



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

# **Report on Minera y Metalurica del Boleo S.A.**

**September 30, 2013**

**OIG-INS-13-01**

*The Export-Import Bank of the United States (Ex-Im Bank) is the official export-credit agency of the United States. Ex-Im Bank is an independent, self-sustaining executive agency and a wholly-owned U.S. government corporation. Ex-Im Bank's mission is to support jobs in the United States by facilitating the export of U.S. goods and services. Ex-Im Bank provides competitive export financing and ensures a level playing field for U.S. exports in the global marketplace.*

*The Office of Inspector General, an independent office within Ex-Im Bank, was statutorily created in 2002 and organized in 2007. The mission of the Ex-Im Bank Office of Inspector General is to conduct and supervise audits, investigations, inspections, and evaluations related to agency programs and operations; provide leadership and coordination as well as recommend policies that will promote economy, efficiency, and effectiveness in such programs and operations; and prevent and detect fraud, waste, abuse, and mismanagement.*



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To: John McAdams, Vice Chair and Chief Operating Officer  
David Sena, Senior Vice President & Chief Financial Officer

From: Mark Thorum  
Assistant Inspector General; Inspections & Evaluations

Subject: Inspection Report on Minera y Metalurgica del Boleo S.A. de C.V.  
AP084609XX-MEXICO

Date: September 30, 2013

Attached please find the final inspection report (redacted version) on Minera y Metalurgica del Boleo S.A. de C.V. AP084609XX-MEXICO. The report outlines seven recommendations for corrective action. In a response to an earlier draft of the report, management concurred with the recommendations. Management's response is included as an appendix to the final report.

We consider management's proposed actions to be responsive. The recommendations will be closed upon completion and verification of the proposed actions.

We appreciate the courtesies and cooperation extended to us during the inspection. If you have any questions, please contact me at (202) 565-3939 or [mark.thorum@exim.gov](mailto:mark.thorum@exim.gov).

Cc: Fred Hochberg, Chairman and President  
Osvaldo Gratacos, Inspector General  
Claudia Slacik, Senior Vice President Export Finance  
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Inci Tonguch-Murray, Business Compliance Officer

# Executive Summary

## Report on Minera y Metalurica del Boleo S.A.

### Inspections Report OIG-INS-13-01

#### September 30, 2013

#### Why We Did This Inspection

OIG's inspection seeks to develop a coherent explanation of events and causal factors that led to the substantial cost overruns and subsequent default of the project; to examine the possibility of corporate misconduct by any of the involved parties; and with the benefit of hindsight, to identify potential systemic vulnerabilities. In writing this report, OIG recognizes that our findings primarily relate to the Boleo project financing, and may not be generalizable to the broader universe of Ex Im Bank transactions.

#### What We Recommend

Ex-Im Bank would benefit from a comprehensive review of its credit analysis and approval procedures with a view to improving its transaction risk assessment and BCL classification and to ensure the independence and objectivity of the credit evaluation process.

Establish a systematic and automated invoice submittal and review process for both US exports and local costs. Create a web portal for client interface.

Extend the scope and frequency of CRTI procedures to the top local vendors during both due diligence and project construction phases.

When assessing resource allocation, Ex-Im Bank should consider augmenting staff and resources in both, the pre- and post operative transaction monitoring teams, as well as supporting internal resources.

#### What We Found

The Boleo Project involves the development of an underground copper-cobalt-zinc mine located in Baja California, Mexico. The Project posed numerous challenges to its lenders including an inexperienced and financially-weak Sponsor/Guarantor, complex mining issues, and the lack of an effective independent engineer. With the benefit of hindsight, it is apparent that certain identified risks were not sufficiently vetted in the initial due diligence process, nor mitigated in the structuring phase, nor adequately managed by the responsible parties.

In the aggregate, these factors posed greater risks to Ex-Im Bank, facilitated substantial cost overruns and contributed to the project's default within six months of financial closing. Indeed, there is evidence that suggests significant cost overruns had already occurred prior to Ex-Im Bank's last disbursement under its facility.

In November 2012, Ex-Im Bank successfully restructured its \$419.6 million direct loan facility in, what appears to be, a no loss situation for Ex-Im Bank. The original Ex-Im Bank project financing was terminated and replaced with a new \$419.6 million facility to a state-owned Korean entity and member of the original consortium of sponsors. The project facilities remain in default, however, as the remaining lenders continue to re-negotiate their Standstill Agreement with the Borrower.

Our inspection revealed evidence of inappropriate conduct by several parties including the Borrower's failure to make timely disclosure of significant cost overruns, inaccurate representations, allegations of fraud related to one of the project's local vendors, management impropriety, and an over-arching lack of governance.

In addition, we observed that Ex-Im Bank's current policies and procedures related to the reimbursement of local costs may not be sufficiently developed to guard against waste, fraud, and abuse by local suppliers. Moreover, Ex-Im Bank lacks the infrastructure and resources to effectively process the high volume of local cost disbursements.

We also noted that Ex-Im Bank's Character Reputational & Transaction Integrity (CRTI) or Know Your Customer procedures for local cost vendors would benefit from a broader review of public sources and more frequent application. This could be accomplished through periodic checks beginning with the initial due diligence phase and continuing through the construction period. The enhanced procedures would alert Ex-Im Bank to possible risks of fraud and corruption in the host country on an ongoing basis.

For additional information, contact the Office of Inspector General at (202) 565-3908 or visit [www.exim.gov/oig](http://www.exim.gov/oig).

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## CONCLUSIONS

The Boleo transaction provides a cogent reminder of the need to fully evaluate and vet transaction risks as part of the approval process. The combination of an inexperienced sponsor/developer, limited sponsor resources, complex mining issues, and lack of an effective Independent Engineer resulted in a higher risk profile for the Project. While no single factor resulted in the project's subsequent default, in the aggregate, they weakened the transaction's credit profile.

In the opinion of OIG, the above vulnerabilities were not sufficiently addressed in Ex-Im Bank's due diligence efforts, nor sufficiently evaluated in the internal documents submitted to the Board of Directors for consideration. Although Ex-Im Bank did not lose money after its restructuring of the original deal, with the benefit of hindsight, it does not appear that sufficient measures were taken to safeguard Ex-Im Bank against these risks in the structuring and managing of the transaction.

In writing this report, OIG recognizes that Ex-Im Bank successfully restructured this transaction. Moreover, that our findings primarily relate to the Boleo Project financing, and may not necessarily be generalizable to the broader universe of Ex-Im Bank transactions. Nonetheless, these observations are instructive and may indicate a systemic vulnerability in certain Ex-Im Bank policies and procedures. Our inspection produced seven key findings related to the four points of inquiry:

**Point of Inquiry 1** Did Ex-Im Bank conduct sufficient due diligence of all aspects of the project financing and parties in accordance with Ex-Im Bank policies and procedures? Were the relevant risks identified, disclosed, and mitigated? Was the CRTI/KYC analysis adequately performed?

**Finding 1 A:** Ex-Im Bank played a limited role in the initial structuring of the Boleo financing as well as the technical due diligence completed by the Technical Agent, Independent Engineer, and Sponsor. Transaction risks were not sufficiently vetted in the due diligence phase and only partially mitigated through credit structuring.

**Finding 1 B:** Key transaction risks were identified but not sufficiently evaluated in the Memorandum to the Ex-Im Bank Board of Directors dated June 17, 2010.

**Recommendation 1:** Ex-Im Bank would benefit from a comprehensive review of its credit analysis and approval procedures with a view to improving its transaction risk assessment and BCL classification and to ensure the independence and objectivity of the credit evaluation process. This recommendation is particularly cogent for those transactions with a higher risk profile, exposure amount, or if the proposed terms depart from Ex-Im Bank's established policies and procedures. To this end, Ex-Im Bank should consider the following:

- Ex-Im Bank should benchmark its current credit review and approval procedures against current best practices and U.S. financial regulatory guidance.
- Ex-Im Bank should evaluate the BCL rating process for structured financings to ensure a consistent approach across industries, countries, and financing structure as well as rating agency criteria for comparable transactions.
- Ex-Im Bank should implement a more systematic approach to pre-Board briefings including

a standardized briefing package that includes a full risk assessment.

- Ex-Im Bank should involve representatives from the Asset Management Division at an earlier stage of the credit approval process to benefit from AMD's experience with similar transactions in its portfolio and to effect a smooth transition from pre to post-operative status.

### **Management Response:**

Management agrees with this recommendation and will consider the suggestions presented by the OIG. The Bank has made important progress in its credit analysis and approval procedures and will be pleased to present this information to the OIG as they proceed to close out the recommendations presented in this report. Please see Appendix F: Management Response.

### **Evaluation of Management's Response:**

Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Point of Inquiry 2** Is there any evidence of inappropriate conduct on the part of the Borrower or other parties involved with the transaction?

**Finding 2 A:** There is evidence that the Borrower failed to make timely disclosure of cost overruns, issued inaccurate representations under the Ex-Im Bank facility, as well as an overall lack of financial governance at the senior management level of MMB/Baja. Finally, there is evidence that suggests MMB knowingly violated Ex-Im Bank's local cost policy.

**Recommendation 2:** Ex-Im Bank should consider the implementation of a risk-based approach to monitoring that specifically identifies and addresses the potential vulnerabilities of the transaction. With respect to Boleo, this approach would suggest a more pro-active focus on the performance of the EPCM contractor, budget revisions such as project change orders, and more "boots on the ground" inspections of the project.

### **Management Response:**

Management agrees with this recommendation, and currently uses a risk-based approach to monitoring EPCM performance and other risks.

The Board Memorandum prepared by the Structured Finance Division ("SFD") in conjunction with the Engineering and Environmental ("E & E") Division, the Office of General Counsel, and other divisions, includes identification and analysis of all construction, performance, payment, sponsor, and other risks.

The Asset Management Division ("AMD"), in conjunction with E & E, conducts a full risk analysis in the form of a Project Finance / Corporate Rating Report. This allows for a downgrade, if appropriate, on a credit on this first review. AMD identifies transactions in its portfolio which may present greater risk and therefore require closer monitoring. Routine monitoring and an annual credit review process are also accomplished for all transactions in



the AMD portfolio.

For example, it was shortly after the Boleo transaction transferred to AMD, which was working with E & E on project performance, that disbursements were stopped, the credit was downgraded, and the Bank placed “boots on the ground” to further assess the situation. AMD staff was able to use the risk mitigation provisions to mitigate sponsor risk that allowed the Korean shareholder to increase its equity contributions. Ultimately, that shareholder was able to work with AMD to create the successful restructuring of the loan facility as a no loss situation for the Bank. This reflects the risk-based approach to monitoring used by the Bank. Please see Appendix F: Management Response.

### **Evaluation of Management’s Response:**

Management’s proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Point of Inquiry 3** Are Ex-Im Bank’s current policies and procedures related to the reimbursement of local costs sufficiently developed to guard against waste, fraud, and abuse by suppliers?

**Finding 3 A:** Ex-Im Bank’s current policies, procedures, and infrastructure did not sufficiently handle the high volume of local cost disbursements.

**Recommendation 3:** Ex-Im Bank should establish a streamlined, automated electronic invoice submittal system with a client web-portal that seamlessly provides input for loan disbursement and data tracking control, review, and processing purposes covering both local costs and U.S. exports.

### **Management Response:**

Management supports this recommendation.

Ex-Im Bank identified the need for streamlining the loan disbursement process in its Structured and Project Finance leaning initiative. In addition, the replacement of the Application Processing System (APS) and implementation of the new Financial Management System are currently underway. Ex-Im Bank is currently developing a Smart Form Exporter’s Certificate and an electronic document management system both of which are necessary components of an electronic disbursement submittal system. The Financial Management System (planned for October 2014) includes an enhanced loan processing and disbursement module including sharing and providing views to financial disbursement information to the transaction system (ExIm Online and APS replacement). The overall solution would provide customers with integrated capabilities for status reporting, online invoicing, and disbursement.

Management would like to note that Finding 3A states there have been “policy changes that have relaxed the reporting requirements for local vendors.” Management disagrees with this statement and had previously commented to the OIG that no supporting information has been provided to the Bank. Finding 3A also states that “OIG learned that Ex-Im Bank may pay local vendors estimated installments on the contractual amount.” However, Ex-Im Bank does not



pay local cost providers directly, but reimburses the Borrower for payments made to local cost providers. No supporting information or source of that information is presented in the report. Please see Appendix F: Management Response.

### **Evaluation of Management's Response:**

OIG's concerns regarding current reporting requirements for local vendors are outlined on page 35 of the Inspection Report: "there do not appear to be appropriate controls in place to ensure that the contractual unit price or services are correctly billed, nor is there a validation process to confirm that the reimbursed invoice amount is for contractual work that was actually completed. Furthermore, due to the increasing number of large direct loan transactions, reimbursements are typically aggregated with imprecise descriptions and limited to one per month." In addition, OIG outlines the relaxation of local cost financing criteria in footnote 63 on page 35: "In 2007, local cost provisions in the OECD Arrangements were amended to increase the amount of local cost that may be supported from 15 percent to 30 percent. In addition, the prior requirement to finance local costs and U.S. exports on a pro rata basis has been dropped."

OIG recognizes the above-referenced initiatives to improve current disbursement, reporting and management procedures. Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Finding 3 B:** Ex-Im Bank could strengthen its CRTI/KYC procedures by including a review of local vendors both at project inception, or as soon as available, and on a continuing basis.

**Recommendation 4:** To enhance the CRTI/KYC process, OIG recommends that a full check (including local media sources) on local vendors and third party contractors be performed as part of the initial due diligence and on an ongoing basis during the local cost disbursement period. In the case of Boleo, a search of local media sources would have alerted Ex-Im Bank of the pending fraud allegations against the local union. Finally, Ex-Im Bank should maintain an internal watch list of any local cost provider or U.S. exporter that may have been involved with questionable practices in the past. This practice would better inform the bank's due diligence/KYC practices going forward and improve Ex-Im Bank's institutional knowledge to combat waste, fraud, and abuse.

### **Management Response:**

Management agrees with this recommendation, however must operate within budgetary and legal constraints.

Management will evaluate the recommendation and work with the OIG to develop an enhanced KYC/CRTI process. Due to budgetary and staffing constraints, the Bank will need to conduct a cost-benefit analysis to determine the level of participant review which is both practical and feasible. The level of review described by the OIG would require a significant amount of staff time and at considerable cost to the Bank. In addition, the maintenance of an internal "Watch List" may have legal ramifications in light of the Privacy Act and Federal

debarment regulations which require Bank compliance. Please see Appendix F: Management Response.

**Evaluation of Management's Response:**

Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Recommendation 5:** OIG recommends that Ex-Im Bank evaluate its current fraud prevention practices for local costs, with a view to establishing a more robust and proactive approach. Ex-Im Bank should review and benchmark current practices with the best practices currently employed by other multilateral agencies and U.S. federal agencies. In addition to the current representations from the Borrower, Ex-Im Bank may want to encourage its Borrowers to adopt certain contractual provisions: a provision obligating the Borrower to maintain accurate books and records; an effective system of internal controls; and a contractual right of termination in case of breach of anti-corruption laws.

Following the practice of various multilateral financial institutions, Ex-Im Bank may consider including additional prohibited practices in its contractual agreements with the Borrower, which may extend to entities that the Borrower owns or controls. This provision would enable broader and more consistent due diligence requirements with respect to local cost providers. Finally, OIG recommends a provision encouraging transaction parties to report fraud, waste and abuse and corruption to the Inspector General of Ex-Im Bank.

**Management Response:**

Management agrees to evaluate its current fraud prevention practices for local costs.

Management will evaluate the recommendation and work with the OIG to develop a more robust and proactive approach for local cost fraud prevention. The Bank will consider the suggestions made by OIG regarding additional contractual provisions in agreements with Borrowers. The Bank would need to determine the legal ramifications of adding the suggested provisions to any contractual agreements. Please see Appendix F: Management Response.

**Evaluation of Management's Response:**

Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Point of Inquiry 4** Did Ex-Im Bank sufficiently manage and structure the project loan in light of the project risks, the lack of sponsor experience, and lack of financial resources?

**Finding 4 A:** While numerous factors suggested the need for closer monitoring of the transaction, Ex-Im Bank project staff relied heavily on external third parties to perform this important function. This is particularly relevant as Ex-Im Bank had prior knowledge of the IE's close working relationship with Sponsor and the Financial Advisor and, as a result, may have lacked the necessary independence to perform its function.

**Finding 4 B:** The Boleo Project experienced several structural issues related to the legal documentation and structure of the project financing that merit further discussion.

**Finding 4 C:** OIG's interviews with Ex-Im Bank staff indicate that the lack of available staff and insufficient travel budget may hamper Ex-Im Bank's ability to properly manage the transaction prior to operational status and to monitor the transaction once operational status has been achieved.

**Recommendation 6:** Ex-Im Bank should increase its staff in both the pre- and post-operative transaction monitoring teams and related internal resources. This will better equip Ex-Im Bank to handle a growing volume of complex transactions and to implement a more proactive approach to site visits, loan structuring, and in the selection of an independent engineer.

**Management Response:**

Management concurs with this recommendation, however must operate within budgetary constraints.

To keep pace with growth in authorizations, Ex-Im Bank has reallocated positions to underwriting, asset management, and compliance positions and has increased the complement to effectively manage the added responsibility. In FY 2008, Ex-Im Bank had 359 total full-time equivalent (FTE) employees and at the end of FY 2012, Ex-Im Bank had 406 FTEs. Many of the new FTEs have been allocated to underwriting, asset management, and legal counsels.

Ex-Im Bank requested additional resources in the FY 12, FY 13 and FY 14 budgets; however the FY 12 and FY 13 requests were not approved by Congress despite the fact that Ex-Im Bank generated more than a billion in excess revenue for the taxpayers during that time frame. The Bank has not yet received its FY 14 budget from Congress. It should be noted that Ex-Im Bank has made significant modifications to its workforce to address the issues raised by OIG, while still working within the constrained budget. Please see Appendix F: Management Response.

**Evaluation of Management's Response:**

Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

**Recommendation 7:** Ex-Im Bank should conduct a postmortem review of the structural issues encountered in the Boleo transaction and formulate recommendations. All parties involved in the transaction should participate in the review.

**Management Response:**

Management agrees with this recommendation.

The Asset Management Division (AMD), in the Office of the Chief Financial Officer (OCFO), in conjunction with the Policy and Planning Division, prepared a "Lessons Learned" memorandum which was presented to the Bank's Credit Policy Committee in March 2013. Based on comments received, staff revised the memorandum and will present it to the

Enterprise Risk Committee. Please see Appendix F: Management Response.

**Evaluation of Management's Response:**

OIG acknowledges that a "Lessons Learned" memorandum was prepared, however, it is OIG's understanding that certain divisions involved with the transaction did not participate in this review exercise. OIG recommends that "All parties involved in the transaction should participate in the review."

Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.

## APPENDIX A: INSPECTION METHODOLOGY

Both quantitative and qualitative techniques were employed by the Office of Inspector General; Inspection and Evaluation team as part of its review. These included the following:

- A review of the Boleo transaction's financing documents, both pre- and post-restructuring.
- A review of internal EX-IM Bank reports and correspondence related to the transaction.
- Interviews with EX-IM staff who worked on the transaction including Export Finance, Office of General Counsel, Portfolio Monitoring Group, Office of the CFO, Office of Operations and Data Quality, and the Engineers Division
- Interviews with involved external parties.
- A review of Baja's financial statements and regulatory filing requirements.
- A review of the project's disbursement requests and payment history.
- A review of the Boleo project invoices submitted for reimbursement.
- Network Analysis (Palatir)

This analysis is performed to assess the effectiveness of the disbursement procedures conducted by the Operations Department. The focus is on the validation process for invoices submitted for reimbursement. Since the local cost was 100 percent disbursed at the beginning of the project (amount), the analysis was done mainly on the local invoices submitted for reimbursement.

The Recovery Operations Center (ROC) was engaged for the analysis of invoices submitted for reimbursement with the disbursement requests under the 2010 Ex-Im Facility for the Boleo project. The supporting documents for the three disbursements made by Ex-Im are provided by the Operation Department.

The information of all vendors and their submitted invoices is used for this analysis.

The ROC analyst conducted a search of open source news articles, company websites, and Dun & Bradstreet collecting information to build the vendor profiles. The vendors' information was imported into Network Analysis (Palantir) to identify business relationships and cross-ownership ties between the vendors and the entities involved in the Boleo project. A search was also conducted in Financial Crimes Enforcement Network (FinCEN) for each company and associated executives.

## APPENDIX F: MANAGEMENT RESPONSE LETTER



EXPORT-IMPORT BANK  
OF THE UNITED STATES

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September 27, 2013

Osvaldo Gratacós  
Inspector General  
Office of the Inspector General  
Export-Import Bank of the United States  
811 Vermont Avenue NW  
Washington, DC 20571

Dear Inspector General Gratacós,

Thank you for providing the Export-Import Bank of the United States ("Ex-Im Bank" or "the Bank") Management with the Office of the Inspector General's (OIG) "Report on Minera Y Metalurica del Boleo S.A." (September 10, 2013) ("Boleo"). Management continues to support the OIG's work and inspections which complement the Bank's efforts to continually improve its processes. Ex-Im Bank is proud of the strong and cooperative relationship it has with the OIG.

Management is pleased that the OIG has recognized that the Bank's staff successfully restructured the Boleo direct loan facility to be a no loss situation for the Bank. Ex-Im Bank staff's contributions in structuring the original transaction, back-ended disbursements, effective Intercreditor Arrangements, and Ex-Im Bank's comprehensive risk management framework, including proactive monitoring directly contributed to this successful outcome.

Management recognizes the time constraints faced by the OIG in trying to produce timely reports. The Bank appreciates the OIG taking the time to conduct further discussions with staff on the accuracy of the information presented and make revisions to the initial draft report. The OIG final Draft Report was distributed on September 12, 2013, with a corrected version distributed on September 19, 2013. The Bank is providing this Management response in an effort to comply with the OIG's requested deadline, however, due to the short timeframe, some recommendations cannot be fully responded to at this time without additional analysis and evaluation by Management. In addition, as the time constraints did not allow for the opportunity to receive clarification of some sections of the report from OIG, the Bank will continue to work with the OIG to get further clarification of the OIG findings and recommendations.



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The Bank remains committed to full cooperation with the OIG. In order to strengthen the working relationship, Management and the OIG are in the process of developing a framework in which to operate for future inspections and audits.

The “Report on Minera Y Metalurica del Boleo S.A.” makes several recommendations in the areas of credit review, risk-based monitoring, invoice submittal process, Character, Reputational, Transactional Integrity (CRTI) checks, fraud prevention, resource allocation, and post-mortem transaction review. Management concurs with the OIG recommendations as noted below.

Recommendation 1: Ex-Im Bank would benefit from a comprehensive review of its credit analysis and approval procedures with a view to improving its transaction risk assessment and BCL classification and to ensure the independence and objectivity of the credit evaluation process. To this end, Ex-Im Bank should consider the following:

Ex-Im Bank should benchmark its credit review and approval procedures against current best practices and U.S. financial regulatory guidance.

Ex-Im Bank should evaluate the BCL rating process for structured financings to ensure a consistent approach across industries, countries, and financing structure as well as rating agency criteria for comparable transactions.

Ex-Im Bank should implement a more systematic approach to pre-Board briefings including a standardized briefing package that includes a full risk assessment.

Ex-Im Bank should involve representatives from the Asset Management Division at an earlier stage of the credit approval process to benefit from AMD’s experience with similar transactions in its portfolio and to effect a smooth transition from pre- to post-operative status.

Management Response: Management agrees with this recommendation and will consider the suggestions presented by the OIG. The Bank has made important progress in its credit analysis and approval procedures and will be pleased to present this information to the OIG as they proceed to close out the recommendations presented in this report.

Recommendation 2: Ex-Im Bank should consider the implementation of a risk-based approach to monitoring that specifically identifies and addresses the potential vulnerabilities of the transaction. With respect to Boleo, this approach would suggest a more pro-active focus on the performance of the EPCM contractor, budget revisions such as project change orders, and more “boots on the ground” inspections of the project.

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Management Response: Management agrees with this recommendation, and currently uses a risk-based approach to monitoring EPCM performance and other risks.

The Board Memorandum prepared by the Structured Finance Division (“SFD”) in conjunction with the Engineering and Environmental (“E & E”) Division, the Office of General Counsel, and other divisions, includes identification and analysis of all construction, performance, payment, sponsor, and other risks.

The Asset Management Division (“AMD”), in conjunction with E & E, conducts a full risk analysis in the form of a Project Finance / Corporate Rating Report. This allows for a downgrade, if appropriate, on a credit on this first review. AMD identifies transactions in its portfolio which may present greater risk and therefore require closer monitoring. Routine monitoring and an annual credit review process are also accomplished for all transactions in the AMD portfolio.

For example, it was shortly after the Boleo transaction transferred to AMD, which was working with E & E on project performance, that disbursements were stopped, the credit was downgraded, and the Bank placed “boots on the ground” to further assess the situation. AMD staff was able to use the risk mitigation provisions to mitigate sponsor risk that allowed the Korean shareholder to increase its equity contributions. Ultimately, that shareholder was able to work with AMD to create the successful restructuring of the loan facility as a no loss situation for the Bank. This reflects the risk-based approach to monitoring used by the Bank.

Recommendation 3: Ex-Im Bank should establish a streamlined, automated electronic invoice submittal system with a client web portal that seamlessly provides input for loan disbursement and data tracking control, review and processing purposes, covering both local costs and U.S. exports.

Management Response: Management supports this recommendation.

Ex-Im Bank identified the need for streamlining the loan disbursement process in its Structured and Project Finance leaning initiative. In addition, the replacement of the Application Processing System (APS) and implementation of the new Financial Management System are currently underway. Ex-Im Bank is currently developing a Smart Form Exporter’s Certificate and an electronic document management system both of which are necessary components of an electronic disbursement submittal system. The Financial Management System (planned for October 2014) includes an enhanced loan processing and disbursement module including sharing and providing views to financial disbursement information to the transaction system (ExIm Online and APS replacement). The overall solution would provide customers with integrated capabilities for status reporting, online invoicing, and disbursement.



Management would like to note that Finding 3A states there have been “policy changes that have relaxed the reporting requirements for local vendors.” Management disagrees with this statement and had previously commented to the OIG that no supporting information has been provided to the Bank. Finding 3A also states that “OIG learned that Ex-Im Bank may pay local vendors estimated installments on the contractual amount.” However, Ex-Im Bank does not pay local cost providers directly, but reimburses the Borrower for payments made to local cost providers. No supporting information or source of that information is presented in the report.

Recommendation 4: To enhance the KYC/CRTI process, OIG recommends that a full check (including local media sources) on local vendors and third-party contractors be performed as part of the initial due diligence and on an ongoing basis during the local cost disbursement period. In the case of Boleo, a search of local media sources would have alerted Ex-Im Bank of the pending fraud allegations against the local union. Finally, Ex-Im Bank should maintain an internal “watch list” of any local cost provider or U.S. exporter that may have been involved with questionable practices in the past. This practice would better inform the Bank’s due diligence/KYC practices going forward and improve Ex-Im Bank’s institutional knowledge to combat waste, fraud and abuse.

Management Response: Management agrees with this recommendation, however must operate within budgetary and legal constraints.

Management will evaluate the recommendation and work with the OIG to develop an enhanced KYC/CRTI process. Due to budgetary and staffing constraints, the Bank will need to conduct a cost-benefit analysis to determine the level of participant review which is both practical and feasible. The level of review described by the OIG would require a significant amount of staff time and at considerable cost to the Bank. In addition, the maintenance of an internal “Watch List” may have legal ramifications in light of the Privacy Act and Federal debarment regulations which require Bank compliance.

Recommendation 5: OIG recommends that Ex-Im Bank evaluate its current fraud prevention practices for local costs, with a view to establishing a more robust and proactive approach. Ex-Im Bank should review and benchmark current practices with the best practices currently employed by other multilateral agencies, and U.S. federal agencies. In addition to the current representations from the Borrower, Ex-Im Bank may want to encourage its Borrowers to adopt certain contractual provisions: a provision obligating the Borrower to maintain accurate books and records, an effective system of internal controls; and a contractual right of termination in case of breach of anti-corruption laws.

Following the practice of various multilateral financial institutions, Ex-Im Bank may consider including additional “prohibited practices” in its contractual agreements with the Borrower, which may extend to entities that the Borrower owns or controls. This provision would enable

broader and more consistent due diligence requirements with respect to local cost providers. Finally, OIG recommends a provision encouraging transaction parties to report fraud, waste and abuse and corruption to the Inspector General of Ex-Im Bank.

Management Response: Management agrees to evaluate its current fraud prevention practices for local costs.

Management will evaluate the recommendation and work with the OIG to develop a more robust and proactive approach for local cost fraud prevention. The Bank will consider the suggestions made by OIG regarding additional contractual provisions in agreements with Borrowers. The Bank would need to determine the legal ramifications of adding the suggested provisions to any contractual agreements.

Recommendation 6: Ex-Im Bank should increase its staff in both, the pre- and post-operative transaction monitoring teams, and related internal resources. This will better equip Ex-Im Bank to handle a growing volume of complex transactions and to implement a more proactive approach to site visits, loan structuring, and in the selection of an independent engineer.

Management Response: Management concurs with this recommendation, however must operate within budgetary constraints.

To keep pace with growth in authorizations, Ex-Im Bank has reallocated positions to underwriting, asset management, and compliance positions and has increased the complement to effectively manage the added responsibility. In FY 2008, Ex-Im Bank had 359 total full-time equivalent (FTE) employees and at the end of FY 2012, Ex-Im Bank had 406 FTEs. Many of the new FTEs have been allocated to underwriting, asset management, and legal counsels.

Ex-Im Bank requested additional resources in the FY 12, FY 13 and FY 14 budgets; however the FY 12 and FY 13 requests were not approved by Congress despite the fact that Ex-Im Bank generated more than a billion in excess revenue for the taxpayers during that time frame. The Bank has not yet received its FY 14 budget from Congress. It should be noted that Ex-Im Bank has made significant modifications to its workforce to address the issues raised by OIG, while still working within the constrained budget.

Recommendation 7: Ex-Im Bank should conduct a post-mortem review of the structural issues encountered in the Boleo transaction and formulate recommendations.

Management Response: Management agrees with this recommendation.

The Asset Management Division (AMD), in the Office of the Chief Financial Officer (OCFO), in conjunction with the Policy and Planning Division, prepared a "Lessons Learned" memorandum

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which was presented to the Bank's Credit Policy Committee in March 2013. Based on comments received, staff revised the memorandum and will present it to the Enterprise Risk Committee.

We thank the OIG for your efforts to ensure the Bank's policies and procedures continue to improve, as well as the work you do with us to protect Ex-Im funds from fraud, waste, and abuse. We look forward to strengthening our working relationship and continuing to work closely with the Office of the Inspector General.

Sincerely,




John A. McAdams  
Chief Operating Officer  
Export-Import Bank of the United States

### **Acknowledgements**

This report was prepared by Mark S. Thorum, Assistant Inspector General for Inspections and Evaluations, and Vania Georgieva, Inspector, with the Office of Inspector General for the Export-Import Bank of the United States.





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