



OFFICE OF INSPECTOR GENERAL
EXPORT-IMPORT BANK
of the **UNITED STATES**

**WORKING CAPITAL GUARANTEE
DELEGATED AUTHORITY PROGRAM**

Audit Report
July 08, 2011
OIG-AR-11-04



Office of Inspector General

Export-Import Bank
of the United States

July 08, 2011

MEMORANDUM

TO: Pamela Bowers
Vice President, Working Capital Finance Division

FROM: Jean Smith
Assistant Inspector General for Audit

A handwritten signature in cursive script that reads "Jean Smith".

SUBJECT: Audit of the Working Capital Guarantee Delegated Authority Program

This memorandum transmits Audit Report OIG-AR-11-04, Working Capital Guarantee (WCG) Delegated Authority (DA) Program. This audit was initiated by the Office of Inspector General of the Export-Import Bank of the United States to determine whether Export-Import Bank supplied sufficient oversight of lenders granted DA to approve Working Capital guarantees.

The audit found that the Working Capital Financial Division (WCFD) generally complied with its policies and procedures to perform an examination of WCGDA lenders and to notify lenders of identified exceptions found. In addition, the audit identified no trend on type of waivers lenders requested. While WCFD's efforts were positive, improvements are needed to strengthen follow-up procedures and controls and to maintain DA data. We made three recommendations to address these findings. Management concurred with the findings and recommendations.

We appreciate the courtesies and cooperation provided to the auditors during the audit. If you have any questions, please call me at (202) 565-3944.

cc: Fred P. Hochberg, Chairman and President
Alice Albright, Executive Vice President and Chief Operating Officer
Audit Committee
Charles D. Tansey, Senior Vice President, Small Business
Richard Brackley, Managing Director, Claims and Recoveries Section
John Simonson, Chief Financial Officer and Audit Liaison
Patricia Wolf, Supervisor, Financial Reporting

EXECUTIVE SUMMARY

The Office of Inspector General conducted an audit of the Working Capital Guarantee (WCG) Delegated Authority (DA) Program. We performed this audit because approximately 80 percent of all Working Capital Guarantees are committed under DA, making it a high risk area of concern. The Working Capital Finance Division (WCFD)'s major priority is the effective management and monitoring of the use of the DA Program.

The objective of this audit was to determine whether Export-Import Bank of the United States (Ex-Im Bank) supplied sufficient oversight of lenders granted DA to approve Working Capital guarantees. The specific audit objectives were to evaluate: (1) oversight practices used to ensure that lenders comply with Ex-Im program guidelines; (2) timeliness in notifying lenders of identified exceptions; (3) internal controls to ensure examination results are properly managed; and (4) internal controls over lenders to reduce/eliminate claims and to safeguard taxpayer funds.

As of September 30, 2010, there were 45 active DA lenders in the WCG Program approved by Ex-Im Bank with an open loan facilities value of approximately \$1.5 billion. The audit focused on lenders with current facility loans under the WCGDA agreement during fiscal years 2009 and 2010. We selected a sample of 10 lenders out of 45 current WCGDA lenders during this period for our review. We also selected 12 claim files for a limited review to determine whether procedures were followed and appropriate decisions were made.

Our audit found that WCFD generally complied with its policies and procedures to perform an examination of WCGDA lenders. Examinations are scheduled at annual intervals unless more frequent examinations are required. Of the ten lenders reviewed, we found that an examination was generally performed annually by WCFD.

We also found that WCFD generally complied with its policies and procedures to notify lenders of identified exceptions found during examination. Of the ten lenders reviewed, WCFD discussed all findings with lenders' management at the examination exit conference and generally timely sent the lender a notification letter summarizing the examination results.

In addition, we identified no trend on type of waivers lenders requested. Of the 10 lenders sampled, we reviewed 17 loan files and found 62 waivers requested by lenders and approved by WCFD. These 62 waivers generally covered different Ex-Im Bank requirements. We performed this test because lending officers stated that requirements should be reduced because a waiver is frequently needed. Therefore, we reviewed approved waivers to determine if Ex-Im Bank should consider changing a requirement(s) based on the requirement's importance and frequency of a requested waiver.

While WCFD's efforts were positive, we noted that improvements are needed to strengthen follow-up procedures and controls and to maintain DA data. We made three recommendations to address these findings. Management concurred with the findings and recommendations (see Appendix A).

The recommendations are:

- WCFD Vice President (VP) should develop a policy and procedures to (a) ensure that a follow-up is timely performed to verify that the lender had taken the appropriate action on a material exception, (b) closely monitor potential problematic lenders by performing more frequent on-site examinations, (c) take action to alert lenders with repeated material exceptions of possible removal of their DA from Ex-Im Bank, and (d) establish a performance level to identify an acceptable claim rate against the total authorized facilities from a lender.
- WCFD VP should maintain a central record to document all examination results on lenders in the WCGDA Program.
- WCFD VP should maintain vital information to evaluate the WCGDA Program performance.

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I. BACKGROUND

Export Import Bank of the U.S. (Ex-Im Bank) Working Capital Guarantee (WCG) encourages commercial lenders to make loans to U.S. businesses for various export-related activities. The program covers 90 percent of the loan's principal and accrued interest, and carries the full faith and credit of the U.S. Government.

The Program facilitates the expansion of U.S. exports. It primarily helps small and medium-sized businesses that have the potential to export but lack sufficient funds to support export efforts. It may be used to cover a working capital loan to a creditworthy U.S. business if the lender shows that the loan would not have been made without Ex-Im Bank's guarantee.

Since October 1994, Ex-Im Bank has given Delegated Authority (DA) to qualified lenders, which allows them to commit Ex-Im Bank's guarantee as soon as they have made their internal credit decision. No further analysis is done by Ex-Im Bank. As an added incentive, Ex-Im Bank allows the DA lender to retain a portion of the facility fee, and separately collateralize the ten percent un-guaranteed portion of the loan.

The Master Guarantee Agreement is made and entered into by Ex-Im Bank and the lender, and sets forth the terms and conditions that govern Ex-Im Bank's guarantee of all loan facilities made by the lender under the program. In addition, Ex-Im Bank confers DA status through the DA Letter Agreement, which outlines the specific terms and conditions between Ex-Im and the lender with respect to the exercise of the lender's DA.

Ex-Im Bank reserves the right to determine the level of DA authorized for each lender. WCGDA is available at six levels. The lender's exercise of its WCGDA is subject to the maximum dollar limits applicable to lender's WCGDA level authorized by Ex-Im Bank. The six WCGDA levels are:

- Super: a maximum principal amount per loan facility of \$10 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$150 million.
- High Plus: a maximum principal amount per loan facility of \$7.5 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$100 million.
- High: a maximum principal amount per loan facility of \$5 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$75 million.

- Medium: a maximum principal amount per loan facility of \$3.5 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$50 million.
- Basic: a maximum principal amount per loan facility of \$2 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$25 million.
- Community: a maximum principal amount per loan facility of \$1 million and a maximum aggregate principal amount outstanding from time to time for all loans facility of \$10 million.

Lenders qualify for such WCGDA by completing training required by Ex-Im Bank and by successfully concluding a certain number of Ex-Im Bank transactions, ranging between two and ten.

As a condition of its approval, the Board required the Working Capital Finance Division (WCFD) to conduct periodic examinations of the lenders to review on-going transactions and lender compliance with the DA Program. The objective of an examination is to determine whether the lender is processing, closing and executing disbursements in accordance with prudent lending practices and Ex-Im Bank policies, procedures and contractual obligations.

As of September 30, 2010, there were 45 active WCGDA lenders approved by Ex-Im Bank with an open loan facilities value of approximately \$1.5 billion.

II. OBJECTIVES

The objective of this audit was to determine whether Ex-Im Bank supplied sufficient oversight of lenders granted DA to approve Working Capital guarantees. The specific audit objectives were to evaluate the:

- Oversight practices used to ensure that lenders comply with Ex-Im program guidelines;
- Timeliness in notifying lenders of identified exceptions;
- Internal controls to ensure examination results are properly managed; and
- Internal controls over lenders to reduce/eliminate claims and to safeguard taxpayer funds.

III. SCOPE AND METHODOLOGY

The scope of the audit focused on lenders with current facility loans under the Working Capital DA agreement during fiscal years (FYs) 2009 and 2010. We selected a sample of 10 lenders out of 45 current WCGDA lenders during this period for our review. We also selected 12 claim files for a limited review to determine whether procedures were followed and appropriate decisions were made.

We interviewed key Ex-Im Bank staff to obtain relevant information/documentation pertinent to this audit and to clarify relevant Ex-Im Bank policies and procedures. Specifically, we met with representatives from: WCFD, Claims and Recoveries Section (CARS), Credit Review and Compliance Division, Office of the Chief Financial Officer (OCFO), and the Office of General Counsel (OGC). We also performed a site visit, along with the WCFD staff members, to a lender in February 2011.

We analyzed data obtained from Ex-Im Bank staff, as well as other information available such as the *Policy and Procedures for the Business Credit Division – Working Capital Guarantee Program*.

We conducted our fieldwork from January 4, 2011, to April 13, 2011.

We performed this audit because approximately 80 percent of all Working Capital Guarantees are committed under DA, making it a high risk area of concern. WCFD's major priority is the effective management and monitoring of the use of the WCGDA Program.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on our audit objectives.

IV. AUDIT RESULTS

WCFD generally complied with its policies and procedures to perform an examination of WCGDA lenders. Examinations are scheduled at annual intervals unless more frequent examinations are required. Of the ten lenders reviewed, we found that an examination was generally performed annually by WCFD.

WCFD generally complied with its policies and procedures to notify lenders of identified exceptions found during examination. Of the ten lenders reviewed, WCFD discussed all findings with lenders' management at the examination exit conference and generally timely sent the lender a notification letter summarizing the examination results.

In addition, there was no trend on type of waivers lenders requested. Of the 10 lenders sampled, we reviewed 17 loan files and found 62 waivers requested by lenders and approved by WCFD. These 62 waivers generally covered different Ex-Im Bank requirements. We performed this test because lending officers stated that requirements should be reduced because a waiver is frequently needed. Therefore, we reviewed approved waivers to determine if Ex-Im Bank should consider changing a requirement(s) based on the requirement's importance and frequency of a requested waiver.

While WCFD's efforts were positive, we noted that improvements are needed to: ensure lenders take corrective action; closely monitor problematic lenders; alert lenders with repeated material exceptions; establish a lender performance level, and obtain data to measure the WCGDA Program. Discussion on these improvements is presented below.

A. FOLLOW-UP PROCEDURES AND CONTROLS NEED STRENGTHENING

WCFD did not perform a follow-up examination on lenders identified with a material exception. Instead, WCFD relied on the lender's statement that the exception was corrected. Without a follow-up examination, it is difficult to determine if the lender took appropriate corrective action to address the exception and prevent it from happening in the future. Also, WCFD did not maintain a central record to document examination results from prior years but relied on the most recent results for planning the upcoming examination. Without a central record of past examination results, WCFD cannot determine if lenders repeated findings over the years.

Regarding follow up on findings, WCFD *Policy and Procedures for the Business Credit Division – Working Capital Guarantee Program – Chapter 12 Policies and Procedures for Delegated Authority Lender Examinations* states the following:

“Exams that receive a Pass with Qualification or Fail rating require subsequent corrective action. The subsequent action will depend on the exceptions noted at the exam and the

corrective actions committed to by the lender. The timeframe for follow-up on corrective action is based on a reasonable timeframe for the lender to correct any exceptions. For example, if semi-annual collateral exams have not been completed, and the lender indicates that it will take two months to complete a collateral exam, the examiner should follow-up with the lender two months later. Additionally, any material exceptions regarding a specific Loan Facility should be documented by memo to the Ex-Im Bank file, with supporting documentation. Any follow-up of the lender should be documented in the DA exam file, DA lender file and loan file (if follow-up relates to a specific loan).

One of the most important aspects of the exam...is obtaining a commitment from a lender for corrective action and its timeframe. For instance if ...Borrowing Base Certificates have not been reconciled for a specific loan, the examiner should obtain a firm commitment from the lender as to when the reconciliation will be completed. If corrective action is not taken or not accomplished within the agreed timeframe, the on a case-by-case basis, the lender should be re-evaluated by the examiner with a memo outlining the situation with a recommended course of action to be approved by the Division's Vice President. The loan worksheet and exam report should include details as to the material exception, the corrective action, and the name of the lender's representative who made the commitment of corrective action."

Of the ten selected lenders for testing, we identified three lenders with material exceptions and no follow-up examination was performed. Examples of these exceptions were: use of financial statements prepared for tax purposes instead of financial statements prepared in accordance with Generally Accepted Accounting Principles and untimely field examinations. One of these three lenders had the same findings identified in both FYs 2009 and 2010.

We also selected 12 claim files for a limited review and determined that procedures were followed and appropriate decisions were made. We noted that in the event of a questionable claim, officers from CARS, OCFO, WCFD, and OGC met to discuss the case and reach an agreement on whether to deny or approve the claim.

While procedures for claim decisions were followed, we identified one potential problematic lender through our comparison of the number of facilities and claims filed by WCGDA lenders. This lender, from FYs 2001 to 2010, had 302 authorized facilities and filed claims on 27 of them (8.9 percent). Of the 27 paid claims totaling \$17.1 million, Ex-Im Bank recovered \$1.2 million (7.3 percent). Even though the lender has been in the WGCDA program for at least 10 years, WCFD's examination performed in FY 2010 noted 7 material exceptions, in addition to non-material issues.

Sound practices for the management and supervision of risk include establishing acceptable ratios of the number of claims filed vs. the total number of facilities authorized by a lender and the amount paid vs. recovered. However, the WGCDA Program did not address this factor to determine if a lender should be removed from this program.

A follow-up examination would ensure lenders are taking the appropriate action to prevent the material exception from recurring. If material exceptions continue in the lender's operations, WCFD should issue a letter to the lender emphasizing the applicable requirements, as specified in the Master Guarantee Agreement and DA Letter Agreement, are needed to retain DA. Also, a central record of all examination results would supply Ex-Im Bank with useful lender performance data.

Recommendation 1

WCFD Vice President (VP) should develop a policy and procedures to:

- a. Ensure that a follow-up is timely performed to verify that the lender had taken the appropriate action on a material exception.
- b. Closely monitor potential problematic lenders by performing more frequent on-site examinations.
- c. Take action to alert lenders with repeated material exceptions of possible removal of their DA from Ex-Im Bank.
- d. Establish a performance level to identify an acceptable claim rate against the total authorized facilities from a lender.

Management Response

Management concurs with this recommendation. WCFD is in the process of updating policies and procedures for Delegated Authority Lender Examinations (a) to ensure that examination findings are followed up on a timely basis and appropriate action has been taken by the lender. Additionally, policies and procedures will be put in place to determine (b) when more frequent on-site examinations are required, and (c) when lenders with repeated material exceptions should be notified of possible removal of their DA from Ex-Im Bank. WCFD will also establish (d) overall performance levels to identify acceptable claim rates for the lenders.

Completion Dates: Recommendations (a), (b), (c) July 31, 2011
Recommendation (d) November 1, 2011

OIG Comment

When accomplished, the above action should satisfy this recommendation.

Recommendation 2

WCFD VP should maintain a central record to document all examination results on lenders in the WCGDA Program.

Management Response

Management concurs with this recommendation. A central record to document all examination results on lenders in the WCGDA Program will be created and maintained.

Completion Date: July 31, 2011

OIG Comment

When accomplished, the above action should satisfy this recommendation.

**B. IMPROVEMENT IS NEEDED FOR MAINTAINING DELEGATED
AUTHORITY DATA**

Ex-Im Bank did not maintain information on the WCGDA Program to effectively evaluate the Program's performance. The audit found that WCGDA data was not maintained separately from the non-WCGDA Program. Without the applicable data, it is difficult to evaluate the performance level of either Program in order to determine whether a Program is achieving its intended purpose at the lowest possible cost.

Ex-Im Bank's two recent five-year Strategic Plans included a strategic goal of providing financing support for qualified exports for which private market financing is not available. These Plans were designed to build on the strengths of the organization, substantially increase the number of companies it serves and expand their access to global markets, as well as meet its congressional mandates in future years. To determine whether planned goals are met, sound management practice is to have access to applicable data for evaluation and determination on the effectiveness, efficiency, and usefulness of the program.

Because Working Capital Guarantee financial data for DA and non-DA are maintained together, accurate and reliable information was not available. While high-level officials advised us that the WCGDA Program is designated as self-sustaining, the OCFO was not able to verify this statement. The OCFO's data, from FY 2003 to February 28, 2011, reported the entire Working Capital Guarantee Program had a net loss of approximately \$6.8 million. Since approximately 80 percent of all Working Capital Guarantees are committed under the WCGDA Program, we estimated that the WCGDA Program could have a net loss of approximately \$5.4 million for the same period.

Additionally, because Working Capital Guarantee claims data for DA and non-DA are maintained together, both the CARS and the WCFD staff had to perform extra procedures to provide claim information for WCGDA activities. As a result of their efforts, we found that from FYs 2001 to 2010, Ex-Im Bank had 140 claims filed under the WCGDA Program. Of those claims, Ex-Im Bank paid a total of approximately \$159.3 million and recovered approximately \$23.5 million, a recovery rate of 14.8 percent.

Recommendation 3

WCFD VP should maintain vital information to evaluate the WCGDA Program performance.

Management Response

Management concurs with this recommendation. This information is currently available from the Office of the CFO for the Working Capital Guarantee Program on a combined basis for both Delegated Authority and non- Delegated Authority transactions. Specific information relating to WCGDA Program performance currently has to be prepared manually. The Office of the CFO and the Office of the CIO have agreed to develop a reporting system that will flag, identify, and sort Delegated Authority from non- Delegated Authority transactions automatically. Upon implementation of the system, WCFD's Vice President will be able to evaluate WCGDA Program performance more easily and effectively.

Completion Date: February 1, 2012

OIG Comment

When accomplished, the above action should satisfy this recommendation.

ACRONYMS

CARS	Claims and Recoveries Section
DA	Delegated Authority
Ex-Im or the Bank	Export Import Bank of the United States
FY	Fiscal Year
OCFO	Office of the Chief Financial Officer
OGC	Office of General Counsel
VP	Vice President
WCFD	Working Capital Finance Division
WCG	Working Capital Guarantee
WCGDA	Working Capital Guarantee Delegated Authority

APPENDIX A: MANAGEMENT RESPONSE

SEE NEXT PAGE



EXPORT-IMPORT BANK
OF THE UNITED STATES

MEMORANDUM

TO: Jean Smith
Assistant Inspector General for Audit, Office of the Inspector General

FROM: Pamela Bowers
Vice President, Working Capital Finance Division (WCFD) *PB*

DATE: July 5, 2011

SUBJECT: Management Response to Audit of the Working Capital Guarantee
Delegated Authority Program

This memorandum responds to the Office of the Inspector General's (OIG) Working Capital Guarantee Delegated Authority (WCGDA) draft report issued May 19, 2011. We agree with the draft's findings and provide additional comments below concerning the draft report's recommendations.

1. OIG Report, Section IV, Audit Results, Recommendation 1:

Draft Audit Recommendation: WCFD Vice President (VP) should develop a policy and procedures to:

- a. Ensure that a follow-up is timely performed to verify that the lender had taken the appropriate action on a material exception.
- b. Closely monitor potential problematic lenders by performing more frequent on-site examinations.
- c. Take action to alert lenders with repeated material exceptions of possible removal of their DA from Ex-Im Bank.
- d. Establish a performance level to identify an acceptable claim rate against the total authorized facilities from a lender.

Response to Draft Audit Recommendation: WCFD is in the process of updating policies and procedures for Delegated Authority Lender Examinations (a) to ensure that examination findings are followed up on a timely basis and appropriate action has been taken by the lender. Additionally, policies and procedures will be put in place to determine (b) when more frequent on-site examinations are required, and (c) when lenders with repeated material exceptions should

be notified of possible removal of their DA from Ex-Im Bank. WCFD will also establish (d) overall performance levels to identify acceptable claim rates for the lenders.

Completion Dates: Recommendations (a), (b), (c) July 31, 2011.
Recommendation (d) November 1, 2011.

2. OIG Report, Section IV, Audit Results, Recommendation 2:

Draft Audit Recommendation: WCFD VP should maintain a central record to document all examination results on lenders in the WCGDA Program.

Response to Draft Audit Recommendation: A central record to document all examination results on lenders in the WCGDA Program will be created and maintained.

Completion Date: July 31, 2011.

3. OIG Report, Section IV, Audit Results, Recommendation 3:

Draft Audit Recommendation: WCFD VP should maintain vital information to evaluate the WCGDA Program performance.

Response to Draft Audit Recommendation: This information is currently available from the Office of the CFO for the Working Capital Guarantee Program on a combined basis for both Delegated Authority and non- Delegated Authority transactions. Specific information relating to WCGDA Program performance currently has to be prepared manually. The Office of the CFO and the Office of the CIO have agreed to develop a reporting system that will flag, identify, and sort Delegated Authority from non- Delegated Authority transactions automatically. Upon implementation of the system, WCFD's Vice President will be able to evaluate WCGDA Program performance more easily and effectively.

Completion Date: February 1, 2012.