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Report to Congressional Requesters

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FOREIGN AID

Overseas Private Investment Corporation's Management of Loans

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National Security and
International Affairs Division

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May 6, 1988

The Honorable Terry Sanford
Chairman, Subcommittee on International
Economic Policy, Trade, Oceans and Environment
Committee on Foreign Relations
United States Senate

The Honorable John F. Kerry
Chairman, Subcommittee on Terrorism,
Narcotics, and International Operations
Committee on Foreign Relations
United States Senate

This report responds to your request of November 13, 1987, that we review the adequacy of loan approval and monitoring procedures by the Overseas Private Investment Corporation (OPIC) and the completeness of its loan documentation. In October 1987, your subcommittees held a joint hearing to obtain information about lending practices of OPIC. In particular, you were concerned about OPIC's procedures for approving and monitoring a loan to Maderas Tropicales, S.A., a Costa Rican corporation that is majority-owned by U.S. investors. The corporation experienced operating problems, and the loan was in default.

We reviewed five individual loans and OPIC's current efforts to improve loan management. We also obtained information on OPIC's overall loan portfolio and the status of its efforts to recover the Maderas Tropicales loan. Our work is summarized in this letter and details are presented in the appendixes.

Loan Portfolio

OPIC makes direct loans to small U.S. investors for projects in developing countries to promote social and economic growth. As of March 31, 1988, OPIC had 75 active loans with an outstanding balance of approximately $48.0 million.[1]

Thirty of the 75 OPIC loans, or 40 percent, were in delinquent status—in arrears 90 days or more in payment of principal, interest, or both. The delinquent principal was approximately $5.1 million, or 10.6 percent of the $48.0 million outstanding balance, and delinquent interest was $2.3 million.

[1] Excludes capitalized interest of $2.9 million for eight loans.

organized and complete. Key documents such as loan papers recommending loan approval, loan agreements with borrowers, and promissory notes issued by borrowers, were on file.

OPIC did not adequately consider the financial performance of two borrowers in making loan approval decisions. Specifically, OPIC did not obtain current information on these borrowers' financial condition before loan approval. This information, when obtained, showed that each borrower was experiencing operating losses. If this information had been obtained in a timely manner, it could have been considered by agency management prior to loan approval. Also, for one of these loans, OPIC did not determine whether the borrower had an adequate accounting system.

On one of the 1987 loans, OPIC did not obtain key financial information on the borrower's operating forecast for 1988 as required by the loan agreement. Consequently, OPIC could not monitor project progress by comparing estimated financial operations with actual experience. Thus, a potential "early warning system" for identifying possible loan problems was lost. OPIC officials stated that the agency approved a delay until May 15, 1988, for submitting the operating forecast because of its long and satisfactory relationship with the borrower.

In addition, we identified some overall weaknesses in the loan management process that tended to confirm findings of the Peat Marwick study. While OPIC reviewed credit risk as well as development, foreign policy, and domestic benefits for proposed projects, it did not have policy guidance in assessing whether these benefits offset the project's credit risk. Also, OPIC did not perform an independent review of the loan approval and monitoring process.

Although we focused on OPIC's loan management process, we question whether one of the loans we reviewed—a $750,000 loan to Caribbean Teleview Services in April 1987—was consistent with the agency's role to improve economic conditions in less developed countries, as opposed to wealthier nations. Specifically, it is not clear whether the loan satisfies OPIC's developmental role because of (1) the marginal developmental benefits for St. Maarten, (2) the country's good economic conditions as compared with most Caribbean nations in which OPIC has programs, and (3) the major investor's significant financial resources.

The Peat Marwick report made several recommendations to OPIC management to improve its loan management process, such as teams in reviewing proposed loans, the credit review officer will perform post disbursement evaluation of the loan portfolio, and the managing director will have overall responsibility for both of these functions.

We agree that both of these functions are important in improving loan management. In our view, however, the ability of the credit review group to objectively perform post disbursement oversight would be enhanced if this group did not participate in the pre-approval process to determine if proposed loans meet OPIC's policies and standards. We recommend that the President of OPIC take steps to separate the post disbursement oversight function from the pre-approval process to ensure that objectivity is attained in managing the loan program.

Efforts to Recover Maderas Tropicales Loan

You also requested us to obtain information on the status of OPIC efforts to recover the Maderas Tropicales loan. OPIC approved this $375,000 loan in December 1983. The project was to consolidate three existing woodworking operations in Costa Rica (timber, sawmill, and wood products) into one and expand the product line. The project had manufacturing and financial problems and is in default.

As previously noted, OPIC procedures for approving and monitoring the loan and problems experienced with the loan were the subject of a hearing before your subcommittees in October 1987. OPIC officials testified that the agency initiated foreclosure proceedings and referred information on possible fraud by the borrowers against the U.S. government to the Justice Department.

In March 1988, OPIC was in process of foreclosing on its mortgage. Legal proceedings had been initiated in the Costa Rican courts, and OPIC was attempting to locate potential purchasers for the mortgaged land. The Justice Department investigation into possible fraud by the borrowers is underway.

Views of Agency Officials

As agreed with your staff, we did not obtain formal written agency comments; however, we discussed the contents of this report with OPIC officials and considered their comments in preparing the report. OPIC officials agreed with the thrust of our recommendation.

In commenting on our questioning the Caribbean Teleview loan, these officials stated that in the loan program OPIC tries to satisfy numerous policy mandates and at the same time, ensure that new loans meet

Empacadora is supposed to provide OPIC with an annual operating forecast, which includes projected quarterly financial statements for the year and a statement of assumptions on which the forecast is based. The operating forecast for 1988 was due December 1, 1987, but has not been received by OPIC.

OPIC officials stated that the operating forecast was not received on time because the agency approved Empacadora's request to delay submitting it until May 15, 1988. OPIC agreed to the delay because of its long and satisfactory relationship with the borrower.

Timely receipt of annual operating forecasts, including estimated quarterly financial statements, would assist OPIC in monitoring project progress. Comparisons could be made of estimated versus actual experience on a quarterly basis and would be useful in early identification and resolution of problems.

Caribbean Teleview Services - Netherlands Antilles

Background

OPIC approved a $750,000 loan to Caribbean Teleview Services in April 1987 to construct and operate a cable television service which will be available to residents on the Dutch side of St. Maarten, Netherlands Antilles. The service will provide news, sports, and educational programming. Caribbean Teleview Services is a Netherlands Antilles corporation owned by two Americans and two St. Maarten nationals. The major investor is an American.

The loan is fully disbursed, having been paid out in two segments, both in December 1987. The borrower is current in payment of interest. The first principal payment is due January 1, 1990.

Assessment

The OPIC credit risk analysis and collateral obtained for the loan appear to be adequate. The major investor has previously demonstrated the ability to successfully market cable television in St. Croix, Virgin Islands, and has other successful television enterprises. The major collateral securing the loan is a letter of intent by the government of St. Maarten for OPIC to assign the cable television license to an agreed upon

Kyndyl International, Ltd. - Malawi

Background

OPIC approved a loan for $150,000 in December 1985 to help Kyndyl (Malawi), Ltd., a wholly owned subsidiary of Kyndyl International, Ltd., produce and market high efficiency wood and charcoal burning cook stoves in the African nation of Malawi. In 1985, Kyndyl International, a Bahamian Corporation, was an operating division of Industrial Insulations, Inc., a California-based and U.S.-owned corporation. Kyndyl (Malawi) licensed Encor Products, Ltd., a Malawian company, to manufacture the stoves; Kyndyl (Malawi) was to market them. The loan is fully disbursed.

OPIC support for the project was primarily based upon the potentially significant developmental benefits it offered to Malawi, a country with a 1982 per capita income of $165. Use of the stove would improve local health and safety conditions, promote energy conservation, and help curtail deforestation. The project would generate local employment and increase tax revenues. By reducing fuel consumption, the stove would increase disposable income for users.

The project experienced manufacturing and marketing problems. The first 5,000 stoves produced proved to have defective linings. Marketing problems then developed. In December 1987, the Managing Director of Kyndyl (Malawi) informed OPIC that the company could no longer continue operations due to insufficient market demand for the stove caused by a drop in consumers' disposable income. OPIC did not receive the first required interest payment and, as of February 1988, the loan was in default.

OPIC did not obtain a lien on project assets as collateral for the loan, since these assets (equipment and vehicles) were movable and of relatively limited value. It was not considered cost-effective to attempt to secure a lien on these assets. OPIC's security for the loan included a loan guaranty from the project director. The guaranty, however, is backed by limited personal assets. In February 1988, OPIC was considering what, if any, collection action should be pursued.

Assessment

OPIC recognized the marketing, collateral, and other risks associated with this project, but concluded that given the relatively small amount of the monitoring the project, OPIC made suggestions for improving Taino Farms' accounting records.

Management Analysis

The investor attempted to expand the papaya farm on his own after a partner suffered a fatal stroke. The project team's loan paper to the OPIC Investment Committee recommending loan approval stated that the investor had extensive agricultural experience and would be responsible for overseeing all aspects of the project. The memorandum commented that the investor had some experience in manufacturing juice, but because of the company's expansion, OPIC would require him to hire a more experienced manager to be responsible for this phase of the operations. It was anticipated that this would create management depth and enable the borrower to concentrate on farming operations. On September 30, 1985, the Investment Committee unanimously approved the loan.

Financial Analysis

On August 30, 1985, the former OPIC investment officer met with a partner of the investor's certified public accounting firm during a preapproval visit to the project in the Bahamas. At the meeting, there were discussions about the accounting firm sending unaudited financial statements for Taino Farms as of July 31, 1985, to the former investment officer. By letter dated September 2, 1985, the accounting firm sent the financial statements (balance sheet and statement of income) to the former investment officer. The income statement shows that Taino Farms operated at a loss from February 23 to July 31, 1985. This was the initial period that the borrower operated the papaya farm as the sole owner. The former investment officer stated, however, that the financial statements were not received by OPIC until October 1985, after loan approval on September 30, 1985.

The project team's loan paper to the Investment Committee discusses Taino Farms' successful production and marketing operations in the pilot program. The loan paper, however, did not comment on the company's historical financial performance nor did it mention nonreceipt of the financial statements. The former investment officer told us that based on the investor's ability to produce and market papaya, the pilot program was considered a "technical" success. This was the overriding factor in recommending approval of the loan. Nevertheless, if the unfavorable financial information had been obtained in a timely manner and brought to the Investment Committee's attention, the loan might have been disapproved and the present default situation avoided. In any

The former OPIC investment officer for the project stated that there was a perceived need to capitalize on the market potential for the farm's produce and the farm had made an impressive start up, producing a first-year crop and exporting $800,000 worth of produce to Europe. In addition, the former investment officer visited the project site in June 1986 and collected enough information to be satisfied that the project could handle the expansion. On August 27, 1986, the Investment Committee considered the investment officer's paper which recommended approval of the second loan. The Committee voted unanimously to approve the loan. A loan agreement was signed October 23, 1986, and loan funds were disbursed on October 28, 1986.

Following disbursement of the loan funds, problems surfaced for Roydan, including (1) continued operating losses, (2) failure to submit financial statements after the first quarter of 1987, (3) late payments, beginning with interest due in December 1986, (4) severe weather damage to crops, and (5) allegations that Roydan had an inadequate accounting system.

According to an OPIC official, the first interest payment on the second loan was due to OPIC on December 31, 1986. This payment was not made on time, but was received in two installments of $20,000 each in April and May 1987. The next payment (covering interest and principal for both the first and second loans) was due on June 30, 1987. This payment was missed and collected 4 months later in November 1987, when an OPIC official visited the project. The latest payment was due on December 31, 1987, but was not made until February 1988.

Because of heavy borrowing, Swiss American Bank became Roydan's largest creditor. On March 4, 1988, Swiss American Bank notified OPIC that the Bank had decided to call its loan and put Roydan under control of a locally appointed receiver. Swiss American advised that it wanted to work with OPIC so that both parties could maximize the return on their investments.

OPIC now considers the loan in default. The OPIC loan is secured by a first lien on the project assets, except for a packing plant which was financed with the principal investor's own funds.

Assessment

OPIC did not obtain the latest financial information available on the borrower's operating experience under the first loan before approving the second loan. If this information—which showed an operating loss—had instruct them on the correct procedures for reviewing accounting systems and records.

The OPIC investment officer visited the Roydan project before the first and second loans were disbursed. This official stated that although a site visit in June 1986 did not include a review of Roydan's accounting system or records, he tried unsuccessfully to meet with the corporation's accountant. The Treasury officials' monitoring trips to the project were made in May and September 1987.

In early 1987, OPIC became aware of allegations by a former business associate of the major investor in Roydan that the company did not have an adequate accounting system. The monitoring visits to the project site by Treasury officials suggested that Roydan's accounting system might not be adequate. One official claimed that Roydan's accountant did not supply complete accounting records, and the few records he did review could not be traced to Roydan's financial statements. The second official claimed he was frustrated in attempts to review Roydan's accounting records and stated that the records he did see were in poor condition.

If OPIC's investment officer had reviewed Roydan's accounting system and records or if a monitoring trip had been conducted by the Treasurer's Office before the second loan disbursement, OPIC could have identified the accounting deficiencies earlier. OPIC could then have required Roydan to make improvements to ensure reliable financial data was provided by its accounting system.

Finance Department officials stated that under the new loan approval and monitoring system, investment officers will concentrate more on accounting matters and be given training to enhance their ability to review accounting systems and records. If necessary, we believe that the newly established credit analysis group should also be given this training so that the group can assist investment officers in reviewing accounting systems.

analyzing and rating credit risk, as well as developmental and other benefits—the agency will make a judgment as to whether to approve or disapprove the loan.

Credit Analysis and Risk Rating in Loan Approval

A group within OPIC's Finance Department is responsible for reviewing loan applications submitted by prospective borrowers. This group, or project team as it is referred to, includes the managing director of small business, an investment officer, and a financial analyst. Legal assistance is provided by OPIC's General Counsel's Office. The project team analyzes the applicant's financial condition, assesses the applicant's technical and management capability, and reviews the marketing potential for the item to be produced by the project. The team summarizes the results of its review in a loan paper submitted to OPIC's Investment Committee, recommending approval of the loan. The Investment Committee, made up of OPIC vice presidents, approves or disapproves the loan. We noted from our review of 5 loans that the Committee's action was consistent with the project team's recommendation.[1]

In commenting on OPIC's loan approval procedures, Peat Marwick stated that the agency should place more emphasis on credit risk analysis. Peat Marwick recommended that OPIC establish a group within the Finance Department to provide credit analysis support to the project team. This group should be dedicated to ensuring credit quality.

In responding to Peat Marwick's recommendation, the president of OPIC announced on January 25, 1988, that a group within Finance, separate from the loan origination groups, will be established to perform credit analysis, as well as risk rating on proposed loans. The new group will provide support to project teams in reviewing applicants' financial statements (balance sheet and statement of income) and in making cash flow analyses. It will assist in assigning a credit risk rating (excellent, average, marginal, or unacceptable) to proposed projects. Projects rated unacceptable will be rejected. Projects with marginal or above credit ratings will then be reviewed for development, U.S. foreign policy, and domestic benefits. Each of these factors will be rated as high, medium, or low. The new credit analysis group will participate in assessing whether development and other benefits of a proposed project offset the project's credit risk.

[1]Effective March 8, 1988, the Investment Committee was renamed the Investment Policy Committee; it will now consider primarily policy issues relative to recommended projects. The Credit Committee, to be comprised of representatives from the Finance Department and the Treasurer's Office and the special assistant to the OPIC President, will resolve credit and business issues for proposed projects.

Peat Marwick stated that if this process is to be effective, it must be independent and achieve consistent and professional review of the loan portfolio.

In responding to Peat Marwick's recommendations, OPIC's president announced on January 25, 1988, that the Office of the Treasurer will participate with the Finance Department in developing credit policies and standards and in ensuring that proposed loans meet these policies and standards. In addition, the OPIC president announced that the Office of the Treasurer has been given responsibility for performing independent oversight on the agency's portfolio after disbursement of loans to determine whether loans remain in compliance with OPIC standards and monitoring is proper.

Concerning oversight responsibility, OPIC's action plan for implementing Peat Marwick's recommendations shows that the Office of the Treasurer will develop a loan evaluation system to provide for reviewing and reporting on (1) overall loan portfolio, (2) selected projects, (3) loan officers' performance, and (4) policy and procedures compliance. Both review of proposed loans and post disbursement oversight will be performed by a newly established credit review group in the Office of the Treasurer.

The new group will include three employees—a managing director, a senior credit officer, and a credit review officer. The managing director, employed by OPIC in January 1988, has extensive international lending and credit experience and will be responsible for the group's overall activities. The credit officer, an OPIC employee at the time the group was established, will participate, with the Finance Department, in reviewing proposed loans. The credit review officer will perform post disbursement evaluation of the loan portfolio. OPIC is seeking a certified public accountant to fill this position and in March 1988, it was reviewing applications. The position requires a minimum of 3-5 years experience in financial statement review, loan portfolio analysis, and credit reviews or audits in a commercial bank. The credit review process will begin formally when the new officer comes on board in mid-May.

Assessment of OPIC Efforts to Improve Loan Management

In general, the actions initiated by OPIC to implement Peat Marwick's recommendations, when completed, should improve the agency's process for managing the loan program. These actions should also correct specific weaknesses in approval and monitoring procedures identified in our review of individual loans. The recently established credit analysis

Efforts to Recover Maderas Tropicales Loan

OPIC approved a $375,000 loan to Maderas Tropicales, S.A. in December 1983. The project was to consolidate three existing woodworking operations in Costa Rica (timber, sawmill, and wood products) into one and expand the product line. The project had manufacturing and financial problems and the loan is in default.

OPIC has a mortgage on timberland in Costa Rica because of its loan to Maderas Tropicales. The land which consists of four parcels— three located in Heredia province and one in Alajuela province—covers approximately 1,976 acres.

On October 22, 1987, OPIC began foreclosure proceedings in Costa Rica which consist of successive auction dates for bidding. The first auction date was set for March 7, 1988, and any buyer willing to pay the full amount of the OPIC loan in cash had the opportunity to bid. When no such bidder came forward, OPIC's attorney requested the court to set a second auction date.

According to March 1988 OPIC documents, any cash bid in excess of 75 percent of the loan outstanding will be considered at the second auction. If no acceptable bids are received by the second auction, OPIC can discharge 50 percent of its debt (including interest and expenses) and take title to the property. The remaining 50 percent of the debt would not be extinguished, but would still be due from Maderas Tropicales. Taking title to the property would enable OPIC to negotiate directly with potential purchasers of the property. OPIC could consider providing credit terms rather than requiring an all cash offer. If OPIC does not choose to exercise its options at the second auction, a third auction date can be set, at which time any bid can be accepted.

In the meantime, OPIC has attempted to locate potential purchasers for the timberland in Costa Rica. It placed an advertisement in the Wall Street Journal (March 11, 1988) announcing the availability of the timberland and requesting interested parties to contact OPIC for further information. Some expressions of interest have been received and will be pursued. OPIC also had discussions with interested individuals and conservation groups before the advertisement was placed. An OPIC officer traveled to Costa Rica to gather financial information about one potential purchaser. However, OPIC ultimately determined that the interested party did not have the financial resources to support the long-term credit arrangement sought. The conservation groups initially indicated some interest in making a proposal, but none have been submitted to date.

Loan Provisions

OPIC policy concerning interest rates, equity contributions, and collateral are discussed below.

Interest rates on OPIC loans are based on U.S. Treasury note rates and adjusted for the commercial and political risk applicable to the specific project. The range of interest rates charged on OPIC loans in fiscal year 1987 was 10-11 percent. In general, repayment periods on OPIC loans range from 5-12 years, including grace periods on principal repayments of 1-3 years.

OPIC requires investors to make a contribution to the project, usually at least 25 percent of the estimated equity. The agency is flexible in this regard, however, depending upon the project's developmental and other benefits.

OPIC generally takes as collateral mortgages or similar security interest in the present and future fixed assets of a project. In some instances, OPIC may take collateral in U.S. assets or obtain U.S.-sponsored loan guarantees to ensure adequate protection. In response to a Peat Marwick recommendation, OPIC is in process of preparing a formal policy on collateral.

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OPIC has been told by several sources in Costa Rica and elsewhere that good, hardwood timberland is becoming scarce and that the value of the timber on this property far exceeds the outstanding debt owed to OPIC. Therefore, OPIC is optimistic that if a potential purchaser can be located, a price can be negotiated that would recover the loan.

In March 1988, the Justice Department was investigating possible fraud against the United States by the three investors in Maderas Tropicales (two Americans and one Costa Rican). The Department's Federal Bureau of Investigation and Criminal Division were responsible for the investigation. An investigator from the Office of the Inspector General, Agency for International Development, was assisting with the work.

The thrust of the investigation is to find out what happened to the loan funds of $375,000 and whether false financial statements were filed with the loan application. The investigators interviewed OPIC officials and reviewed agency documents for the loan. The funds were originally deposited in an Indiana bank. The Department of Justice plans to subpoena the bank's withdrawal records for the funds. One of the American investors provided OPIC with a written statement on how he believes the funds were used; testimony will be obtained from the other American investor. The investigators also plan to interview persons who were named as credit references for the borrowers.

The Civil Division of Justice is awaiting the outcome of the Federal Bureau of Investigation/Criminal Division investigation before determining whether to proceed on a civil action.

group should (1) assist project teams in obtaining and critically reviewing information on prospective borrowers' financial condition, (2) ensure that relevant and current financial information is brought to management's attention for consideration in approving loans, and (3) assist in improving the monitoring process by reviewing borrowers' projected and actual financial goals. In carrying out these duties, we believe that the new group should assist in determining whether borrowers have adequate accounting systems.

We have one area of concern in connection with the actions in process by OPIC to improve loan management. In our view, the ability of the credit review group to objectively perform post disbursement oversight would be enhanced if this group did not participate in the pre-approval process to determine if proposed loans meet the agency's policies and standards.

The credit analysis group will include four staff members, a managing director and three financial/credit analysts. In February 1988, OPIC advertised for these positions in the Wall Street Journal. The managing director position requires at least 5 years of commercial lending or other relevant experience in international project analysis and structuring. Also, experience as a supervisor of a bank credit department or credit analysis group is required. The financial/credit analyst positions require at least 2 years or other relevant experience in credit and project analysis, loan structuring, and loan monitoring. By March 1988, OPIC had received several applications for the positions and was in process of reviewing them.

Loan Monitoring

Before the Peat Marwick study, the OPIC Treasurer's Office was responsible for monitoring past due loans. According to the study, this monitoring primarily involved collection and workout of problem loans; generally, no in-depth analysis of actual versus projected financial goals was made.

Peat Marwick recommended that OPIC transfer responsibility for loan monitoring to the Finance Department. The loan monitoring should include review of estimated and actual financial goals for projects and assist in identifying problem loans earlier. Also, assignment of monitoring to Finance would consolidate loan management in one department and avoid fragmented operations.

In responding to this recommendation, OPIC's president announced on January 25, 1988, that responsibility for loan monitoring to the point of workout will be transferred to the Finance Department. The newly established credit analysis support group will provide monitoring support, including financial review, to project teams.

Independent Credit Review

Peat Marwick recommended that a credit review process be established in the OPIC Treasurer's Office to

- participate in loan approval,
- assess and report on loan portfolio quality and loan officers' performance,
- review specific loans for compliance with agency policies and procedures, and
- establish a formal write-off/loss policy for uncollectible loans.

Improvements in Loan Management

Peat Marwick Main & Company's January 1988 report to OPIC on loan management compares the agency's credit process to a similar process in a large, well run, commercial bank. Peat Marwick stated that the comparison identified areas where OPIC can improve the credit process, while recognizing differences in goals between OPIC and commercial banks.

Peat Marwick noted that OPIC's primary goal is to promote economic development and the loan program is designed to provide start-up and expansion financing to small U.S. investors for projects in less developed countries. OPIC emphasizes lending funds to achieve development goals, whereas a commercial bank emphasizes maximum returns and maintaining minimum credit risk. Peat Marwick stated that a number of loans funded by OPIC would be considered credit risks in the commercial banking environment. It reviewed OPIC's credit process in light of the sometimes conflicting goals of enhancing economic development and controlling credit risk.

Some of the consultant's major recommendations and the status of OPIC implementation efforts follow.

Credit Policy

Peat Marwick stated that OPIC has no formal policy defining the risks/losses that are acceptable in making loans and, therefore, the agency's credit analysis of proposed borrowers may be subordinated to development benefits of the project. Peat Marwick recommended that OPIC develop a policy which provides direction on acceptable credit risk, given the agency's development mandate. It also recommended that OPIC formalize a policy addressing the types of collateral (e.g. project assets, investor guarantees, U.S. assets) required from borrowers to reduce OPIC's financial risk.

In responding to Peat Marwick's recommendations, OPIC issued a philosophy statement in April 1988, specifying that it will disapprove loans that do not meet at least marginal credit risk criteria. Due to OPIC's developmental mandate, however, the agency will take risks that may not be acceptable to many commercial banks. That is, OPIC may approve projects meeting marginal credit criteria because of their positive developmental, U.S. foreign policy, and U.S. effects benefits. The philosophy statement further provides that OPIC will strive to protect its investment in projects and to ensure that any losses are the result of events that could not reasonably be anticipated. OPIC officials told us that—after been obtained, OPIC may have disapproved the second loan and avoided some of the subsequent problems. Regardless, as in the case of Taino Farms, the agency would have made a more informed approval decision. OPIC approved both loans without determining whether the borrower had an adequate accounting system.

Financial Analysis

Roydan's income statement for the 9 months ending March 31, 1986, showed an operating loss. Before loan approval, OPIC obtained from Roydan updated operating information for April and May 1986. This information showed that Roydan had operating income for this 2-month period, which converted the loss at the end of March to a net gain at the end of May. This net gain for the 11-month period (July 1985-May 1986) was mentioned in the loan paper submitted to the Investment Committee recommending approval of the loan, and an operating statement for this 11-month period was attached.

OPIC's agreement with Roydan for the first loan provides that periodic financial statements (balance sheet and statement of income) should be submitted within 45 days after the end of each fiscal quarter. This means that statements for the quarter ending June 30, 1986 were due to OPIC by August 14, 1986. OPIC, however, did not receive these financial statements until mid-September 1986, almost a month late and more than two weeks after the second loan had been approved. The income statement for the quarter ending June 30, 1986, showed that Roydan was again operating at a loss. If OPIC had obtained the required financial statements on time, Roydan's more current adverse financial condition could have been considered by the Investment Committee before loan approval.

Accounting System

Before the Peat Marwick study, officials from both the Office of the Treasurer and the Finance Department conducted site visits to projects. Normally, investment officers and financial analysts from the Finance Department visited a project before loan approval to obtain information on the proposed or existing project. During these visits, they generally did not concentrate on accounting matters.

Officials from the Treasurer's Office performed monitoring visits to projects after loan funds had been disbursed. These trips typically included a review of a project's accounting system and records. While not all Treasury officials have accounting backgrounds, we were told by a senior official of the Treasurer's Office that an attempt was made to event, the Committee would have made a more informed approval decision.

Accounting Records

During a visit to the project site after the loan was approved, an OPIC staff member identified a need for Taino Farms to keep more accurate financial records and made suggestions for improvement. The staff member found that Taino Farms did not have accurate information on the number of boxes of papayas (1) sold to the local market, for which payment had not been received or (2) shipped to its broker, for which credit had not been received. The staff member suggested that Taino Farms' accountant schedule papaya shipments to the local and export market and match the shipments with payments when received.

Roydan - Antigua

Background

In July 1985, OPIC approved a $700,000 loan to establish a winter fruit and vegetable growing farm in Antigua. The farm's objective was to produce green beans, green peppers, and galia melons for export to the European market. In August 1986, OPIC approved a $600,000 loan to expand the farm. The focus of our review was on OPIC procedures for approving the second loan because of the borrower's experience under the first loan.

Roydan, Ltd. is a corporation organized under the laws of Antigua. We were told by an OPIC official that it is his understanding that the corporation is 50-percent owned by two American citizens, and the other 50 percent is owned by an Israeli citizen.

On July 23, 1986, OPIC's Credit Committee[1] considered the proposal for the second Roydan loan. The Committee expressed concern that Roydan had requested the second loan before it had established a repayment record on the first loan (only one interest payment came due) and had experienced a second growing season. Another concern was that Roydan might not be able to absorb such a rapid increase in the size of its operations.

[1] At the time, the Credit Committee was comprised of professional employees in the Finance Department. The Committee did not approve or disapprove loans. It made preliminary reviews before proposed loans were submitted to the Investment Committee for approval.

loan, the project's potentially significant development benefits warranted taking the risks. Also, the project was located in Africa where OPIC traditionally has had difficulty identifying suitable loan candidates.

Taino Farms - Bahamas

Background

OPIC approved a loan for $502,500 to Taino Farms in September 1985 primarily to expand papaya farming in the Bahamas. Taino Farms started a 55-acre pilot papaya farm in 1982 to test soil and growing conditions and market acceptance of the product. OPIC considered the pilot project successful, since Taino Farms grew and exported over 100,000 cartons of papaya in 15 months and established U.S. and European marketing channels for the product. In addition to expanding papaya farming operations, an additional 165 acres, Taino Farms planned to install a juice processing facility to use for fruit not suitable for export. Taino Farms is wholly owned by a U.S. citizen.

Taino Farms experienced production and financial problems. Although a market for papaya appeared to exist, Taino Farms was unable to grow the fruit in sufficient quantity and quality to make the operation financially successful. In October 1987, the investor decided that he could not continue farming operations due to extensive damage to his crop, caused by a poor grade of fertilizer. As of February 1988, the loan was in default and OPIC was acting as receiver for the project. OPIC was trying to interest other investors in the project.

Collateral for OPIC's loan includes a first lien on land, machinery, equipment, buildings, and inventory owned and to be acquired in the future by the company. OPIC has a leasehold interest in land rented by the company; a portion of this land, however, is subject to a previously existing first real property mortgage. A potential law suit for damages against the fertilizer supplier could be a source of funds for recovering amounts due OPIC.

Assessment

OPIC critically reviewed Taino Farms' management capability and required it to take steps to improve project management before approving the loan. The agency, however, did not obtain current information on the company's financial operating experience before loan approval. In third party if Caribbean Teleview defaults. Collateral also includes a lien on project assets and a fee subordination agreement. This agreement precludes Caribbean Teleview from paying fees for management services to other entities operated by the major investor when payments are due on the OPIC loan.

Role to Promote Economic Growth in Developing Countries

We question whether the Caribbean Teleview loan is consistent with OPIC's role to promote economic growth in less developed countries, as opposed to wealthier nations. Specifically, it is not clear whether this loan satisfies OPIC's developmental role because of the (1) marginal developmental benefits for St. Maarten, (2) good economic conditions in the country as compared with most of its Caribbean neighbors in which OPIC has programs, and (3) major investor's significant financial resources.

- The project's projected developmental benefits include transferring cable television technology to St. Maarten, training of electrical technicians and installers, and employing approximately 12 people.
- The Netherlands Antilles is one of the higher income Caribbean nations in which OPIC has programs. Moreover, information available to OPIC at the time of loan approval showed that the economy of St. Maarten was strong in relation to the economies of other members of the Netherlands Antilles federation. Based on a 1985 population of 21,688, the projected per capita income for St. Maarten was almost $6,000—considered impressive in the economic information available to OPIC.
- The major investor in the project has a net worth of several million dollars and has significant investments in other cable television and communication enterprises. With his personal resources, this investor would appear to be a good credit risk and could obtain any needed financing from commercial sources.

In commenting on the Caribbean Teleview loan, OPIC officials stated that OPIC tries to satisfy numerous policy mandates and at the same time, ensure that new loans meet acceptable levels of credit risk. These officials stated that consistency in attaining these goals is difficult, as every project will not meet every goal. They also said that OPIC strives for balance in its loan portfolio, and is confident the Caribbean Teleview loan will be repaid.

Review of Individual Loans

We found that OPIC files for the five loans we reviewed were generally well organized and complete. We noted that key documents, such as loan papers recommending loan approval, loan agreements with borrowers, and promissory notes issued by borrowers were on file. Background information and our assessment of OPIC procedures for approving and monitoring the five loans are presented below.

Empacadora Nacional - Ecuador

Background

OPIC approved this loan of up to $6 million in April 1987 to increase the production capacity of Empacadora Nacional, a 20-year-old Ecuadorian company that exports shrimp to the United States. Empacadora is a wholly owned subsidiary of Excellent Products Corporation of Panama, which is wholly owned by International Proteins Corporation of Fairfield, New Jersey.

The loan is disbursed in increments; as of February 1988, $2.67 million had been disbursed. Empacadora is current in making interest payments; the next one is due October 15, 1988. The first principal payment is due October 15, 1989.

Assessment

The OPIC analysis of credit risk and collateral obtained for the loan was adequate. OPIC considered (1) Empacadora's operating history, (2) its current and projected financial position, (3) the current and projected demand for shrimp, and (4) the experience and technical capabilities of its managers. We noted one instance where loan monitoring could be improved.

OPIC is securing the loan with a lien on project assets and has a loan guaranty agreement with Empacadora, Excellent Products Corporation, and International Proteins Corporation. These parties jointly agreed to pay off the loan, even if the project does not generate enough cash to service the debt. OPIC also has a project completion agreement with Empacadora, Excellent Products, and International Proteins. Under this agreement, the three parties agreed to contribute the funds necessary to complete the project, even if the funds required exceed the estimated cost of the project outlined in the loan agreement.

Contents

Abbreviations

OPIC	Overseas Private Investment Corporation

acceptable levels of credit risk. Consistency in attaining these goals is difficult, however, as every project will not meet every goal. The officials also stated that OPIC strives for balance in its loan portfolio, and they were confident the Caribbean Teleview loan will be repaid.

We made our review in accordance with generally accepted government auditing standards from January to March 1988 at OPIC headquarters in Washington, D.C. We obtained information on OPIC's loan portfolio and reviewed OPIC's efforts to improve loan management based on recommendations by a consulting firm. We reviewed documents in agency files for five individual loans and obtained information from OPIC officials on the status of the Maderas Tropicales loan.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 6 days from the date of issue.

Frank C Conahan

Frank C. Conahan
Assistant Comptroller General

- formulate a policy which provides direction on acceptable credit risk, given OPIC's mandate to finance projects in less developed countries,
- establish a separate group within the Finance Department to provide credit analysis support to project teams reviewing loan applications and monitoring projects, and
- establish an independent credit review group within the Office of the Treasurer to participate in the loan approval process, as well as to perform post disbursement oversight on the agency's loan portfolio.

OPIC management agreed with and is in process of implementing most of Peat Marwick's recommendations. The target date for completing action on all recommendations is September 30, 1988.

Conclusions and Recommendation

The actions initiated by OPIC to implement Peat Marwick's recommendations, when completed, should improve the agency's process for managing the loan program. These actions should also correct specific weaknesses in approval and monitoring procedures identified in our review of individual loans. In responding to a Peat Marwick recommendation, OPIC issued a philosophy statement discussing credit risk versus development and other benefits. This statement should assist project teams and support staff in reviewing proposed loans.

As recommended by Peat Marwick, OPIC is in process of establishing two separate groups to assist in improving management of the direct loan program; a credit analysis group and an independent credit review group. The credit analysis group will (1) assist project teams in obtaining and critically reviewing information on prospective borrowers' financial condition, (2) ensure that relevant and current financial information is brought to management's attention for consideration in approving loans, and (3) assist in improving the monitoring process by reviewing borrowers' projected and actual financial goals. In carrying out these duties, we believe that the new credit analysis group should assist in determining whether borrowers have adequate accounting systems.

OPIC established the independent credit review group to perform two functions: (1) participate in ensuring that proposed loans meet agency credit policies and standards and (2) perform oversight on its loan portfolio after disbursement of funds. This new group will include three employees: a managing director, a senior credit officer, and a credit review officer. The senior credit officer will participate with project

Management Improvements and Review of Loans

Because of congressional concerns about the Maderas Tropicales loan, in September 1987, OPIC awarded a contract to Peat Marwick Main & Co., a management consulting firm, to review its loan management process. On January 12, 1988, Peat Marwick submitted its report to OPIC. The report discusses OPIC's organizational structure for administering the loan program and key elements of the management process, such as credit policy, credit analysis, and credit review. Peat Marwick did not review individual loans in detail.

The Peat Marwick report identified weaknesses in OPIC's process for managing the loan program. The weaknesses included

- lack of policy guidance on what is an acceptable credit risk given OPIC's mandate to finance projects in developing countries,
- insufficient emphasis on analysis of credit risk in reviewing proposed loans,
- inadequate monitoring of approved loans, and
- absence of independent oversight on the loan approval and monitoring process.

We reviewed OPIC procedures for approving and monitoring five active loans totaling approximately $8.0 million. The loans, ranging from $150,000 to $6 million, were made to finance projects in five different countries. The loans were approved before the Peat Marwick study—two were approved in fiscal year 1987, two in fiscal year 1986, and one in fiscal year 1985.

In judgementally selecting these loans, we considered several factors, such as the amount, year approved by OPIC, project location, and current repayment status. As of March 31, 1988, the two fiscal year 1987 loans were current in payment of principal and interest; however, the other three loans were in default. We selected the problem loans to determine whether weaknesses in OPIC's loan review process and loan management were contributing factors to the eventual default of each loan.

In assessing a loan application, OPIC reviews credit risk, technical expertise, management capability, marketing potential, collateral, and development, U.S. foreign policy, and domestic benefits. We found that for the five loans OPIC's review was adequate, except for its review of credit risk on two loans. We identified one weakness in project monitoring after loan approval. The OPIC files for the five loans were generally well