



*Office of Inspector General
Export-Import Bank
of the United States*

Report on EXIM Bank's Local Cost Policy and Procedures

*September 29, 2017
OIG-EV-17-06*

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

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

This evaluation was conducted in accordance with the 2012 Quality Standards for Inspection and Evaluation as defined by the Council of Inspectors General on Integrity and Efficiency. This report does not constitute a Government audit and therefore, it was not conducted following the Generally Accepted Government Auditing Standards (GAGAS).



Office of Inspector General

To: David Sena, SVP & Chief Financial Officer
Kenneth Tinsley, SVP & Chief Risk Officer

From: Mark Thorum
Assistant Inspector General, Inspections & Evaluations

Subject: Report on EXIM Bank's Local Cost Policy and Procedures

Date: September 29, 2017

Attached please find the final evaluation Report on EXIM Bank's Local Cost Policy and Procedures. The report outlines six recommendations for corrective action. On September 22, 2017, EXIM Bank provided its management response to a draft of this report, agreeing with all of the recommendations. We consider management's corrective actions to be responsive. The recommendations will be closed upon completion and verification of the implementation of those actions.

We appreciate the courtesies and cooperation extended to us during the evaluation. If you have any questions or comments regarding the draft report, please contact Mark Thorum at (202) 565-3939.

cc: Charles J. Hall, Chairman of the Board of Directors & President (Acting)
Jeffrey Goettman, EVP & Chief Operating Officer
Terry Settle, Acting Inspector General
Troy Fuhrman, Acting SVP & General Counsel
Inci Tonguch-Murray, Deputy CFO
Jennifer Fain, Deputy AIGIE
Lilith Sanchez, Senior Inspector
Parisa Salehi, Counsel, OIG
Cristopolis Dieguez, Director, Internal Controls and Compliance
Goda McEachern, Business Compliance Analyst
Lawrence Wielinski, Inspector
Kemi Riley-Telfort, Paralegal

Attachment: Draft Evaluation Report on EXIM Bank's Local Cost Policy and Procedures,
OIG-EV-17-06, September 2017

EXECUTIVE SUMMARY

Evaluation Report Local Cost
OIG-EV-17-06, September 2017

Why We Did This Evaluation

We completed an evaluation of EXIM Bank's local cost policy and procedures. We initiated the review as part of our annual review plan. The primary objective of the Office of Inspector General's (OIG) evaluation was to ascertain the adequacy of EXIM Bank's internal controls, documentation requirements, verification mechanism and compliance with policies and procedures related to local costs.

What We Recommend

To improve EXIM Bank's administration of local costs and further strengthen related internal control activities, OIG recommends the following enhancements: (1) issue detailed procedures and guidelines for review and approval of local cost goods and services, providers, and amounts using the AL; (2) provide enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for preparation and submission of reimbursement requests; (3) update procedures and guidelines to require, at minimum, submission of information that describes in sufficient detail the goods or services being invoiced creating a verifiable audit trail; (4) establish a transparent and documented process by which Bank staff review and approve invoices submitted in a foreign language; (5) update procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost; and (6) update the procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates that provide local cost goods or services as a primary provider or sub-contractor.

What We Found

EXIM Bank's local cost policy operates on the premise that some amount of local labor and raw material is necessary to efficiently build or assemble the end-product of the U.S. export. The policy permits the financing of up to 30 percent of the value of the U.S. exports for locally originated and/or manufactured goods and services. This support is in addition to the maximum support of up to 85 percent of the U.S. net contract price. We reviewed a judgmental sample of seven transactions with local cost components and 14 related disbursements.

We found that EXIM Bank was generally compliant in its financing of local costs for the seven transactions reviewed. We noted no exceptions in our testing of two medium-term transactions. However, our review of five long-term transactions identified a sufficient number of inconsistencies to indicate weaknesses in internal controls relating to local costs. Specifically, we determined that the Bank's procedures and guidelines related to the local cost policy as implemented are not sufficiently clear as to the treatment of the Acquisition List (AL). Nor do they specify what constitutes an appropriate level of detail for describing local costs on the AL. For the five long-term transactions, we observed inconsistencies in the description of local costs, the identification of local cost providers, and the documenting of the Engineer's review and approval of the AL. These inconsistencies make it difficult to confirm that the local cost provider and related local goods and services presented in a disbursement request are those approved by the Bank.

Finally, we determined that EXIM Bank can strengthen other control activities for local cost to minimize reputational and operational risk such as the review and reconciliation of disbursement documents, management and maintenance of records, and treatment of subsidiary and affiliate companies to further mitigate opportunities for fraud and abuse.

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ABBREVIATIONS AND GLOSSARY

| Term | Description |
|-----------------------|---|
| APS | Application Processing System |
| AL | Acquisition List |
| Bank or EXIM Bank | Export-Import Bank of the United States |
| BG Energy | BG Energy Holdings. The BG Energy transaction (AP085833XX) is one of seven transactions with a local cost component selected by the OIG for review. |
| Board | The EXIM Bank Board, which is responsible for approving all medium- and long-term transactions generally over \$10 million or exceeding seven years repayment. |
| Board Memo | A memorandum submitted to the EXIM Bank Board as part of the process for approving a transaction for Bank support. |
| Buyer or Borrower | A foreign buyer of U.S. capital goods and/or services. |
| Coverage | Coverage refers to credit risks assumed by EXIM Bank through its extension of a loan, guarantee, or insurance policy to support an export transaction. |
| CRC | Credit Review and Compliance Division, EXIM Bank |
| Credit Administration | A group within the EXIM Bank OMR Division. The Credit Administration group is responsible for the evaluation of requests for utilization under operative loan and guarantee agreements. |
| Credit Agreement | A legal contract generally between a lender and borrower that sets forth the terms and conditions of the credit in addition to those contained in the promissory note, any security agreement, and any other related finance document. The Credit Agreement's provisions usually include the lender's commitment to lend, repayment and note terms, the conditions precedent for disbursement of the loan, representations and warranties, affirmative and negative covenants, and events of default. |
| CRTI | Character, Reputational and Transaction Integrity. CRTI due diligence is a process initiated by EXIM Bank to vet transaction participants, which consists of analyses of companies and individuals to identify potential fraud, corruption and integrity risks associated with parties to a transaction. |
| Dhuruma | Dhuruma Electricity Company. The Dhuruma transaction (AP084344XX) is one of seven transactions with a local cost component selected by the OIG for review. |
| ECA | Export Credit Agency. An ECA is a private or quasi-governmental institution that acts as an intermediary between national governments and exporters to issue export financing. |
| ECP | Electronic Compliance Program. The ECP is a web-based certification system utilized by EXIM Bank for the approval of disbursements and guarantee issuance. |
| E&E | Engineering and Environment Division, EXIM Bank |
| ERS | EXIM Bank Reporting System |
| EOL | EXIM Online |
| Eskom | The Eskom Limited transaction (AP085292XX) is one of seven transactions with a local cost component selected by the OIG for review. |
| Exporter | An individual or entity that sells goods or services to a purchaser in another country. |

| Term | Description |
|-------------------------|---|
| Facility Agent | Generally, a financial institution that acts as an agent for a lender or lenders in administering a facility. In the case of an EXIM Bank guaranteed loan, the facility agent acts as the agent for the EXIM Bank facility lenders, which provide financing to the borrower for the purchase and export of U.S. goods and services to the borrower's country. In the case of an EXIM Bank direct loan, the facility agent will serve as facility agent for the benefit, and on behalf of EXIM Bank in connection with administration of the credit agreement and other finance documents. |
| Final Commitment | An authorization of financing by EXIM Bank. |
| Foreign Content | The cost of goods and services produced outside of the U.S. and outside the country of the buyer. |
| Gasmart | The Gasmart Comercializadora, S.A. De C.V. transaction (583803) is one of seven transactions with a local cost component selected by the OIG for review. |
| GC | Guarantee Certificate. The GC is EXIM Bank's certificate of guarantee with respect to the disbursements made in accordance with a Credit Agreement. Under the ECP, EXIM Bank electronically documents its disbursement approval and guarantee in the Bank's EOL system that is accessible to the lender. |
| Global Foundries | The Global Foundries Inc. transaction (AP086105XX) is one of seven transactions with a local cost component selected by the OIG for review. |
| Guaranteed Lender | The lender that makes credit available to a foreign bank or buyer and EXIM Bank guarantees the repayment of the foreign bank or buyer's obligations. |
| Guarantor | The Guarantor guarantees to the lender and EXIM Bank the payment of principal and interest on the credit when due, including any additional amounts payable under a Credit Agreement or each note. |
| Liviero | The Liviero Group (Pty) Ltd. transaction (541862) is one of seven transactions with a local cost component selected by the OIG for review. |
| Loan Manual | EXIM Bank's Loan, Guarantee and Insurance Manual, which sets forth the policies and procedures for due diligence, structuring and monitoring of Bank transactions. |
| Local Cost | Local costs are project-related costs of goods and services that originate from the buyer's country. |
| MGA | Master Guarantee Agreement |
| OIG | Office of Inspector General, EXIM Bank |
| OMR | Operations and Management Reporting Division, EXIM Bank |
| Operative Date | The date that EXIM Bank determines that all conditions precedent (i.e., all conditions and agreements) for a transaction are satisfied and the transaction is available for disbursement. |
| Participation Agreement | An umbrella agreement between all parties to the transaction that specifies each participant's role in the transaction and the conditions necessary for their involvement. The main provisions of this agreement may include funding and notice mechanics, the conditions precedent for the disbursement of the loan, refinancing provisions, the indemnities and the representations and warranties. |
| SFD | Structured and Project Finance Division, EXIM Bank |
| TD | Transportation Division, EXIM Bank |
| TFID | Trade Finance and Insurance Division, EXIM Bank |
| Transnet | Transnet SOC Limited. The Transnet transaction (AP088827XX) is one of seven transactions with a local cost component selected by the OIG for review. |

EVALUATION REPORT ON EXIM BANK'S LOCAL COST POLICY AND PROCEDURES

INTRODUCTION

We completed an evaluation of the Export-Import Bank of the United States (EXIM Bank or Bank) local cost policy and procedures. We initiated the review as part of our annual review plan. The primary objective of the Office of Inspector General's (OIG) evaluation was to ascertain the adequacy of the Bank's internal controls, documentation requirements, verification mechanism and compliance with policies and procedures for local costs.

SCOPE AND METHODOLOGY

To evaluate EXIM Bank's local cost policy and procedures, we employed a combination of qualitative techniques and document reviews. We judgmentally selected seven transactions for review, with a total net authorized local cost amount of (b) (4), and total exposure local cost amount of (b) (4) as of July 30, 2017.¹ The seven transactions (two medium-term and five long-term) were authorized by the Bank during fiscal years 2010 to 2014. To test compliance with the Bank's local cost disbursement requirements for the seven transactions, we reviewed a judgmental sample of 14 disbursements, totaling (b) (4).

See Appendixes B and C for a list of transactions and disbursements reviewed and the related narratives.

In conducting our evaluation, we reviewed applicable policies and procedures, legal, financial and trade documents, and related internal Bank reports and correspondence; interviewed Bank management and staff, including representatives from Credit Administration, a group within the Operations and Management Reporting Division (OMR), the Credit Review and Compliance Division (CRC), the Engineering and Environment Division (E&E), the Office of the Chief Financial Officer (OCFO), the Structured and Project Finance Division (SPFD), the Trade Finance and Insurance Division (TFID), and the Transportation Division (TD); and reviewed disbursement requests, supporting schedules, and other documents required as support for disbursements. See Appendix D for a list of documents submitted for disbursement requests.

To facilitate the evaluation, OIG engaged the services of Ernst and Young LLP (EY) through contract to conduct an external independent review of the Bank's local cost policy and procedures and related legal, financial and trade documents for the five long-term transactions. EY also participated in interviews of Bank staff and management. The results of their work have been incorporated into this report. The evaluation was performed at EXIM Bank's main location in Washington, DC.

¹ The total Net Authorized Local Cost amount reflects transferred and cancelled authorization amounts.

Points of Inquiry

The following two points of inquiry directed our focus and guided our evaluation:

POINT OF INQUIRY 1: Did EXIM Bank finance local costs in accordance with established policies and procedures?

POINT OF INQUIRY 2: Are EXIM Bank's current policies and procedures for financing local costs sufficient to safeguard against fraud, waste and abuse?

The OIG conducted this evaluation during fiscal year 2017 in accordance with the *Quality Standards for Inspection and Evaluation* issued by the Council of Inspectors General on Integrity and Efficiency.² Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our evaluation objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

BACKGROUND

Established in 1934 through Executive Order, and subsequently made an independent agency of the United States (U.S.) through congressional Charter in 1945, EXIM Bank is a wholly-owned government corporation whose fundamental mission is to aid in the financing and to facilitate the export of U.S. goods and services, and to contribute to the employment of U.S. workers. EXIM Bank's Charter, through its enabling legislation, establishes the Bank's operations and programs and is reauthorized on a periodic basis. With the passage of the *Export-Import Bank Reform and Reauthorization Act of 2015*, the authorization of the Bank's Charter was extended through September 30, 2019.³

The Bank's core financing programs include direct loans and guarantees to foreign buyers, export credit insurance for exporters and foreign buyers, and working capital finance to U.S. small business exporters. The Charter requires "reasonable assurance of repayment" for all Bank transactions, which are backed by the full faith and credit of the U.S. government.⁴ EXIM Bank has functioned on a self-sustaining basis since fiscal year 2008, covering its operational costs and provisioning for expected losses through loan loss reserves, funded by fees and interest it charges its customers.⁵

² For more information on the *Quality Standards of Inspection and Evaluation*, see <https://www.ignet.gov/sites/default/files/files/committees/inspect-eval/iestds12r.pdf>.

³ See the *Export-Import Bank Reform and Reauthorization Act of 2015*, included in "Division E—Export-Import Bank of the United States" of the "FAST Act," which became public law on December 4, 2015 (Pub. L. No. 114-94) at <https://www.congress.gov/114/bills/hr22/BILLS-114hr22enr.pdf>.

⁴ See the *Charter of the Export-Import Bank of the United States* at http://www.exim.gov/sites/default/files/2015_Charter_-_Final_As_Codified_-_02-29-2016.pdf.

⁵ See the *Export-Import Bank of the United States Annual Report 2015* at <http://www.exim.gov/sites/default/files/reports/annual/EXIM-2015-AR.pdf>.

Local Cost Policy

When financing loans, guarantees or medium-term insurance in support of U.S. exports, EXIM Bank may provide financing for local costs incurred for goods and services that originated and/or were manufactured in the buyer's country. The Bank's local cost policy approved by the Board operates on the premise that some amount of local labor and raw material is necessary to efficiently build or assemble the end product of the U.S. export. The policy permits the financing of up to 30 percent of the value of the U.S. exports for locally originated and/or manufactured goods and services. This support is in addition to the maximum support of up to 85 percent of the U.S. net contract price.

In 2001, EXIM Bank revised its local cost policy to distinguish between project finance transactions (limited recourse) and non-project finance transactions (non-limited recourse). The policy for limited recourse transactions permitted the approval of local cost support if the costs were deemed within the scope of the underlying project. For non-limited recourse transactions, the policy permitted the approval of local costs if the costs were deemed functionally connected to the U.S. exporter's supply contract and certified by the exporter. Over time as the Bank moved to more of a hybrid structured finance approach to transactions, administration of the two separate policies for long-term transactions became difficult and the rationale for their distinction no longer existed.

In March 2011, EXIM Bank updated the local cost policy to address internal inefficiencies and to reduce exporter and borrower issues associated with the local cost feature for long-term transactions. The harmonization of the two policies resulted in a single policy that treats all transactions for long-term cover within the principles of limited recourse project finance, with eligibility subject to review and approval by E&E.⁶ In addition, the certification requirements were aligned, requiring only the borrower to certify for the amount and content of supported local costs. Under the prior the local cost policy, non-limited recourse project finance transactions required both the exporter and borrower to make the certifications for supported local costs. Finally, the policy update required an additional Borrower certification that the local cost coverage was not applied to products that could reasonably be purchased in the U.S.

Criteria for Support

Local cost support is subject to two types of criteria for approval: (1) the availability for obtaining local cost support, and (2) eligibility requirements for the local costs' inclusion in the Bank's financing package. The availability criteria differ for medium and long-term transactions. For medium-term transactions, EXIM Bank may provide financing if the U.S. exporter can prove either: (i) the availability of official export credit support for the local cost; or (ii) hardship in obtaining private sector financing of local costs for the transaction. For all long-term and select medium-term transactions, local cost financing is available subject to the Bank's approval.⁷ In addition, automatic local cost support is offered by the

⁶ EXIM Bank's local cost policy treats a medium-term limited recourse project finance transaction as if it were long-term.

⁷ Ibid.

Bank for environmental exports, medical exports, transportation security exports, project finance transactions (including medium-term transactions), and exports that fall under the engineering multiplier program transactions. The Bank's requirements for eligibility for medium and long-term transactions are detailed in Table 1 below.

| Table 1: EXIM Bank's Local Cost Eligibility Requirements | |
|---|--|
| Medium-Term Transaction | Long-Term Transaction |
| Local cost must be: | Local cost must be: |
| <ul style="list-style-type: none"> • "functionally" connected to costs the U.S. exporter needs to incur to complete the contractual obligations of its export; | <ul style="list-style-type: none"> • beneficial to the project; |
| <ul style="list-style-type: none"> • certified by the U.S. exporter in the Exporter's Certificate; | <ul style="list-style-type: none"> • certified by the Borrower; |
| <ul style="list-style-type: none"> • detailed in the credit approval; and | <ul style="list-style-type: none"> • detailed in the Acquisition List; and |
| <ul style="list-style-type: none"> • originated/manufactured in the host country. | <ul style="list-style-type: none"> • originated/manufactured in the host country. |

Source: EXIM Bank's Local Cost Policy (July 2012) and Loan Manual

Administration and Implementation

Within EXIM Bank, E&E has primary responsibility for administering the local cost policy. The assigned Engineer for a transaction approves all local costs associated with a transaction and is responsible for reviewing and approving the contents of the Acquisition List (AL) and any post-authorization related amendments. The Engineer is also responsible for ensuring that local cost providers identified after authorization are vetted through the Bank's Character, Reputational and Transaction Integrity (CRTI) process and providing guidance on local cost-related issues.

Additional Bank staff involved in the implementation of the local cost policy includes the Loan Officer, Portfolio Manager, and Credit Administration Officer (CAO) as described below. The Loan Officer within SPFD, TFID or TD who is responsible for underwriting the transaction, ensuring local cost providers identified prior to authorization are vetted through the CRTI process, and processing amendments prior to operative status. The Portfolio Manager within the Asset Management Division (AMD) or the Transportation Portfolio Monitoring Division (TPMD) is responsible for monitoring, processing amendments and ensuring repayment once a transaction is operative.

The assigned CAO within OMR is responsible for the review and processing of disbursements for local cost. As needed, the Engineer assists the CAO in "understanding documentation and correlating items contained in the disbursement requests with items in the transaction's ..." approved AL (e.g., goods listed on the invoice).⁸ CRC is responsible for monitoring compliance with CRTI transaction and enhanced due diligence procedures and evaluating compliance with the local cost policy through random post-disbursement reviews.

⁸ EXIM Bank E&E Staff Memorandum 13-1, dated July 31, 2013.

As of July 31, 2017, there are 127 transactions (91 long-term and 36 medium-term) in EXIM Bank's portfolio with exposure to local cost. The transactions represent an aggregate total net authorized local cost amount of approximately (b) (4) and total exposure amount of approximately (b) (4). The total aggregate disbursed and undisbursed amounts were approximately (b) (4), respectively.

Prior Reviews of EXIM Bank's Local Cost Policy and Procedures

This is the first evaluation of EXIM Bank's local cost policy and procedures by the OIG. Prior to this evaluation, the OIG conducted two inspections of structured financings with local cost components. In conducting the reviews, OIG observed certain deficiencies and made recommendations to address identified vulnerabilities.

EXIM Bank OIG Report (OIG-INS-13-01)

In fiscal year 2013, OIG inspected EXIM Bank's \$419.6 million project financing of an underground copper mine located in Baja California, Mexico.⁹ Our inspection revealed that the Bank's current policies and procedures related to the reimbursement of local costs were not sufficiently developed to guard against fraud, waste and abuse by local suppliers. Moreover, we found that the Bank lacked the infrastructure and resources to effectively process the high volume of local cost disbursements. Our report made three recommendations to strengthen the Bank's local cost policy and procedures. As of the date of this report, all three recommendations are closed.

EXIM Bank OIG Report (OIG-INS-14-01)

In fiscal year 2014, OIG inspected EXIM Bank's \$3.0 billion project financing of a vertically-integrated liquefied natural gas project in Papua New Guinea.¹⁰ In conducting the review, OIG was not able to validate compliance with the Bank's local cost policy due to insufficient information provided to the Bank under its Credit Agreement. Moreover, we found that local cost eligibility criteria were not applied consistently to goods and services. Finally, OIG found that although the credit documentation permitted the Bank to reasonably request information from the Borrower, its right to inspect and audit the relevant books and records to validate compliance with the local cost policy was limited to the occurrence of an event of default. To address the identified vulnerabilities related to local costs, OIG made a recommendation to enhance transparency in the financing of local costs. As of the date of this report, the recommendation is closed.

⁹ For more information, see EXIM Bank OIG's *Report on Minera y Metalurica del Boleo S.A.* (OIG-INS-13-01, dated September 30, 2013) available at <https://www.exim.gov/sites/default/files/oig/reports/REDACTED-Report-on-Minera-y-Metalurica-del-Boleo-SA-Report-Final-OIG-INS-13-01-130930.pdf>.

¹⁰ For more information, see EXIM Bank OIG's *Report on PNG LNG Project Financing* (OIG-INS-14-01, dated June 18, 2014) available at <https://www.exim.gov/sites/default/files/oig/reports/PNG-LNG-INSPECTION-REPORT-508-Final-Redacted.pdf>.

EXIM Bank Local Cost Reviews

In response to OIG-INS-13-01, EXIM Bank through contract engaged three independent vendors to conduct local cost reviews. The scope of work was to perform due diligence and provide information to the Bank on the existence, ability to perform, viability of going concern, and a reasonable expectation that the contract work between a project and the in-country suppliers had been performed. To date the vendors have completed reviews of four transactions involving local Engineering, Procurement and Construction (EPC) companies that were responsible for the procurement of goods and services: Refineria de Cartagena, S.A.; Australia Pacific LNG; Sadara Chemical Company; and Samalkot Power limited, which represented approximately 42 percent of the total authorized amount in local cost financing of (b) (4). In general, the vendors found that the transactions complied with EXIM Bank's local cost requirements with no evidence of fraud, waste or abuse. The local cost providers that supplied goods and/or services had a strong presence in the host country and each had a valid local business registration. The EPCs' procedures were well considered and effective and personnel were deemed knowledgeable about them. There was no reason to believe that the work invoiced by local providers was not duly performed or performed in any country other than the buyer's country. As of the date of this report, the Bank is in the process of completing a second round of assessments. OIG understands that updates may be made to EXIM Bank's local cost policy framework using the vendors' feedback as a resource.

PRINCIPAL FINDINGS AND RECOMMENDATIONS

Point of Inquiry 1: Did EXIM Bank finance local costs in accordance with established policies and procedures?

Applicable Standards, Terms and Conditions

OIG reviewed various Applicable Standards, Terms and Conditions and focused on the following:

1. Procedures for the financing of local costs outlined in Chapter 8 *Standard Credit Structure*, Chapter 14 *Project Finance*, and Appendix 24-1 *CRTI Transaction and Enhanced Due Diligence Guidelines* of Chapter 24 *Credit Review and Compliance Division* of EXIM Bank's Loan, Guarantee and Insurance Manual (Loan Manual), dated April 2015 and May 2017, respectively;
2. Policy for *Local Cost* outlined in the Bank's Policy Handbook (Policy Handbook), dated July 2012;
3. *Change in the Application of Local Costs in Long-Term Transactions* outlined in a Memorandum to the Board of Directors (Memorandum), dated March 21, 2011 and approved March 29, 2011;
4. *Instructions for Administering EXIM Bank's Local Cost Policy* outlined in E&E's Staff Memorandum 13-1 (E&E Memorandum), dated July 31, 2013;
5. Procedures for processing disbursements outlined in the Bank's *Operations and Data Quality Division Manual, Credit Administration: Guarantees and Loans* (Disbursements Manual), Updated through August 2010 and January 2016, respectively;
6. EXIM Bank's *Frequently Asked Questions for Loans and Guarantees* (FAQs);¹¹
7. Terms and conditions of the respective Master Guarantee Agreement (MGA), Credit Agreement and/or Participation Agreement for the seven judgmentally selected transactions; and
8. Federal guidance on internal controls and policies for credit programs outlined in the General Accountability Office's (GAO's) *Standards for Internal Controls for the Federal Government* and the Office of Management and Budget's (OMB) Circular A-123, *Management's Responsibility for Internal Controls* and Circular A-129, *Policies for Policies for Federal Credit Programs and Non-Tax Receivables*.

¹¹ For more information, see "Credit Administration Fact Sheets" at <http://www.exim.gov/tools-for-exporters/credit-administration-and-operations>. The Bank has FAQs for Invoices, Evidence of Payment, Evidence of Export and Exporter's Certificate.

EXIM Bank Policies, Procedures and Guidelines

The basic features, processing and underwriting requirements for the financing of local cost are outlined in EXIM Bank's Loan Manual. Other requirements for local costs are outlined in the Bank's Policy Handbook and related memoranda, which define the parameters and rationale for local cost, and administration. Additional guidelines can be found in the Bank's Disbursements Manual, and on-line FAQs for loans and guarantees.

The terms and conditions for local cost specific to a transaction is outlined in the respective MGA, Credit Agreement or Participation Agreement (the "Agreements") between the Borrower, the lender, and/or EXIM Bank. The Agreements include a schedule or annex that outlines the utilization procedures for funds disbursements, including reimbursement procedures. These procedures include the requirements for reimbursement documents and related forms (e.g., Exporter's Certificate, Request for Local Cost Reimbursement, Itemized Statement of Payments-Local Costs (ISP), Anti-Lobbying Certificate, Acquisition List, and invoices).¹²

Federal Guidance on Internal Controls and Policies for Credit Programs

As prescribed in OMB Circular A-123, *Management's Responsibility for Internal Control*, EXIM Bank management has a "fundamental responsibility to develop and maintain effective internal control."¹³ Internal control is a process effected by EXIM Bank's Board of Directors and management, designed to provide reasonable assurance about the achievement of the Bank's mission and objectives in regard to effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. As stated in the GAO's *Standards for Internal Control in the Federal Government*, "control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives to achieve the entity's objectives and address related risks."¹⁴

Management is responsible for designing control activities to achieve an entity's objectives and to respond to risks in its operations. Common control activities identified in the GAO standards include "segregation of duties," and "appropriate documentation of transactions and internal control."¹⁵ For segregation of duties, "Management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event."¹⁶ In regards to

¹² See Appendix D for details on the documents to be submitted for local cost disbursement requests.

¹³ For more information, see https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/omb/circulars/a123/a123_rev.pdf and <https://obamawhitehouse.archives.gov/sites/default/files/omb/memoranda/2016/m-16-17.pdf>.

¹⁴ For more information, see <http://www.gao.gov/assets/80/76455.pdf> and <http://www.gao.gov/assets/670/665712.pdf>.

¹⁵ Ibid.

¹⁶ Ibid.

documentation, “Management clearly documents internal control and all transactions and other significant events, in a manner that allows the document to be readily available for examination. The documentation may appear in management directives, administrative policies, or operating manuals, in either paper or electronic form. Documentation and records are properly managed and maintained.”¹⁷ Both the OMB Circular A-123 and GAO standards prescribe separate and ongoing evaluations of internal control activities as part of monitoring by federal agencies.

OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, requires departments and agencies to “[o]perate each credit program under a robust management and oversight structure, with clear and accountable lines of authority and responsibilities for administering programs and independent risk management functions; monitoring programs in terms of programmatic goals and performance within acceptable risk thresholds; and taking action to improve or maintain efficiency and effectiveness.”¹⁸

Finding 1: EXIM Bank was generally compliant in its financing of local costs for the seven transactions reviewed.

Overall, EXIM Bank administered the financing of local costs for the seven transactions reviewed in accordance with established policies and procedures. In assessing the judgmental sample of seven transactions for compliance, we found that the Bank generally followed procedures for the review and approval of local cost during origination and disbursement. With few exceptions, the disbursement files contained the required documents and support for local cost disbursements. We observed evidence that disbursement documents had been previously reviewed by Bank staff for compliance. For example, documents contained tick marks, highlights and/or notations.¹⁹ We also found that all local costs were invoiced on or after the initial eligibility date for the transactions. We noted no exceptions in our testing of the medium-term transactions. However, we identified certain control weaknesses in the Bank’s implementation of the local cost policy, and related procedures and guidelines for the five long-term transactions as detailed below under Point of Inquiry 2.

RECOMMENDATIONS

OIG does not make any recommendations related to this finding.

¹⁷ Ibid.

¹⁸ For more information, see https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a129/rev_2013/pdf/a-129_main.pdf.

¹⁹ For example, invoices included tick marks/highlights near typical components (e.g., buyer and seller names, invoice number, date(s) and amounts) and notations (e.g., “no-deductions”); ISPs included tick marks and notations (e.g., “accepted” or “not eligible”); and a supplementary schedule provided by a Borrower include a column added by Bank staff to document questions or comments (e.g., adjustments for reachback and ineligible expenses).

Point of Inquiry 2: Are EXIM Bank's current policies and procedures for financing local costs sufficient to safeguard against fraud, waste and abuse?

Applicable Standards, Terms and Conditions

OIG reviewed various Applicable Standards, Terms and Conditions and focused on the following:

1. Procedures for the financing of local costs outlined in Chapter 8 *Standard Credit Structure*, Chapter 14 *Project Finance*, and Appendix 24-1 *CRTI Transaction and Enhanced Due Diligence Guidelines* of Chapter 24 *Credit Review and Compliance Division* of EXIM Bank's Loan, Guarantee and Insurance Manual (Loan Manual), dated April 2015 and May 2017, respectively;
2. Policy for *Local Cost* outlined in the Bank's Policy Handbook (Policy Handbook), dated July 2012;
3. *Change in the Application of Local Costs in Long-Term Transactions* outlined in a Memorandum to the Board of Directors (Memorandum), dated March 21, 2011 and approved March 29, 2011;
4. *Instructions for Administering EXIM Bank's Local Cost Policy* outlined in E&E's Staff Memorandum 13-1 (E&E Memorandum), dated July 31, 2013;
5. Procedures for processing disbursements outlined in the Bank's *Operations and Data Quality Division Manual, Credit Administration: Guarantees and Loans* (Disbursements Manual), Updated through August 2010 and January 2016, respectively;
6. EXIM Bank's *Frequently Asked Questions for Loans and Guarantees* (FAQs);²⁰
7. Terms and conditions of the respective Master Guarantee Agreement (MGA), Credit Agreement and/or Participation Agreement for the seven judgmentally selected transactions; and
8. Federal guidance on internal controls and policies for credit programs outlined in the General Accountability Office's (GAO's) *Standards for Internal Controls for the Federal Government* and the Office of Management and Budget's (OMB) Circular A-123, *Management's Responsibility for Internal Controls* and Circular A-129, *Policies for Policies for Federal Credit Programs and Non-Tax Receivables*.

EXIM Bank Policies, Procedures and Guidelines

See Point of Inquiry 1 above for a summary of these policies, procedures and guidelines.

²⁰ For more information, see "Credit Administration Fact Sheets" at <http://www.exim.gov/tools-for-exporters/credit-administration-and-operations>. The Bank has FAQs for Invoices, Evidence of Payment, Evidence of Export and Exporter's Certificate.

Finding 2: Although EXIM Bank was generally compliant in the financing of local costs, certain control weaknesses were identified.

For the five long-term transactions reviewed, there were a sufficient number of inconsistencies identified to indicate weaknesses in internal controls for the proper management and financing of local costs. We identified control weaknesses in the administration and implementation of the Bank's local cost policy and procedures used to ensure that local goods or services provided are those the Bank approved for financing. These weaknesses decrease the effectiveness of internal controls for local cost to minimize the risk that errors or irregularities may occur or not be detected. We did not find any evidence of fraud in our review of the transactions. However, the Bank's local cost policy and procedures as implemented may not be adequate to protect the Bank from potential fraud or abuse.²¹

Finding 2A: Management and implementation of the Acquisition List for local costs needs improvement.

In assessing internal controls over the administration and financing of local costs, we determined that the Acquisition List (AL) serves as one of the primary control documents for the implementation of EXIM Bank's local cost policy throughout the life cycle of a transaction—from origination to disbursement for long-term transactions. According to Credit Administration staff, the Bank relies on the Borrower to distinguish between U.S. and local costs and to ensure that disbursement requests comply with local cost requirements. This reliance may increase the Bank's exposure to reputational and operational risk should an ineligible good or service be financed or fraudulent event occur. The AL serves as the Bank's preventive control to help mitigate those risks.²²

As a condition precedent for the first utilization of a long-term credit, the Borrower is required to submit an AL to EXIM Bank and the facility agent in the form set forth in the respective Credit Agreement or Participation Agreement.²³ The AL provides an itemization of all Bank approved and supported local cost goods and services, identifies the names of local cost providers, details the cost for each approved item, and provides the total associated local cost amount. The administration of the AL is appropriately segregated between the Bank's assigned Engineer and CAO. The Engineer is responsible for reviewing and approving the contents of the AL submitted by the Borrower, including any

²¹ OIG notes that a prior inspection report (OIG-INS-13-01) produced similar findings as it relates to the potential for fraud or abuse. *Supra* note 9.

²² GAO's Standards for Internal Control defines a preventive control as "an activity that is designed to prevent an entity from failing to achieve an objective or addressing a risk." *Supra* note 14.

²³ Section 1.01 Defined Terms and Section 6 Conditions Precedent of the Credit Agreement and Section 4 Conditions Precedent of the Participation Agreement for the transactions reviewed. The prescribed form of the AL is found in the annexes of the Credit Agreement or Participation Agreement. A fillable version of the AL form is available at <https://www.exim.gov/sites/default/files/forms/ebd-m-59.pdf>.

amendments, to ensure the subject goods and/or services are related to the scope of the overall project or the U.S. exporter's scope of work.²⁴ The CAO is responsible for reviewing documentation for long-term credits submitted in the Request for Local Cost Reimbursement for accuracy, such as invoices for local costs that the Borrower certifies are on the AL approved by the Engineer, and processing disbursements.²⁵

While the internal control framework created by the AL appears adequate to mitigate the risk of fraud or abuse, the Bank's procedures and guidelines related to the local cost policy as implemented are not sufficiently clear as to the application of the AL. Nor do they specify what constitutes an appropriate level of detail for describing local costs on the AL. In our review of the ALs for the five long-term transactions, we observed inconsistencies in the description of local costs, the identification of local cost providers, and the documenting of the Engineer's review and approval. For example, OIG found that for one transaction, the description of local cost goods and services in Section B of the AL was blank. For another transaction, multiple versions of the AL were issued using the same date without evidence to confirm E&E's review and approval of the local cost providers. For a third transaction, the AL contained no evidence such as initials or date to confirm that it was reviewed and approved by E&E.

When there are inconsistencies in the management and usage of the AL, the ability to confirm that the local cost provider and related local goods and services presented in the request for reimbursement are those approved by EXIM Bank is difficult. Insufficient focus on the AL could lead to the Bank financing ineligible goods and services. Clarifying requirements for the AL and therefore strengthening this control will help to improve the Bank's review and approval of what and to whom it is financing for local costs and creates a clearer audit trail for the disbursement process.

Finding 2B: Other control activities relating to the review and approval of local cost disbursements should be strengthened to protect the Bank from potential fraud, reputational and operational risk.

The organizational structure created by EXIM Bank management to sustain effective internal control around local costs appears sound. For example, the administration and implementation of the local cost policy for a transaction is appropriately segregated between the Engineer, the Loan Officer, the CAO, and the Portfolio Manager where no one individual controls all keys aspects of a transaction or event. However, some of the procedures and mechanisms in place to minimize reputational and operational risk such as the review and reconciliation of disbursement documents, management and maintenance

²⁴ Part C of the Operative Memorandum applies to the Engineer, who certifies to his/her examination and acceptance of the final or preliminary/partial Acquisition List submitted by the Borrower. The AL contains a place for the Engineer to initial and date, confirming his/her review and approval of the list.

²⁵ For long-term guarantees, the Guaranteed Lender is responsible for reviewing documents submitted in the Request for Local Cost Reimbursement prior to submission to EXIM Bank.

of records, and treatment of subsidiary and affiliate companies can be improved to further mitigate opportunities for fraud and abuse.

Review and Reconciliation of Disbursement Documents

Our review of the five long-term transactions identified a number of inconsistencies in the documentation reviewed and approved by EXIM Bank staff for local cost disbursements that illustrate a need for improved internal controls on part of the Bank. Although we observed evidence that Bank staff reviewed disbursement documents for compliance, there were instances where we were unable to confirm the local goods or services described on invoices were consistent with the approved goods or services described on the approved AL or the ISP as illustrated in the cases below. These inconsistencies make it difficult to review and reconcile disbursement documents (e.g., invoices to the AL or ISP) to confirm the accuracy of the documents, appropriateness of the disbursement, and compliance with the policies and procedures relating to local cost. The following examples illustrate some of the inconsistencies observed.

Eskom Limited (Eskom). On April 22, 2013, EXIM Bank approved the Borrower's local cost reimbursement request of (b) (4) (includes exposure fee of (b) (4)) for disbursement for local labor. The disbursement represented the maximum amount authorized for local cost under this transaction. The Borrower relied on the breakdown of the invoices between U.S., local and third country costs provided by the local cost provider, Black & Veatch International (B&V). During an on-site monitoring visit in late September 2013, the Bank's assigned Engineer learned that B&V misunderstood what qualified as local cost and categorized a majority of U.S. services as local costs. The local cost provider believed U.S. employees working on-site at the project constituted local services. The Bank required B&V to reconcile its invoices and reallocate the (b) (4) disbursed between U.S., local and third country costs. Of the original disbursement amount, only (b) (4) (includes exposure fee of (b) (4)) was identified as eligible local cost. Additional local cost invoices were to be submitted by the Borrower as support for the difference of approximately \$158.3 million.

Although we observed evidence that Bank staff reviewed disbursement documents for compliance (e.g., invoice numbers, dates and amounts matched to the ISP) and made adjustments for ineligible costs (e.g., expenses relating to B&V personnel's family), the CAO's review of disbursement documents did not identify the misallocation of costs by B&V. This occurred because the Bank relied on the local cost provider, who did not fully understand the Bank's U.S. content and local cost policy, to distinguish between U.S., local, and third country costs and the Borrower's certification. The disbursement reconciliation schedule and invoices submitted for reimbursement did not contain sufficient detail to validate the local cost provider's determination. Under the current procedures, there is limited assurance that the Bank would have caught the misallocation without the Engineer's on-site monitoring visit, which is not a requirement for disbursement. The Borrower was able to submit an additional (b) (4) (b) (4) in invoices (includes exposure fee of (b) (4)) as substitute, resulting in a final total local cost disbursement amount for this transaction of (b) (4) (includes exposure fee of (b) (4)).

Global Foundries Inc. (Global). On December 5, 2013 and September 8, 2014, EXIM Bank approved the Borrower's local cost reimbursement requests for (b) (4) and (b) (4), respectively, for disbursement. The (b) (4) in local costs reimbursed was for the installation of equipment associated with semiconductor fabrication by two local cost providers, M&W Integrated Solutions GmbH and Scholpp Montagetechnik GmbH. In reviewing the disbursement documents, we observed evidence that Bank staff reviewed the invoices for confirmation of typical components (e.g., invoice dates, numbers and payment amounts) and adjustments were made to the ISP for one local cost provider (e.g., removed reachback amounts). However, we were unable to verify the local services described on the invoices were consistent with the approved local cost services for the transaction because some of the invoices were in German and the ALs provided did not include local costs.²⁶ As an alternative, Bank staff provided email correspondence from the assigned Engineer that included two schedules used by the Borrower to account for EXIM Bank draws and a final AL for U.S. costs. In an interview, E&E staff implied that the AL was misplaced and explained for larger projects that they may receive an AL accompanied by a supplemental spreadsheet that provides more details. Though not in the form prescribed for the AL in the Credit Agreement, according to Bank staff, the spreadsheets submitted by the Borrower were considered acceptable by the Engineer. This change in practice of accepting spreadsheets as a substitute for the AL has yet to be formalized in EXIM Bank procedures and guidance. Bank staff explained that although the local cost invoices were in German, there was sufficient English on the invoices to determine that the types of invoiced services matched the more detailed description of local costs on the spreadsheet for the local cost providers. Further, according to Bank staff, the ISP described these items under the general heading of "hookup various tools" and the local cost providers' evidence of payment letters confirmed that the invoices were for "hookup various tools." The disbursement documentation did not contain any explanation as to how Bank staff reviewing the request for disbursement was able to reconcile the invoice descriptions to the description of approved services on the AL. Lastly, there was insufficient detail in the invoices to determine exactly what local goods or services were being provided (e.g., "Indirectke Kosten").

EXIM Bank's procedures and guidelines for local cost do not explicitly address how to treat invoices in a foreign language. However, section 13.11 of the Credit Agreement for this transaction requires that all documents delivered by any party pursuant to the terms of the agreement be provided in English or accompanied by an English translation. According to the Loan Officer, this is standard language included in the Credit Agreement, meant to speed up the review of documentation. In an interview, Bank staff explained that section 13.11 does not apply to local cost providers on the understanding that they are not officially party to the Credit Agreement. The Bank's Loan Manual requires that certain documents, if not in English, be accompanied by an English translation, such as the export contract, financial statements, and standard

²⁶ Approximately 83 percent of the sampled invoices reviewed from the first and second disbursement were in German. *Infra* note 32.

conditions precedent. However, there is no explicit mention of disbursement documents for local costs in the Loan Manual. Further, whereas the Disbursements Manual acknowledges that an invoice for local cost may be issued by the local cost provider in a language and currency of the Borrower's country, the only guidance provided is referral to the respective Credit Agreement for procedures on converting local currency to U.S. dollars. In a briefing, EXIM Bank staff indicated that it had contemplated and accepted the risk of allowing invoices in a foreign language to be submitted. Bank staff emphasized the risk is mitigated by the Borrower's certifications, which are legally enforceable.

BG Energy Holdings Limited (BG Energy). On December 15, 2015, EXIM Bank approved the Borrower's local cost reimbursement request for (b) (4) for disbursement. The local costs reimbursed were for construction and project management services, and civil works provided by local cost provider, Bechtel Australia Limited (Bechtel Australia), and two local sub-contractors, Theiss Pty Ltd. and John Holland Pty Ltd. In reviewing the disbursement documents, we found that the Borrower submitted documentation for reimbursement comprised of invoices from Bechtel Australia totaling (b) (4) in local costs. However, the reimbursement requested only totaled (b) (4) (or (b) (4)) and supporting documentation, including the ISP and Proof of Payment confirmed only that this amount corresponded to eligible local costs.

To arrive at the local cost amount, Bechtel Australia included a Continuation Sheet for Progress Payment Claim Invoices (Continuation Sheet) that listed the total of each invoice along with a table that simply recreated the approved local cost AL and translated amounts from AUD to USD. According to Bank staff, approval of the disbursement was based on information included in the ISP and the Continuation Sheet and they worked in advance of the disbursement with the Borrower and its consultant to understand the process for commercial invoicing and relating local cost progress invoices to Bechtel Australia. The CAO pre-reviewed and approved the accompanying invoice certification letter and Continuation Sheet. However, this approach and evidence supporting the pre-review and approval was not part of the disbursement file. Further, our review of these documents did not find sufficient evidence to reconcile clearly the invoices and ISP to the local cost amount or to the description of goods and services on the approved AL. For example, the Continuation Sheet did not identify which of the invoices were being used to support the (b) (4) request for local cost reimbursement.

We observed evidence that Bank staff reviewed invoices for confirmation of typical components (e.g., invoice dates, numbers and amounts), checked total amounts on the ISP and invoice amounts on the Continuation sheet. However, the disbursement documentation did not contain any explanation as to how Bank staff reviewing the request for disbursement were able to reconcile the invoice descriptions to the description of approved goods or services on the AL. Further, there was insufficient detail in the invoices to determine exactly what local services were being provided (e.g., "Anticipated Progress").

The Bank's practice of accepting the Borrower's certification of local costs without an apparent match between the underlying invoices and the amounts and descriptions on the

AL creates an opportunity for fraud and abuse. The presence of the inconsistencies discussed above where local cost disbursements were approved by the Bank illustrate that the current procedures and guidelines relating to the local cost policy as implemented may not adequately protect the Bank from reputational and operational risk. As a result, EXIM Bank has limited assurance that the local cost goods and services provided and submitted for reimbursement were those approved by the Bank.

Management and Maintenance of Records

In reviewing the five long-term transactions, we found that EXIM Bank's practices in regards to the management and maintenance of accurate and up-to-date records for local cost should be improved. We found that the Bank's files generally contained the required documents and support for local cost disbursements outlined in the respective Credit Agreement or Participation Agreement. However, we observed inconsistencies in the management and maintenance of records relating to CRTI results and ALs.

For example, the Bank's files did not contain evidence to support which local cost providers were included in CRTI screening or confirmation that local cost providers subject to screening had been cleared (i.e., "hit or no hit"). This makes it difficult to determine who has been vetted and to confirm the outcome. In addition, we found inconsistencies in the documenting of E&E's review and approval of ALs. Although the AL form contains a place for sign-off evidencing review and approval by the Engineer, we observed forms that were not signed. According to E&E staff, the current process is to use emails to document the review and approval of the AL. This change has yet to be formalized in E&E's instructional memoranda. The proper management and maintenance of records provides evidence to confirm that the appropriate processes and controls are in place to prevent the disbursement of funds for ineligible goods or services.

Treatment of Subsidiary and Affiliate Companies

EXIM Bank's procedures and guidelines related to the implementation of the local cost policy do not provide sufficient guidance on how to treat parent companies, their affiliates or subsidiaries with respect to the AL, CRTI screening, and the review and approval of local cost disbursements. Further, the AL does not differentiate between the local cost provider, sub-contractor, subsidiary or affiliate companies. Although review and approval of local costs and local cost providers by the Engineer prior to achieving operative status is an important and valuable control activity, accurately identifying the specific entity providing local cost goods or services and their parents or subsidiaries relevant to the project will provide a greater level of protection to the Bank in terms of risk related to fraud and misuse of local cost financing.

RECOMMENDATIONS

OIG recommends that EXIM Bank undertake the following enhancements with respect to the Acquisition List required for long-term transactions:

1. Issue detailed procedures and guidelines on its current process for reviewing and approving local cost goods and services, providers and amounts using the Acquisition List. This would include determining whether the current definition of what constitutes "sufficient detail" is adequate and clarifying the roles and

responsibilities of Bank staff, timeline and requirements for administering the Acquisition List.

OIG recommends that EXIM Bank undertake the following enhancements to strengthen internal control activities:

2. Provide enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for the preparation and submission of reimbursement requests. This would include providing a clear delineation between U.S. and local cost goods and services.
3. For reimbursement requests, update the procedures and guidelines for local cost to require, at minimum, the submission of information that describes in sufficient detail the goods or services being invoiced for confirmation with the approved Acquisition List; therefore, creating a verifiable audit trail.
4. In the event that invoices are submitted in a foreign language, the Bank should establish a transparent and documented process by which Bank staff review and approve those invoices.
5. Update procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost. This should include ensuring that all updates and changes to the Acquisition List, CRTI screening support (e.g., requests, notifications of clearance and hits), and Bank staff correspondence are retained in the appropriate Bank files.
6. Update procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates with respect to the Acquisition List and CRTI screening when those subsidiaries or affiliate firms are providing local cost goods or services as a primary provider or sub-contractor. This would include updating the Acquisition List to distinguish between the specific entity providing local cost goods or services.

Management Response:

Please see Appendix A, Management Response and OIG Evaluation.

CONCLUSION

Our evaluation found that EXIM Bank was generally compliant in its financing of local costs for the seven transactions reviewed. We noted no exceptions in our testing of two medium-term transactions. However, our review of five long-term transactions identified a sufficient number of inconsistencies to indicate weaknesses in internal controls relating to local costs. Specifically, we determined that the Bank's management and usage of the AL for local costs needs improvement. The Bank's procedures and guidelines related to the local cost policy as implemented are not sufficiently clear as to the application of the AL. Nor do they specify what constitutes an appropriate level of detail for describing local costs on the AL. For the five long-term transactions, we observed inconsistencies in the description of local costs, the identification of local cost providers, and the documenting of the Engineer's review and approval of the AL. These inconsistencies make it difficult to confirm that the local cost provider and related local goods and services presented in a disbursement request are those approved by the Bank.

Finally, we determined that EXIM Bank can strengthen other control activities for local cost to minimize reputational and operational risk such as the review and reconciliation of disbursement documents, management and maintenance of records, and treatment of subsidiary and affiliate companies to further mitigate opportunities for fraud and abuse.

APPENDIXES

Appendix A: Management Response and OIG Evaluation



Reducing Risk. Unleashing Opportunity.

September 22, 2017

Terry Settle
Acting Inspector General
Office of the Inspector General
Export-Import Bank of the United States
811 Vermont Avenue, NW
Washington, DC 20571

Dear Ms. Settle,

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”) evaluation “Report on EXIM Bank’s Local Cost Policies and Procedures”, OIG-EV-17-06, dated September, 2017 (the “Local Cost 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.

EXIM Bank appreciates the OIG’s acknowledgment that “EXIM Bank administered the financing of local costs for the seven transactions reviewed in accordance with established policies and procedures.”

Further, EXIM values the OIG’s finding that it “did not find any evidence of fraud in our review of the transactions.”

Additionally, the Bank values OIG’s determination that “the Bank generally followed procedures for the review and approval of local cost during origination and disbursement” and that for the medium-term transactions selected for this review OIG “noted no exceptions in our testing.”

Lastly, EXIM appreciates that OIG “observed evidence that disbursement documents had been previously reviewed by Bank staff for compliance.”

The Bank continuously strives to improve its policies and practices and agrees to all six OIG recommendations in this report.

811 Vermont Avenue, NW
Washington, DC 20571
Main: 202 565 3946
Fax: 202 565 3380
exim.gov

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Recommendation 1: that EXIM Bank undertake the following enhancements with respect to the Acquisition List required for long-term transactions:

Issue detailed procedures and guidelines on its current process for reviewing and approving local cost goods and services, providers and amounts using the Acquisition List. This would include determining whether the current definition of what constitutes “sufficient detail” is adequate and clarifying the roles and responsibilities of Bank staff, timeline and requirements for administering the Acquisition List.

Management response: Management agrees with this recommendation. EXIM Bank will issue detailed procedures and guidelines on its current process for reviewing and approving local cost goods and services, providers and amounts using the Acquisition List, to include determining whether the current definition of what constitutes “sufficient detail” is adequate and clarifying the roles and responsibilities of Bank staff, timeline and requirements for administering the Acquisition List.

Recommendation 2: that EXIM Bank undertake the following enhancements to strengthen internal control activities:

Provide enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for the preparation and submission of reimbursement requests. This would include providing a clear delineation between U.S. and local cost goods and services.

Management response: Management agrees with this recommendation. EXIM Bank works closely with the Borrowers to ensure that their knowledge and understanding of EXIM’s policies and procedures is current. In order to provide a clear delineation between U.S. and local cost goods and services, EXIM will provide enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for the preparation and submission of reimbursement requests.

Recommendation 3: that EXIM Bank undertake the following enhancements to strengthen internal control activities:

For reimbursement requests, update the procedures and guidelines for local cost to require, at minimum, the submission of information that describes in sufficient detail the goods or services being invoiced for confirmation with the approved Acquisition List; therefore, creating a verifiable audit trail.

Management response: Management agrees with this recommendation. EXIM Bank has implemented robust internal controls to confirm that the invoiced local cost goods and services are on the approved Acquisition List. First, the EXIM Bank engineer reviews and approves the Local Cost Acquisition List including vetting the local cost providers and their supply contracts. Second, the borrower under long-term transactions certifies in their disbursement request as to the origin and use of the local cost goods and services presented for reimbursement attaching a detailed Itemized Statement of Payment for each local cost provider listing invoices, contract numbers and Acquisition List reference information. Such certifications are legally binding.

Credit Review and Compliance (CRC) division is conducting an extensive review of the local cost program and to date has uncovered no issues of fraud, waste or abuse in this area. At the conclusion of this review, EXIM Bank will review CRC's findings and determine what, if any, additional internal controls are needed to ensure that the submission of information that describes in sufficient detail the goods or services being invoiced for confirmation with the approved Acquisition List.

Recommendation 4: that EXIM Bank undertake the following enhancements to strengthen internal control activities:

In the event that invoices are submitted in a foreign language, the Bank should establish a transparent and documented process by which Bank staff review and approve those invoices.

Management response: Management agrees with this recommendation. EXIM Bank, for foreign language invoices, will establish a transparent and documented process by which Bank staff review and approve those invoices.

Recommendation 5: that EXIM Bank undertake the following enhancements to strengthen internal control activities:

Update procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost. This should include ensuring that all updates and changes to the Acquisition List, CRTI screening support (e.g., requests, notifications of clearance and hits), and Bank staff correspondence are retained in the appropriate Bank files.

Management response: Management agrees with this recommendation. EXIM Bank will update its procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost. The Bank's CRTI Transaction and Enhanced Due Diligence Guidelines require that CRTI requests, Library's response, hit or no hit, and other detailed information resulting from the search, is filed by staff. EXIM will communicate the importance of this requirement during mandatory CRTI training of EXIM staff.

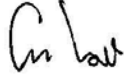
Recommendation 6: that EXIM Bank undertake the following enhancements to strengthen internal control activities:

Update procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates with respect to the Acquisition List and CRTI screening when those subsidiaries or affiliate firms are providing local cost goods or services as a primary provider or sub-contractor. This would include updating the Acquisition List to distinguish between the specific entity providing local cost goods or services.

Management response: Management agrees with this recommendation. EXIM Bank will update procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates with respect to the Acquisition List and CRTI screening when those subsidiaries or affiliate firms are providing local cost goods or services as a primary provider or sub-contractor.

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

Sincerely,

A handwritten signature in black ink, appearing to read "C. Hall", is positioned above the printed name.

Charles J. Hall
Chairman of the Board of Directors and President (acting)

OIG Evaluation

On September 22, 2017, EXIM Bank provided its management response to a draft of this report, agreeing with all six of the OIG’s recommendations. The response identified the Bank’s actions to address the recommendations. OIG considers the Bank’s actions sufficient to resolve the reported recommendations, which will remain open until OIG determines that the agreed upon corrective actions are completed and responsive to the reported recommendations.

The Bank’s management response to the reported recommendations and OIG’s assessment of the response are as follows:

RECOMMENDATION 1

Recommendation 1: Issue detailed procedures and guidelines on its current process for reviewing and approving local cost goods and services, providers and amounts using the Acquisition List. This would include determining whether the current definition of what constitutes “sufficient detail” is adequate and clarifying the roles and responsibilities of Bank staff, timeline and requirements for administering the Acquisition List.

Management Response: Management agrees with this recommendation. EXIM Bank will issue detailed procedures and guidelines on its current process for reviewing and approving local cost goods and services, providers and amounts using the Acquisition List, to include determining whether the current definition of what constitutes “sufficient detail” is adequate and clarifying the roles and responsibilities of Bank staff, timeline and requirements for administering the Acquisition List.

Evaluation of Management’s Response: Management’s actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

RECOMMENDATION 2

Recommendation 2: Provide enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for the preparation and submission of reimbursement requests. This would include providing a clear delineation between U.S. and local cost goods and services.

Management Response: Management agrees with this recommendation. EXIM Bank works closely with Borrowers to ensure that their knowledge and understanding of EXIM’s policies and procedures is current. In order to provide a clear delineation between U.S. and local cost goods and services, EXIM will provided enhanced guidance and training on local costs and related requirements to the Borrower and those responsible for the preparation and submission of reimbursement requests.

Evaluation of Management’s Response: Management’s actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

RECOMMENDATION 3

Recommendation 3: For reimbursement requests, update the procedures and guidelines for local cost to require, at minimum, the submission of information that describes in sufficient detail the goods or services being invoiced for confirmation with the approved Acquisition List; therefore, creating a verifiable audit trail.

Management Response: Management agrees with this recommendation. EXIM Bank has implemented robust internal controls to confirm that the invoiced local cost goods and services are on the approved Acquisition List. First, the EXIM Bank engineer reviews and approves the Local Cost Acquisition List including vetting the local cost providers and their supply contracts. Second, the borrower under long-term transactions certifies in their disbursement request as to the origin and use of the local cost goods and services presented for reimbursement attaching a detailed Itemized Statement of Payment for each local cost provider listing invoices, contract numbers and Acquisition List reference information. Such certifications are legally binding. Credit Review and Compliance (CRC) division is conducting an extensive review of the local cost program and to date has uncovered no issues of fraud, waste or abuse in this area. At the conclusion of this review, EXIM Bank will review CRC's findings and determine what, if any, additional internal controls are needed to ensure that the submission of information that describes in sufficient detail the goods or services being invoiced for confirmation with the approved Acquisition List.

Evaluation of Management's Response: Management's actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

RECOMMENDATION 4

Recommendation 4: In the event that invoices are submitted in a foreign language, the Bank should establish a transparent and documented process by which Bank staff review and approve those invoices.

Management Response: Management agrees with this recommendation. EXIM Bank, for foreign language invoices, will establish a transparent and documented process by which Bank staff review and approve those invoices.

Evaluation of Management's Response: Management's actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

RECOMMENDATION 5

Recommendation 5: Update procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost. This should include ensuring that all updates and changes to the Acquisition List, CRTI screening support (e.g., requests, notifications of clearance and hits), and Bank staff correspondence are retained in the appropriate Bank files.

Management Response: Management agrees with this recommendation. EXIM Bank will update its procedures and guidelines for the maintenance and retention of documentation related to all internal control aspects of local cost. The Bank's CRTI Transaction and

Enhanced Due Diligence Guidelines require that CRTI requests, Library's response, hit or no hit, and other detailed information resulting from the search, is filed by staff. EXIM will communicate the importance of this requirement during mandatory CRTI training of EXIM staff.

Evaluation of Management's Response: Management's actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

RECOMMENDATION 6

Recommendation 6: Update procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates with respect to the Acquisition List and CRTI screening when those subsidiaries or affiliate firms are providing local cost goods or services as a primary provider or sub-contractor. This would include updating the Acquisition List to distinguish between the specific entity providing local cost goods or services.

Management Response: Management agrees with this recommendation. EXIM Bank will update procedures and guidelines for local cost to clarify how to treat vertically integrated companies and their affiliates with respect to the Acquisition List and CRTI screening when those subsidiaries or affiliate firms are providing local cost goods or services as a primary provider or sub-contractor.

Evaluation of Management's Response: Management's actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification that the actions have been implemented.

| Table 2: Summary of Management's Comments on the Recommendations | | | | |
|--|--|--|-----------------------------------|------------------------------|
| Rec. No. | Corrective Action: Taken or Planned | Expected Completion Date ²⁷ | Resolved: Yes or No ²⁸ | Open or Closed ²⁹ |
| 1. | EXIM Bank will issue detailed procedures and guidance on its current process for using the Acquisition List (AL), assess the current definition of "sufficient detail," and clarify roles, responsibilities, timeline and requirements for administering the AL. | No Target Completion Date | Yes | Open |
| 2. | The Bank will enhance local cost | No Target | Yes | Open |

²⁷ EXIM Bank OIG has requested target completion dates for each of the outstanding recommendations.

²⁸ "Resolved" means that (1) Management concurs with the recommendation, and the planned, ongoing, and completed corrective action is consistent with the recommendation; or (2) Management does not concur with the recommendation, but alternate action meets the intent of the recommendation.

²⁹ Upon determination by the EXIM Bank OIG that the agreed-upon corrective action has been completed and is responsive to the recommendation, the recommendation can be closed.

| Table 2: Summary of Management's Comments on the Recommendations | | | | |
|--|---|--|-----------------------------------|------------------------------|
| Rec. No. | Corrective Action: Taken or Planned | Expected Completion Date ²⁷ | Resolved: Yes or No ²⁸ | Open or Closed ²⁹ |
| | related guidance and training to the Borrower and those involved in preparing and submitting reimbursement requests. | Completion Date | | |
| 3. | Upon completion of CRC's review, EXIM Bank will consider whether additional controls are needed to ensure information submitted for confirmation with the approved AL sufficiently details goods or services being invoiced. | No Target Completion Date | Yes | Open |
| 4. | The Bank will establish a transparent and documented process of staff review and approval of invoices submitted in a foreign language. | No Target Completion Date | Yes | Open |
| 5. | EXIM Bank will update procedures and guidelines for documentation maintenance and retention relating to local cost. Further, the Bank plans to communicate to staff the importance of retaining CRTI screening support and other information. | No Target Completion Date | Yes | Open |
| 6. | EXIM Bank will update local cost procedures and guidelines and clarify the treatment of vertically integrated companies and their affiliates; particularly for subsidiaries or affiliate firms that are providing local cost goods or services as a primary provider or sub-contractor. | No Target Completion Date | Yes | Open |

Appendix B: Transactions and Disbursements Reviewed

(b) (4), (b) (5)

³⁰ The Net Authorized Local Cost amounts reflect transfers and cancellations of authorized amounts.

³¹ EXIM Bank approved the disbursement of the total net authorized local cost amount of (b) (4) . The Bank subsequently discovered that the U.S. exporter and local cost provider misunderstood what qualified as local cost and categorized a majority of U.S. services as local costs. This resulted in a reallocation of the (b) (4) local cost disbursement between U.S., local and third country costs. In total, only (b) (4) was disbursed as eligible local costs, with the remainder supported as U.S. costs using substitute U.S. cost invoices.

Table 4: Disbursements Reviewed

(b) (4), (b) (5)

³² For the seven transactions, we submitted a request to the Bank for the disbursement files on April 11, 2017. At that time, 14 requests for local reimbursements had been reviewed and approved for disbursement by the Bank. For two of the transactions (Eskom and Transnet), additional disbursements occurred in July 2017. However, these disbursements were not reviewed as part of this evaluation. With the exception of Global Foundries, we reviewed 100 percent of the invoices included in the 14 disbursement files. For Global Foundries, which had two local cost disbursements, we reviewed 100 percent of the invoices for the first disbursement but chose a systematic random sample from the 620 invoices included in the second disbursement. Using a 5.7 percent margin of error and 95 percent confidence level, we drew a statistical sample of 203 giving an interval of $620/206 = 2.98$, which we rounded to 3. Using the itemized invoice list as a sample frame and a random number generator between 1-10 to identify our starting point (in this case 3), we reviewed every third invoice in the set to arrive at a total review of 203 invoices.

³³ “Amount” reflects the total amount invoiced adjusted by the Bank for ineligible content, etc.

³⁴ The exposure fee for Global Foundries and BG Energy is being charged as an Annual Exposure Premium.

Appendix C: Transactions Reviewed – Narratives

Medium-Term Transactions

Liviero Group (Pty) Ltd. (Liviero) – 541862 (Loan Guarantee)

Under individual delegated authority, EXIM Bank approved a loan guarantee to Liviero Group (PTY) Ltd. for \$5.3 million on October 15, 2012. The purpose of the loan guarantee was to support the purchase of new tractors from U.S. exporter Caterpillar, Inc. for use at a coal mine located in Vanggatfortein, South Africa. The loan guarantee included local cost support of (b) (4) for the servicing of the tractors and value added taxes. EXIM Bank's guarantee was needed to address the limited availability of private financing. The local cost component is fully disbursed. As of July 30, 2017, the Bank's exposure for local cost was (b) (4).

Gasmart Comercializadora, S.A. De C.V. (Gasmart) – 583803 (Loan Guarantee)

Under individual delegated authority, EXIM Bank approved a loan guarantee for Gasmart Comercializadora, S.A. De C.V. for \$10.3 million on March 10, 2014, which was subsequently amended to \$10.1 million. The purpose of the loan guarantee was to support the purchase of equipment and accessories from U.S. exporter Grupo Petro Gas Llc. for the construction of gas stations located in Mexico. The loan guarantee included local cost support of (b) (4) to cover equipment installation by local contractors. EXIM Bank's guarantee was needed to address the limited availability of private financing. The local cost component is fully disbursed. As of July 30, 2017, the Bank's exposure for local cost was (b) (4).

Long-Term Transactions

Dhuruma Electric Company (Dhuruma) –AP084344XX (Direct Loan)

On July 8, 2010, EXIM Bank's Board approved a direct loan to Dhuruma Electric Company for \$381.5 million, which was subsequently amended to \$367.0 million, in support of the purchase of combustion turbines, spare parts and related services primarily from U.S. exporter General Electric for the Riyadh PP11 Independent Power Project located in Saudi Arabia. The direct loan included local cost support of (b) (4) for the installation of the U.S. equipment and civil works. EXIM Bank financing was needed to address competition from foreign suppliers and export credit agencies (ECA), and the availability of long-term, private foreign capital. The local cost component is fully disbursed. As of July 30, 2017, the Bank's exposure for local cost was (b) (4).

Eskom Limited (Eskom) – AP085292XX (Direct Loan)

On May 26, 2011, EXIM Bank's Board approved a direct loan to Eskom Limited for \$805.6 million, which was subsequently amended to \$799.1 million, in support of the purchase of engineering and construction management services from U.S. exporter Black & Veatch for the construction of the Kusile Power Station located 100 km from Johannesburg, South Africa. The direct loan included local cost support of (b) (4) for local labor, which was amended to (b) (4). EXIM Bank financing was needed to address the limited availability of long-term debt financing and ECA competition. The total amount disbursed

for local costs was (b) (4). As of July 30, 2017, the Bank's exposure for local cost was (b) (4).³⁵

Global Foundries Inc. (Global Foundries) – AP086105XX (Direct Loan)

On December 13, 2012, EXIM Bank's Board approved a direct loan to Global Foundries, Inc. for \$1.0 billion in support of the purchase of semiconductor manufacturing equipment from seven U.S. exporters for use at its silicon wafer fabrication facility in Dresden, Germany. The direct loan included local cost support of (b) (4) for installation of the equipment, which was subsequently amended to (b) (4). EXIM Bank financing was needed to address the limited availability of commercial financing and ECA competition. The local cost component is fully disbursed. As of July 30, 2017, the Bank's exposure for local cost was (b) (4).

BG Energy Holdings Limited (BG Energy) – AP085833XX (Direct Loan)

On December 27, 2012, EXIM Bank's Board approved a direct loan to BG Energy Holdings for \$1.8 billion in support of the export of U.S. goods and services under the Bechtel EPC contract for the construction of the Queensland Curtis LNG plant located on Curtis Island in Queensland, Australia. The direct loan included local cost support of (b) (4) for construction and project management services, and civil works, which was subsequently reduced to (b) (4). EXIM Bank financing was needed to address the availability of long-term debt financing and ECA competition. The local cost component is fully disbursed. As of July 30, 2017, the Bank's exposure for local cost was (b) (4).

Transnet SOC Limited (Transnet) – AP088827XX (Loan Guarantee)

On July 31, 2014, EXIM Bank's Board approved a loan guarantee to Transnet SOC Ltd. for \$563.5 million, subsequently amended to \$365.6 million, in support of the export of (b) (4) locomotive kits by U.S. exporter General Electric for final assembly by Transnet Rail (b) (4) Engineering in Pretoria, South Africa. The loan guarantee included local cost support of (b) (4) for local labor, which was subsequently amended to (b) (4). EXIM Bank's guarantee was needed to diversify funding sources and to address foreign competition backed by non-OECD government-sponsored financing programs such as China. As of July 30, 2017, for local cost, (b) (4) had been disbursed with a total exposure of (b) (4).

³⁵ *Supra* note 31.

Appendix D: Local Cost – Disbursement Support and Submission Requirements

For the seven transactions reviewed, the utilization procedures are outlined in the respective annexes of the MGA for the medium-term guarantees, Credit Agreement for the long-term direct loans, and Participation Agreement for the long-term guarantee. The standard documents required as support for local cost disbursements are:

1. Commercial invoice.
2. Proof of payment.
 - a. Paid stamp on invoice signed by the local cost provider,
 - b. Copy of a commercial bank's advice of payment to the local cost provider,
 - c. Copy of both sides of a cancelled check made payable to the local cost provider, or
 - d. Letter from the local cost provider confirming payment.
3. Exporter's Certificate (for medium-term transactions only).
4. Borrower's certifications in the Request for Local Cost Reimbursement (for long-term transactions only).
5. Anti-lobbying Certificate (direct loan transactions only).

| Table 5: Disbursement Support – Documentation Submission Requirements | | |
|---|--|--|
| Deal No. and Borrower | Borrower to Guaranteed Lender | Guaranteed Lender to EXIM Bank |
| Medium-Term Guarantees | | |
| 541862 – Liviero | <ul style="list-style-type: none">• Invoices• Proof of Payment• Exporter’s Certificate | <ul style="list-style-type: none">• EOL Request for Disbursement Approval (ECP Checklist) |
| 583803 – Gasmart | | |
| Long-Term Guarantees | | |
| AP088827XX –Transnet | <ul style="list-style-type: none">• Request for Local Cost Reimbursement• Itemized Statement of Payments – Local Cost• Invoices• Proof of Payment | <ul style="list-style-type: none">• EOL Request for Reimbursement• Certificate Authorizing Reimbursement• Request for Local Cost Reimbursement• Itemized Statement of Payments – Local Cost• Invoices• Proof of Payment |

| Table 5: Disbursement Support – Documentation Submission Requirements | |
|---|--|
| Borrower to Facility Agent and Facility Agent to EXIM Bank | |
| | Long-Term Direct Loans |
| AP084344XX – Dhuruma | <ul style="list-style-type: none"> • Request for Local Cost Reimbursement • Itemized Statement of Payments – Local Cost • Proof of Payment • Anti-lobbying Certificate • Invoices |
| AP085292XX – Eskom | |
| AP086105XX – Global Foundries | |
| AP085833XX – BG Energy | |

Source: Annexes of the respective MGA, Credit Agreement or Participation Agreement; EXIM Bank's Disbursement Manual, and disbursement documents; and EXIM Bank Interviews

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Office of Inspector General
Export-Import Bank *of the* United States
811 Vermont Avenue, NW
Washington, DC 20571
202-565-3908
www.exim.gov/about/oig

