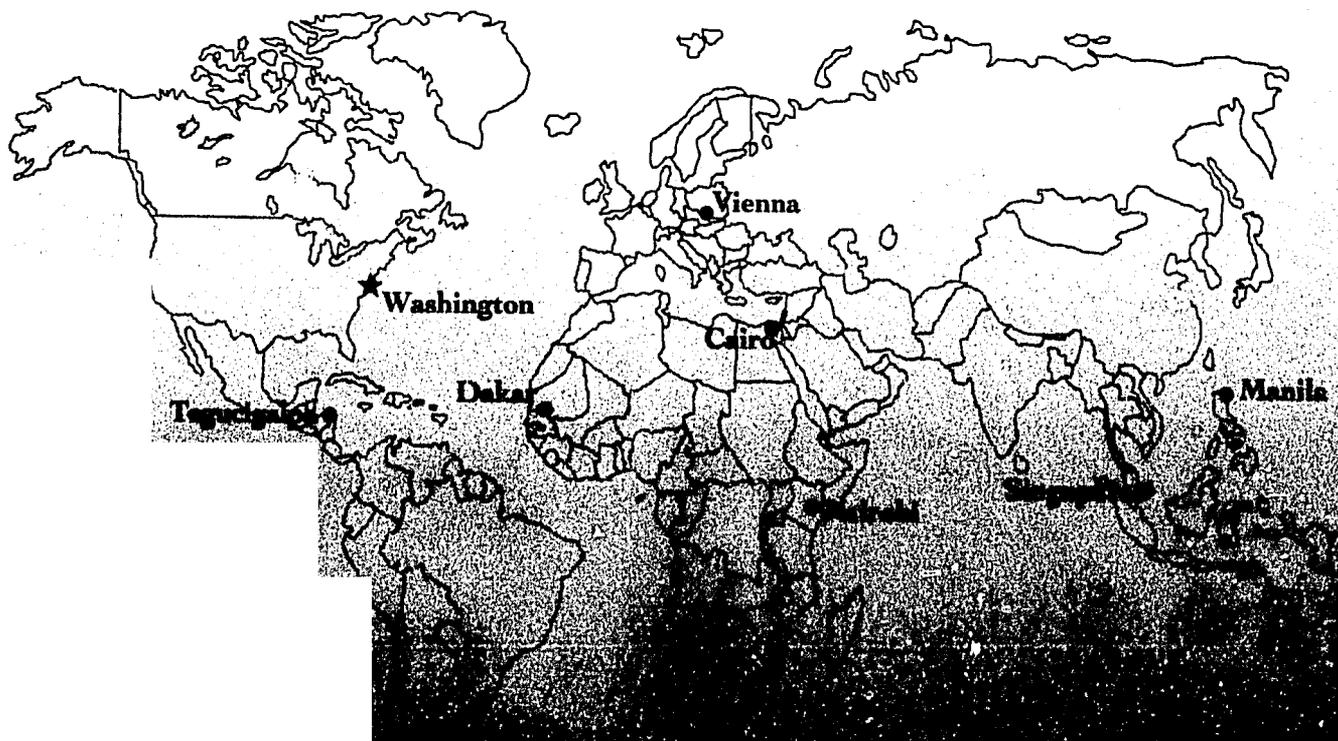


**Regional Inspector General For Audit
Bonn**

**Audit of Selected Privatization
and Restructuring Activities in Russia
(Project No. 110-0005)**

**Audit Report No. 8-118-95-007
March 10, 1995**



U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

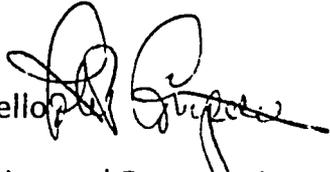


U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
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AMERICAN EMBASSY
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GERMANY

March 10, 1995

MEMORANDUM

TO: DAA/PA, Barbara Turner

FROM: RIG/A/Bonn, John Competello 

SUBJECT: Audit of Selected Privatization and Restructuring
Activities in Russia (Project No. 110-0005)
Audit Report No. 8-118-95-007

Attached is the final report on the subject audit. We considered your comments to the draft report in preparing the final report. However, due to the late receipt of your comments, we were unable to fully consider the detailed information that was attached. We have included your comments in their entirety as Appendix III.

The report contains four recommendations. Based on your comments and actions, we consider Recommendation No. 2 closed and the other three resolved. We will close the three open recommendations when we have received evidence that they have been appropriately implemented. So that we may promptly close the recommendations, please provide us with information within 30 days concerning actions taken to implement them.

I appreciate the cooperation extended to my staff during the audit.

EXECUTIVE SUMMARY

In response to the dramatic collapse of the Soviet Union in 1991, the United States and other countries quickly provided the Newly Independent States (NIS) of the former Soviet Union with a wide array of humanitarian and economic assistance. The United States, through the United States Agency for International Development (USAID), focussed on assisting NIS republics to transform their Soviet-style command economies into open-market, competitive economic systems. To this end, the rapid privatization of state-owned properties was considered by many to be the single most important effort to support economic reform. This report discusses USAID's implementation of selected privatization activities in Russia.

The Government of Russia (GoR), with USAID-financed technical support, initiated an aggressive privatization program aimed at (1) quickly transferring a large number of properties from state to private ownership, and (2) identifying and correcting structural impediments to the economic viability of the newly privatized properties. Assisting the GoR achieve these objectives in a timely manner was considered essential to the long-term stability of the country, and perhaps one of the greatest developmental challenges that USAID has ever encountered.

Despite limited experience and information about Russia and the other new independent states, USAID quickly designed and approved 13 NIS regional projects under which it has financed a wide array of activities in support of Russia's privatization program. Most of the activities fall under the Private Sector Initiatives Project (110-0005), which was authorized on April 22, 1992. As of June 30, 1994 USAID reported that \$196 million had been obligated for Russia under this project, of which \$84 million had been spent. USAID's Bureau for Europe and the New Independent States (ENI) has overall management responsibility for these activities.

RIG/A/B selected for review certain technical assistance activities under Project No.110-0005 to determine if the ENI Bureau had established adequate management controls over their implementation to ensure that USAID-financed contractors (1) provided the type and level of technical assistance and commodities (inputs) that they agreed to, and (2) produced the results (outputs) that were planned. These activities were being carried

out by six contractors and one grantee with budgets totaling \$67.5 million (Appendix II).

The ENI Bureau established a streamlined procurement process which enabled it to rapidly procure and deliver a significant amount of technical assistance to Russia. According to GoR reports, this assistance has helped it transfer thousands of state-owned enterprises to private hands and begin to address structural impediments to the long-term economic viability of these new enterprises. However, while ENI's streamlined procurement process enabled it to accelerate deliveries, it also required that greater attention be given to certain internal controls to better ensure that resources were not wasted. The audit noted that two control techniques - work plans and contractor reporting - were not being effectively used. In addition, activities were also being negatively affected by restrictive equipment procurement requirements and inadequate support by certain GoR agencies. A brief summary of these problems follows:

- USAID-financed contractors were to implement activities in accordance with approved work plans. Work plans were to describe the specific expected results (outputs) of the activity and the type and level-of-effort (inputs) and tasks required to achieve the results, and were to be approved by ENI before work began. However, in some instances contractors: (1) began work on activities before the work plan was approved by ENI; (2) did not adequately define the inputs to be provided or the outputs to be accomplished; and (3) frequently made unilateral changes or extended the time for completing activities in approved work plans. In these cases, their value in assisting project officers direct and control USAID-financed contractors was reduced. Thus, there was a higher risk that activities would not be implemented or achieve their outputs in an efficient and effective manner. To minimize these potential risks, the ENI Bureau stated it intentionally limited task orders to six-month periods. While limiting the time frame of activities to six months is a means of limiting potential waste, it does not replace the value of adequately developed work plans. The Bureau agreed that well-defined inputs and outputs were crucial to the success of the program, but had not established written standards or instructions for their development. Thus there was less assurance that task orders or work plans were prepared in a consistent manner. We recommended that Bureau establish and issue written guidance covering the development of work plans (page 6).
- USAID-financed contractors were to periodically report on the implementation of activities. If appropriately designed and used

these reports would provide project officers with the information necessary to quickly determine the status of key task/events specified in the work plan, and if necessary, take prompt corrective action. Although the contractors reported on their activities, the reports did not always relate to activities included in the approved work plans. These problems existed because ENI had not established specific reporting requirements for contractors to follow. The ENI Bureau agreed that it should add language in the task orders to clarify existing guidance to the contractors. In addition, project officers will be instructed to ensure that status reports conform to the expanded task order requirements. ENI was also establishing a new monitoring and reporting system for all activities in its portfolio (page 11).

- Many of the USAID-financed activities required computer and other office equipment in order to accomplish their objectives. Some activities were delayed due to equipment procurement problems because contractors were required to follow a cumbersome procurement process. This despite the fact that contract task orders covering privatization activities in Russia were generally designed to be accomplished in six months or less. Although USAID took unusual actions to expedite procurement of the services of U.S. contractors, it did not follow through to ensure these contractors would be able to expedite their required procurements. We recommended that the Bureau work with the Office of Procurement on identifying ways to minimize such procurement problems (page 13).
- Equipment procured for USAID-financed activities is traditionally exempt, under bilateral agreements with host countries, from local taxes and fees. It is USAID policy not to use USAID funds to pay host country taxes and fees. Achieving compliance with the Bilateral Agreement in Russia (which exists in English only) has been problematic. However, the audit identified problems relating to taxation and customs duties in Russia. We recommended that the ENI Bureau determine the significance of the problem and how it should be corrected (page 17).

The ENI Bureau stated that it shared the report's concerns that there be adequate work plans and contractor reporting, and appropriately tailored procurement procedures, as well as commitment and support by the Russian agencies with which USAID works. However, it did not believe the draft report adequately recognized the nature of early privatization support required and delivered, nor the control systems used to assure proper use

of the support made available. Furthermore, the Bureau did not believe the draft adequately reflected the improvements that had been made in managing activities. The final report was modified as deemed appropriate to reflect the Bureau's concerns. Based on Bureau comments and actions we closed recommendation No. 2 and consider the remaining three recommendations resolved. We will close them on receipt of evidence that they have been appropriately implemented.

Office of the Inspector General

Office of the Inspector General
March 10, 1995

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INTRODUCTION

Background

The dramatic collapse of the Soviet Union in 1991 presented a historic opportunity for a more peaceful and stable international order. The dissolution of the Soviet empire, however, also resulted in some potentially significant political and social instabilities, which have presented the United States with some concerns as well as opportunities. In response to these changes and requests for assistance, the United States and other countries provided the Newly Independent States (NIS) of the former Soviet Union with a wide array of humanitarian and economic assistance.

A major focus of the United States was to assist NIS republics to transform their Soviet-style command economies into open-market, competitive economic systems. To this end, the rapid privatization of state-owned properties was considered by many to be the single most important effort to support economic reform. The United States Agency for International Development (USAID) was tasked with primary responsibility for developing and implementing a rapid-response privatization program for the NIS. This report discusses USAID's implementation of selected privatization activities in Russia.

The Government of Russia (GoR), with USAID-financed technical support, initiated an aggressive privatization program aimed at (1) quickly transferring a large number of properties from state to private ownership, and (2) identifying and correcting structural impediments to the economic viability of the newly privatized properties.

USAID has financed many activities under its 13 NIS regional projects in support of these two efforts. However, most of the activities fall under the Private Sector Initiatives Project (110-0005), 1 of the 13 projects which was authorized on April 22, 1992. As of June 30, 1994, USAID reported that \$196 million had been obligated under this project for Russia, of which \$84 million had been spent.

For this audit, we judgmentally selected activities that were being implemented by six contractors and one grantee based on their relative dollar value and the apparent significance of those activities in the privatization process. As of June 30, 1994, USAID reported that \$52.1 million of the \$67.5 million budgeted for these activities had been spent (see Appendix II for information on the activities and contractors selected for review).

There are three principal groups involved with implementing activities in Russia under Project No. 110-0005. USAID's Bureau for Europe and the New Independent States (ENI) has overall management responsibility. Day-to-day management responsibility rests with ENI's Office of Privatization and Economic Restructuring and, specifically, in its NIS Privatization Division (ENI/PER/NISP). Staff in this Division are responsible for project design, implementation, and monitoring. Other USAID units assisting ENI with these activities include:

- USAID/Moscow, which shares selected project management responsibilities, such as the coordination and monitoring of design and implementation of privatization activities among contractors, a grantee, Russian officials, and USAID project management officials in the ENI Bureau; and
- USAID's Office of Procurement in Washington and its regional contract office in Kiev, Ukraine which provided contract design and administration functions.

The second group and primary benefactor of these activities is the GoR. The State Committee of the Russian Federation for the Management of State Property (GKI) - an entity in the executive branch of the Russian Government - also has local oversight responsibility for these activities. USAID initially relied on GKI for technical direction and monitoring support. However, these roles have been increasingly assumed by the still evolving Russian Privatization Center (RPC) and its subsidiary network of regional privatization centers. The RPC is headed by a Governing Board comprised of nine members who represent civic organizations, State bodies and foreign non-governmental organizations. A GoR minister is the current chairman of the board of directors of RPC. This quasi-governmental organization, established in April 1993, is responsible for managing all privatization and restructuring assistance projects in Russia supported by USAID and other donors.

The third important group involved with these activities comprises the U.S. contractors funded by USAID to provide technical assistance. These

contractors work closely with the GoR and USAID in performing their work.

Omnibus Contracts

USAID procured U.S. technical assistance primarily through multi-purpose contracts, commonly referred to as "omnibus" contracts. Our audit sample included three such contracts. Unlike fully defined single-purpose contracts, the omnibus contracts provided for the performance of activities, many of which needed to be further defined. USAID used these contracts to retain the services of U.S. companies that had the ability to mobilize, either in-house or through the use of sub-contracts, the resources and expertise needed to identify and implement privatization and restructuring activities. Although the description of work was very general, the contracts were used to establish an obligation under which USAID could reimburse contractors for costs incurred up to the amount specified in the contract.¹ These contracts required the subsequent development of "task orders" and "work plans" for the purpose of further defining the activities a contractor was to perform.

Task orders were used to identify the country in which a contractor would be required to work and the type of activities the contractor would be responsible for implementing during the period of the task order -- about six months. For example, a task order negotiated under one of the omnibus contracts called for the contractor to "perform mass privatization work in Russia." Within about a month of arrival in the designated country, the contractor was responsible for preparing a work plan, sometimes referred to as an action plan, in order to define the specific activities to be implemented. Theoretically, these work plans were to document the agreements reached by the involved parties - host government, USAID, and the contractor - as to what needed to be done, and how it was going to be achieved. Once the three parties agreed to the work plan, the contractor was to begin work on the activities. According to USAID officials, many of the Russia work plans were prepared by the State Committee of the Russian Federation for the Management of State Property (GKI) as assisted by USAID-financed advisors. These work plans were issued directly to contractors for implementation, as part of a task order.

In this manner the omnibus contract process achieved significant time savings. For example, if USAID had contracted separately for each individual work plan, it may have required six months or longer before

¹ In May 1994, the Office of Inspector General (OIG) questioned the legitimacy of establishing USAID obligations under omnibus contracts before adequately defining their scopes of work. This and other issues raised by the OIG relating to planned follow-on privatization contracts have now been addressed by USAID.

implementation of any project activity could begin. Under the omnibus contract approach, no additional time was spent in initiating and awarding separate procurements to address these activities. The omnibus contractor was responsible for implementing them as soon as task orders were issued.

Audit Objective

The audit was included in the Office of the Inspector General's fiscal year 1994 audit plan for the purpose of determining if the ENI Bureau had established adequate management controls over the implementation of privatization and restructuring activities in Russia in order to ensure that USAID-financed contractors (1) provided the type and level of technical assistance and commodities (inputs) that they agreed to, and (2) produced the results (outputs) that were planned.

Specifically, the audit was designed to answer the following objective:

- **Did the Bureau for Europe and the New Independent States manage privatization and restructuring activities in Russia to ensure that USAID-financed inputs were provided as agreed, and resulted in outputs as planned?**

Appendix I contains a discussion of the scope and methodology of this audit.

REPORT OF AUDIT FINDINGS

Did the Bureau for Europe and the New Independent States manage privatization and restructuring activities in Russia to ensure that USAID-financed inputs were provided as agreed, and resulted in outputs as planned?

The Bureau for Europe and the New Independent States (ENI) managed privatization and restructuring activities in Russia to reasonably ensure that USAID-financed inputs were provided and used to implement these activities. However, at least during the start-up phase, the Bureau did not always ensure that inputs and outputs were adequately described in either the task orders or subordinate work plans. In such cases, it was not readily apparent what specific inputs and outputs were agreed to and planned.

ENI has provided substantial assistance to Russia in support of the arduous and ambitious task of privatization. According to GoR reports, the Russian privatization program has thus far been a success story. Reportedly, during the past two years the Russian privatization program, assisted by USAID-financed activities, has resulted in the transfer of thousands of state-owned enterprises to private hands and has begun to address structural impediments to the long-term economic viability of these new enterprises.

USAID-financed technical assistance and commodities indeed had been delivered and used to accomplish specific activities in support of the Russian privatization program. However, USAID's management of these activities was hindered due to problems in the following areas: (1) inadequate work plans; (2) inadequate contractor reporting; (3) restrictive equipment procurement requirements; and (4) inadequate support by certain GoR agencies.

Need for Improved Contractor Work Plans

According to the omnibus contracts, subordinate task orders, and cooperative agreement, contractors were to prepare work plans within the first month of arriving in country that described the activities to be implemented. These work plans were to specify the specific expected results (outputs) of the activity and the type and level-of-effort (inputs) and tasks required to achieve the results. The work plans were to be approved by ENI before work began, and were intended to be key control mechanisms in the tripartite management and monitoring of activities.

The audit found that work plans were not always functioning as effective controls. In some instances contractors: (1) began work on activities before the work plan was approved by ENI; (2) did not adequately define the inputs to be provided or the outputs to be accomplished; and (3) frequently made unilateral changes or extended the time for completing activities in approved work plans.

During the audit we noted that work often started on an activity before the work plan had been approved. For example:

- In October 1993, Price Waterhouse was verbally directed by ENI to initiate work to establish financial systems for the Russian Privatization Center (RPC). However, the initial work for the RPC was completed by Price Waterhouse under a different activity: establishment of an All-Russia Auction System. Subsequently, USAID approved a \$500,000 work plan modification for the RPC work on December 23, 1993.
- Under a \$15.7 million cooperative agreement, the Harvard Institute of International Development (HIID) was to assist GKI in implementing the Russian privatization program. Although the audit identified activities the Institute was involved in, we found no evidence of an ENI-approved work plan.

Also, task orders and work plans for 19 of the 26 activities we reviewed did not define inputs that the responsible contractor was to provide. It was often unclear how levels of effort had been determined or precisely what experience levels and technical skills were required. For example:

- Under Deloitte & Touche Task Order No. 2-0007, the budget prescribes an estimated level of effort of 213 expatriate and 1,250 local employee days. However, the work plan identified

a need for 1,573 days of foreign labor and 8,342 days of local labor. Additionally, the task order called for skills such as "Advertising, Public Relations, Research, and Grassroots outreach" without further amplification of the type of experience or the level of expertise required.

- Under Deloitte & Touche Task Order No. 3-0010, the work plan called for 1,564 days of professional labor, which included a requirement of 396 staff days for "Russian Specialists (Consultants & Managers)." Again, no further explanations were given.
- Collectively, under Price Waterhouse Task Order No. 2-0008, KPMG Peat Marwick Task Order No.2-0009, and Deloitte & Touche Task Order Nos. 3-0010 and 5-0014, a total of \$3.3 million in equipment was to be delivered. However, it was not clear what this money would be spent for or the basis for the cost estimates.
- Under KPMG Peat Marwick Task Order No. 2-0009, \$225,000 was budgeted for "subcontracts" without further explanation.

For 20 of the 26 activities reviewed, defined outputs lacked the specificity needed to determine if contractors had performed satisfactorily. For example:

- Under Task Order No. 2-0008, Price Waterhouse was required to perform six activities for an estimated cost of \$6.6 million. One cannot determine from this contract and its implementing documents what is needed to develop an adequate management information system for the national auction center. It is also not clear how much money needed to be budgeted in order to build the system, which included undefined equipment needs as well as software development requirements.
- Under Deloitte & Touche Task Order No. 2-0007, valued at \$683,812, the statement of work described in general terms what functions were to be performed but specific outputs were not quantified. For example, it was not stated how many television commercials, television programs, radio spots, advertisements, etc. were to have been produced. Therefore, neither USAID nor the audit could determine whether the numbers actually delivered were sufficient, or whether the

amounts budgeted for specific categories of deliverables were appropriate. The follow on Task Order No. 4-0015 for \$3.9 million lacked specificity as well.

Finally, although changes to activities are not unusual and would be expected in the Russian environment, the audit identified several changes that resulted in implementation delays and other problems. For example:

- Under Task Order No. 2-0008, Price Waterhouse was to establish administrative procedures, systems and controls for the RPC. However, the RPC did not make certain decisions about its organizational structure in a timely manner. As a result, Price Waterhouse was delayed at least three months in completing this activity. Because the original tasks had not been adequately defined (that is, described, budgeted and scheduled in detail), the cost impact of the time delay could not be measured.
- Deloitte & Touche procured equipment in support of 35 regional depository centers. However, the GoR decided to delete the requirement for five of the centers after the equipment had already been procured. During the audit a project use for the equipment had not been defined; four of the equipment sets were kept in storage while the fifth was used by Deloitte & Touche in its Moscow Office.
- Problems developed between the original contractor for the public education campaign, Sawyer Miller, and GKI officials. The contractor claimed GKI requested changes to its work which it felt were either inappropriate or beyond its scope of work. The dispute resulted in unquantifiable delays.

In discussing these problems, the Bureau indicated that the lack of experience and information at the beginning of the privatization program coupled with the pressure to quickly implement activities in Russia made it difficult to always fully develop and document adequate scopes of work in task orders and work plans. ENI stated specificity and measurability of development was a major and chronic problem for USAID as a whole. It was particularly challenging in a program of the size, complex interdependence, and urgency of this one. Therefore, precise definition of some inputs was deliberately deferred until sufficient information was available to maximize efficiency and effectiveness. The Bureau stated that it recognized the potential risks associated with operating in this mode, but believed the benefits of quickly responding to the needs of the Russians

superseded the potential risks associated with delaying implementation until work plans were fully documented. To minimize the risks, the ENI Bureau stated it intentionally limited task orders to six-month periods. The Bureau believed this provided flexibility in adapting inputs/outputs as well as an automatic check to measure performance at the end of the six-month period.

The Bureau agreed that well-defined inputs and outputs were crucial to the success of the program, and felt that it had made improvements in this area. The Bureau stated that the experience that has been gained since the program's inception resulted in its project officers preparing better task orders that adequately describe the outputs and inputs associated with specific activities. However, the ENI Bureau had not established written standards or instructions for their development. Thus, there was less assurance that task orders or work plans were prepared in a consistent manner.

Additional audit work was performed to test the Bureau's claim that current task orders adequately addressed the problems identified by audit. Four recent task orders prepared by ENI's Office of Privatization and Economic Restructuring, NIS Privatization Division (ENI/PER/NISP) were randomly selected. These task orders were approved in November and December 1994, and covered activities to be implemented in Russia and Ukraine. The review showed that the task orders contained more useful narrative from which better descriptions of inputs and outputs could be determined, but, in our opinion, still did not define or present information in a manner that could be construed as effective internal control document. There was some confusion as to what the major activity elements - outcome, outputs, tasks, inputs - were because of the use of different terms to describe them. Also, these elements were not always clearly defined, and there was no discernible linkage among them. Also, task orders which involved multiple outputs did not identify the cost associated with producing each output. Such information is particularly relevant given the current emphasis within the Agency to eliminate low priority activities. The problems noted with the more recent task orders, despite their amelioration, further underscores the need for written guidance.

As a result of the problems affecting work plans, their value as a key internal management control was reduced. That is, USAID project managers did not always use them as tools to direct and control the actions of USAID-financed contractors. Thus, there was a higher risk that activities would not be implemented or achieve their outputs in an efficient and effective manner. While these risks may have been more easily justified at the at the program's beginning, they are harder to justify now. ENI needs

to issue guidance to ensure the adequate and consistent development of task orders and work plans, especially as these omnibus contracts are about to be renewed.

Recommendation No. 1: We recommend that the Bureau for Europe and New Independent States, in consultation with the Agency's Procurement Executive:

- 1.1 issue guidance covering the development and preparation of task orders and/or subordinate work plans which includes defining in quantifiable and qualitative terms the results ("outputs") that are planned to be achieved by the activity and the resources ("inputs") and key tasks required to accomplish the outputs; and**
- 1.2 take steps to ensure that existing activities are in compliance with the new work plan guidance.**

Management Comments and Our Evaluation

In responding to the draft report, the ENI Bureau stated that the interactive process between USAID, the GoR, and the contractors had been successful in producing exceptional program results as evidenced by both quantifiable and qualitative indicators. Nonetheless, ENI management stated that it had instructed all USAID project officers that work plans must include: the ENI program objective to which the activity contributes, defined inputs and outputs, as well as targets, and if appropriate, milestones to measure the progress of activities. The Bureau felt that this action, and the fact that it was in the process of installing a new overall monitoring and evaluation system which was to cover and integrate all Bureau projects and activities, fully satisfied the intent of this recommendation as well as a recommendation made in a prior RIG/A/B audit report. In this regard, an audit of ENI Bureau's monitoring, reporting, and evaluation systems found that the ENI Bureau had not fully documented this new system. That audit recommended that the ENI Bureau fully document its monitoring, reporting, and evaluation system (Report No. 8-000-95-002).

We agree that ENI actions should, when implemented, improve project management. We consider the recommendation resolved and, in view of our prior recommendation which is also resolved, will close this recommendation upon receipt of the Bureau's written guidance covering the development of work plans.

Contractor Reporting Should to Be Improved

The omnibus contracts and task orders require contractors to periodically report on the implementation of activities. As with work plans, these periodic reports are another management control intended to assist project officers to monitor the progress of implementing activities. If appropriately designed and used these reports would provide project officers with the information necessary to quickly determine the status of key task/events specified in the work plan, and if necessary, take prompt corrective action.

The audit found that although the contractors reported on their activities, the reports did not always relate to activities included in the approved work plans. For example, one of the key objectives of technical assistance provided to GKI under contract No. CCN-0005-C-00-3068 by the McKinsey Company was

...to develop models for enhancing the commercial viability of privatized enterprises with emphasis on assistance that helps multiple enterprises and/or investors and is broadly replicable.

Under this contract, technical assistance was to have been provided to three to five enterprises. However, neither the contract nor the status reports identified how much assistance was needed by each firm, and how much was actually provided. Also, status reports did not contain a description of progress achieved in developing the models because the contractor was not clearly directed to report progress against this objective. Under the contract's reporting requirements the contractor was merely

...to submit a brief status report (monthly) on the implementation and achievements plus any proposed changes or refinements to the approved work plan.

This general reporting requirement did not allow adequate reporting against the key contract objectives. It was not clear from the progress reports or other documents in the USAID/Moscow project file whether the contract objectives had been accomplished.

Another example involved Price Waterhouse's Task Order No. 2-0008 (Contract CCN-0005-C-00-3107). PW periodically provided progress reports to USAID; however, the progress reports could not be specifically related to activities and deliverables identified in its work plan. For example, the work plan specified that 10 share registry inspections were to be carried out by Price Waterhouse, 10 by GKI with Price Waterhouse guidance, and 10

by an unnamed "third" party with Price Waterhouse guidance. The task order's statement of work specified:

Monthly reports will be submitted at the end of each month. The reports will be comprehensive but precise in detail and report on only that information which is critical to the success of the project including issues of implementation and achievements plus any proposed changes or refinements to the work plan.

While PW provided three status reports in March 1994, none of the reports addressed the numbers of share registry inspections conducted. It was therefore unclear whether share registry inspections had been conducted, or if these inspections were conducted in the numbers specified in accordance with a schedule.

These problems existed because ENI had not established specific reporting requirements for contractors to follow. Consequently, the usefulness of these reports in monitoring progress of completing activities was limited.

During the audit ENI agreed that it should add language in the task orders to clarify existing guidance to the contractors. In addition, project officers will be instructed to ensure that status reports conform to the expanded task order requirements.

Recommendation No. 2: We recommend that the Bureau for Europe and New Independent States issue guidance to its project officers, and through them to contractors, to ensure that progress reports are linked specifically to the input, task, and output statements described in work plans.

Management Comments and Our Evaluation

In responding to the draft audit report, the ENI Bureau stated that its new monitoring and evaluation system covers the subject of contractor reporting and the need to link work plans to assistance targets and ENI program objectives. The Bureau added that it was compiling targets for its programs in all CEE and NIS countries and would complete this process by the end of March, 1995. Subsequently, its field offices and Missions would report progress periodically against the achievement of these targets and program objectives.

Based on the Bureau's efforts to improve its overall monitoring and reporting systems and its willingness to implement the recommendation in Audit Report No. 8-000-95-002, we consider this recommendation closed.

Restrictive Equipment Procurement Requirements Should Be Reviewed

Contract task orders covering privatization activities in Russia were generally designed to be accomplished in six months or less. Many of the USAID-financed activities required computer and other office equipment in order to accomplish their objectives. Unless otherwise authorized, USAID requires its contractors to follow USAID procurement policies when procuring commodities for USAID-financed projects. The FREEDOM Support Act, the legislation authorizing assistance to the NIS, provides USAID with authority to deviate from normal procurement practices. This unique authorization was added to the law because of Congressional interest in seeing U.S. assistance move forward quickly.

On May 1, 1992 the USAID Administrator issued a blanket waiver of formal full and open competitive procurement procedures for activities financed and directly procured by USAID in the NIS. This waiver was extended on April 1, 1993 for one year ending April 30, 1994 because the ability to procure goods and services on an expedited basis was considered crucial if USAID was to remain responsive to the urgent needs of the NIS.

The audit nevertheless revealed several activities that were delayed due to equipment procurement problems. These problems occurred for a variety of reasons, as the following examples illustrate:

Impact of Computer Procurement Problems

Representatives of KPMG Peat Marwick, Deloitte & Touche, and Price Waterhouse (PW) claimed that project activities had been seriously delayed due to problems in procuring computer equipment. For example, the Deloitte & Touche Clearing and Settlement Organization Task Order No. 3-0010 was twice extended beyond its original completion date in February 1994 to its current completion date in December of 1994. Because cost performance is not tracked in detail (by sub-task) for ENI Bureau projects, the costs of these delays are difficult to estimate. However, the ENI Bureau stated that the cost of the delay was estimated by the contractor to be \$77,372. A Deloitte official further stated that during the four months of the delay, that the project was placed "on hold" and that six project specialists had to be returned to the U.S. because there was no work for

them without the equipment.

Under a PW task order (No. 2-0008) for the All Russia Auction System, PW needed to procure \$1.5 million in computer equipment. The original task order was to be completed in six months, later extended by four months. However, after nine months, only about \$950,000 in equipment had been procured. The rest of the equipment would have had to be procured during the remaining month of the performance period and under a follow-on Task Order No. 10-0050. Because most of the activities under the PW sub-tasks were not individually scheduled and budgeted, the cost impact of these delays could not be determined.

Direct USAID Letter of Commitment

KPMG Peat Marwick, Deloitte & Touche, and PW experienced procurement delays in part because USAID required the contractors to use a direct USAID letter of commitment for financing procurements of computer equipment. According to the ENI Bureau this funding mechanism was used in order to reduce overall project costs and because these procurements were mostly unforeseen. However, according to Deloitte & Touche, this procurement mode caused problems because:

- A Letter of Commitment is not an acceptable guaranty to a Russian bank, and it would be too costly (because of high interest rates) for the supplier to borrow money even for a short period of time in order to finance the equipment purchase.
- Completing all documents and submissions required by USAID is difficult even for a western company. Unless the required documentation is in order, payments will not be made.
- The credit lines that most Russian suppliers have set up with western producers are limited. If it takes longer than one month to clear an account, the credit line could be temporarily frozen, with serious consequences for the supplier's other business.

At the time of our review, USAID was considering addressing these problems by requiring its contractors to use Bank Letters of Commitment, which could provide for more timely payments by a bank to the suppliers.

Source and Origin Requirements

Price Waterhouse had attempted procurements of U.S.-manufactured photocopiers, dot-matrix printers and facsimile machines for its

privatization task in Russia. However, U.S. manufacturers generally do not produce this equipment with European specifications, that is, for 220 volt/60 cycle current. The use of voltage transformers was also not a feasible alternative because equipment warranties would be invalidated and the equipment could be damaged. On January 31, 1994 PW therefore requested a source and origin waiver which, as of May 10, 1994 according to the principal Price Waterhouse omnibus contract representative, was denied. However, ENI Bureau stated in December, 1994 that the waiver was subsequently granted.

Operational Problems

Price Waterhouse competitively procured 11 U.S. manufactured computers (MBL-386) in the U.S. Seven of the computers were installed in the USAID-assisted auction center. These computers almost immediately experienced operational problems which resulted in much data being lost. Some of the computers had to be replaced because they could not be relied on or repaired locally. According to a PW representative, the equipment needed to be returned to the U.S. for repair. A PW representative explained that more reliable and maintainable equipment was available locally, but could not be procured under existing USAID computer procurement regulations.

These equipment procurement and maintenance problems occurred because ENI required contractors to follow a cumbersome procurement process, which includes lengthy (up to six months) open competitive procurement procedures, impractical financing procedures, and full compliance with in some cases impractical source and origin requirements. One contractor stated that a study of the USAID procurement process for computer equipment showed that 48 separate actions needed to be completed to satisfy normal USAID procurement requirements, not including any additional effort needed to overcome taxation and customs problems. For example, in addition to the foregoing, USAID prescribed: special reviews by USAID/Washington/IRM, markings, insurance, preference for U.S. flag carriers, and others.

The ENI Bureau stated that the Administrator's blanket waiver was for USAID direct procurements, not procurements made by its contractors. In addition, the Administrator's waiver did not waive source and origin requirements. In regard to Letter of Commitment process, ENI agreed that the first purchases were very time-consuming and, in retrospect, would have been easier as USAID direct procurements. The Bureau said the system had worked "modestly well" for some subsequent purchases, but it was not recommended for future requirements.

In short, unless streamlining equipment procurement occurs, it is not realistic to expect contractors to complete urgent tasks involving equipment requirements in six months or less. If there is a need to waive competition for the omnibus contracts as a whole, because of the time sensitivity of the privatization work, then measures must be taken to shorten the lead- time for the delivery of associated equipment.

In conclusion, great stress has been placed on providing assistance as quickly as possible by:

- (1) the inclusion of sweeping "notwithstanding" provisions in authorizing legislation;
- (2) the use of unique, and flexible, omnibus contracts;
- (3) the use of short-term (6-month) task orders to access and implement these contracts; and
- (4) a requirement to develop relevant work plans within one month of task order implementation.

Notwithstanding these authorities and innovations, however, delays have occurred and will continue to hamper progress unless they are adequately addressed.

Recommendation No. 3: We recommend that the ENI Bureau, in consultation with the Office of Procurement, identify and modify, as appropriate, all procurement provisions that could prevent contractors/grantees from implementing their activities within specified time frames.

Management Comments and Our Evaluation

In responding to the draft audit report, the ENI Bureau agreed that there were computer procurement problems and delays for which USAID/Moscow together with the U.S. Embassy had worked hard to resolve. The Bureau stated that it was eager to streamline procurement procedures and be as innovative as possible. However, it was still obliged to operate within the framework of USAID and U.S. Government procurement requirements. In any case, the Bureau said it was not in a position to modify procurement provisions on its own.

There are many obstacles and challenges to procuring and delivering equipment and other supplies to Russia in a timely manner. Some of the procurement delays and problems might have been avoided or minimized had the Bureau and its contractors given more consideration to them at the time task orders and work plans were developed. Major procurements should have been identified as key tasks within the work plans. If progress reports had been linked to work plans, ENI project officers would have been in a better position to identify and act on delays encountered in procurement and delivery of equipment. Implementation of Recommendation Nos. 1 and 2 should help in this regard. In addition, ENI should consult with the Office of Procurement on identifying other measures that can or should be taken to minimize procurement delays. Recommendation No. 3 is considered resolved, and will be closed when fully implemented.

Russian Bureaucratic Problems Have Caused Implementation Delays and Unnecessary Costs

Equipment procured for USAID-financed activities is traditionally exempt, under bilateral agreements with host countries, from local taxes and fees. The U.S. and the GoR signed an agreement in April 1992 that covered this issue. However, achieving compliance with this agreement, which was executed in English only, has been problematic. The audit identified problems relating to taxation and customs duties in Russia.

A February 1994 ENI Bureau monitoring trip disclosed that USAID-financed commodities were subject to excise taxes imposed by the Russian Government despite U.S. efforts to obtain tax exempt status. For example, a Value-Added Tax of 23 percent was levied on contractor commodity purchases in Russia.

Additionally, according to some contractors, Russian customs officials were levying up to 65 percent tax on personal effects and up to 40 percent on imported computers. Because USAID/Moscow had not obtained exemptions from these taxes and USAID was prevented from paying these taxes for the contractors, imported equipment was being delayed in customs until the tax issue was resolved. These levies significantly impacted contractors' ability to receive computer equipment for the privatization tasks.

Finally, because the import duty issue was not resolved as of late July 1994, a Deloitte & Touche representative indicated that some computer equipment valued at \$170,000 for pilot registrar installations had been

delayed in customs by about six months.

This equipment was reportedly accumulating storage charges of about \$5,000 to \$6,000 per month until the customs duty issue was resolved and the equipment could be cleared. Additionally, computer equipment valued at \$360,000 procured for regional depository centers had been delayed in customs for about four months, while accumulating charges of about \$15,000 each month. In December 1994 the ENI Bureau stated that Deloitte & Touche had estimated the total additional cost associated with the delays (additional customs charges, travel and logistics expenses, and project implementation delays) was \$77,372.

USAID/Moscow had, since March of 1993, explored several ways to overcome the taxation difficulties. Most actions appeared *ad hoc* in response of specific problems, which helped to temporarily alleviate problems. One of USAID/Moscow's initiatives involved bringing contractors together to discuss common problems and identify possible solutions. USAID/Moscow also issued letters to contractors stating that they were tax exempt. However, these letters had only limited success.

Another USAID/Moscow initiative involved having the commodity imports classified as "humanitarian assistance." This approach involved potential political risks, and eventually proved impractical because of the myriad documents needed to satisfy customs officials.

We asked an RPC official what actions were being taken to resolve the taxation impasse. He replied only that GKI officials were aware of the problem. No further explanations were forthcoming.

Recommendation No. 4: We recommend that the Bureau for Europe and the New Independent States determine and document the extent of customs and taxation problems experienced by its contractors and grantees, develop a decision paper with options for eliminating these problems, and implement the selected option.

Management Comments and Our Evaluation

The Bureau agreed that such bureaucratic problems have occurred and that it had already taken action to implement the recommendation. The recommendation is, therefore, considered resolved, and we will close it upon receipt of the recommended decision paper.

SCOPE AND METHODOLOGY

We audited USAID-funded privatization activities under the Private Sector Initiatives Project (Project No. 110-0005) in Russia in accordance with generally accepted government auditing standards. We conducted the principal audit work from March 15, through December 1, 1994, and covered 9 contracts and 1 cooperative agreement. Three of the contracts in our audit sample were omnibus contracts and contained 11 task orders. As of June 30, 1994, the total budgeted for the sampled activities was \$67.5 million of which USAID reported that \$52.1 million had been spent.

We reviewed project documentation at the Bureau for Europe and New Independent States (USAID/ENI) in Washington, D.C., USAID/Moscow, and the Moscow offices of contractors Bain Link, Deloitte & Touche, KPMG Peat Marwick, Price Waterhouse and Sawyer Miller Group. We reviewed the project documentation to determine if inputs provided by the contractors were, in fact, inputs agreed upon in the contract/agreement. Likewise, we reviewed project documentation to identify outputs to be provided by the contractors. We visited the All Russia Auction Center, the Moscow Cash Union, the Registrar Support Center, the Lomo Corporation in St. Petersburg, a brokerage house and a regional depository center. We performed these visits to verify that project inputs were being provided and outputs were being achieved. Further, we interviewed officials from these organizations to verify and provide clarification on inputs delivered and outputs produced through project activities. Additionally, we met with representatives of the Russian Privatization Center (RPC) and the Russian Ministry of Privatization (GKI) to determine the extent of host country input into the assistance provided by the USAID-financed contractors.

In January 1995 we met with ENI Bureau staff to discuss privatization audit work in Russia as well as in the Central Asia Republics. During this meeting ENI Bureau staff claimed that more recently approved task orders for the NIS adequately addressed the problems identified in the draft audit report. To verify these claims, we selected and reviewed four task orders

that were approved during the November - December 1994 time frame. These task orders were randomly selected and covered privatization activities in Russia and Ukraine.

To meet our audit objective, we reviewed scopes of work, work statements and budgets to identify what the project inputs to be provided were. Analysis of these documents provided us with criteria for the individual activities. In order to determine what inputs and outputs were provided, we reviewed project documentation provided to us by USAID contractors. Documentation consisted of time sheets, bills of lading and quarterly progress reports that listed the names and hours of individuals working on the activities, purchases of equipment and project accomplishments. We then reviewed project documentation at USAID/Moscow and spoke with USAID project officials to determine how they managed privatization activities, and accounted for the inputs and outputs provided by the contractors.

The objective did not allow for sufficient testing to comment on all internal controls of either the Bureau for Europe and the New Independent States or USAID/Moscow, or their overall compliance with applicable laws and regulations. Accordingly, we are not issuing separate reports on internal controls or compliance with applicable laws and regulations.

Audit Sample of Contracts/Agreements

CONTRACTOR/ GRANTEE	AGREEMENT NUMBER	TASK NUMBER	PROJECT DATES	BUDGETED 6/30/94	EXPENDED 6/30/94	PROGRAM DESCRIPTION
Bain & Co.	CCN0005-C-00-3062-00	Not Applicable	3/8/93 to 6/30/94	\$4,400,000	\$3,826,267	Four teams of Russians, trained by Bain Link, travel to 30 of the remotest regions set up auction marts and educate citizens on privatization issues.
Sawyer Miller	CCS0005-C-00-2082-00	Not Applicable	9/30/92 to 6/30/93	\$8,277,716	\$8,244,147	Supported GKI with the public education and mass media campaign by providing: policy/strategic planning; public relations; advertising and training.
Deloitte & Touche	CCN0005-C-00-3053-00	Not Applicable	2/20/93 to 12/31/93	\$2,754,110	\$2,484,264	Identify and develop institutions to serve as regional depository centers (rdc's) to gather privatization vouchers. Twelve rdc's were developed.
Deloitte & Touche	CCN0005-C-00-3123-00 (Omnibus Contract)	1-0006 DTT	7/19/93 to 2/2/94	\$187,260	\$152,916	Review capital markets and identify pilot institutions for further development as capital markets institutions - depository, custodian, etc.
		2-0007 DTT	7/22/93 to 8/16/93	\$683,812	\$507,945	Through this task order, Sawyer Miller continued work in the public education and mass media program, as a subcontractor to Deloitte & Touche.
		3-0010 DTT	8/17/93 to 12/1/94	\$2,907,341	\$2,175,783	A continuation of work begun under task order #1-0003-DTT. Deloitte officials were to identify & develop at least 2 depository and 10 registrar offices.
		4-0015 DTT	8/17/93 to 10/31/93	\$5,106,855	\$4,686,480	A continuation of work begun under task order #2-0007-DTT. Mass media public education, advertising and corporate governance.
		5-0014 DTT	9/27/93 to 6/15/94	\$1,383,447	\$902,856	Voucher roll out program. Continuation of work begun under contract #3053. An additional 10 rdc's were identified and developed to collect vouchers.
KPMG Peat Marwick	CCN0005-C-00-3108-00 (Omnibus Contract)	1-0003-KPMG	7/6/93 to 1/20/94	\$165,517	\$114,792	Identical task order to Deloitte & Touche's #1-0003-DTT. Identify and develop 9 to 18 depository, custodian and transfer agencies.
		2-0009-KPMG	8/20/93 to 4/30/94	\$3,523,646	\$2,620,064	A continuation of work begun under task order # 1-0003-KPMG.
		5-0013-KPMG	11/1/93 to 1/31/94	\$1,892,938	\$1,572,906	This task order is a continuation of the mass media, advertising campaign begun by Sawyer Miller. However, Sawyer is replaced by Burson Marsteller.
		7-0025-KPMG	11/1/93 to 3/31/94	\$905,478	\$779,425	Subcontractors Bain Link were to create a commercial property registry and improve conditions for small business real estate development.
		8-0030-KPMG	11/1/93 to 6/30/94	\$4,824,444	\$2,013,319	Continuation of work begun by Bain Link in the voucher auction management program. Provide post auction support - corp. governance, registries.
Price Waterhouse	CCN0005-C-00-3107-00 (Omnibus Contract)	2-0008-PW	8/1/93 to 6/30/94	\$5,078,291	\$4,988,663	Support All Russia Auction system, establish financial systems for RPC, audit and funds monitoring functions for GKI, conduct training and procure equipment
Price Waterhouse	CCN0005-C-00-3046-00	Not Applicable	3/1/93 to 6/30/94	\$4,377,376	\$3,887,081	Technical assistance to GKI in planning privatization activities for Russia, develop viable management and ownership plans to accelerate priority enterprise sales.
Price Waterhouse	DPE-0016-Q-00-1002-00	DO #36	8/28/92 to 5/31/93	\$1,418,109	\$1,328,176	Assist GKI in planning privatization activities, prepare action plan and strategy papers, provide on-the-job training to GKI employees.
		DO #45	12/21/92 to 12/21/93	\$2,149,097	\$1,821,830	Conduct auction of up to 10 enterprises in 5 regions.
McKinsey	CCN0005-C-00-3068-00	Not Applicable	3/22/93 to 12/15/93	\$1,753,000	\$1,753,000	Provide restructuring assistance for between 3 and 5 firms.
Harvard College	CCN0005-A-00-3023-00	Not Applicable	12/8/92 to 8/7/95	\$15,673,994	\$8,190,920	Provide short-term and resident consulting teams to GKI in planning privatization implementation, developing a strategy, coordinating assistance programs among the various donors.
				\$67,467,431	\$52,051,334	

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U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

FEB 25 1995

TRANSMITTAL MEMORANDUM

TO: RIG/A/B, John P. Competello
D/RIG/A/B, Fred Kalhammer

FROM: DAA/ENI/FS, Barbara Turner *BT*

SUBJECT: Draft Audit Report on Selected Privatization and
Restructuring Activities in Russia (110-005)

This memorandum and its attachments constitute ENI Bureau and USAID/Moscow comments on the draft report dated January 18, 1995.

We appreciate the fact that the report was revised to reflect many of our comments on the discussion draft. We share the report's concerns that there be adequate work plans and contractor reporting, and appropriately tailored procurement procedures, as well as commitment and support by the Russian agencies with which USAID works.

In our opinion, however, the draft does not convey (1) the nature of early privatization support required and delivered to meet Russia program objectives nor (2) the control systems used to assure proper use of the support made available. Furthermore, the report does not adequately reflect "learning curve" improvements made in the USAID-GoR management system over the program period covered by the audit. Finally, the report fails to reflect the enormous transition underway in Russia to a market reform economy and the role USAID played as the key international donor facilitating this process. As a whole, this must be considered one of the most cost effective efforts ever undertaken by USAID. The isolated criticism of this effort, while constructive and useful, should not obscure its success and innovative approach.

The Early Framework

The initial challenge of privatization and restructuring in Russia was to define and start up, with host country support, an appropriate program of work toward two shared objectives:

- 1) Transfer of state-owned assets to the private sector, and
- 2) Establishment of a business environment supportive of private sector growth.

Initial work toward the first objective involved considerable uncertainty about the "how to's" of transferring thousands of assets from an all-inclusive state sector to an undefined private sector. Technical issues included designing a voucher auction program and implementing it nationwide, which involved establishing the auction centers, bid reception sites, and regional depository centers for vouchers, and conducting thousands of enterprise auctions; launching the capital markets; and disseminating public information to engage and attract the participation of the Russian people.

Uncertainties about how to achieve program objectives put an early premium on designing flexible workplans to produce feasible approaches. In the start-up phase of the program, it was not possible to specify, in great detail, the best-practice approaches to follow. The program thus followed the principle of starting with pilot initiatives at the local level to test and refine privatization models, concepts, policies and operating procedures that can be replicated nationally during the "roll-out" stage.

USAID adhered to two principles in supporting the early program design:

- 1) To obtain the best available talent for privatization work with Russian counterparts; and once work plans were negotiated and agreed to with the Russian reformers, place these consultants in the field within 30 days.
- 2) To fund the technical assistance on a very short-term basis (six months or less) to allow for learning and training of Russians, and definition of appropriate next steps, including possible redirection of effort; pilot programs were replicated nationally at which time the U.S. consultants were phased out and the Russian managers took over.

What emerged from this management methodology was an effective USAID/GKI partnership supported by HIID. Momentum was established and maintained toward program objectives. In addition, a learning curve process got underway that facilitated more definite program planning and implementation. The draft report should reflect this early program framework and methodology. We refer to it in commenting on details of the report.

Attachment A includes our specific comments and suggestions concerning the Audit Findings.

Recommendations

The **first recommendation** is that the "ENI Bureau consult with the Agency's Procurement Executive to: (1) issue guidance covering the development and preparation of work plans...inputs and

outputs...objectives...and indicators...; and (2) ensure existing activities are in compliance with the new...guidance."

We believe that the interactive process between USAID, the GOR, HIID and the contractors for determining task order inputs and outputs has been successful in producing exceptional results as evidenced by both quantifiable and qualitative indicators. Nonetheless, ENI management has instructed all USAID project officers that program workplans must include: the ENI program objective to which the activity contributes, defined inputs and outputs, as well as targets, and if appropriate, milestones to measure the progress of activities. Task Orders that do not include this information are not being approved.

These workplans are part of the Bureau's new overall monitoring and evaluation system which is being installed. This system was described in our recent response to Audit Report No. 8-000-95-002. It provides for (1) Monitoring and Reporting on Individual Activities, (2) Evaluating and Reporting on Achievement Towards Assistance Objectives and targets related to those objectives, and, in larger country context, (3) Monitoring and Analysis of Country Progress Indicators. This system covers and integrates all Bureau projects and activities. In effect, the Bureau is standardizing best practice approaches to all ENI assistance.

We believe this system will improve our current practices. Taken together with the management instructions noted above, implementation of the new Bureau system will fully satisfy the intent of this audit recommendation.

Recommendation 2 is that the ENI Bureau issue guidance to its project officers, and through them to contractors, to ensure that progress reports are linked specifically to the input and output statements described in work plans. The Bureau's new monitoring and evaluation system covers the subject of contractor reporting and the need to link workplans to assistance targets and ENI program objectives.

ENI is now compiling targets for its programs in all CEE and NIS countries and will complete this process by the end of March, 1995. Subsequently, field offices and Missions will report progress periodically against the achievement of targets and program objectives. The system is being installed now and is expected to be fully operational by June 1995.

The **third recommendation** is that the ENI Bureau identify and modify, as appropriate, all procurement provisions that could prevent contractors/grantees from implementing their activities within specified time frames. We agree with the audit finding that there were computer procurement problems and delays. USAID/Moscow together with the US Embassy in Moscow have worked hard to resolve these delays by the Russian bureaucracy. ENI is eager to streamline procurement procedures and be as innovative as possible (although the magnitude of computer financing will likely be less in the future than it has been to date). However, we are obliged to operate within the framework of USAID and USG procurement requirements. The audit report's utility could be increased, in our opinion, by analyzing the realities of USAID's procurement processes, and the alternatives currently available to ENI. In any case, the recommendation should not imply that ENI is in a position to modify procurement provisions on its own.

Recommendation 4 is that the ENI Bureau determine and document the extent of customs and taxation problems experienced by its contractors and grantees, and develop a decision paper with options for eliminating these problems. These problems have been determined and documented. The USAID and Embassy/Moscow are considering options for eliminating the problems through both bilateral and multilateral (G-7 group) channels. Attachment B is an update on the status of this effort.

Attachments

- A. Detailed USAID Comments on Audit Findings

Attachment A

**Detailed USAID Comments on Audit Findings
of Selected Privatization and Restructuring Activities in Russia**

Please note that page 4, paragraph 2 is misleading when it states that "USAID relies on ... the omnibus contractors for implementation and recommendations for additional work" and that "...contractors work with the host government in identifying specific privatization and restructuring needs, and in designing and implementing the activities to address those needs." ENI does not rely on omnibus contractors' recommendations for additional work. USAID together with the GOR decides what, if any, follow-on work a contractor will be asked to perform. In addition, omnibus contractors do not design the activities. USAID, and the GOR as assisted by HIID, design the activities and develop the work plans which omnibus contractors then implement.

Contractor Work Plans

1. Timing of work plan approval.

On page 6, the report states "that work often started on an activity before the work plan had been approved." USAID and the omnibus contractors are acutely aware that activities under the omnibus contracts are not to be undertaken without agreement between the parties on a work plan. The vehicle developed for work plans under the omnibus contracts is the task order. However, task orders are not the contractual documents, but subsidiary documents that more precisely define activities under existing contracts. In practice, USAID and the contractors sometimes determine there is enough agreement on the work plan that work may start while the task order documentation is being finalized. In these cases, USAID provides written approval to start, in the form of a comfort letter or other written document. This is done to save time and minimize delay. Contractors understand if they start work without written authorization, it is at their own risk, if the task order or amendment is subsequently not approved.

In the example cited on page 6 regarding Price Waterhouse, after many meetings and discussions, USAID was in the process of amending the task order. Any assistance Price Waterhouse provided was at their own risk. Price Waterhouse was selected to do this work because they had individuals with the necessary skills already on the ground working on the auditing and management information system components of their task order for the All-Russia Auction System. Additionally, Price Waterhouse was able to provide the RPC this assistance under an existing task order without increasing the overall budget of T.O. No. 2-0008. By amending the Price Waterhouse existing task order at no additional cost, USAID was able to be responsive to this urgent RPC request.

In the page 6 example regarding HIID, we note that the HIID Cooperative Agreement does not operate under the Omnibus Task Order system. USAID's award of a cooperative agreement to HIID in December 1992 was based on the successful assistance that HIID had been providing the GKI since December 1991. HIID as a grantee is assisting USAID and the GOR in the design and management of all the for-profit Omnibus contractors. USAID project officers work in daily collaboration with HIID project officers. On a semi-annual basis, USAID, the GKI and HIID together produce a series of task orders, that taken as a unit, constitute a workplan for a given period. For example during the period covered by the audit, ENI/PER staff travelled to Moscow every six months for intense work plan design and drafting sessions with HIID and GKI. As a result of the January 1993 session, seven task orders were written to launch the voucher auction and small scale privatization programs. In July/August 1993 ENI TDY staff together with USAID/Moscow, HIID and GKI prepared twelve task orders for continuation of the mass privatization program, initial capital markets work, warehouse demonopolization, and port privatization. In January 1994 the same group met and produced 20 new task orders covering projects in capital markets, legal, land privatization and post privatization. Task orders are developed based on GOR needs and direction. The particular approach of grouping together task order development on a predetermined set of objectives is a more appropriate approach to a workplan given the environment of Russia.

In summary, we do not feel the examples given support the findings regarding the timing of workplans. As noted on page 3, "...many of the Russia work plans were prepared by the State Committee of the Russian Federation for the Management of State Property (GKI) as assisted by USAID-financed advisors." For the most part, work plans were defined and included in the task order at the time the task order was signed.

2. Definition of inputs and outputs.

ENI does not agree that "Contractors did not adequately define the inputs to be provided or the outputs to be accomplished..." (page 6). We do not believe it is the contractors' role to define the inputs or outputs to be accomplished, but rather USAID and the GOR's responsibility. Of course contractors provide their comments and opinions about program needs. A negotiation of the task order's objectives, budget, inputs and deliverables usually ensues.

The report maintains that inputs (more precisely, objectives) were sometimes not well defined and that contractor interim reporting did not always link specifically to the input and output statements described in workplans. In our view, this statement is not supported. The report does not demonstrate that actual inputs differed from agreed upon inputs. Nor do we believe it is shown

that contractor performance was not ultimately judged by achievement of planned for and agreed upon objectives. While outputs were sometimes modified after the task order was signed - such as when the number of regional depository centers was reduced- this was always done consciously with the agreement of the contractor, USAID and the GOR, and was based on compelling reasons of efficiency and effectiveness.

In our opinion, the audit does not adequately credit USAID for its innovative and ambitious approach of limiting task orders to six month periods. This not only allowed for an unusual precision and specificity of outputs and inputs -compared to other USAID activities of longer duration- but also appropriate flexibility in adapting inputs/outputs to changing circumstances in a dynamic, complex environment. Furthermore, our Task Order system put an automatic check on how far inputs and outputs could diverge from what was agreed upon. (Sometimes even six months was too long a period to go without adjusting objectives.) Even if a contractor's interim report was sometimes inadequate, USAID always measured performance under the task order at the end of the six month period and took appropriate action in any case of poor contractor performance. Additionally, USAID project officers met frequently with the contractors. GKI and the HIID resident advisors met weekly or more frequently with the contractors. Maintaining this intense degree of monitoring and evaluation was critically important in a program tasked with programming \$193 million in 18 months.

Page 7, paragraph 1 of the draft report states that "It was often unclear how levels of effort had been determined or precisely what experience levels and technical skills were required." Selecting individuals with appropriate skills and experience is taken very seriously by both ENI and the GKI on this project. Resumes are carefully reviewed by USAID. Individuals filling key positions were interviewed by USAID and GKI and some were rejected.

Levels of effort continue being determined by USAID project officers based on needs defined by the GOR. The intensity, duration and number of regions where the contractors would work have been taken into consideration. The nature of the workplan dictated the technical skills and level of effort required as did the task orders. Task order budgets allow the contractors to vary the major line items of cost (except fixed fee and indirect costs) by up to 15%, provided that the task order's total cost is not increased. This allows the contractor to make adjustments as required given the dynamic environment of implementing privatization in Russia.

Page 7, paragraph 2, of the draft report states the level of effort noted in the budget of Task Order No. 2-0007 is much less than the amount identified as necessary in the work plan.

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The auditors note that there was little amplification of the type of experience of the level of expertise required. The explanation for this is as follows: This task order was for continuation of the work being implemented by the same contractor utilizing the same staff of Contract CCS-0005-C-00-2082-00 which had a period of performance from October 1992 to mid July 1993. Based on the 10 months of experience with this activity -which was being continued via the omnibus contract task order mechanism- USAID had an excellent basis for estimating the level of effort on this project. In addition, we had a clear understanding of the skills and individuals required for the project, though they may not have been amplified well in the task order. During preparation of Task Order No. 2-0007, a six month period was planned. However, at the time of signing this task order, ENI had not received its apportionment. Therefore funding was quite limited and Task Order No. 2-0007 was prepared for a one month time period (July - August 1993) with a greatly reduced level of effort. This task order was essentially a "band-aid". When the funds were released, Task Order 4-0015 was issued for this same activity for the period August 1993 through February 1994. The report's comments on T.O. No. 2-0007 on pages 7 and 8 should take this into consideration, particularly the claim it could not determine "whether the amounts budgeted for specific categories of deliverables were appropriate."

Additionally, we note that the public information program is monitored extremely closely by the GKI Press Secretary, an HIID resident advisor and a USAID/Moscow project officer. The GKI is closely involved with the contractor's negotiations with Russian media and is acutely interested in obtaining the lowest prices and broadest coverage for these services.

On page 7, paragraph 4 of the draft report, it is noted that "\$3.3 million in equipment was to be delivered. However it was not clear what this money would be spent for or the basis for the cost estimates." Under the four task orders cited, the amounts of \$1.5 million, \$650,000, \$650,000 and \$480,000 respectively were estimated by USAID and the GOR as reasonable to cover the needs during the period for the four associated workplans. The equipment to be purchased included computers, printers, software, and fax machines to be utilized in the implementation of the mass privatization program which involved setting up bid reception sites in most of Russia's 89 regions; the transfer agency projects which involved institutional strengthening of emerging capital markets organizations; and establishment of 30 regional depository centers across Russia. It was only under these four task orders that significant procurements were required. All other work plans required minimal amounts of equipment.

At the signing of these task orders, it was premature to attempt more precise equipment needs of the recipient institutions before the work had begun. The actual procurement, however, was closely

monitored by GKI as well as an HIID subcontractor specialized in telecommunications, computers and system design, plus USAID project officers, and the USAID/W Information Resource Management unit (IRM). The HIID subcontractor, Ian Freed Consulting, reviewed the computer system software designs and costs proposed by Omnibus contractors to ensure that the computer systems were not overly designed and that the equipment to be procured was appropriate to the requirements of the activity.

In sum, we do not agree with the finding that inputs were not adequately defined for the majority of activities. In the cases cited above, precise definition of some inputs was deliberately deferred until sufficient information was available to maximize efficiency and effectiveness. In such cases, USAID, GOR and the contractor followed up to refine these inputs at the appropriate time. The magnitude, complexity, and urgency of the program demanded this kind of flexibility.

Page 7 of the draft report states that "defined outputs lacked the specificity needed to determine if contractors had performed satisfactorily." Specificity and measurability of development objectives are a major and chronic problem for USAID as a whole. It is particularly challenging in a program with the size, complex interdependence, and urgency of this one. Given the political urgency of implementing this program in a particularly fluid environment, USAID acknowledged upfront that traditionally defined outputs common to USAID programs through the world, would be nearly impossible to specify at the outset. However, to compensate, USAID employed the following measures: 1) The cooperative agreement with HIID was designed to provide GKI with resources that ensured its deep engagement in the design process and a significant GOR role in establishing objectives. 2) Limiting task orders to six month periods reduced complex processes into more measurable, discrete steps. 3) Additional funding for an activity and a particular contractor depended upon the outputs produced during the six month period.

The outputs of the privatization program have been exceptional. More than 16,315 medium and large enterprises and 71,896 small companies have been privatized in less than two years. The extreme interdependence of the task orders for implementing privatization allowed USAID project managers to know if outputs were being met. For example, if Deloitte Touche did not establish the 30 regional depository centers required in its task order, then Price Waterhouse's work in implementing the National Auction System would not have proceeded, and consequently the 16,315 enterprises would not have been privatized. Due to this extraordinary interdependence of the work being implemented by the different Omnibus contractors, weekly meetings were attended by all the task order project managers and USAID in order to coordinate the activities.

Another significant output has been the creation of the Federal Commission on Securities and the Stock Market which is critical in overseeing and regulating Russia's emerging capital markets.

Based on the above evidence, we do not believe that lacking specified outputs hindered our ability to determine if contractors had performed satisfactorily. We believe that the task orders generally included defined objectives and were suited to the specific circumstances.

3. Changes to Activities

Page 6, paragraph 3 of the report states "...contractors:... (3) frequently made unilateral changes or extended the time for completing activities in approved work plans." We see no discussion or examples to support such a finding and therefore suggest it be deleted. Page 8, paragraph 2 of the draft audit states that "...although changes to activities are not unusual and would be expected in the Russian environment, the audit identified several changes that resulted in implementation delays and other problems."

The first example cited on page 8 concerns the Russian Privatization Center not making "certain decision about the organizational structure it wanted to operate within a timely manner" which caused a delay to Price Waterhouse. It should be noted that no additional costs were incurred by Price Waterhouse as a result of this delay. It is also important to recognize that the Russian Privatization Center, an unprecedented body in Russia managing a critical and complex privatization and economic reform program, was in a start-up phase. The RPC is managed by a board of nine directors representing six Russian organizations and three international universities. It is not unusual that arriving at a decision on organizational structure might take more time than anticipated. A World Bank loan was initially supposed to finance the Center, but never materialized. USAID subsequently agreed to finance the RPC for a two year period.

In the second example cited on page 8, the GKI decided to have Deloitte & Touche help establish only 30 regional depository centers instead of 35 because it was not cost effective. The marginal benefit of establishing the final five centers did not warrant the associated costs when GKI analyzed the number of vouchers being collected and the number of enterprises being privatized in those regions, and given that the resources could be applied to other program priorities. We feel the decision to reallocate resources should be seen as positive.

In summary, we do not feel that including a discussion on delays, due to changes or decisions made by the GOR, serves to support the IG's findings regarding workplans and USAID management of

activities. These delays may occur for a variety of reasons, some of which are beyond the control of either USAID or our contractors.

Contractor Reporting

Page 10 of the draft report states that under the contract with McKinsey & Company, "status reports did not contain a description of progress achieved in developing the models..." "It was not clear from the progress reports or other documents in the USAID/Moscow project file whether the contract objectives had been accomplished." USAID acknowledges that this contractor's written status reports did not include a great amount of detail. However, verbal status reports were provided on a regular basis to USAID and the GKI. The reason that detailed written reports were not provided was due to the absolute confidentiality that the contractor must provide the enterprises it was working with. In particular, there was enormous commercial value attachable to any detailed information the contractor would have provided, since these companies were being privatized and such information could affect their stock prices. USAID had to be sensitive to the fact that there was an international investor market which would want information discussing the commercial viability of the enterprises the contractor was working with. This confidentiality conforms to contractors' practices on similar activities for USAID and other donors. At the same time, USAID met frequently with the contractor during implementation to monitor progress and developments.

ENI verified that the contract objectives were fully accomplished through its periodic meetings with the contractor and through meetings the contractor held with the GKI. Additionally, the contractor made a final detailed presentation to senior ENI Bureau management. As for the more important question regarding the quality of the accomplishment, USAID, GKI, and RPC agree that the work was a major success. The contractor's work with the Lomo company has become a demonstration case for post voucher enterprise restructuring projects which are now being implemented one year after the contractor completed its contract with USAID. The RPC specifically cited the success of the contractor's work to the ENI Assistant Administrator. The RPC has been able to use the success of this activity to attract other international donors to finance post privatization restructuring based on the Lomo model.

Restrictive Equipment Procurement Requirements

Please review the memorandum from Deloitte & Touche regarding the cost of the delay in computer equipment for Task Order No. 3-0010. We feel that the draft audit (pages 12 and 16) should not include an inaccurate, unsubstantiated cost made by a Deloitte manager.