



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

**Audit of Export-Import Bank's  
Examinations of Delegated  
Authority Lenders  
Participating in the Working  
Capital Guarantee Program**

**September 28, 2016**  
**OIG-AR-16-07**

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Commercial and financial information that was obtained from outside parties and is privileged and confidential has been redacted from the publicly released version of this report.

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**EXPORT-IMPORT BANK**  
*of the UNITED STATES*

INSPECTOR GENERAL

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To: Pamela Bowers  
Vice President, Business Credit Division

From: Terry Settle *TL*  
Assistant Inspector General for Audits

Subject: Audit of Export-Import Bank's Examinations of Delegated Authority  
Lenders Participating in the Working Capital Guarantee Program

Date: September 28, 2016

This final report presents the results of our audit of Export-Import Bank's ("EXIM Bank" or "the Bank") Examinations of Delegated Authority Lenders participating in the Working Capital Guarantee Program. The objective of this audit was to determine whether EXIM Bank's oversight of delegated authority lenders was effective to ensure lenders were complying with program guidance.

The report contains twelve recommendations for corrective action. In response to our report, management concurred with all twelve recommendations. Management's comments are included as Appendix II in this report. We consider management's proposed actions to be responsive. The recommendations will be closed upon completion and verification of the proposed actions.

We conducted this 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 conclusions based on our audit objectives.

We appreciate the cooperation and courtesies provided to this office during the audit. If you have questions, please contact me at (202) 565-3498 or [terry.settle@exim.gov](mailto:terry.settle@exim.gov). You can obtain additional information about the Export-Import Bank Office of Inspector General and the Inspector General Act of 1978 at [www.exim.gov/oig](http://www.exim.gov/oig).

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## Why We Did This Audit

The Export-Import Bank's Business Credit Division (BCD) is responsible for EXIM Bank's Working Capital Guarantee Program (WCGP) which provides a 90 percent guarantee to lenders extending working capital loans to borrowers for the export of goods and services. According to EXIM Bank's FY 2014 and 2015 Annual Reports, there were 533 working capital guarantee authorizations totaling \$2.6 billion in FY 2013, 431 totaling \$2.4 billion in FY 2014, and 261 totaling \$1 billion in FY 2015. Approximately 80 percent of the working capital guarantees are committed under delegated authority. BCD conducts periodic examinations of delegated authority lenders to review lender compliance with the WCGP. The objective of this audit was to determine whether EXIM Bank's oversight of delegated authority lenders was effective to ensure lenders were complying with program guidance.

## What We Recommended

We made 12 recommendations for the Bank to: (1) Ensure examiners thoroughly review collateral examinations and fully assess and document the lenders' responsibilities in the reported findings; (2) Develop a mechanism for tracking the findings of lenders' collateral examinations during examinations; (3) Develop mechanisms to track required corrective actions to address collateral examination findings and ensure the corrective actions are taken by both borrowers and lenders; (4) Ensure resources are properly allocated in the BCD to accomplish the responsibilities of the division including the performance of thorough examinations; (5) Establish a separate examination group in the BCD comprised of individuals who are solely examiners and are independent of the lender relation role of the BCD; (6) Revise the loan facility review worksheet to require reviews of subsequent or updated credit memos for all loans reviewed during examinations; (7) Require a more in-depth review and documentation of lenders' collateral examinations during delegated authority lender examinations; (8) Require examiners to determine whether significant waiver stipulations were followed; (9) Update the BCD loan facility worksheet to differentiate between the initial examination and subsequent examinations; (10) Revise the requirements for the number of BBCs and the supporting documentation required to be provided during an examination; (11) Require lenders to maintain BBCs for the entire life of the loan; and (12) Update its Master Guarantee Agreement. Management concurred with all twelve recommendations.

## What We Found

The Office of Inspector General (OIG) found that the Export-Import Bank's examinations of delegated authority lenders (DAL) participating in the Working Capital Guarantee Program (WCGP) were not fully effective to ensure lenders complied with program guidance. We found the DAL examinations performed by the Bank's Business Credit Division (BCD) were timely and the lenders were properly notified of findings identified during the exam. We also found the examinations ensured lenders properly obtained and documented waiver requests. However, we found actions are needed to improve the effectiveness of the Bank's oversight of the lenders. Specifically, we identified (1) the quality and thoroughness of the DAL examination needs improvement; (2) the DAL examinations should be independent of the BCD's lender relation roles; (3) the Bank's WCGP policies for DAL examinations and the program's Master Guarantee Agreement need to be updated.

As a result, we identified the BCD missed important issues in two of its examination reports. The BCD did not identify one lender's lack of support for a \$1.5 million loan refinance on a \$1.99 million loan facility. Additionally, the BCD did not identify another lender's failure to hold a borrower accountable for obtaining the buyer's verification of export. We also identified that examinations were not able to ensure Borrowing Base Certificate (BBC) compliance throughout the life of a loan and the examiners' ability to identify fraud indicators on BBCs was limited.

The WCGP is a unique program that allows the growth of small businesses internationally. Strengthening the delegated authority lender examination process will help increase lender compliance with the WCGP and ensure performance standards required by the program are met. As such, we made 12 recommendations to improve the quality, thoroughness, independence, and internal controls for the oversight of the delegated authority lenders participating in the WCGP.

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## Introduction

This report presents the results of our audit of Export-Import Bank’s (“EXIM Bank” or “the Bank”) examinations of delegated authority lenders (DAL) participating in the Working Capital Guarantee Program (WCGP). The objective of this audit was to determine whether EXIM Bank’s oversight of delegated authority lenders was effective to ensure lenders were complying with program guidance. To answer our objective, we reviewed applicable federal laws, regulations and guidance. We also interviewed officials from EXIM Bank’s Business Credit Division (BCD) to gain an understanding of the Bank’s WCGP and the DAL examination process. Additionally, we reviewed examination documentation for four judgmentally selected DALs from the 41 participating in the WCGP. We selected these four banks in order to review one “medium level” DAL - (b) (4), one “high plus level” DAL - (b) (4), one “super high level” DAL - (b) (4) and (b) (4) – (b) (4). We selected different level banks to compare the examination process across the different levels. We selected (b) (4) based on its claims history. (b) (4) (b) (4)

(b) (4), or (b) (4) of the total dollar amount of claims paid for the entire program in FY 2014. The other DALs we selected for review did not file any claims in FY 2014. Overall, the Bank paid (b) (4) claims in FY 2014 for \$7,662,205 and (b) (4) claims in FY 2015 for \$832,172.

As of December 31, 2015, the combined portfolios of the four selected DALs included 53 loans totaling \$291.5 million dollars and represented 21 percent of the total number and 24 percent of the total dollar amount of loans in the entire DAL portfolio. Specifically, (b) (4) had (b) (4) loan facility for (b) (4); (b) (4) had (b) (4) facilities for (b) (4); (b) (4) had (b) (4) loan facilities for (b) (4); and (b) (4) had (b) (4) loan facilities for (b) (4). The total DAL portfolio as of December 31, 2015 consisted of 258 loans totaling \$1.2 billion. For the four DALs, we judgmentally selected and reviewed a total of 17 DAL loan facilities totaling \$104.7 million from the seven DAL examinations conducted by the BCD for these lenders in fiscal years (FY) 2014 and 2015. We interviewed the DAL examiners and relationship managers assigned to these lenders and also interviewed Vice Presidents for the four lenders. Finally, we interviewed personnel in EXIM Bank’s Asset Management Division and Credit Review and Compliance division. For more details on the audit scope and methodology see Appendix I.

We conducted this performance audit from June 2015 through August 2016 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

## Background

The BCD is responsible for EXIM Bank’s WCGP, which provides a 90 percent guarantee to commercial lenders extending working capital loans to borrowers to facilitate the export of

goods and services. EXIM Bank's WCGP allows U.S. exporters to obtain loans to produce or buy goods or services for export. The loans provide exporters with the liquidity to pursue new business, grow international sales, and compete more effectively in the global marketplace. These loans support the raw material, labor, and overhead costs of manufacturing an export item or providing a service to an international buyer. The WCGP does not have minimum or maximum transaction amounts and the typical loan term is one year. The loans may be used to acquire inventory; pay for direct and indirect costs for the manufacture or purchase of goods or provision of service; support letters of credit used as bid bonds, performance bonds, or payment guarantees; refinance existing short-term debt (on a case-by-case basis with approval by EXIM Bank), and finance indirect exports. A key element of the WCGP is the Master Guarantee Agreement. Chapter 16 of EXIM Bank's *Loan, Guarantee and Insurance Manual* (Chapter 16 of the Manual), Appendix B, *Master Guarantee Agreement*, includes the general terms and conditions of the lenders agreement with EXIM Bank. The Master Guarantee Agreement together with the specific terms and conditions set forth in each Loan Authorization Notice, the Borrower Agreement, and the Delegated Authority Letter Agreement, comprise the complete agreement of the lenders with respect to EXIM Bank's guarantee.

Since approximately 80 percent of Working Capital Guarantees are committed under delegated authority, the BCD's major priority is the effective management and monitoring of the use of the DAL Program. Under the DAL Program, a lender and EXIM Bank enter into a Delegated Authority Letter Agreement, which allows the lender to approve loans and receive an EXIM Bank guarantee without having to submit individual applications for approval. There are six levels of delegated authority with the smallest being "Community" which can approve up to \$1 million per borrower and \$10 million aggregate. The largest are "fast track" lenders under the "Super level". Their limits are \$25 million per borrower and \$300 million total. According to EXIM Bank's FY 2014 and FY 2015 Annual Reports, there were 533 working capital guarantee authorizations totaling \$2.6 billion in FY 2013, 431 totaling \$2.4 billion in FY 2014 and 261 totaling \$1 billion in FY 2015. As of December 31, 2015, there were 41 active DALs participating in the program. The WCGP had a default rate of 0.149 percent as of June 30, 2016.

As a condition of DAL Program approval, EXIM Bank's Board of Directors required the BCD staff to conduct periodic examinations of DALs to review on-going transactions and lender compliance with the DAL Program. According to Chapter 16 of the Manual, the examinations are conducted by BCD field examiners and are scheduled at annual intervals unless more frequent examinations are required. The objective of an examination is to determine whether the lender is processing, closing and executing disbursements in accordance with prudent lending practices and EXIM Bank policies, procedures and contractual obligations. The scope of the examination is to determine whether the DAL exercised its authority in accordance with the terms and conditions of the Delegated Authority Lender Agreement. The examination is either a full scope examination or a limited scope examination. Limited scope examinations have a flexible format and are generally used to investigate adverse or unusual situations and/or determine progress in correcting deficiencies noted in a previous full scope examination. According to Chapter 16 of the Manual, the depth at which the full scope examination is completed is in proportion to EXIM Bank's risk exposure. The risk associated with a lender is measured by evaluating the lender's portfolio size, level of delegated authority, volume of

problem loans, and claim history. The examiners use the Loan Facility Review Worksheet (worksheet) as a written record of their review and evaluation of the lender’s underwriting and credit administration for a sampled loan. The review of the loan using the worksheet also enables the examiner to verify the consistency of the lender’s credit memo, Loan Authorization Notice, Borrowing Base Certificate (BBC), and collateral examinations. See Table 1 for a description of these key elements of the worksheet. The results of each examination are detailed in an Examination Report and summarized in a Notification Letter to the DAL. At the completion of an examination, the lender is issued a rating of “Pass”, “Pass with Qualification” or “Fail”. Lenders that receive a “Pass with Qualification” or “Fail” rating require corrective action. Corrective actions and subsequent follow-up fall into three types: (1) corrective action that is taken during the examination and is followed-up and verified before a final report is issued; (2) corrective action that occurs within an agreed upon time frame after the examination report is issued and is followed-up and verified before the next examination is performed; and (3) corrective action that occurs after the examination report is issued but can only be followed-up and verified at the next examination. The DAL examination findings and corrective actions are tracked in BCD’s central record of findings.

**Table 1: Key Elements Reviewed on the Worksheet**

Credit Memo	Details the specifics of the request, the history of the company, the proposed products to be exported, a financial analysis and any other relevant information that would affect the credit decision.
LAN	Loan Authorization Notice. Sets forth the specific terms and conditions of the loan facility that is guaranteed by EXIM Bank and agreed upon between the lender and EXIM Bank.
BBC	Borrowing Base Certificate executed by a borrower detailing the export-related borrowing base supporting the credit accommodations. The Master Guarantee Agreement requires delivery of BBC to lenders at least once each month with accompanying Export Orders or Accounts Receivable Aging Report. BBCs are required monthly to support credit accommodations and provide reasonable assurance of repayment.
Collateral Examination	A lender’s examination of a borrower’s collateral focused primarily on accounts receivable and inventory. Typically performed by a 3 <sup>rd</sup> party hired by the lender to perform the examination.

Source: Working Capital Guarantee Program Guidance

**Results: EXIM Bank’s Examinations of Delegated Authority Lenders Need Improvement to Ensure Lenders Fully Comply with Program Guidance**

We determined that EXIM Bank’s examinations of delegated authority lenders (DAL) participating in the Working Capital Guarantee Program (WCGP) were not fully effective to ensure lenders complied with program guidance. We found lender examinations were performed timely and lenders were properly notified of findings identified during the exams. We also found lender examinations ensured lenders properly obtained and documented waiver

requests. However, we identified improvements are needed in terms of the quality and thoroughness of DAL examinations to ensure all findings are identified. Specifically, the review and documentation of lender collateral examinations needs to be improved and examiners should be required to review waivers to determine if there were any stipulations required to be followed. Further, we found that the roles of DAL examiners should be independent of the BCD's lender relation roles to ensure major issues are not overlooked. We also found the WCGP policies for DAL examinations should be updated to improve the loan facility review worksheet used by the examiners and the amount of records and supporting documentation required to be provided for the review of BBC. This will ensure a proper audit trail is established and help mitigate the risk of fraud. Finally, we found the program's Master Guarantee Agreement is outdated and needs to be updated to reflect current best practices and proper internal controls.

A lack of adequate resources impacted the quality, thoroughness and independence of the DAL examinations. Specifically, the BCD stated there were not enough personnel to conduct in-depth reviews during DAL examinations and additional resources would be helpful in achieving efficiencies of scale.

As a result, we identified the BCD missed important issues in two of its examination reports. The BCD did not identify one lender's lack of support for a \$1.5 million loan refinance on a \$1.99 million loan facility. Additionally, the BCD did not identify another lender's failure to hold a borrower accountable for obtaining the buyer's verification of export. We also identified that examinations were not able to ensure BBC compliance throughout the life of a loan and the examiners' ability to identify fraud indicators on BBCs was limited.

We made twelve recommendations to correct the identified deficiencies and management concurred with all twelve recommendations.

## **Finding 1: The Quality and Thoroughness of DAL Examinations Needs Improvement**

We found lender examinations were performed timely and lenders were properly notified of findings identified during the exams. Out of 41 DALs, only one DAL annual examination was overdue. We also found the examinations ensured lenders properly obtained and documented waiver requests. However, we found improvements are needed in terms of the quality and thoroughness of DAL examinations to ensure all findings are identified. We reviewed a total of 17 DAL loan facilities from the 7 DAL examinations conducted by the BCD in FY 14 and FY 15 and we selected four lenders for review – (b) (4)

We found the examination process was the same regardless of the lender's level of delegated authority or performance history. For example, a "high plus" level lender with no claims was required to provide the same amount of supporting documentation for review as a (b) (4)

As discussed below, of the seven examinations reviewed, two missed important issues. Further, as will be discussed in finding 3, the examination process in general lacked a clear and transparent loan facility worksheet and did not require sufficient documentation to support BBCs. These issues also impacted the quality and thoroughness of the examinations.

The DAL examinations for two banks - (b) (4) and (b) (4) - missed important issues because the examiners did not thoroughly review and document the lenders' collateral examinations as required. Chapter 16.11 of EXIM Bank's *Policies and Procedures for DAL Examinations WCGP*, requires examiners to document the dates for the two most recent collateral exams and whether the lender/borrower rectified any problems identified or provided a plan to rectify the problems. Additionally, examiners are required to document if the lender is monitoring any corrective actions of the borrowers. Collateral examinations are required under the WCGP. These examinations provide the lender an opportunity to evaluate the financial condition of a borrower, as well as the accuracy of the information provided by a borrower, especially as it relates to the BBC. Furthermore, there was no requirement for DAL examiners to determine whether significant waiver stipulations were followed.

***Improperly routed borrower payments identified during a collateral examination and issues with a related loan refinance were not questioned during the DAL examination***

A collateral examination of (b) (4) which was required to be reviewed and documented during the DAL examination conducted by the BCD, showed some of the borrower's payments for a \$1.99 million loan facility were routed to a lender other than (b) (4). As part of the WCGP, payments from borrowers are usually routed directly to the lender who originated the EXIM Bank guaranteed loan. In this case, however, the BCD issued a waiver allowing the lender to use \$1.5 million of loan proceeds to refinance a previous loan with (b) (4). After paying off the (b) (4) loan, some borrower payments continued to be routed to (b) (4) rather than to (b) (4). The collateral examination recommended the (b) (4) account be closed. However, this issue was not noted or resolved during the DAL examination. Given this loan's default within six months of the completion of BCD's DAL examination, the improperly routed borrower payments (b) (4)

Furthermore, BCD's waiver for the refinance stipulated that the outstanding loan balance at the time of the refinance must meet EXIM Bank's BBC requirements and the initial disbursement under the facility must support exports. Nevertheless, there was no evidence in the DAL exam loan facility worksheet or in the examination file, that the initial disbursement under this facility supported exports as required. The (b) (4) loan was refinanced on May 29, 2014 and the examination file included two BBCs from February 28 and March 31, 2015 which were supported by a summary of Export Orders. Although the BCD indicated that the February and March 2015 BBCs were sufficient to demonstrate the use of the refinanced loan from the previous year, we found no information in the BBCs or the supporting documentation to verify that the May 29, 2014 refinance met EXIM Bank requirements. The earliest export order shown on the summary supporting the BBC was from October 2014. The lack of supporting documentation left us unable to determine if \$1.5 million of the loan was used as intended in the lender's Master Guarantee Agreement.

After we concluded the audit and drafted the report, however, BCD provided a BBC dated May 14, 2014, which showed the initial disbursement made by (b) (4) for its loan facility supported exports. As a result of the audit, BCD recognized this documentation should have

been required to be provided by the lender during the examination and maintained for third-party review.

***A DAL examination did not follow up on an issue identified during a lender's collateral examination regarding a borrower's lack of verification of exports***

A collateral examination of (b) (4) found a borrower with a \$5 million loan facility was not retrieving notification from its buyers that goods were actually exported to foreign countries. Specifically, the collateral examination found the borrower did not receive confirmations of exports when the shipments were passed to customer arranged freight forwarders at the border. The borrower rejected the finding stating the final export destination was reflected in the purchase order. There was no evidence in the loan file that the lender took action to mitigate this concern with the borrower and it was not mentioned as a risk during the BCD's DAL examination as required. According to the BCD, the purchase order's final destination is reasonable documentation to show that an export is being transacted and retrieving notification from the buyer is not a workable recommendation especially in cases where hundreds of purchase orders are being transacted. BCD further stated this recommendation would place an unnecessary burden on small business exporters. The Master Guarantee Agreement, however, required the lender to follow its customary practice. During our audit, we interviewed the four lenders in our sample and asked them what constitutes adequate evidence that goods were actually exported and reached their final destination. The lenders consistently stated they considered invoices, shipping documents, and bills of lading to be adequate evidence. The lenders also stated they require verification by a third-party collateral examination. Buyer notifications can help reduce the risk of fraudulent shipments. Therefore, it appears the finding in the collateral examination was appropriate. Given the examiner's responsibilities to document whether the lender (1) rectified any problems noted in the collateral examinations or provided a plan to rectify the problems and (2) was monitoring any corrective actions of the borrower, this issue should have been noted during the lender's DAL examination and considered in the lender's rating.

The BCD agreed semi-annual collateral examinations need to be more thoroughly documented during DAL examinations and agreed to document the pertinent findings of the most recent collateral inspection reports going forward. Finally, BCD stated any open finding of a collateral inspection report shall be followed up by the examiner with the lender.

**Recommendations, Management Comments and OIG Response:**

To improve the quality and thoroughness of Delegated Authority Lender Examinations we recommend the Vice President of the Business Credit Division:

1. Ensure examiners thoroughly review the lender's collateral examinations and fully assess and document the lenders' responsibilities in any of the reported findings.

**Management Comments**

Management agreed with this recommendation. The Business Credit Division will update its policies and procedures to ensure that examiners thoroughly review the

lenders' collateral examinations and fully assess and document the lenders' responsibilities in any of the reported findings.

**OIG Response**

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

2. Develop a mechanism for tracking the findings of lenders' collateral examinations during DAL examinations.

**Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will develop a procedure to document and track the findings of lenders' collateral examinations during DAL examinations.

**OIG Response**

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

3. Develop mechanisms to track required corrective actions to address collateral examination findings and ensure the corrective actions are taken by both borrowers and Delegated Authority Lenders.

**Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will develop a procedure to document and track required corrective actions to address collateral examination findings and ensure that the corrective actions are taken by both borrowers and Delegated Authority Lenders.

**OIG Response**

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

4. Ensure resources are properly allocated in the BCD to accomplish the responsibilities of the division including the performance of quality and thorough DAL examinations.

**Management's Comments**

Management agreed with this recommendation. The Bank will ensure that resources are properly allocated in the Business Credit Division to accomplish the responsibilities of the division including the performance of quality and thorough DAL examinations.

### **OIG Response**

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

## **Finding 2: DAL Examinations Should be Independent of the Lender Relation Role of the BCD**

Our audit found that BCD Relationship Managers (RM) were also serving as DAL examiners. Office of Management and Budget Circular A-123- "Management's Responsibility for Internal Control" states management is responsible for developing and maintaining internal control activities that include policies, procedures and mechanisms in place to help ensure agency objectives are met. One responsibility is the proper segregation of duties. Proper segregation of duties requires separate personnel with the authority to authorize a transaction, process the transaction, and review the transaction.

The role of an RM is to create new business and maintain relationships with their assigned lenders. The RM's primary responsibility is the preparation of credit memorandums for non-delegated loans. The credit memorandum details the specifics of the request, the history of the company, the proposed products to be exported, a financial analysis, and any other relevant information that would affect the credit decision. While this only impacts non-delegated loans, a delegated lender may choose to submit certain loans for EXIM Bank approval and therefore, the RM would prepare the credit memos on behalf of the lender for those particular transactions. In addition, all requests for waivers or side letters must be submitted by the lender in writing and the RM must analyze the request and respond in writing. Further, the lender is responsible for conducting an annual review of each loan facility and submits a summary of each review to EXIM Bank. The RM reviews the findings of the lender and signs off on the lender's annual review. The RMs are also responsible for evaluating lenders' requests for initial delegated authority and requests to increase delegated authority limits; and confirming the DAL's Know Your Customer procedures.

The role of the DAL examiner is to conduct DAL examinations and review a sample of loan files to determine if a lender is processing, closing and executing disbursements in accordance with prudent lending practices and EXIM Bank policies, procedures and contractual obligations. Based on the results of the examination, the examiner recommends a rating of "Pass, "Pass with Qualification or "Fail".

During the audit, we identified there were not adequate controls in place to ensure RMs did not also serve as DAL examiners. Our audit found that two examiners had dual responsibilities for a period of time as RMs and examiners and that as of April 15, 2016, one individual continued to serve both roles. For example, the RM for (b) (4) also served as the examiner for the bank's DAL examination. When an RM conducts compliance reviews, there is a risk the RM will overlook findings and issues in order to maintain business relationships with the lenders in the program. This is a lack of segregation of duties that presents a major conflict of interest for the DAL examination process.

This lack of adequate internal control occurred due to a lack of resources to keep the roles and responsibilities separate for all personnel. The BCD stated it will introduce a further measure of control by restricting RMs to participate only in field examinations of lenders that are not part of their assigned relationships, when possible.

### **Recommendation, Management Comments and OIG Response:**

To ensure the independence of Delegated Authority Lender examinations, we recommend the Vice President of the Business Credit Division:

5. Establish a separate DAL Examination group in the BCD comprised of individuals who are solely examiners and are independent of the lender relation role of the BCD.

#### **Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will create a separate DAL Examination group in the Business Credit Division comprised of individuals who are solely examiners and are independent of the lender relation role of the Business Credit Division.

#### **OIG Response**

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

### **Finding 3: EXIM Bank's WCGP Policies for DAL Examinations Need Improvement**

We found the WCGP policies and procedures for DAL examinations need to be updated in terms of improvements to the loan facility review worksheet used by the examiners and the amount of records and supporting documentation required to be provided for the review of Borrowing Base Certificates (BBC) during DAL examinations. We also found the program's Master Guarantee Agreement (MGA) is outdated and needs to be updated.

#### ***The Loan Facility Review Worksheet used during DAL Examinations needs Improvement***

The BCD DAL loan facility review worksheet used during DAL examinations needs improvement. The Loan Facility Review Worksheet is a written record of the examiner's review and evaluation of the lender's underwriting and credit administration for a sampled loan. According to Chapter 16.11 of EXIM Bank's *Policies and Procedures for DA Lender Examinations* WCGP Appendix A, the loan worksheet provides detailed information for a specific loan, especially for unsatisfactory aspects uncovered by the examination. Although the worksheet's format offers consistency in reporting style, its design lacks the clarity needed to facilitate a more precise and transparent report. Specifically, the worksheet does not require in-depth documentation of certain key elements presented on the worksheet and requires clarification in terms of what items are required for an initial DAL examination versus a subsequent examination. While there is no need to develop separate worksheets for initial and

subsequent examinations, further clarification is needed to determine which steps are required for each individual examination.

The worksheet is comprised of eight sections: (1) Loan Authorization Notice (LAN); (2) Application; (3) Credit Memo; (4) Semi Annual Collateral Examination; (5) Collateral Administration; (6) EXIM Bank's Borrower Agreement; (7) Listing of waiver letters; and (8) Misc. Comments.

**Loan Authorization Notice, Application and Borrower Agreement:** In completing the Loan Authorization Notice, Application and Borrower Agreement sections of the worksheet, examiners are required to determine the accuracy and completeness of these documents. However, as the Loan Authorization Notice, Application, and Borrower Agreement remain the same throughout the entire life of the loan, there is no need for examiners to re-test these documents after the first DAL examination covering this loan. The checklist, however, is not clear in this regard and our audit found that examiners re-tested the documents in subsequent DAL examinations. The checklist should be clear that although the Loan Authorization Notice, Application, and Borrower Agreement are required to assist the examiner in reviewing other sections of the worksheet, after the first DAL exam, a re-test of the Loan Authorization Notice, Application, and Borrower Agreement is unnecessary. The examiners could better spend their time on other areas of the examinations if they were only required to complete the Loan Authorization Notice, Application and Borrower Agreement sections of the worksheet for the first DAL examination covering the loan.

**Credit Memorandum:** On the loan facility review worksheet, the credit memorandum section requires examiners to document information on the condition of the loan facility's credit that existed at the time of approval. There is no requirement, however, for the examiner to document updated information included in the more current version of the credit memorandum. Although reviews of updated credit memos are completed by EXIM Bank separately from the DAL examinations; reviews of the current credit memo during DAL examinations could improve the overall examination process and reduce risk. For example, if there was a significant change in the financial analysis for a loan, it would be documented in the updated credit memorandum and it would be helpful for the examiner to be aware of this information during the examination.

**Semi-Annual Collateral Inspections:** Chapter 16.11 of the Manual, Appendix A requires a thorough review of lender collateral examinations. However, our audit found that examiners simply included the date of the collateral examination and marked this section of the worksheet as satisfactory without including any documentation of the results and findings of the collateral examinations. BCD stated if the examiner found the lenders collateral exam to be "robust and complete" then the section was dated and marked satisfactory. As a result, issues documented in the lender's collateral examination may not be reflected in the DAL examination worksheet as we identified above. As stated above, the BCD agreed semi-annual collateral examinations need to be more thoroughly documented during DAL examinations and agreed to document the pertinent findings of the most recent collateral inspection reports going forward. Finally, BCD stated any open finding of a collateral inspection report shall be followed up by the examiner with the lender.

**Waivers:** This section of the worksheet lists waiver letters by date. It also indicates what requirement of the WCGP is being waived. Complex or long waivers are attached to the worksheet. Chapter 16.11 of EXIM Bank's *Policies and Procedures for DA Lender Examinations WCGP* does not require DAL examiners to determine whether significant waiver stipulations were followed. As discussed above, this resulted in an important issue being missed during the DAL examination of (b) (4) related to the lack of required documentation for a loan refinance.

***BBC Documentation Required During DAL Examinations Is Not Sufficient to Establish a Proper Audit Trail and Mitigate the Risk of Fraud***

The BCD does not have adequate policies for the amount of records and supporting documentation required to be provided for the review of BBCs during DAL examinations. According to Chapter 16 of the Manual, Appendix A, a lender may only make loan disbursements or issue Letters of Credit on behalf of the borrower against actual export orders or invoiced accounts receivable. The borrower is required to submit an Export-Related Borrowing Base Certificate as frequently as the lender customarily requires from its borrowers but at least once per month, within thirty calendar days of its month-end. According to Chapter 16.11 of EXIM Bank's *Policies and Procedures for DA Lender Examinations WCGP*, an effective credit administration program includes borrowing base monitoring, which requires the evaluation and reconciliation of BBCs with A/R aging reports, inventory schedules, export orders, and reviewing and monitoring the borrower's financial condition through annual and quarterly financial statement reporting. EXIM Bank's *Policies and Procedures for DA Lender Examinations WCGP* policies states that in order to properly evaluate the credit administration of the lender's portfolio, a review of collateral examinations and recent BBCs with supporting documentation should be undertaken with regard to each loan in the designated sample for the examination.

Our audit found that lenders were only required to provide the two most recent BBCs for review during a DAL examination. Furthermore, the lenders were only required to maintain approximately six months' worth of BBCs for their loan facilities in accordance with their Master Guarantee Agreement. Exceeding EXIM Bank's requirements, three of the four lenders we reviewed stated they maintained BBCs for at least two years, generally encompassing the life of the loan. The other lender – (b) (4) – stated it maintained BBCs on file for six months. According to the three lenders, it is important to maintain BBCs for a longer period of time because a BBC is the primary document used for borrowers to report and certify their collateral availability and BBCs establish an audit trail for third-party review purposes. Due to the limited retention of BBCs by (b) (4), the auditors did not always have access to the same BBCs that the BCD examiners reviewed during (b) (4) DAL examinations. This created a situation where the auditors did not have a sufficient audit trail to validate the adequacy of the examination or the compliance of the borrower. Requiring the lenders to provide and examiners to review additional BBCs would improve the thoroughness of the DAL examinations.

During the audit we also found that in practice, DAL examiners only required A/R aging reports as supporting documentation for BBCs and did not require any of the other supporting documentation one would expect with a BBC as identified in the Master Guarantee Agreement.

Lenders may only make loan disbursements or issue Letters of Credit against actual export orders or invoiced accounts receivable and the Master Guarantee Agreement requires a sample of invoices to support the A/R aging report when a claim is processed. Nevertheless, invoices for the A/R, inventory schedules, and export orders are not required to be provided during DAL examinations. While the BCD recommends that lenders maintain all supporting documentation for BBCs because it is a requirement for the claims process, there is no requirement for the documentation to be produced by the lenders during DAL examinations.

By not reviewing all supporting documentation for BBCs during DAL examinations, examiners were unable to determine the accuracy and completeness of the BBCs. Specifically, the examiners were unable to determine if borrowers had ever overstated their eligible A/R and inventory to obtain higher loan disbursements. Overstatements of A/R and inventory on BBCs impact the borrower's reasonable assurance of repayment, which is the primary requirement for all EXIM Bank loans. Additionally, an inadequate review of the BBCs increases the risk that examiners will be unable to identify indicators of fraud during their examinations.

### ***The Master Guarantee Agreement Needs to be Updated***

The Master Guarantee Agreement for the WCGP is part of EXIM Bank's *Loan, Guarantee and Insurance Manual* and outlines the facility fees, all obligations of the lender, claims procedures, and other miscellaneous items. The Master Guarantee Agreement has not been updated since December 2005. It needs a fresh review to ensure the policies are up to date and in line with current best practices and also needs improvement to address internal control deficiencies.

The *Loan Guarantee and Insurance Manual* states the Credit Policy Division will maintain and manage annual updates of the manual, however, material changes to a credit or other policy, program and/or law should not wait for the annual update and instead, such changes should be incorporated into the applicable chapter(s) by the responsible division and submitted to the Credit Policy Division as soon as possible.

As part of our audit work we met with EXIM Bank personnel from the Asset Management Division. During our discussion, we identified the following improvements that should be incorporated into the Master Guarantee Agreement: (1) Lenders should be required to visit a borrower's facility before the first payment disbursement, and (2) A BBC, A/R aging report, invoices, site visit, and collateral exam should be required before the first payment disbursement. The first payment disbursement is typically the largest disbursement and by not requiring invoices before it occurs increases the risk for fraud through overstating inventory and A/R to obtain loan disbursements without reasonable assurance of repayment.

According to the BCD personnel, the Master Guarantee Agreement has not been recently updated because there have been very few changes to the working capital program. Therefore, rather than update the Master Guarantee Agreement documents, the modifications to the working capital program have been addressed separately in letters to the DALs (if applicable). During our audit, however, BCD senior management agreed to update the Master Guarantee Agreement and related documents and stated the updates were in process. During the audit we did not verify whether these updates were in process.

## **Recommendations, Management Comments and OIG Response:**

To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division:

6. Revise the loan facility review worksheet to require reviews of subsequent or updated credit memos for all loans reviewed during DAL examinations regardless of if the loan has been subject to a previous examination.

### **Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will update the form of Loan Facility Review Worksheet to require reviews of subsequent or updated credit memos for all loans reviewed during DAL examinations. The form of Loan Facility Review Worksheet will be updated to include this requirement.

### **OIG Response**

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

7. Require a more in-depth review and documentation of lenders collateral examinations during DAL examinations.

### **Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will require a more in-depth review and documentation of lenders' collateral examinations during DAL examinations.

### **OIG Response**

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

8. Require DAL examiners to determine whether significant waiver stipulations were followed.

### **Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will require DAL examiners to determine whether significant waiver stipulations were followed.

### **OIG Response**

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

9. Update the BCD loan facility worksheet to differentiate between initial DAL examinations and subsequent examinations for certain components.

**Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will update the form of Loan Facility Review Worksheet to differentiate between initial DAL examinations and subsequent examinations. The form of Loan Facility Review Worksheet will be updated to include this requirement.

**OIG Response**

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

10. Revise the requirements for the number of BBCs and the supporting documentation required to be provided during a DAL examination to ensure a proper audit trail, enhance the thoroughness of DAL examinations and mitigate the risk of fraud.

**Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will expand the requirements for the number of Borrowing Base Certificates and supporting documentation to be provided during a DAL examination.

**OIG Response**

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

11. Require lenders to maintain BBCs for the entire life of the loan.

**Management Comments**

Management agreed with this recommendation. The Bank's Business Credit Division will require that lenders maintain Borrowing Base Certificates for the entire life of the loan.

**OIG Response**

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

12. Update its Master Guarantee Agreement, dated December 31, 2005 to ensure the policies are up to date and in line with current best practices and to address internal control deficiencies.

**Management Comments**

Management agreed with this recommendation. The Bank is currently updating the Master Guarantee Agreement (MGA) to ensure that policies are up to date and in line with current best practices and to address internal control deficiencies.

**OIG Response**

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

Management's comments are included in their entirety in Appendix II.

**CONCLUSION**

The WCGP is a unique program that allows the growth of small businesses internationally. However, EXIM Bank's oversight of delegated authority lenders participating in the WCGP needs improvements to ensure lenders comply with the program guidance.

Strengthening the internal controls identified during our audit will help increase lender compliance with the WCGP and ensure performance standards required by the program are met. As such, we made 12 recommendations to improve the quality, thoroughness, independence, and internal controls for the oversight of delegated authority lenders participating in the WCGP.

## Appendix I: Scope and Methodology

The objective of this audit was to determine whether EXIM Bank’s oversight of delegated authority lenders was effective to ensure lenders were complying with program guidance.

To answer our objective, we reviewed applicable guidance, including Chapter 16.11 of EXIM Bank’s Loan, Guarantee and Insurance Manual, *Policies and Procedures for Delegated Authority Lender Examinations WCGP*; the Master Guarantee Agreement; the Office of Management and Budget’s Circular No. A-123, *Management’s Responsibility for Internal Control* and Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*. We also interviewed officials from EXIM Bank’s Business Credit Division to gain an understanding of the Bank’s Working Capital Guarantee Program (WCGP) and the Delegated Authority Lender (DAL) examination process. In addition, we consulted with our Office of Investigations and Office of Inspections and Evaluations. Finally, we interviewed personnel in EXIM Bank’s Asset Management Division and Credit Review and Compliance division.

We reviewed examination documentation for four judgmentally selected DALs from the 41 participating in the WCGP. Of the four lenders selected ((b) (4)), we reviewed 17 DAL loan facilities from seven DAL Exams conducted by the BCD. We reviewed: one “medium level” DAL - (b) (4) - (b) (4) loan facility for (b) (4); one “high plus level” DAL with (b) (4) (b) (4) - (b) (4) - (b) (4) facilities for (b) (4); another “high plus level” DAL - (b) (4) - (b) (4) facilities for (b) (4); and one “super high level” DAL - (b) (4) - (b) (4) for (b) (4). We selected different level banks to compare the examination process across the different levels. We selected (b) (4) based on its claims history, which we retrieved from the BCD’s record of claims filed in FY 2013 and 2014. (b) (4) (b) (4)

(b) (4), or (b) (4), or (b) (4). The other (b) (4) DALs we selected for review did not file any claims in FY 2014. Overall, the WCGP paid (b) (4) claims in FY 14 for \$7,662,205 and (b) (4) claims in FY 15 for \$832,172. In addition, we reviewed BCD’s central record of findings, exam status reports, and organization chart. Further, we interviewed the DAL Examiners and relationship managers assigned to these lenders and also interviewed Vice Presidents for the four lenders.

We conducted this performance audit from June 2015 through August 2016 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 conclusions based on our audit objective.

### Review of Internal Controls

We reviewed and evaluated the internal controls associated with EXIM Bank’s oversight of delegated authority lenders participating in the Working Capital Guarantee Program. We found that improvements can be made to ensure more effective oversight of the program. Our

recommendations, if implemented, should correct the weaknesses we identified.

### **Prior Coverage**

During the last 5 years, the EXIM Bank OIG and GAO have issued two reports of particular relevance to the subject of this report. Unrestricted reports can be accessed on the Internet at <http://www.exim.gov/oig/reports/audits-and-evaluations.cfm> (EXIM Bank OIG) and <http://www.gao.gov> (GAO).

Ex-Im Bank OIG:

- “Working Capital Guarantee Delegated Authority Program” (OIG-AR-11-04, July 8, 2011).

GAO:

- “Enhancements Needed in Loan Guarantee Underwriting Procedures and for Documenting Fraud Processes” (GAO-14-574, September 2014).

## Appendix II: Management Comments



EXPORT-IMPORT BANK  
OF THE UNITED STATES

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September 21, 2016

Michael McCarthy  
Deputy Inspector General  
Office of the Inspector General  
Export-Import Bank of the United States  
811 Vermont Avenue, NW  
Washington, DC 20571

Dear Mr. McCarthy,

Thank you for providing the Export-Import Bank of the United States (“EXIM Bank” or “the Bank”) management with the Office of the Inspector General’s (“OIG”) “Audit of Export-Import Bank’s Oversight of Delegated Authority Lenders Participating in the Working Capital Guarantee Program”, dated August 26, 2016 (the “Report”). Management continues to support the OIG’s work which complements the Bank’s efforts to continually improve its processes. EXIM Bank is proud of the strong and cooperative relationship it has with the OIG.

The Bank is also proud of its effective management of its portfolio as evidenced by the recent quarterly default rate of 0.149 percent in the Working Capital Guarantee Program reported to Congress for the period ending June 30, 2016. In FY 2015, 67 percent of total authorizations in the Working Capital Guarantee Program supported exports by small businesses.

The Bank appreciates the OIG recognizing that “the DAL examinations performed by the Bank’s Business Credit Division were timely and the lenders were properly notified of findings identified during the exam. Further, the examinations ensured lenders properly obtained and documented waiver requests.”

The OIG has made twelve recommendations to improve the quality, thoroughness, independence, and internal controls for the oversight of the delegated authority lenders (“DAL”) participating in the Working Capital Guarantee Program. The Bank concurs with all twelve recommendations and will move forward with implementing the recommendations.

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Recommendation 1: To improve the quality and thoroughness of Delegated Authority Lender Examinations we recommend the Vice President of the Business Credit Division ensure examiners thoroughly review the lender's collateral examinations and fully assess and document the lenders' responsibilities in any of the reported findings.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will update its policies and procedures to ensure that examiners thoroughly review the lenders' collateral examinations and fully assess and document the lenders' responsibilities in any of the reported findings.

Recommendation 2: To improve the quality and thoroughness of Delegated Authority Lender Examinations we recommend the Vice President of the Business Credit Division develop a mechanism for tracking the findings of lenders' collateral examinations during DAL examinations.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will develop a procedure to document and track the findings of lenders' collateral examinations during DAL examinations.

Recommendation 3: To improve the quality and thoroughness of Delegated Authority Lender Examinations we recommend the Vice President of the Business Credit Division develop mechanisms to track required corrective actions to address collateral examination findings and ensure the corrective actions are taken by both borrowers and Delegated Authority Lenders.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will develop a procedure to document and track required corrective actions to address collateral examination findings and ensure that the corrective actions are taken by both borrowers and Delegated Authority Lenders.

Recommendation 4: To improve the quality and thoroughness of Delegated Authority Lender Examinations we recommend the Vice President of the Business Credit Division ensure resources are properly allocated in the BCD to accomplish the responsibilities of the division including the performance of quality and thorough DAL examinations.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will ensure that resources are properly allocated in the Business Credit Division to accomplish the responsibilities of the division including the performance of quality and thorough DAL examinations.

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Recommendation 5: To ensure the independence of Delegated Authority Lender examinations, we recommend the Vice President of the Business Credit Division establish a separate DAL Examination group in the BCD comprised of individuals who are solely examiners and are independent of the lender relation role of the BCD.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will create a separate DAL Examination group in the Business Credit Division comprised of individuals who are solely examiners and are independent of the lender relation role of the Business Credit Division.

Recommendation 6: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division revise the loan facility review worksheet to require reviews of subsequent or updated credit memos for all loans reviewed during DAL examinations regardless of if the loan has been subject to a previous examination.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will update the form of Loan Facility Review Worksheet to require reviews of subsequent or updated credit memos for all loans reviewed during DAL examinations. The form of Loan Facility Review Worksheet will be updated to include this requirement.

Recommendation 7: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division require a more in-depth review and documentation of lenders collateral examinations during DAL examinations.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will require a more in-depth review and documentation of lenders' collateral examinations during DAL examinations.

Recommendation 8: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division require DAL examiners to determine whether significant waiver stipulations were followed.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will require DAL examiners to determine whether significant waiver stipulations were followed.

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Recommendation 9: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division update the BCD loan facility worksheet to differentiate between initial DAL examinations and subsequent examinations for certain components.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will update the form of Loan Facility Review Worksheet to differentiate between initial DAL examinations and subsequent examinations. The form of Loan Facility Review Worksheet will be updated to include this requirement.

Recommendation 10: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division revise the requirements for the number of BBCs and the supporting documentation required to be provided during a DAL examination to ensure a proper audit trail, enhance the thoroughness of DAL examinations and mitigate the risk of fraud.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will expand the requirements for the number of Borrowing Base Certificates and supporting documentation to be provided during a DAL examination.

Recommendation 11: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division require lenders to maintain BBCs for the entire life of the loan.

Management Response: The Bank concurs with this recommendation.

The Bank's Business Credit Division will require that lenders maintain Borrowing Base Certificates for the entire life of the loan.

Recommendation 12: To improve internal controls for the Delegated Authority Lender examination process, we recommend the Vice President of the Business Credit Division update its Master Guarantee Agreement dated December 31, 2005 to ensure the policies are up to date and in line with current best practices and to address internal control deficiencies.

Management Response: The Bank concurs with this recommendation.

The Bank is currently updating the Master Guarantee Agreement (MGA) to ensure that policies are up to date and in line with current best practices and to address internal control deficiencies.



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