

July 1989

INTER-AMERICAN
DEVELOPMENT BANK

Questions Concerning
Payment to Nicaragua



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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-234194

July 5, 1989

The Honorable Jesse Helms
United States Senate

Dear Senator Helms:

In response to your February 1988 request, we reviewed actions taken by the Inter-American Development Bank (IDB) in making loan disbursements to Nicaragua in November 1987. You asked us to determine whether these payments, allegedly made in contravention of IDB's regulations and charter, may have violated United States law and whether they should be recovered for IDB. Also, you asked that we obtain the audit memorandum prepared by the IDB Auditor General concerning the Nicaragua transaction.

We provided you an interim response in April 1988. This report completes our response to your request.

Nicaragua had been delinquent on its loan payments to IDB since November 1986. By cable dated November 11, 1987, the Central Bank of Nicaragua informed IDB that Nicaragua had instructed its commercial bank to pay IDB \$14.9 million to clear its arrearage. IDB accepted the notification as evidence of payment and resumed loan disbursements to Nicaragua on November 16, 1987.

Results in Brief

IDB did not follow its established norm when it cleared Nicaraguan arrearages in November 1987, before they were actually paid. As a result, IDB then imprudently made \$22.5 million in loan disbursements and additional funds available to Nicaragua. Because the money was made available before Nicaragua had actually paid the previous arrearages, the November disbursements could conceivably have been used improperly to clear the arrearages. Nicaragua again fell into arrears within a few days of the initial IDB disbursements.

The IDB payments to Nicaragua were from its general funds, which are not subject to U.S. laws. Funds originally supplied by the Department of the Treasury lose their identity as U.S. taxpayers' moneys once they are disbursed to international institutions. After reviewing the November 1987 payments, IDB's Auditor General issued a report on the matter and recommended that procedural weaknesses be corrected. IDB has issued new procedures to guard against future improprieties.

IDB Handling of the Nicaragua Transaction

As required by IDB procedures for handling loans that are 180 days in arrears, in May 1987 IDB notified Nicaragua that it had been delinquent on its loan payments since November 1986, and that disbursements on all Nicaraguan loans and other forms of credit would be suspended until the arrearages were cleared. On November 12, 1987, IDB received a cable from the Central Bank of Nicaragua dated November 11, 1987, which stated that Nicaragua's commercial bank was instructed to pay IDB \$11.8 million in foreign exchange and 245 million cordobas (about \$3.1 million) to clear its arrearage of \$14.9 million. IDB accepted the notification as evidence of payment even though it did not specify the date that payment would actually be made, as required by IDB procedures. IDB made loan disbursements to Nicaragua of \$11.1 million on November 16, 1987 and took several other actions on November 18 and 19, 1987, to make additional funds available to Nicaragua. On November 20, 1987, Nicaragua again fell into arrears and became delinquent on its loan payments.

Our review of available information on IDB's handling of the Nicaragua arrears payment in November 1987 disclosed that IDB, by deviating from its management-approved norm in clearing arrearages, put Nicaragua in the position to receive foreign exchange disbursements and letters of credit on previously approved development loans totaling \$22.5 million. Because the money was made available to Nicaragua one day before its commercial bank had completed payment of previous arrearages to IDB, it is possible that the new disbursements were used improperly to clear the arrearages.

The payments to Nicaragua in November 1987 were made from IDB's general funds; no direct U.S.-appropriated funds were involved.

IDB Internal Audit Memorandum

We were unable to obtain the audit memorandum issued by the IDB Auditor General on the 1987 disbursement to Nicaragua, because it was not released to the participating country representatives or to the Department of the Treasury. Instead, the IDB President prepared a summary memorandum in June 1988 on the IDB Auditor General's review of the Nicaragua loan transactions of November 1987. A copy of this memorandum, which was provided to the IDB U.S. Executive Director and to the Department of the Treasury, has been sent to you separately.

We were told that the IDB Auditor General had questioned several of the disbursements made to Nicaragua in November 1987 that were based on unsupported disbursement requests. The Auditor General concluded

that IDB did not exercise reasonable prudence and good business judgment in authorizing the November 1987 disbursements and extending letters of credit to Nicaragua. According to the U.S. Executive Director, unsupported disbursement requests could represent prefinancing rather than disbursement for specific costs incurred on the investment projects financed, as required by IDB procedures. This raises the possibility that such funds may have been used for other than approved loan purposes.

The IDB President stated that these procedural weaknesses would be corrected and IDB issued revised procedures in 1988 that could prevent such occurrences in the future. Because we do not have direct authority to audit IDB's internal records, we could not independently determine how the November 1987 disbursements were actually used, or confirm whether IDB had implemented the revised procedures. Additional details concerning these matters are presented in appendixes I and II.

Conclusions and Recommendations

Since the payments to Nicaragua involved IDB's general funds rather than direct U.S.-appropriated funds, no violation of U.S. laws occurred. However, based on evidence available to us, we believe that IDB acted imprudently in handling the Nicaragua transactions in November 1987. By deviating from management-approved procedures and accepting notification of payment, which did not provide the required payment date, IDB improperly opened the way for Nicaragua to receive additional loan disbursements. In addition, in our opinion it would have been prudent, particularly in light of Nicaragua's extensive period of arrears, to revalidate previously approved disbursement requests and to obtain the required supporting documentation for letters of credit and advances.

The issuance of revised procedures in 1988 for collecting loan service payments in arrears shows that IDB had considered it appropriate to take action on its Auditor General's recommendations to strengthen procedures. However, we are not certain that the revised procedures have been implemented.

Accordingly, we recommend that the Secretary of the Treasury request, through the IDB U.S. Executive Director, the IDB Auditor General to determine whether (1) the revised procedures issued in 1988 for clearing arrears have been implemented by IDB and whether they satisfy the recommendations of the Auditor General and (2) the funds disbursed in November 1987 as advances have been actually used for loan purposes. If it is found that these funds, or equivalent funds of the Government of Nicaragua, have not been used for valid loan purposes, we recommend

that the Secretary of the Treasury request IDB to recover these amounts from the Government of Nicaragua.

Agency Comments

In its comments, the Department of the Treasury did not take a position on our recommendations, but Treasury officials agreed with the issues discussed in the report. Treasury also noted that IDB had implemented new procedures on arrearages in December 1988. (See app. III.)

Objectives, Scope, and Methodology

As previously stated, our ability to respond to your request was impaired by the fact that we do not have direct authority to audit the internal records of the multilateral development banks, including IDB. Accordingly, we examined available records at the Department of the Treasury and the office of the U.S. Executive Director at IDB. Because we could not obtain the IDB Auditor General's memorandum, we held discussions with appropriate officials about the audit findings and actions taken by IDB.

We made our review in accordance with generally accepted government auditing standards, from March to November 1988.

We plan no further distribution of this report until 5 days from the date of issue. At that time, we will send copies to the Chairmen, Senate Committee on Foreign Relations, House Committee on Foreign Affairs, Senate Committee on Governmental Affairs, House Committee on Government Operations, Senate and House Committees on Appropriations; the Secretary of the Treasury; the Director, Office of Management and Budget; and other interested parties.

This report was prepared under the direction of Nancy R. Kingsbury, Director, Foreign Economic Assistance Issues. Other major contributors are listed in appendix IV.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

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National Security and International Affairs Division,
Washington, D.C.

Abbreviations

IDB Inter-American Development Bank

Questions Concerning Inter-American Development Bank's Payment to Nicaragua

Nicaragua had been delinquent on its loan payments to the Inter-American Development Bank (IDB) since November 1986. Following its established procedures for handling delinquent loans, in May 1987 IDB notified Nicaragua that it was 180 days in arrears on its payments and suspended disbursements on all Nicaraguan loans. IDB also informed Nicaragua that new loan applications would not be considered until the arrearages were cleared.

On November 12, 1987, IDB received a cable from the Central Bank of Nicaragua, dated November 11, 1987, which stated that Nicaragua's commercial bank had been instructed to pay IDB \$11.8 million in foreign exchange and 245 million cordobas to clear Nicaragua's arrearage of \$14.9 million, as reflected in IDB's November 6, 1987, arrears report.

IDB accepted the notification as evidence of payment and, on November 13, 1987, instructed its bank in New York to pay Nicaragua \$11.1 million on November 16, 1987. This amount was based on loan disbursement requests submitted by Nicaragua and accumulated by IDB during the period of suspension. In addition, on November 18 and 19, 1987, IDB increased guarantees on previously authorized letters of credit for a total of \$8.1 million and capitalized \$3.3 million of interest due on one loan. The total foreign exchange benefit to Nicaragua was \$22.5 million.

On November 17, 1987, one day after IDB disbursed the \$11.1 million to Nicaragua, IDB received \$8.7 million of Nicaragua's past due collections payable in U.S. dollars. The remaining collections payable in other foreign exchange currencies were received by IDB between November 18 and November 20, 1987. IDB records show that on November 20, 1987, Nicaragua again fell into arrears (\$1.6 million) on its loan payments. We were advised in November 1988 that Nicaragua was still in arrears on its payments to IDB.

Alerted about the Nicaragua transaction by the IDB U.S. Executive Director in November 1987, the Department of the Treasury requested IDB to investigate the matter. The Department's concern was whether the funds used by Nicaragua to pay its arrears were "round-tripped" (term used to describe a transaction where the debtor uses new bank funds to pay off a delinquent loan or a portion of the loan). The IDB Auditor General reviewed the Nicaragua transaction and in January 1988, issued a report to the IDB President, which was read by the U.S. Executive Director during March 1988. In April 1988, a new IDB president took office and promised to investigate the Nicaragua matter and report the results to the Board of Executive Directors.

On June 14, 1988, the IDB President released a memorandum entitled Summary of the Office of the Auditor General (AUG) Review of Nicaragua Loan Transaction in Foreign Exchange Currencies - November 1987. This memorandum provided information about circumstances that occurred during the Nicaraguan loan disbursements of November 1987, but it did not contain full information on the IDB Auditor General's conclusions and recommendations. The memorandum stated, however, that all audit recommendations had been implemented. The Department of the Treasury was given a copy of this memorandum.

Imprudent Handling of the Nicaragua Transaction

Our review of available information on IDB's handling of the Nicaragua arrears payment in November 1987 showed that IDB had deviated from its management-approved norm in clearing arrearages, thus putting Nicaragua in the position to receive foreign exchange disbursements and credits totaling \$22.5 million, and had accepted unsupported disbursement requests as a basis for payments. Additionally, we are not certain that IDB had implemented the procedures that were revised to strengthen internal controls over arrearages. These matters are summarized below.

IDB Norm Not Met in Clearing Nicaragua's Arrearages

IDB procedures in effect in November 1987 required that IDB only accept as evidence of payment (1) amounts actually received or (2) a written confirmation from the borrower's central bank that instructions have been given to pay the amounts due, in the currencies owed, with precise information about the banks involved and the date that credit of the payment is requested. IDB accepted the Central Bank of Nicaragua's cable of November 11, 1987, as evidence of payment, although the cable did not specify the date of expected payment. IDB removed Nicaragua from its arrearages report and proceeded to process payments to Nicaragua on 11 disbursement requests that had been withheld and accumulated during the preceding year and on 3 requests that the IDB resident representative in Nicaragua had handcarried to Washington in November 1987.

By accepting Nicaragua's notice without the required expected payment dates as satisfactory evidence of payment, IDB cleared the way for removing Nicaragua from the arrears report. This put Nicaragua in a position to receive further disbursements and letters of credit on its loans. Nicaragua had been ineligible for disbursements on its loans from IDB since May 1987, when it exceeded the 180-day arrears period. The

IDB actions in November 1987 gave Nicaragua a foreign exchange benefit totaling \$22.5 million.

We do not have complete information on why IDB accepted notice of payment that did not meet its stated standards, or which IDB officials were responsible for these actions. According to Department of the Treasury officials, a possible motivation for removing Nicaragua's arrears may have been IDB's desire to avoid a significant arrears situation with a borrower that would have to be disclosed on the bank's year-end financial statements. IDB acted with speed in clearing Nicaragua's arrearages and authorizing disbursements during November 12 through November 19, 1987—the only period when Nicaragua was not in arrears. The Secretary of the Treasury informed a congressional committee in April 1988 that he believed Nicaragua took advantage of IDB's lax policies and practices in November 1987 and, in effect, used IDB funds to pay off its arrearages.

Questions Concerning IDB Disbursements

Generally, IDB finances investment projects, and loan disbursements in foreign exchange are related to funding specific items of such projects. However, the disbursement requests submitted by Nicaragua included five advances, rather than direct reimbursement for costs incurred, which totaled \$6.1 million. The IDB Auditor General questioned IDB's handling of these disbursements and felt that IDB should have sought revalidation and additional assurance for these advances before authorizing payment. According to the U.S. Executive Director, such advances, if not justified by supporting documents, represent prefinancing rather than reimbursement for project costs incurred and raise questions about the use of these funds.

Also, the IDB Auditor General questioned IDB's handling of other Nicaragua loan transactions in November 1987 that did not meet IDB norms for loan disbursement deadlines and for obtaining supporting documents. For example, the Auditor General felt that several disbursement requests were paid too close to disbursement deadlines and loan cutoff dates. Also, certain requests for increases in letters of credit, which made the loan over 90-percent committed, were processed without obtaining proper documents as required by IDB procedures. Because of the long time lapse between original approval dates and disbursements in November 1987, the Auditor General believed that, as a matter of good business judgment, IDB should have exercised additional care in processing these transactions.

Payments made to Nicaragua in November 1987 were from IDB's general funds, which are not subject to U.S. laws. Funds originally supplied by the Department of the Treasury lose the identity as U.S. taxpayers' moneys once they are disbursed to international institutions.

Revised Procedures Have Not Been Implemented

We were told that the IDB Auditor General recommended that IDB modify its procedures for clearing arrears and processing loan disbursement requests. As a result, in April 1988, IDB issued new procedures for collecting loan service payments in arrears. These procedures, which were to take effect on the date of issue, appeared to address the concerns of the Auditor General. For example, the new procedures require that (1) payment of the arrears be evidenced only by a confirmed credit to the bank's accounts, (2) for arrearages over 60 days, retained disbursement requests should be recertified before further disbursements are authorized, and (3) for arrearages over 180 days, the field office should not accept new disbursement requests until all arrearages have been cleared.

IDB acknowledged that the procedures in effect in November 1987 were inadequate and that corrective action was appropriate. However, according to the IDB U.S. Executive Director, the April 1988 revised procedures had not been formally implemented. The U.S. Executive Director said that the IDB President's memorandum of June 1988 was misleading because IDB, contrary to the memorandum, had not implemented all audit recommendations.

In August 1988, IDB issued revised arrears procedures that, according to the IDB U.S. Executive Director, weakened some of the features contained in its April 1988 revision. For example, the procedures to be taken by IDB when loans are over 60 days in arrears were dropped and other exceptions for suspending disbursements were allowed. The modifications were to take effect on September 15, 1988. However, in November 1988, the IDB U.S. Executive Director was still uncertain about which arrears policy was being followed by IDB and asked IDB for clarification and management action to resolve this matter. In commenting on our draft report in April 1989, the Department of the Treasury said that IDB had implemented new procedures in December 1988. While we verified the issuance of these procedures, we were not able to independently confirm whether they have been implemented or whether they satisfy the IDB Auditor General's concerns.

Responses to Questions

To obtain additional data on the IDB-Nicaragua loan transactions, we requested, through the Department of the Treasury and the IDB U.S. Executive Director, supplemental information about IDB's norms and procedures and their application to the Nicaraguan loans. IDB did not respond to each question in detail but provided certain data and explanations. The responses represent our characterization of the information provided.

Question 1: What was the amount of IDB loans made to Nicaragua as of November 11, 1987, and how much was Nicaragua in arrears in its payments? Please provide specific details of loan amounts, loan balances, payments made, payments due, and arrearage calculations.

Response: According to IDB records, on October 31, 1987, Nicaragua had 31 active loans with outstanding balances of \$341.8 million. The arrearages on these loans amounted to \$14.9 million as of November 6, 1987, the cut off date for determining arrearage status closest to November 11, 1987.

Question 2: When and by what means did Nicaragua cure its arrearage status? Please provide a copy of the cable sent by Nicaragua on November 11, 1987.

Response: Nicaragua's central bank notified IDB by cable dated November 11, 1987, that Nicaragua's commercial bank was instructed to pay IDB \$11.8 million in foreign exchange and 245 million cordobas. IDB accepted the cable as evidence of payment and removed Nicaragua from its next weekly arrears report dated November 13, 1987. IDB did not provide a copy of this cable.

Question 3: Did the notification referred to in the above question constitute actual payment of funds? If not, when were funds actually received?

Response: The notification of November 11, 1987, did not constitute payment of funds. It did not meet IDB-approved standards for clearing arrearages because it did not specify the date that credit of the payment was requested, as required by IDB procedures in November 1987. IDB received \$8.7 million of Nicaragua's past due collections payable in U.S. dollars on November 17, 1987, and the remaining amounts between November 18 and 20, 1987.

Question 4: What was the status of Nicaragua's loan balances on the date of actual receipt of funds referred to in (1) above?

Response: Loan payments on three of Nicaragua loans were due November 6, 9, and 11, 1987, totaling \$1.6 million. In accordance with IDB procedures, these payments were not included in the weekly arrears report of November 13, 1987. They were recognized as arrears when they were published in the IDB arrears report of November 20, 1987.

Question 5: We have received the new IDB procedures for collecting loan service payments in arrears, dated April 21, 1988, which supersede those contained in Document CC-2905, approved in September 1983 and modified in March 1986. Please provide a copy of IDB policy and/or procedure that governed the transactions mentioned in questions (1) through (4) above.

Response: IDB provided us with procedures for collecting loan service payments in arrears that were in effect in November 1987.

Question 6: Who authorized the suspension of Nicaragua's arrearage status, when was the suspension lifted, and how was Nicaragua informed that the suspension was lifted? Please provide copies of documents authorizing the suspension of the arrearage condition and the IDB notification to Nicaragua.

Response: IDB's Finance Department is responsible for determining and reporting that a borrower is in arrears in making its loan service payments. The arrears report is distributed every Friday. It shows all loans that are in arrears as of Wednesday of the previous week and for which evidence of payment has not been received by 10:30 a.m. on the day of the report. Under this procedure, the Finance Department received the Nicaragua cable on November 12, 1987, considered it as sufficient evidence of payment, and removed Nicaragua from the Finance Department's November 13, 1987 report of arrears. At the time of these transactions, IDB had no procedure for notifying the borrower that the arrearage status had been lifted.

Question 7: Please provide us with full details of the 245 million cordoba payment reportedly made to IDB on November 11, 1987, including the nature and terms of the debt for which this payment was made. In addition, (1) did IDB incur any exchange rate gain or loss on this transaction and (2) does IDB have policies and procedures to avoid potential

exchange rate losses on local currency loans? Please provide a written description of the applicable policy and procedures.

Response: According to IDB records, Nicaragua made the cordoba payment to IDB on November 11, 1987, to cover overdue loan service payments payable in local currency on 18 loans and other small projects. To avoid exchange rate losses on local currency loans, IDB procedures provide that the loans are to be repaid in terms of the original U.S. dollar equivalent of the amounts that were disbursed. Thus, the amount of cordoba payment represented the total U.S. dollar equivalent multiplied by the official market rate of exchange of 70 cordobas to one U.S. dollar. IDB maintains that there was no exchange rate gain or loss on this transaction.¹

Question 8: With regard to the \$8.1 million letter of credit transaction and the \$3.3 million credit for interest due, please provide full details of these transactions, including when the transactions were made, and the status of Nicaragua's loan balance due to IDB as of the date of these transactions.

Response: The \$8.1 million letter of credit transaction represented an increase of previously guaranteed letters of credit for one loan, based on requests submitted by Nicaragua. Of this amount, about \$3 million was effective on November 18, 1987, and the remainder on November 19, 1987. This increase resulted in the loan being over 90-percent committed.

At the time of these transactions, the loan was technically in arrears as the next semiannual loan service payment of \$567,247 came due on November 11, 1987. However, because of the time lag in reporting arrearages, this amount was not recognized until it was included in the November 20, 1987, report of arrears.

Question 9: With regard to the \$3.3 million credit, please provide the following information: (1) What were the terms of the loan contract for which this interest payment was credited?, (2) Was this a hard currency transaction?, (3) Was there any exchange rate gain or loss involved in this transaction?, (4) What rate of exchange, if any, was involved in this transaction?, and (5) What was the specific IDB policy and/or procedure that governed these transactions?

¹In our opinion, the settlement of this debt at the unrealistic exchange rate of 70 cordobas to one U.S. dollar when the unofficial market rate was 30,000 to 1 resulted in a virtual write-off of this debt.

Response: Under IDB procedures, loan contracts may provide for financing the interest accruing during the project out of resources of the loan. In November 1987, Nicaragua exercised this loan contract provision and requested that \$3.3 million in interest be charged against the loan. This was considered a hard currency transaction and there were no exchange rate gains or losses involved.

Question 10: Also, please provide us with a written statement which details the status of IDB's examination of the facts and circumstances surrounding these transactions, including (1) the scope of the examination, (2) the methods to be employed in making the examination, and (3) the date when the examination will be concluded, and, the form in which the results will be disclosed to member governments?

Response: In January 1988, the IDB Auditor General issued a report to IDB on its review of Nicaragua loan transactions in November 1987. This report was not released to member country representatives, but in March 1988 the IDB U.S. Executive Director was allowed to read it. A new IDB president took office in April 1988 and promised a report on the Nicaragua matter. In a memorandum dated June 14, 1988, the IDB President provided the Executive Directors with a summary of the review conducted and reported on by the Auditor General.

Comments From the Department of the Treasury



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

April 6, 1989

Dear Mr. Conahan:

I want to thank you for the opportunity to comment on your draft report entitled "Inter-American Development Bank: Questions Concerning Payment to Nicaragua."

An important fact, which you should be aware of, is that the Inter-American Development Bank ("IDB") has implemented new procedures on arrearages, which are described in the attached IDB document. I trust your report will reflect this fact.

Sincerely,

A handwritten signature in black ink, appearing to read "David C. Mulford".

David C. Mulford
Assistant Secretary
International Affairs

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Enclosure

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
NOT FOR PUBLIC USE

GN-1636
8 December 1988
Original: English

TO: The Board of Executive Directors
FROM: The Secretary
SUBJECT: Summary description of policy and procedures for collecting loan
service payments in arrears

Attached for your information is a Management document that contains a
summary description of policy and procedures for collecting loan service
payments in arrears.

Any questions concerning this document may be addressed to Mr. Jerome I.
Levinson, General Counsel (extension 2777).

Other distribution:

Managers and Advisors
Representatives

INTER-AMERICAN DEVELOPMENT BANK

Summary Description of Policy and Procedures for
Collecting Loan Service Payments in Arrears

1. Background

1.01 By Memoranda of April 21, 1988 and August 25, 1988, the pre-existing norms and procedures of the Bank for collecting loan service payments in arrears were superseded by revised norms and procedures to take effect as of September 15, 1988. The revised norms and procedures will apply to all Bank loans and are outlined in this document. Transitional provisions, as described in Section 7, will apply to loans on which there were pre-existing arrears on loan service payments as of September 15, 1988.

1.02 The norms and procedures established by the two referenced memoranda are based upon, and are intended to apply, the relevant provisions of the loan and guarantee contracts between the Bank and the respective borrowers and guarantors. Those provisions are contained in Articles 5.01 and 5.02 of the General Conditions which are included as a part of all IDB loan contracts, and derive as well from Sections 1 and 2 of the standard Guarantee Contract between the Bank and the guarantors of Bank loans.

1.03 The provisions of Article 5.01 of the General Conditions relating to suspension of disbursements when payments are in arrears read, in relevant part, as follows:

"Article 5.01. Suspension of Disbursements. The Bank, by written notice to the Borrower, may suspend disbursements if any of the following circumstances occurs and so long as it continues:

(a) Delay in the payment of any sums owed by the Borrower for the principal, fees, and interest, or for any other reason, under the Contract or any other loan contract entered into between the Bank and the Borrower." 1/

1.04 The General Conditions also provide for termination of the Contract for amounts not yet disbursed or acceleration of maturity of the loan. The Bank can take such action only in accordance with Article 5.02 of the General Conditions:

1/ The remaining paragraphs of Article 5.01 (b through f) provide for suspension of disbursements for reasons other than payment arrears.

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"Article 5.02. Termination or Accelerated Maturity. If any of the circumstances set forth in paragraphs (a), (b), (c) or (e) of the preceding Article continues for more than sixty (60) days, or if the information referred to in paragraph (d) or the clarifications or additional information presented by the Borrower or the Executing Agency, if any, is not satisfactory, the Bank may terminate the Contract with respect to the part of the Financing not yet disbursed and/or may declare immediately due and payable the entire loan or any part of it together with interest and fees accrued up to the date of payment."

2. Payments

- 2.01 For all purposes related to the Bank's policy on arrears, the only form of acceptable payment is a confirmed credit to the accounts of the Bank.

Commentary: Previously, in addition to confirmation of credit to its accounts, the Bank also accepted written advice from the Central Bank of the member country of the borrower of a transfer of funds as evidence that payments were in process. Such advice will no longer be accepted as evidence of payment; only a confirmed credit to the Bank's accounts will be.

- 2.02 A Borrower is in arrears with the Inter-American Development Bank (the Bank or IDB) when, in accordance with the applicable loan contract, it has not made payment to the Bank by close of business of the day when loan service payments are due to the Bank.

- 2.03 The Finance Department (FIN) is responsible for determining whether a Borrower is in arrears as defined in paragraph 2.02 above. Every Friday FIN shall publish and distribute a report showing all loans in arrears as of the close of business on Wednesday of the previous week and for which evidence of payment has not been received as of the close of business on Thursday of the week of the report. The report shall be distributed to the Board of Executive Directors, the Coordination Committee, the Operations and Legal Departments, and the Auditor General.

Commentary: Even though payments from a borrower may be in arrears, no sanctions will be taken until the report appears with that borrower listed. A borrower will be in arrears on a payment for at least eight days, and may be in arrears by as many as fourteen days, before appearing on the list. That "window" is considered to be sufficient time to ensure that the failure to make timely payment was not due to administrative delays or communications delays. The major difference between the old policy and the revised policy is that there will no longer be any de facto suspension of disbursements as of the day the payment is in arrears.

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3. Implementation of Procedures to Obtain Payment

3.01 On the Friday on which a loan in arrears first appears in the report referred to in the preceding paragraph, the Financial Manager shall send a telex to the respective borrower. The telex shall indicate that payment has not been received by the Bank on such loan and that unless payment is received the Bank intends: (a) pursuant to Article 5.01 of the General Conditions of the relevant loan contract, to suspend disbursements under the loan in arrears and all other loans to the Borrower, at any time after the telex is sent but, in any event, within 30 days of the due date, and (b) to take such additional remedial measures as may be appropriate.

Commentary: The "additional remedial measures" referred to in 3.01(b) are intended to reflect the measures available to the Bank under Article 5.02 of the General Conditions.

3.02 The Financial Manager shall also inform the Guarantor of the arrears by the Borrower and of the measures that the Bank may take should the Borrower not make payment.

3.03 Once a Borrower in arrears is listed in the report: (a) no loan proposals in the borrowing member country shall be presented to the Board of Executive Directors for approval; and (b) no loan contract with a Borrower in the country in question may be signed by the Bank, unless all arrears have been paid as of the close of business of the day preceding the respective meeting of the Board or the contract signing. The Executive Director of the country involved shall be advised of these consequences.

4. Imposition of Sanctions for Non-Payment

A. Arrearages of 30 days or more

4.01 After the notice referred to in paragraph 3.01 has been sent, then at the expiry of 30 days from the due date of the payment in arrears (or, if special circumstances warrant, at any time prior to the expiry of 30 days), FIN shall prepare for the signature of the Executive Vice President (EVP), with the clearance of the Legal Department (LEG) and the Operations Department (OPS): (a) a notice to the Borrower of the immediate suspension of disbursements under the loan in question and all other loans to the same Borrower, and (b) a notice to the Guarantor requiring prompt payment of the loan service amounts in arrears.

Commentary: Under normal circumstances, it is anticipated that the Financial Manager will grant the borrower the full 30 days from the due date of the loan service payment before having the notice of suspension of disbursements sent. However, if special circumstances warrant there is discretion to suspend disbursements before the expiry of the full 30 days. If, for example, a borrower is

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notoriously in arrears for long periods and there is no indication that additional payments will be made, it may be considered inappropriate to continue disbursing on loans during the full thirty days and FIN may therefore advise the EVP to send the formal notice of suspension of disbursements forthwith. However, pursuant to the loan contract, under no circumstances would disbursements be suspended prior to the sending of the telex referred to in paragraph 3.01.

4.02 The Financial Manager may grant exceptions to the rules described in paragraph 4.01 concerning suspension of disbursements when (a) payments are owed in currencies which are not generally available in the international financial markets at the time payments fall due (but not when this is a routine problem); or (b) the overdue amount is not more than \$30,000; or (c) he is satisfied, on the basis of information from the financial institutions involved in the transfer of the funds, that the payments are in process.

B. Arrearages of 120 days or more

4.03 Whenever loan service payments continue in arrears for more than 120 days, FIN shall so report in writing to the Coordination Committee. The Coordination Committee shall consider whether to (a) suspend disbursements to the Guarantor on loans made to the Guarantor, and (b) refrain from submitting loan proposals for the country in question to the Loan Committee or Committee of the Whole of the Board of Executive Directors. A decision to suspend disbursements to the Guarantor shall be communicated to the Guarantor by the EVP. The Executive Director of the country involved shall be advised of the measure described in (b) of this paragraph.

C. Arrearages of 180 days or more

4.04 When loan service payments are in arrears for more than 180 days, FIN shall place on a nonaccrual basis all loans to the Borrower in arrears as well as all other loans in the country in question of which the Government, the Central Bank or any Government entity is a borrower or guarantor. The EVP shall notify by telex the relevant authorities in the country in question that (i) such loan service payments exceed 180 days; (ii) all Bank missions to the member country related to loan programming, preparation and processing are suspended until further notice; and (iii) the Bank's Field Office will not accept disbursement requests on any loan for the Borrower and Guarantor.

Commentary: The prior policy on arrears provided for the application of nonaccrual status after loan service payments were in arrears for six months. The revised policy establishes a fixed period of 180 days.

4.05 While any loan remains on nonaccrual status, LEG will not

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process modifications to any loan contracts in the respective member country except for the purpose of extending time deadlines contained in contract clauses.

5. Payment of Arrearages

Upon receipt of the overdue payments, the EVP shall notify the Borrower that the suspension of disbursements has been lifted. The Guarantor and the relevant authorities of the member country will also be informed, as appropriate. Disbursements shall be resumed after OPS has recertified pending disbursement requests.

6. Exemptions from the Suspension of Disbursements

A. Guaranteed Letters of Credit and other Obligations

6.01 Outstanding guarantees of irrevocable letters of credit are legal obligations of the Bank. Hence, disbursements will, under any circumstances, continue to be effected by FIN under guaranteed letters of credit. Similarly, disbursements will continue on other specific obligations to pay fixed amounts directly to suppliers pursuant to undertakings specifically approved, or not objected to, in writing by the Bank. Once disbursements to a Borrower have been suspended, FIN shall not guarantee letters of credit additional to those outstanding or significantly increased amounts of already outstanding letters of credit, and shall not extend the time on outstanding letters of credit or reimbursement guarantees, and the Bank will not approve other obligations to pay fixed amounts to suppliers.

Commentary: It is understood that no increase of the amount of already outstanding letters of credit are to be made. The exception contained in the last sentence of paragraph 6.01 is intended to cover only cases in which the amount needs to be changed for technical reasons and it would be unreasonable to insist on rigidly adhering to the original amount.

B. Other Exemptions

6.02 Disbursements will normally not be suspended in the following cases:

- (i) Non-reimbursable and contingent recovery technical cooperation.
- (ii) Operations under the Bank's Program for the financing of Small Projects.
- (iii) Direct credits to the Bank itself from the proceeds of a loan pursuant to standing instructions from the Borrower.

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7. Transitional Provisions

The revised policy applies to all loans for which arrears of payment are registered for the first time in the weekly report of September 16, 1988. For other loans which were classified in arrears in the weekly report dated September 9, FIN is adopting special transitory measures intended to apply the revised procedure as quickly as possible to all loans in arrears without imposing inequitable burdens on any borrowers. Such transitional measures are detailed below:

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| A. | No disbursement requests received or retained by FIN | Apply revised procedure, except that formal suspension takes effect 30 days from notice rather than 30 days after the due date. |
| B. | All loans fully disbursed | Continue existing practice with non-accrual policy in effect at six months. The same period (six months) will apply to placing a country's loans on nonaccrual status for all loans in arrears prior to September 15. |
| C. | Borrower in arrears for loans with undisbursed balances for which FIN has retained sums otherwise eligible for disbursement | The 90 day telex currently in use may be construed as notice of intent to suspend disbursements (equivalent to FIN/MGR telex on first listing in Memorandum under revised procedures) and should, therefore, be followed by formal suspension on consideration by the Coordination Committee at 120 days or, in any event, prior to 180 days where the period of arrears exceeds 120 days on introduction of revised policy. |
| D. | Borrower current on some loans, but in arrears on others prior to September 15 with FIN having retained sums otherwise eligible for disbursement | The passage into arrears after September 15 of any previously current loans triggers application of revised procedure, except in the case for which FIN is currently retaining disbursements. Such loans should be treated as in C. above. |

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