia-Herzegovina, Mission Director, Howard Sumka

FROM: Director of Audit Operations, RIG/Budapest, Nathan S. Lokos /s/

SUBJECT: Audit of USAID/Bosnia-Herzegovina's Business Development Program (Report No. B-168-03-003-P)

This is our final report on the subject audit. This report presents the results of our Audit of USAID/Bosnia-Herzegovina's Business Development Program. Our audit was designed to determine the status of USAID/Bosnia-Herzegovina's (USAID/BiH) Business Development Program (BDP) and the extent to which the Mission monitored the program. While we found that USAID/BiH was generally monitoring the implementation of the BDP; we also found that some of that monitoring could be strengthened. Therefore, this report contains five recommendations.

We consider that management decision were made and final action taken on all five recommendations.

We appreciate the cooperation and assistance provided to the auditors on this assignment.

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Summary of Results

This audit was designed to determine the status of USAID/Bosnia-Herzegovina's (USAID/BiH) Business Development Program and whether the Mission monitored the program to ensure that results were achieved in accordance with Agency guidance.

USAID and Central Bank of Bosnia-Herzegovina (CBBH) officials have revised, expanded and extended the Business Development Program to promote economic revitalization projects within Bosnia-Herzegovina. These projects have included, among other things, providing loans to both individuals and fully licensed banks, providing home mortgage loans, and authorizing the use of grant proceeds to fund technical assistance contracts (see page 7).

USAID/BiH has generally monitored the Business Development Program to ensure that intended results were achieved. However, we determined that the Mission should strengthen its monitoring by verifying the validity and accuracy of the program's bank account information (see page 12), improving its cash management (see page 13), verifying reported job-creation data (see page 15), periodically assessing its management controls (see page 17), and developing training plans for Cognizant Technical Officers as necessary (see page 18).

USAID/BiH officials appreciated the cooperation and proactive communication with the audit staff and took final action on all of the recommendations.

Background

In March 1992, Bosnia-Herzegovina's move toward independence from the former Socialist Republic of Yugoslavia precipitated a war in the country that lasted for more than three years—from 1992 until the signing of the Dayton cease-fire agreement on October 10, 1995.

(The distributed report included two maps, but because of problems in complying with Section 508 for posting to the website, the maps and introductory sentence have been deleted. Otherwise, the report remains the same.)

After the Dayton cease-fire agreement, the Government of Bosnia-Herzegovina (GOBH) faced the challenges of keeping peace and restructuring its war-torn economy. To help the GOBH meet these challenges, on March 29, 1996, House Joint Resolution 170 (Public Law 104-122) appropriated \$198 million for assistance to Bosnia-Herzegovina in order to address concerns regarding its physical and economic infrastructure.

USAID involvement in Bosnia-Herzegovina began in May 1996 when the Assistant Administrator for the Bureau for Europe and Eurasia (E&E Bureau)¹ authorized a five-year, \$278 million Bosnian Reconstruction Finance Facility (BRFF) Program.² On May 7, 1996, the United States and Bosnia-Herzegovina signed USAID Grant 168L-601 and initiated the BRFF Program, designed to provide the GOBH with immediate balance of payments assistance to “jump-start economic growth and generate employment opportunities for the general population, including refugees and demobilized soldiers.” USAID subsequently obligated and transferred \$232.9 million to the Business Development Program Accounts for loans and technical assistance for the Bosnian people.

In June 2001, Mission officials funded other initiatives to promote economic revitalization projects within Bosnia-Herzegovina. As a result, USAID and Central Bank of Bosnia-Herzegovina (CBBH) officials revised, expanded and extended the Business Development Program.³ The program revision and expansion included, among other activities, providing loans to both individuals and fully-licensed banks, providing home mortgage loans, and authorizing the use of grant proceeds to fund technical assistance contracts. With an extension of the program, the Mission plans to transfer program resources, in phases, to the ownership and control of the GOBH beginning in June 2003.

Audit Objectives

Since 1997, the USAID Office of Inspector General (OIG) has issued nine audit reports on the status of the USAID/Bosnia-Herzegovina’s Business Development Program.⁴ In accordance with its Fiscal Year 2002 audit plan, the Office of Inspector General performed this audit to answer the following questions:

¹ USAID’s Bureau for Europe and Eurasia was formerly named the Bureau for Europe and the New Independent States.

² In June 2001, the name changed to the Bosnia Business Development Program.

³ The CBBH worked with USAID on behalf of the Government of Bosnia-Herzegovina.

⁴ See Audit Report Nos. B-168-97-002-P, dated March 26, 1997; B-168-97-006-P, dated June 27, 1997; B-168-98-001-P, dated October 10, 1997; B-168-98-004-P, dated March 26, 1998; B-168-99-001-P, dated October 30, 1998; B-168-99-004-P, dated August 18, 1999; B-168-00-004-P, dated February 25, 2000; and B168-01-001-P, dated December 21, 2000. Also, see Memorandum Report No. B-168-98-003-S, dated July 21, 1998.

- **What is the status of USAID/Bosnia-Herzegovina’s Business Development Program?**
- **Has USAID/Bosnia-Herzegovina monitored the Business Development Program to ensure that intended results are achieved?**

The scope and methodology of this audit are detailed in Appendix I.

Audit Findings

What is the status of USAID/Bosnia-Herzegovina’s Business Development Program?

As of February 28, 2002, USAID/BiH had approved 572 loans valued at \$157 million and reported the creation of an estimated 17,432 jobs within the country.⁵ Moreover, as detailed below, USAID/BiH obligated a total of \$232.9 million in assistance for the Business Development Program.

SUMMARY OF OBLIGATIONS AND FUND TRANSFERS BUSINESS DEVELOPMENT PROGRAM

OBLIGATING DOCUMENT	AMOUNT (millions)	DATE OF FUNDS TRANSFER
Grant Agreement	\$27.5	July 1996
Amendment #1	12.5	November 1996
Amendment #2	19.5	May 1997
Amendment #3	40.0	September 1997
Amendment #4	30.0	April 1998
Amendment #5	65.4	September 1998
Amendment #6	38.0	February 1999
Amendment #7	0.0	June 2001
Total Obligated and Transferred	\$232.9	

Source: Audited USAID/BiH data

⁵ The Mission used a “blended rate” of the value of the Bosnian Konvertible mark (KM) currently against the U.S. dollar in its reports, since the exchange rate fluctuated. As a result, historically, the value of the approved loans could fluctuate accordingly.

The Business Development Program was developed and implemented under USAID/BiH's Strategic Objective 3.1, entitled "Recovery from Crisis." The \$232.9 million was transferred into a separate dollar account at a U. S. bank to provide funds for economic growth and to generate employment. Although the program was originally developed to provide balance of payment assistance to the GOBH through May 1, 2001, the Mission amended the program grant agreement in June 2001 and estimated cash flows for two of the accounts.

In accordance with the program grant agreement that initiated the Business Development Program, the Mission and the GOBH opened three program bank accounts with the Bank of America in 1996.⁶ The U. S. Government transferred grant funds in U. S. dollars, which were immediately converted to Deutsche Marks (DM), to Account 1⁷. The DMs were then deposited into an interest-bearing account (Account 2) from which loans were to be provided to qualified applicants. USAID/BiH and the CBBH jointly approved all disbursements from Account 2. The officials also used another foreign currency account—a Repayment Account or Account 3—established to receive loan repayments from borrowers.⁸

Seventh Grant Amendment Revises Program

On June 19, 2001, USAID/BiH and the CBBH jointly signed a seventh amendment to the program grant agreement that revised, expanded, and extended the program. Amendment 7 contained revisions that, among other things, changed the name of the program from the Bosnian Reconstruction Finance Facility Program (BRFF) to the Business Development Program, revised the program by redeploying existing resources among existing and new activities, and extended the program. This amendment replaced Annex 1 of the original grant agreement with "Annex 1A to Grant Agreement" and included additional revisions that:

- Extended the program to allow loans not only to commercially viable Bosnian enterprises, but also to fully licensed banks and to individuals as prime beneficiaries;
- Authorized reimbursement of funds from the Separate Account 2 to Repayment Account 3;
- Authorized the return of funds to the U.S. Government;

⁶ These accounts, Accounts 1, 2, and 3, are held in the Bank of America in Frankfurt, Germany.

⁷ In October 2001, the program's Deutsche Marks accounts were converted to Euro accounts.

⁸ From January through May 2000, the Mission and CBBH officials made \$1 million in loan disbursements to borrowers from Account 3. However, the officials decided to discontinue making loans from Account 3 and resumed disbursing loans from Account 2 after May 2000.

-
- Permitted home mortgage loans of up to 15 years;
 - Authorized bank lines of credit, not to exceed 7 years; and
 - Authorized the creation and funding of a Program Trust Account—Account 4—to facilitate continued funding of technical assistance contracts.

Moreover, a variety of additional program guidelines were either revised or added by Annex 1A.

Between April 2000 and March 2002, the Mission and the CBBH jointly approved, signed, and issued 15 Project Implementation Letters (PILs), valued at about \$107 million, to provide guidance on implementing various aspects of the Business Development Program. The chart in Appendix III summarizes the PIL number, the source of Program account funding, the U. S. Dollar equivalent authorized, and the purpose of the PIL .

Business Development Program Account Balances Reflect Expanded Program

During the 26-month period from January 2000 through February 2002, USAID/BiH and the CBBH approved disbursements from Account 2 and Account 3 that significantly impacted the combined balances of those accounts. In addition, two new bank accounts were opened—Account 4 and Account 5. As shown in Appendix IV, the balance of Account 2 ranged from approximately \$120 million in January 2000 to about \$49 million in February 2002. During that period, USAID/BiH and CBBH:

- authorized the disbursement of about \$19 million in loans from Account 2;
- transferred another \$19 million to other accounts for non-lending projects;
- transferred another \$40 million to a newly established Account 5; and
- paid \$1 million for a banking and account information system project.⁹

During this same time, Account 3 increased from \$13 million to \$16 million, as shown in Appendix V. Finally, using funds transferred from both Accounts 2 and 3, the Mission opened both Account 4 and Account 5 in Calendar Year 2001.

Mission Opens Account 4 - As authorized by the Seventh Amendment to the program grant agreement, the Mission opened a fourth account called the Program

⁹ During this time, Account 2 also earned \$8 million in interest.

Trust Fund Account or Account 4, which is owned by USAID as a trustee for the GOBH.¹⁰ As the trustee for the GOBH, the Mission opened this account in March 2001 for the expanded programs authorized by Amendment 7.

Between March 2001 and February 2002, USAID/BiH and CBBH transferred approximately \$47 million from Accounts 2 and 3 to Account 4. During the same time, the Mission also disbursed about \$12 million from Account 4 for technical assistance (as shown in Appendix VI). After calculating interest earned and the impact of exchange rate fluctuations, the balance of Account 4 was about \$35 million as of February 28, 2002.

Mission Opens Account 5 - In accordance with Section 4.2 of the Seventh Amendment of the program grant agreement, the U. S. Government (USG), acting through USAID, could require the Grantee to return any or all grant proceeds that had not been disbursed from DM Account 2. On October 25, 2001, the USG exercised its right to a refund of \$40 million from DM Account 2. USAID/BiH opened a Local Currency Trust Fund Account, or Account 5, with the transferred funds¹¹ and plans to use these funds to finance economic development activities in Central and Eastern European countries. USAID officials planned to use the transferred funds for programs at the American University of Bulgaria, the South East Europe (SEE) University in Macedonia, and the Good Governance and Ethnic Tolerance Fund for Southeast Europe. As of February 28, 2002, the Mission had paid only \$3 million to SEE, leaving a balance in the account of \$36 million. (See Appendix VI for details.)

Business Development Program Achievements

As of June 30, 2002, the Mission reported that Business Finance¹² had disbursed 606 loans valued at approximately \$125 million¹³ for commercial loans, consumer home loans, and lines of credit to banks and micro-credit organizations. At that time, the approximate value of the loan portfolio was \$49 million. Moreover—

¹⁰ Account 4 is a Foreign Currency Trust Fund account held in Euros.

¹¹ USAID officials determined that the DM Account 2 funds had been previously obligated and disbursed under the Business Development Program and were nonappropriated funds that were not subject to certain pre-obligation requirements.

¹² Business Finance, operated by the Barents Group, is composed of a team of experienced U. S. bankers, accountants, and Bosnian staff. Its responsibilities include reviewing and recommending Business Development Program loan applications for USAID approval.

¹³ The number of loans represents all loans—mortgage, small-medium enterprise and letters of credit—according to an internal Mission report. The average exchange rate in June 2002 was KM 2.1 to the U.S. dollar.

and perhaps more importantly—the Mission also reported that the Business Development Program had generated more than 17,000 jobs. Although the Mission reported that the BDP generated 17,000 jobs, this figure was an estimate only. Later in June 2002, the Mission verification showed less than 17,000 jobs had been created (see page 16).

Mission Develops Business Development Program Transfer Plan

After June 30, 2003, USAID/BiH plans to transfer the Business Development Program resources to the ownership and control of the CBBH in three stages. The transfer plan contains the methods for selling the loans and the administration of the proceeds of loan sales and any remaining grant funds.

Loan Sales - USAID/BiH officials expect the Bosnian banks currently managing Business Development Program loans will have the right of first refusal to purchase those loans. The remaining loans would be sold via bids to any bank making an acceptable offer.

Sales Method - Agent banks may be allowed to pay cash for the value of the loans purchased or to borrow the funds and pay the loan proceeds for the value of the Business Finance loans purchased. The Mission expects these loans to be structured as “tier two” capital or sub-debt on bank balance sheets.

Administration - USAID/BiH officials expect that proceeds from the loan sales, micro-credit organization line-of-credit repayments and agent bank sub-debt repayments, as well as any remaining grant funds, will be deposited in an account of the Central Bank of Bosnia-Herzegovina for a duration approved jointly by the CBBH and USAID.

Has USAID/Bosnia-Herzegovina monitored the Business Development Program to ensure that intended results are achieved?

We found that USAID/BiH had generally monitored the Business Development Program to ensure that intended results were achieved. For example, the Mission routinely maintained contact with Business Finance, reviewed loan control documents being evaluated by its contractor, reviewed the contractor’s job-creation data, and maintained contact with some of the loan recipients as well as CBBH officials. However, we also determined that the Mission should strengthen its monitoring by reviewing Business Development Program bank account information, improving its cash management, periodically verifying reported job-creation data, periodically assessing its management controls, and developing training plans for Cognizant Technical Officers as necessary.

USAID/BiH Should Strengthen Controls Over Business Development Program Bank Accounts

Reported Data Should Be Verified – USAID’s Automated Directives System (ADS) E596.5.1a requires cognizant managers to ensure that appropriate and cost-effective management controls are established to (1) safeguard the integrity of programs and operations and (2) facilitate the achievement of results. Moreover, the Standards for Internal Control in the Federal Government, issued by the U.S. General Accounting Office, stresses that ongoing monitoring should occur in the course of normal operations.

We found that USAID/BiH relied on its contractor, Business Finance, to review and reconcile Business Development Program Bank Accounts 2 and 3 in order to ensure that the Bank of America had properly recorded and reported transactions. In addition, Business Finance performed extensive accounting services and provided the Mission with numerous financial reports regarding the Business Development Program accounts. However, despite the Mission’s reliance on Business Finance and its reporting, USAID/BiH did not take steps to verify the reported data.

According to the Mission, this absence of review occurred because USAID/BiH relied on Business Finance—as its financial expert—to adequately review, manage and report on the program accounts. In addition, Mission officials relied on this contractor to ensure that they had the best available data for making management decisions.

Although the Mission relied on data provided by Business Finance to monitor numerous aspects of the Program, USAID/BiH did not periodically verify reported information against source documents to ensure its accuracy. As a result, USAID/BiH could not know the appropriate degree of reliance that could reasonably be placed on Business Finance’s reports.

Recommendation No. 1: We recommend that USAID/Bosnia-Herzegovina periodically verify the validity and accuracy of financial information reported by the Business Development Program contractor.

As a result of our audit, the Mission has already begun to review the Business Development Program bank account information on a monthly basis and has revised the Cognizant Technical Officer’s job description to include a work objective requiring the monthly review of the program’s account information. Consequently, we consider final action to have been taken on the recommendation upon issuance of this report.

Cash Management Should Be Strengthened – USAID policy normally requires that interest earned by a host country on funds disbursed under program assistance be remitted to the U. S. Treasury. Exceptions to the policy are allowed if there is a compelling foreign policy justification. Based on the high priority given reconstruction and rehabilitation assistance to Bosnia-Herzegovina, the Business Development Program grant agreement waived the requirement that the GOBH remit such interest. In that way, the interest earned on program funds could be used to forward the program’s development goals. USAID policy also requires that interest earned on trust fund accounts be maximized (ADS 627.5.6). This requirement, however, was not waived.

During 2000 and 2001, the Business Development Program Bank Accounts 2, 3, 4 and 5 had no less than \$130 million combined on deposit at any one time. Moreover, the accounts earned more than \$9 million of interest and paid more than \$75,000 in bank fees for the administration of the accounts. The Bank of America paid interest on these four accounts at a lower “overnight” rate instead of a higher “time deposit” rate. The overnight rate can fluctuate daily and is usually the lowest rate that a bank pays on any given date. By contrast, time deposit rates, which are usually higher, are paid on funds that can be left on deposit for longer periods of time, such as 30 days, 90 days or longer.

Mission officials indicated that an overnight rate had been desirable because the Business Development Program account funds needed to be available for withdrawal on a daily basis. Moreover, because of Business Finance’s banking and financial expertise, Mission officials had relied on Business Finance to advise them and the CBBH on important matters, such as interest and bank fees. In contrast, Business Finance believed that USAID and the Government of Bosnia-Herzegovina were responsible for these aspects of funds management. Finally, Mission officials noted that they believed that the Government of Bosnia-Herzegovina, as grantee, was ultimately responsible.

Although USAID/BiH needed some program funds available on a daily basis, the Mission did not need all of the funds available as evidenced by the large account balances, balances which did not fall below \$130 million combined. Since the retention of interest was an important part of the program grant agreement, we believe that had the Mission monitored the Business Development Program monthly account balances, interest earned, and fees paid more closely, such monitoring would have helped to maximize the amount of interest earned and the total amount of funds available for grant purposes. For example, a single percentage point increase in the interest rate would equate to approximately \$2.6 million of additional interest over two years. Accordingly, we are making the following recommendation:

Recommendation No. 2: We recommend that USAID/Bosnia-Herzegovina assess the available banking options so as to

maximize the interest earned and minimize the fees paid by the Business Development Program bank accounts, while maintaining appropriate liquidity.

In response to our concerns, USAID/BiH contacted the Bank of America to renegotiate the program's bank fees during our audit. However, the bank refused to decrease its fees for administering the program bank accounts. Nevertheless, during the past several months, the Mission has worked with Bank of America to maximize the interest earned on the accounts. For example, on a monthly basis since the beginning of our audit, the Mission Controller has communicated with bank officials to evaluate the interest earned on the program accounts. We believe that the Mission is making appropriate efforts to minimize the fees assessed to, and maximize the interest earned on, the Business Development Program accounts. Accordingly, we consider final action has been taken on the recommendation as of the date of this report.

Mission Should Strengthen Controls Over Transactions - ADS 596.3.1 requires managers to employ control activities that, among other functions, safeguard assets, and properly record and account for expenditures. In September 2000, USAID/BiH and the CBBH modified one aspect of the Business Development Program's lending policies to include a home mortgage lending facility. While we found that the Mission performed a supervisory review of the initial loan documentation to effect a disbursement, it did not review the final loan recommendation packages.

The Mission implemented a pilot program in November 2000 that provided 43 USAID, U. S. Embassy Sarajevo, nongovernmental and international organization Bosnian employees with home loans valued at approximately \$1.2 million. The Mission's Controller's Office began the disbursement process for these loans with the Central Bank of Bosnia-Herzegovina, the Bank of America, and the Micro Enterprise Bank using a pre-approval Consumer Home Loan Recommendation document.

Although the Mission Controller¹⁴ reviewed control documents from Business Finance, CBBH, and the Bank of America, Mission officials authorized the disbursement of loan funds without the benefit of reviewing any final loan approval documentation. USAID/BiH did not require Business Finance to complete a final approved loan recommendation package after a prospective borrower completed additional essential loan requirements regarding the property to be purchased. Such property details included the type of property, seller and owner information, and registered deed information. Although Business Finance files contained some of this

¹⁴ The Controller was a U. S. Personal Services Contractor.

pertinent information offsite, USAID/BiH officials did not review that documentation before initiating the final approval to disburse the home loan funds to borrowers. Without supervisory review of final loan documentation before disbursement, we believe the Mission was lacking the necessary assurance that loans disbursed to borrowers met all of the established criteria.

The pilot program ended seven months after it began in June 2001. As a result, we are not making a recommendation to address this issue.

USAID/Bosnia-Herzegovina Should Verify Reported Job-Creation Data

USAID guidance states that sound decisions require accurate, current and reliable information.¹⁵ Moreover, while initial estimates may be necessary for making decisions at the beginning of a program, we believe that, once available, actual historical data—used to either supplement or supplant initial estimates—is highly valuable in making good management decisions.

In its May 1998 contract with USAID’s contractor, Business Finance, Mission officials highlighted that the primary objective of the Business Development Program was to increase sustainable employment in Bosnia-Herzegovina. Appropriately, when submitting loan applications, prospective borrowers were required to provide estimates of how many jobs would be created as a result of the proposed loan. However, despite the program’s emphasis on sustainable job creation, USAID/BiH did not require its contractor to follow up on these estimates to determine (1) how many jobs were actually created and (2) whether the created jobs were indeed sustained.

According to USAID/BiH officials, job-creation data was typically not verified or updated after a loan was approved because Mission officials believed that their highest priority was disbursing loan funds to as many qualified applicants as possible. In fact, even though Business Finance implemented a monitoring plan under which its staff made site visits to borrowers, the Mission did not require that Business Finance update the job-creation estimates originally submitted in those borrowers’ loan applications.¹⁶

¹⁵ USAID’s Performance and Monitoring and Evaluation TIPS No. 12 provides guidance on the Agency’s criteria and procedures for ensuring the quality of indicators and data for performance monitoring.

¹⁶ In our Audit Report No. B-168-01-001-P, we reported that— in response to one of our previous recommendations—Business Finance had initiated a monthly borrower contact-monitoring plan to track and report on site visits and other forms of contacts. As of December 2000, Business Finance had averaged over 400 site visits per month.

EMPLOYMENT VERIFICATION UPDATE		
Business Finance Office	Estimate of Full-Time Jobs to Be Created in Business Development Program Loan Recommendations	Owner's Estimate of Full-Time Workers Actually Hired
Banja Luka	1,052	977
Mostar	179	187
Problem Loans	7,733	684
Sarajevo	4,711	4,095
Tuzla	3,757	3,212
Totals	17,432	9,155

Source: Unaudited USAID/BiH data

Our tests of ten borrowers showed that their initial job-creation estimates had not been verified after loans were approved. In fact, our testing showed a wide variation of both over and under reporting of the number of jobs created. Based on these initial results, Mission officials requested that Business Finance verify the Business Development Program borrower employment figures. Business Finance's report of verified job-creation statistics indicated that actual employment figures totaled 9,155 full-time jobs created by the program—a decrease of 8,277 created or about 47 percent—less than the 17,432 full-time jobs previously reported based on initial estimates.¹⁷ It is important that USAID decision-makers have this type of accurate and reliable data for making management decisions. Without such data, USAID managers face heightened risk that they will not make the best decisions concerning the Business

¹⁷ Business Finance reported that 40 companies were classified as “out of business,” including eight that refused to cooperate. Consequently, its report did not include jobs that may have been created at the companies that went out of business. However, the fact that 32 of these 40 companies no longer existed seems to indicate that the jobs created at these firms were not sustainable. It should be noted that Business Finance's reported figure of 9,155 jobs created by the Business Development Program could be understated by the jobs created at the eight companies that refused to cooperate with the contractor. A schedule of all workers at Business Development Program-supported businesses is presented in Appendix VII.

Development Program. Accordingly, we are making the following recommendation:

Recommendation No. 3: We recommend that USAID/Bosnia-Herzegovina require that Business Finance, its Business Development Program contractor, (1) verify job-creation data for approved Business Development Program loans and (2) report on the verified number of jobs created.

We consider Business Finance's recent verification of Business Development Program loan and employment data as the final action necessary on this recommendation as of the date of this report.

Mission Should Periodically Assess Management Controls

ADS 596.3.2 states that managers must continuously assess and improve the effectiveness of their missions' management controls using a variety of information sources to, in part, assess the controls and identify deficiencies. Moreover, ADS 596.3.3.2 requires that each USAID mission establish a Management Control Review Committee (MCRC) to oversee that mission's management controls.

Accordingly, USAID/BiH issued Mission Order Number 1203, which established, among other things, the Mission's MCRC. This mission order stated that the MCRC has responsibility for ensuring the adequacy and effectiveness of the Mission's management controls and is required to periodically meet—at least quarterly—to assess and monitor its management control weaknesses. Unfortunately, the Mission had not conducted any MCRC meetings until May 2002. While Mission officials were unable to tell us why the required quarterly meetings were not held, one official did state that the MCRC had met formally to conduct the annual Federal Managers Financial Integrity Act (FMFIA) review.

Although USAID/BiH did not report any material internal control weaknesses in its Fiscal Years 1999, 2000 and 2001 FMFIA¹⁸ certifications, Mission managers had identified potential internal control weaknesses. During these periods, one Mission official stated that whereas USAID/BiH generally complied with FMFIA requirements in 2001, USAID/BiH did not conduct the required quarterly MCRC meetings. We believe that such meetings are key in helping to ensure that minor

¹⁸ The Federal Manager's Financial Integrity Act (FMFIA) requires that the heads of U.S. Government agencies provide the President with an annual certification concerning the adequacy of their internal controls. As part of the annual FMFIA process in USAID, each mission director provides an annual certification regarding that mission's internal controls to Bureau management.

internal control problems are addressed before they become more serious major internal control weaknesses. Consequently, we are making the following recommendation:

Recommendation No. 4: We recommend that USAID/Bosnia-Herzegovina conduct quarterly Management Control and Review Committee meetings.

USAID/BiH reports that it has commenced quarterly MCRC meetings. As a result, the OIG considers that final action has been taken on this recommendation as of the date of this report.

**Cognizant Technical Officers
Should Receive Formal Training**

ADS 202.3.4.3c notes that there may be situations where an individual who is not a certified Cognizant Technical Officer (CTO) is—nevertheless—nominated to serve in that role. In such cases, the ADS states that the mission must develop a written plan that allows that individual to receive the required training as quickly as possible in order to obtain the necessary competencies and subsequent certification as a CTO.

When the former CTO for the Business Finance contract was reassigned to USAID headquarters in Washington, D.C., one of the Business Development Program project management specialists assumed the role of CTO. Shortly thereafter, the cognizant contracting officer officially designated that project management specialist as the Business Development Program CTO. Although the current CTO is highly capable and knowledgeable about the components of the program, the Mission has not developed a plan to ensure that she receives the required training.

According to Mission officials, USAID/BiH was unable to ensure that the designated CTO receive the required training because of an increased workload and other competing priorities. Moreover, we believe that Mission officials did not develop the requisite training plan because they were unaware of this requirement.

USAID CTOs perform important contract-related duties, such as monitoring the performance of USAID contractors. Without the required training, USAID/BiH faces the heightened risk that the Business Development Program CTO may not be properly equipped to perform his or her required duties, duties which help ensure that USAID receives the highest level of performance from its contractors.

Shortly after our audit fieldwork, the CTO for the Business Development Program

received her first formal class of CTO training. However, to ensure that this and other Mission CTOs are fully equipped to perform their duties, we are making the following recommendation:

Recommendation No. 5: We recommend that USAID/Bosnia-Herzegovina (1) identify Cognizant Technical Officers who are not certified and (2) develop training plans to ensure that those Cognizant Technical Officers are provided the required training.

As of February 2003, the Mission developed a formal training plan for its CTOs. In particular, the Business Development Program CTO has successfully completed four formal acquisition and assistance classes. Therefore, the OIG considers that the Mission has taken final action on this recommendation as of the date of this report.

**Management
Comments and
Our Evaluation**

USAID/BiH officials appreciated the cooperation and proactive communication with the audit staff and took final action on all of the recommendations. Their comments are included as Appendix II of this report.

**Scope and
Methodology****Scope**

The Regional Inspector General/Budapest conducted this audit in accordance with generally accepted government auditing standards, to determine the status of USAID/Bosnia-Herzegovina's Business Development Program and the extent to which the Mission monitored the program to ensure that intended program results were achieved.

The audit focused primarily on program activities conducted from April 1, 2000 to February 28, 2002 at various locations within the country. The program activities were valued at approximately \$233 million, with approximately \$107 million authorized for expenditures during this time frame. These activities related to USAID/Bosnia-Herzegovina's Strategic Objective Number 3.1, entitled "Recovery from Crisis." During the audit we examined the Mission's pertinent management controls including—but not limited to—Mission policies and procedures, monitoring practices and supervisory review. In addition, we also considered relevant findings from prior audits.

Methodology

In answering the audit objective, we reviewed (1) USAID/Bosnia-Herzegovina's Business Development Program bank account data and contractor financial reports; (2) contractor job-creation data; (3) the Mission's guidance and internal control assessments required under the Federal Managers' Financial Integrity Act; (4) external evaluations and assessments of program activities; and (5) progress and activity reports prepared by Mission and contractor officials. We also determined the Mission's compliance with the criteria applicable to this audit contained in (1) USAID's Grant No. 168L-601 and its amendments, Automated Directives System Chapters 201, 202, 596, and 627; (2) contract and grant agreements; and (3) USAID/Bosnia-Herzegovina's Mission Orders.

Furthermore, we interviewed cognizant Mission and Business Finance officials to determine the extent to which Mission officials used and verified contractor data on Business Development Program bank accounts, as well as the extent to which the Mission used statistical data such as the job-creation estimates to assess the impact and effectiveness of USAID/Bosnia-Herzegovina's monitoring of the program and achievement of results.

Finally, we conducted field trips to selected activity sites to interview program loan recipients and review and update reported business job statistics to assess the recipient's progress towards accomplishment of planned results and the strategic objective.

**Management
Comments**



United States Agency for International Development
Sarajevo, Bosnia and Herzegovina

June 17, 2003

From: USAID/Bosnia-Herzegovina, Mission Director, Howard Sumka /s/

To: Director of Audit Operations, RIG/Budapest, Nathan S. Lokos

Subject: Comments to audit of USAID/Bosnia-Herzegovina's Business Development Program
(Report No. B-168-03-XXX-P)

Mission appreciates the cooperation and the pro active communication provided during the course of the audit. The open interaction between the parties facilitated and enhanced the process and brought the findings to satisfactory resolutions.

The Mission and the RIG audit team worked interactively and as a result addressed all the findings and the 5 recommendations. Since all actions have been taken by the Mission as it pertains to the 5 recommendations we therefore request that the recommendations be closed upon issuance of the BDP Audit Report.

USAID/Bosnia-Herzegovina, AmEmbassy Sarajevo, Dept. Of State, Washington DC 20521-7130
Phone Number: 387-33-61-92-11

**Project Implementation Letters (PILs) Authorizing
Movement of Business Development Program Funds**

PIL No	Date	Source Account	*Funds Authorized	Purpose
14	6-Apr-00	2		Resumption-Account 2 (Deutsche Mark account) for loans Central Bank of Bosnia-Herzegovina (CBBH)
15	13-Jul-00	3	\$5.2	Clearinghouse & Settlement Systems
16	13-Jul-00	3	5.2	Federation BiH Deposit Insurance Agency
17	n/a			This PIL was never issued.
18	12-Sep-00			Modification for Consumer Home Loan Program (\$8.3 million budgeted from Acct.2)
19	31-Jan-01	3	10.0	Barents costs Feb.-Sept.30, 2001 (8 months)
20	20-Mar-01	3	6.5	Business Consulting costs
	20-Mar-01	3	2.0	Technical Assistance costs-Barents (Bank Supervision)
	20-Mar-01	3	1.0	Technical Assistance contractor costs (CBBH)
21	22-Mar-01	3	1.6	Bosnia-Herzegovina Federal Bank Hq. office space costs
22	2-Aug-01	2	10.0	Business Finance costs (Sept. 01-July '02)
23	19-Jul-01	3	13.4	Minority return infrastructure
			3.0	Support/improvement of state institutions
24	2-Aug-01			Modification of lending policy for microcredit organization (1-7 years)
25	29-Aug-01	2	1.0	Banking and Accounting Info System (CBBH Technical Assistance costs)
26	4-Sep-01	2	1.0	USAID Bosnia Reconstruction Finance Facility management costs (Sept. 2001-Sept. 2004)
27	9-Oct-01	2	40.0	Transfer to U.S. Government (Account 5)
28	18-Dec-01			Change base interest rate to Euros from LIBOR
29	19-Mar-02	2	7.1	Increase ongoing lending to private sector (balance-Consumer Home Lending Program)
TOTAL *			\$107.0	

Business Development Program Projects

*US Dollars in millions

Source: Audited USAID/BiH data

Bank Account 2 Activity (in millions)

Year 2000

Beginning balance on January 1	\$120
Less disbursements to borrowers (and related fees)	(5)
Plus interest earned on the account balance	<u>4</u>
Balance at December 31	<u>\$119</u>

Year 2001

Less disbursements to borrowers (and related fees)	(13)
Less transfer to Bank Account 3	(8)
Less two transfers to Bank Account 4	(11)
Less transfer to Bank Account 5	(40)
Less payment for Banking and Accounting Information System Project	(1)
Plus interest earned on the account balance	<u>4</u>
Balance at December 31	<u>\$50</u>

Year 2002

Less disbursements to borrowers and related fees	(1)
Balance at February 28	<u>\$49</u>

Note: Account 2 is a euro account (foreign currency account)

Source: USAID's contractor, Business Finance

Bank Account 3 Activity (in millions)

Year 2000

Beginning balance on January 1	\$13
Less disbursements to borrowers (and related fees)	(1)
Plus principal and interest payments received from borrowers	21
Less payment to Centralna Banka	(5)
Less two payments to Federal Deposit Insurance Agency	(5)
Plus interest earned on the account balance	<u>1</u>
Balance at December 31	<u>\$24</u>

Year 2001

Plus principal and interest payments received from borrowers	18
Plus transfer from Bank Account 2	8
Less three transfers to Bank Account 4	(36)
Less payment to the Federation Banking Agency	(1)
Plus interest earned on the account balance	<u>1</u>
Balance at December 31	<u>\$14</u>

Year 2002

Plus principal and interest payments received from borrowers	<u>2</u>
Balance at February 28	<u>\$16</u>

Note: Account 3 is a euro account (foreign currency account).

Source: USAID's contractor, Business Finance

Bank Account 4 Activity (in millions)

Years 2001 and 2002 (the account was opened in March 2001)

Beginning balance on January 1, 2001	\$0
Plus two transfers from Bank Account 2	11
Plus three transfers from Bank Account 3	36
Less disbursements to contractor, Barents Group	(9)
Less disbursements to contractor, Deloitte & Touche, Ltd	(3)
Plus interest earned on the account balance	1
Decrease due to currency rate fluctuations	<u>(1)</u>
Balance at February 28, 2002	<u>\$35</u>

Bank Account 5 Activity (in millions)

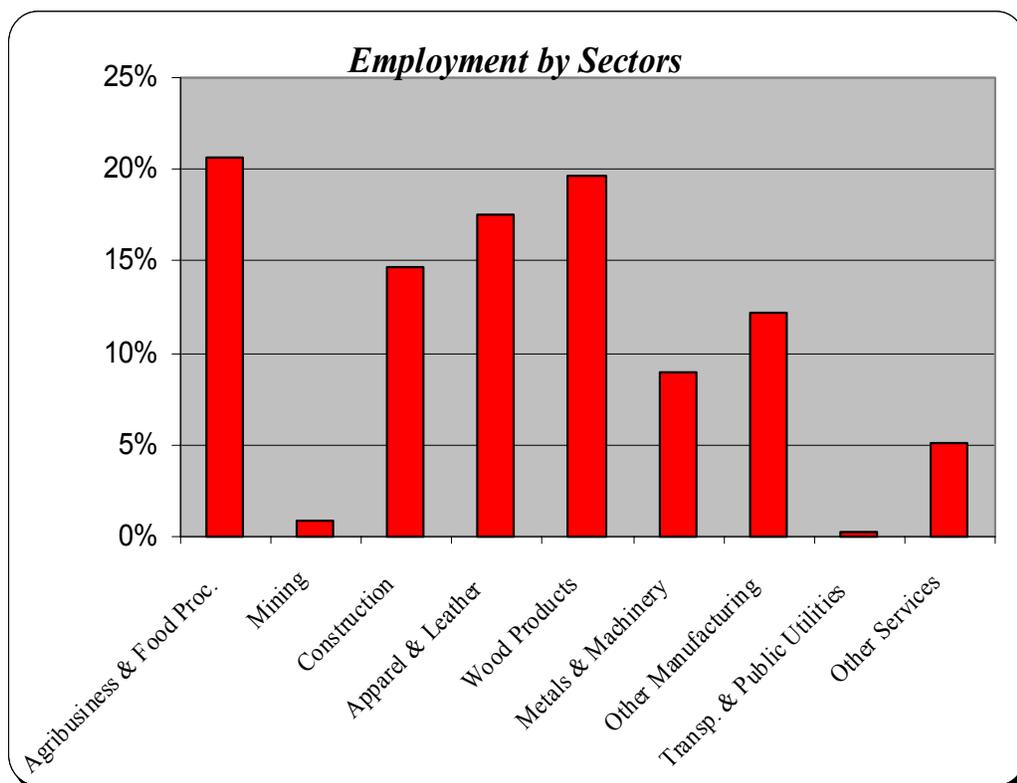
Years 2001 and 2002 (the account was opened in October 2001)

Beginning balance on January 1, 2001	\$0
Plus transfer from Bank Account 2	40
Less disbursement for the South East Europe (SEE) University in Macedonia	(3)
Decrease due to currency rate fluctuations	<u>(1)</u>
Balance at February 28, 2002	<u>\$36</u>

Note: Accounts 4 and 5 are euro accounts (foreign currency accounts).

Source: USAID/Bosnia-Herzegovina

All Workers at Business Development Program-Supported Businesses
(Includes both Business Development Program-created and pre-existing jobs)



	Sectors	# of Jobs	Percent
1	Agribusiness & Food Proc.	5,402	21%
2	Mining	230	1%
3	Construction	3,832	15%
4	Apparel & Leather	4,585	18%
5	Wood Products	5,140	20%
6	Metals & Machinery	2,333	9%
7	Other Manufacturing	3,200	12%
8	Transp. & Public Utilities	74	0%
9	Other Services	1,339	5%
	Total:	26,135	100%

Source: Unaudited USAID/Bosnia-Herzegovina reported data