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## Audit of ENI's Strategy for Managing Its Privatization and Restructuring Activities in Russia

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Audit Report No. 8-118-95-009  
March 17, 1995





**U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT**  
**OFFICE OF THE REGIONAL INSPECTOR GENERAL**  
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**March 17, 1995**

**MEMORANDUM**

**TO:** DAA/ENI/PA, Barbara Turner  
**FROM:** RIG/A/Bonn, John Competello *[Signature]*  
**SUBJECT:** Audit of the ENI Bureau's Strategy for Managing  
Its Privatization and Restructuring Activities in Russia  
Audit Report No. 8-118-95-009

**This is the final report on the subject audit. In preparing the report we considered the comments you provided to our draft report and have included them in their entirety as Appendix II.**

**The report contains three recommendations. Based on your comments and actions we consider all three recommendations closed.**

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

## **EXECUTIVE SUMMARY**

The upheaval and rapid disintegration of the Soviet Union in 1991, and the political and economic instability that followed, resulted in the United States providing the New Independent States (NIS) of the former Soviet Union with substantial humanitarian and economic assistance. One goal of the United States' economic assistance program is to help the countries in the region change their Soviet-style command economies to open-market, competitive economic systems. To this end, the United States, through the United States Agency for International Development (USAID), has helped the NIS to privatize state-owned properties and restructure the regulatory and commercial framework within which private enterprises can fairly compete.

USAID channels economic assistance to Russia and the other new independent states through 13 regional projects. Each of these projects has a specific sectoral emphasis, such as energy efficiency, health care, housing, and democratic pluralism. The greatest concentration of privatization and restructuring activities falls under the Private Sector Initiatives Project (No. 110-0005). However, there are privatization and restructuring-related activities under other regional projects which are incidental to the project's broader sectoral objective. The audit identified a total of 93 activities under these 13 projects that appeared to be related to Russia's privatization and restructuring objectives. USAID's Bureau for Europe and New Independent States (ENI Bureau) has overall management and oversight responsibility for these 93 activities.

In 1992 the Government of Russia (GoR) announced 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 these newly privatized properties. The United States Government concluded that the rapid and effective implementation of Russia's privatization program was essential to the successful transformation of the Russian economy and the avoidance of possible major economic and social crises.

The audit was conducted by RIG/A/B to determine the status of Russia's privatization program, and whether the ENI Bureau had a strategy for effectively managing the aggregate of privatization and restructuring activities in its portfolio of regional NIS projects. A discussion of the scope and methodology for the audit is contained

As of October 1994, Russia had reportedly privatized 16,315 medium and large enterprises, accounting for approximately 75 percent of the Russian industrial work force. Also, by this date, about 72,000 small-scale enterprises had been privatized. The GoR has also reported certain progress in identifying and correcting impediments to the economic viability of the newly privatized concerns (page 7).

The reported accomplishments over such a short time frame appear highly significant. However, interpreting statistics in Russia is particularly difficult. Distrust between certain Russian Ministries, the reluctance of some of Russia's local and regional property committees to supply accurate lists of state-owned enterprises in their communities, and weaknesses in the data gathering process, have raised questions about the completeness and accuracy of data and statistics in Russia (page 8).

To better and more reliably appreciate the progress reportedly being made, the audit asked three fundamental questions.

- ▶ **What was the total number of state-owned enterprises in Russia when the privatization process began?**

Conflicting statistics make an accurate judgment on the extent and significance of the program difficult (page 8).

- ▶ **How do the newly privatized enterprises differ from existing state-owned enterprises?**

Several important basic rights and responsibilities of private ownership have yet to be achieved (page 9).

- ▶ **How near are most newly privatized entities to becoming economically viable?**

Because they still faced many obstacles, it was unclear at the time of audit how soon most new entities would become economically viable (page 10).

The audit noted that until these questions are settled, care should be used in describing program accomplishments so as not to mislead interested parties and decision-makers. The audit also found that the ENI Bureau needs to improve its management systems to better ensure that the assistance delivered is effectively coordinated and used to achieve as much as possible during the time remaining in the program.

This report contains three recommendations for improving the ENI Bureau's management of its privatization and restructuring-related activities. Specifically, we recommend that the ENI Bureau:

- ▶ **Establish specific objectives and quantifiable and qualitative indicators by which to plan and measure progress, especially with respect to components that make up the restructuring objective (page 18);**
- ▶ **Establish adequate information systems to facilitate management (page 20); and**
- ▶ **Assign adequate staff resources to oversee and coordinate these activities (page 21).**

In responding to the draft audit report, the ENI Bureau stated that it shared the report's concerns that there be agreed objectives and indicators in the Russia privatization and restructuring program; a capable management information and tracking system; and appropriate levels and qualifications of staff to manage privatization and restructuring activities. However, the ENI Bureau did not believe the draft audit report accurately discussed the goals and accomplishments of Russia's privatization program nor adequately described ENI Bureau's management of its privatization and restructuring activities in Russia. The final report was modified as deemed appropriate to reflect the Bureau's concerns.

The ENI Bureau stated that it was implementing a new monitoring, reporting, and evaluation system and anticipated that once fully operational this new management information system would help in setting objectives and progress indicators and facilitate overall management of privatization and restructuring activities. The ENI Bureau believed that its new management system would fully satisfy the intent of the audit report's first two recommendations, 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). Based on the ENI Bureau's comments and actions we consider the first two recommendations closed as these recommendations will be addressed upon successful completion of action under Audit Report No. 8-000-95-002. In addition, as the ENI Bureau had already taken action to resolve staff shortages, the third recommendation is also considered closed.

*Office of the Inspector General*

Office of the Inspector General  
March 17, 1995

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# INTRODUCTION

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## **Background**

The upheaval and rapid disintegration of the Soviet Union in 1991, and the political and economic instability that followed, caused the United States and other countries considerable concern. In response to this concern and desire to stabilize the region, the United States and other countries agreed to provide the New Independent States (NIS) of the former Soviet Union with substantial humanitarian and economic assistance.

A goal of the United States' economic assistance program is to help the countries in the region change their Soviet-style command economies to open-market, competitive economic systems. To this end, the United States, through the United States Agency for International Development (USAID), has helped the NIS to privatize state-owned properties and restructure the regulatory and commercial framework within which private enterprises can fairly compete. This report discusses USAID's management of privatization and restructuring activities in Russia.

In 1992 the Government of Russia (GoR) announced 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 these newly privatized properties. The United States Government concluded that the rapid and effective implementation of Russia's privatization program was essential to successfully transforming the Russian economy and avoiding possible major economic and social crises.

USAID channels economic assistance to Russia and the other new independent states through 13 regional projects. As of December 31, 1994, USAID reported that \$1.2 billion had been obligated under these 13 projects only for activities in Russia, of which \$440.4 million (37 percent) had been spent. Each of these projects has a specific sectoral emphasis, such as energy efficiency, health care, housing, and democratic pluralism. The greatest concentration of privatization and restructuring activities falls under the Private Sector Initiatives Project (No. 110-0005). However, there are privatization and restructuring-related activities under other regional projects which are incidental to the project's broader sectoral objective.

The audit identified a total of 93 activities under these 13 projects that appeared to be related to Russia's privatization and restructuring objectives. Twenty-one were related to transferring properties from state to private ownership. Nearly all of these activities are carried out by United States companies with extensive use of Russian nationals under the Private Sector Initiatives Project (No. 110-0005). As of June 30, 1994, USAID had spent about \$48 million of the \$74.7 million obligated for these 21 activities. Examples of these activities include:

- ▶ developing and implementing a Russian national public education campaign on the concepts, process and benefits of privatization;
- ▶ advising the Russian government on privatization program strategies and policy choices; and
- ▶ assisting the Russian government to develop and implement a national voucher program providing opportunities for each Russian citizen to acquire an interest in newly privatized enterprises.

The remaining 72 activities were related to restructuring the regulatory and commercial framework and specific enterprises. These activities are also included under Project No. 110-0005; however, many are included under 11 other NIS projects. These activities are also carried out primarily by United States companies. As of June 30, 1994, USAID had spent about \$99.1 million of the \$323.7 million obligated for these 72 activities. Examples of these activities include:

- ▶ assisting and training Russian lawmakers to create a commercial law and civil code;
- ▶ providing training in banking and finance; and
- ▶ initiating small business development activities.

USAID's Bureau for Europe and New Independent States (ENI Bureau) has overall management and oversight responsibility for the 93 activities that the audit identified as supporting privatization and restructuring activities in Russia.<sup>1</sup> Day-to-day management responsibility is spread among 11 ENI offices, and specifically, the 19 divisions under these 11 offices. ENI's Office of Program and Coordination Strategy is responsible for overall coordination of ENI activities. ENI's USAID/Moscow office provides in-country oversight for these activities.

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<sup>1</sup> USAID did not have a single report that identified all the privatization and restructuring-related activities in its 13 NIS regional projects. Consequently, obligations, expenditures and number of activities noted in this audit report are estimates which the *audit* compiled through the use of numerous reports.

Another key player in the United States' assistance program to Russia is the Department of State NIS Coordinator, an office established by the FREEDOM Support Act to ensure coordination within the Executive Branch of the United States Government for all support and assistance to the NIS.

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## **Audit Objectives**

The audit was included in the Office of Inspector General's fiscal year 1994 audit plan because of the potential inefficiencies associated with managing a large number of privatization and restructuring activities interspersed among different sectoral/regional projects. Specifically, this audit was designed to answer the following audit objectives:

- ▶ **What is the status of the privatization program in Russia?**
- ▶ **Does the Bureau for Europe and the New Independent States have a strategy for effectively managing its privatization and restructuring activities in Russia?**

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

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# **REPORT OF AUDIT FINDINGS**

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## **What is the status of the privatization program in Russia?**

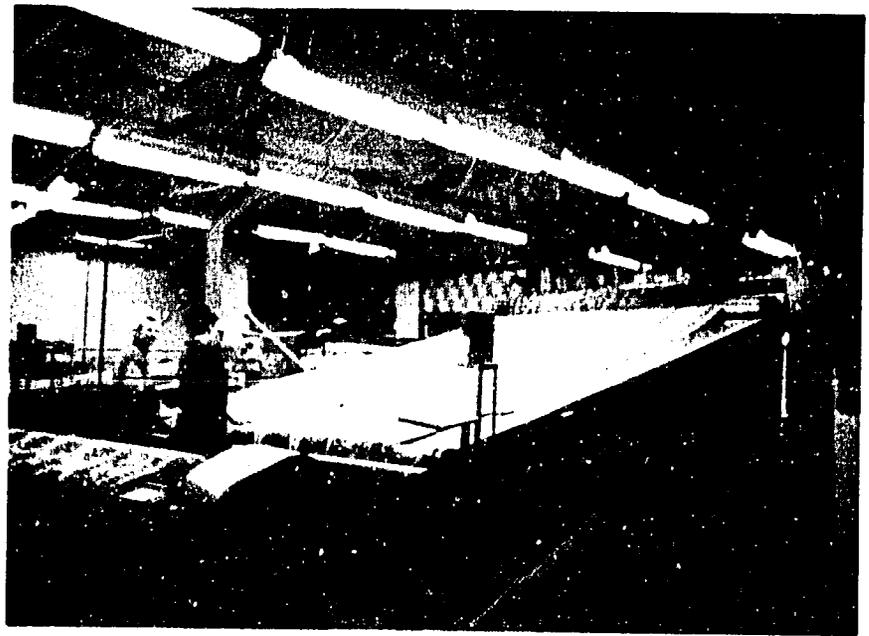
During the first two years since the Government of Russia (GoR) embarked on its privatization program, it reported that thousands of state-owned enterprises had been transferred to private hands. In addition, the GoR identified and began to correct structural barriers hindering the progress of these newly established enterprises. While it is too early to fully measure the significance of these accomplishments, there is no doubt that there has been advancement of privatization in Russia during the past two years, an accomplishment to which, we believe, USAID-financed activities have undoubtedly contributed.

### **A Process in Continuing Evolution**

Prior to the collapse of the Soviet Union, the then Soviet government controlled almost all aspects of the economy. The government established production targets, controlled and allocated production inputs, and controlled the pricing and distribution of finished products. During the last few years of the regime of Michael Gorbachev, some relaxation of government controls over state-owned enterprises began to occur. By December 1991, according to a World Bank report, enterprises were being taken over by their management and employees. Such "spontaneous privatization" prompted the new Russian government to initiate a rapid and massive privatization program in order to take advantage of the momentum that had begun to build, and to prevent orthodox ministries and bureaucracies from asserting control over the economy.

Under the GoR's 1992 privatization program, small-scale enterprises (less than 200 employees) were the first to be privatized. These enterprises were sold either through tender offers or auctions. Subsequently, the GoR initiated a mass privatization program for medium and large state-owned enterprises.

**The Liubertsy Carpets company, an example of a "spontaneous privatization" (Moscow, May 1994)**



Unlike the privatization models developed in some central European countries that emphasized restructuring enterprises first and then selling them off to the private sector, the plan in Russia was to change ownership first and then work on restructuring. This model was chosen, according to various documents and officials involved in the Russian privatization program, because it would quickly give a large number of Russians a vested interest in commercial enterprises -- and thus a genuine stake in seeing market reforms succeed. USAID also believed that this approach, which relied on market forces to effect change, would be the fastest way to restructure a large number of state-owned enterprises.

To ensure public support for and participation in the overall privatization process, the GoR developed a national voucher program providing opportunities for each Russian citizen to acquire an interest in newly privatized enterprises. Also, unlike the voucher program in the Czech Republic which sold vouchers for a nominal fee to citizens, the Russian program did not involve any charge for the vouchers. Instead, vouchers with a face value of 10,000 rubles (the equivalent of about U.S. \$33 when first distributed) were given to every Russian born before September 30, 1992. The vouchers could be used to acquire shares of privatized enterprises, invested in voucher investment funds, or sold for cash. The voucher program was slated to end by July 1994, but was later extended by three months. By July 1994, the ENI Bureau reported that 144.5 million vouchers, representing approximately 97 percent of the Russian population, had been claimed and used. At that time, the equivalent value of vouchers had fallen to about U.S. \$5.



**Russians at Moscow's National Auction Center  
considering how they might use their vouchers (May 1994)**

According to documents and officials involved with the Russian privatization program, the transfer of medium and large state properties to private ownership was to be accomplished in two phases. During the first phase, medium and large enterprises transformed themselves into joint-stock companies. This process was referred to as "corporatization." The first step in the process was the establishment of "working commissions" which were responsible for developing a Privatization Plan for the enterprise and submitting it to the local state property committee for approval. The commissions included individuals that represented employees, management, the local state property committee, and other parties with a stake in the enterprise. The workers and management of the company chose one of three alternative options for privatization permitted by Russian law and regulations. Based on which option was selected, workers and managers were able to obtain a large block of shares in their enterprises, up to 51 percent, in exchange for their vouchers.

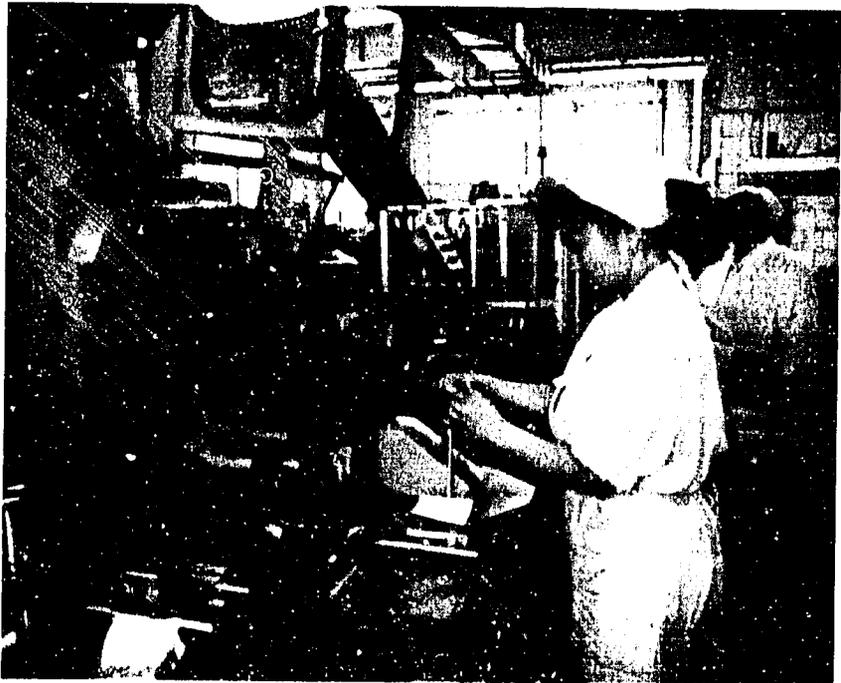
In the second phase, the shares that were not retained by the workers, managers, and the state were to be offered to the public through the voucher auction program. The ENI Bureau reported that these shares averaged about 20 percent of the enterprises' total shares. Finally, beginning July 1, 1994, the shares retained by the state were to be sold for cash in accordance with provisions of the State Program for the Privatization of State and Municipal Enterprises in the Russian Federation. However, as of January 1995, there had not been any cash auctions, according to the ENI Bureau.

## **Status of Transferring Ownership**

The GoR's State Committee of the Russian Federation for the Management of State Property (GKI) reported in its 1992 annual report that it planned to convert 5,000 medium and large state-owned enterprises to private ownership by the end of 1993.<sup>2</sup> Also, between 40 to 60 percent of small, state-owned enterprises were to be privatized; however, no clear target date was specified. As of March 1994, the GKI estimated that 10,320 medium and large enterprises, located in 86 of Russia's 90 regions and accounting for 13.3 million (46 percent) of an estimated 29 million employees in the Russian industrial work force, had been privatized. Further, according to a western advisor to GKI, approximately 68,000, or 70 percent, of the small-scale enterprises had been privatized.

According to the ENI Bureau, by October 1994, the GKI reported that the number of medium and large enterprises privatized had increased to 16,315, accounting for approximately 22 million (75 percent) of the Russian industrial work force. Also, by this date, about 72,000, or 74 percent, of small-scale enterprises had been privatized.

**Red October Chocolate  
Factory, privatized  
in 1993 via the voucher  
auction process (Moscow,  
May 1994)**



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<sup>2</sup> Other documents reviewed as part of this audit indicated that as many as 25,000 medium and large enterprises were to be privatized under the privatization program. This was noted in an amendment to the December 1992 cooperative agreement between USAID and the Harvard Institute for International Development (HIID), which provided technical assistance under this program, and the World Bank's Privatization Implementation Assistance Project Report, dated November 23, 1992. There was no clear time-frame associated with the 25,000 planned privatizations. However, in our opinion, it appears that the period was from the fall of 1992 through July 1994, the initial expiration date of the voucher program. In lieu of attempting to firmly establish time-frames and goals, the audit focused on determining the significance and meaning of the reported accomplishments.

The reported accomplishments over such a short time frame appear highly significant. However, statistics in Russia cannot always be considered completely reliable, thus interpreting them is particularly difficult. Distrust between certain Russian Ministries and the reluctance of some of Russia's local and regional property committees to supply accurate lists of state-owned enterprises in their communities have raised questions about the completeness and accuracy of data and statistics in Russia. Also, the GKI has cited inadequate mail and communications technology as an impediment to collecting data. The ENI Bureau contends that while GKI has taken measures to improve communications with the support of computers supplied with USAID financing, problems remain. Nevertheless, GKI maintained that the data offered a useful picture of what transpired at the time of the audit, although it cannot be viewed as being absolutely precise and there were still significant holes and weaknesses in the data gathering process.

Given these data reliability problems, few statistics can be viewed as meaningful without a better understanding of the overall privatization context. To better and more reliably appreciate the progress reportedly being made, one requires more information, such as:

- ▶ **What was the total number of state-owned enterprises in Russia when the privatization process began?** This baseline information is critical to understanding how far the program has progressed. Therefore, to validate the information regarding the percentage of state-owned enterprises which have been transformed into privatized enterprises it would first be necessary to determine the total number of enterprises in Russia. However, according to discussions with GKI and Russian Privatization Center (RPC) officials,<sup>3</sup> as well as with U.S. contractors responsible for gathering such data, obtaining complete and accurate statistics in Russia is extremely difficult. For example, GKI estimates the total number of small enterprises to be about 100,000, while Russia's State Committee for Statistics' (Goskomstat) estimate is approximately 470,000;<sup>4</sup> another source, the World Bank,

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<sup>3</sup> The RPC was established in April 1993 as a precondition for receiving a World Bank loan. The main objective of the RPC and its subsidiary network of regional privatization centers are to implement technical assistance programs in support of privatization, provide assistance to privatized enterprises, and support the development of capital markets and anti-monopoly policy. The RPC is headed by a Governing Board comprised of nine members who represent civic organizations, state bodies, and foreign non-governmental organizations. The chairman of its board of directors was a GoR Minister. The RPC was funded on a grant basis by various foreign aid agencies and the World Bank. However, USAID provided the majority of RPC's operating costs.

<sup>4</sup> A plausible explanation for the difference in numbers cited by GKI and Goskomstat is the difference in their accounting procedures. According to GKI's 1992 annual report, GKI data lists the numbers of enterprises as the total number with independent balance sheets. Thus, a group of firms with a single balance sheet is counted as one enterprise. Goskomstat lists multiple firms on a single balance sheet as separate and independent entities.

indicates that 200,000 small enterprises are subject to privatization.

With regard to medium and large enterprises, a western advisor to GKI stated that he was not aware if GKI or Goskomstat had information on the total number in Russia. World Bank documents indicated that there were a total of 24,800 medium and large enterprises subject to privatization. Inconsistencies were also noted in the numbers reported for firms privatized. For example, when we asked RPC officials for a breakdown according to size of the 10,320 medium and large firms reportedly privatized as of March 1994, RPC's detailed information added up to only 9,884, not 10,320 privatized entities.

In short, conflicting statistics make an accurate judgment on the extent and significance of the program difficult.

- ▶ **How do the newly privatized enterprises differ from existing state-owned enterprises?** Notwithstanding the progress which has been made in transferring a large number of enterprises to the private sector, several important rights and responsibilities of private ownership have yet to be achieved. For example, according to USAID, the new enterprises generally do not own their land. While current GoR decrees authorize the privatization of land beneath existing enterprises, none of the decrees, at the time of the audit, had been implemented. The Government of Russia reportedly continued to hold the land thus preventing enterprises from selling or pledging the land as collateral for raising needed capital. Without private ownership of land there also exists the possibility of government seizure without payment of just compensation. The ENI Bureau noted that this problem is due to tremendous Russian bureaucratic interference and resistance to change. Nevertheless, the ENI Bureau stated that it would continue to help the GoR address this problem so that enterprises can acquire outright title, or at least a long-term lease, to the land from the relevant municipality.

According to the ENI Bureau, the GoR also continues to hold at least 20 percent of the shares in the newly privatized medium and large enterprises; therefore, these newly privatized enterprises are still subject to some degree of GoR influence. These newly privatized enterprises also lack capital, which is partly due to the fact that no new capital was generated through the auction process because of the use of free vouchers. ENI has stated that the GoR made a deliberate decision that vouchers were to be distributed free of charge in order to encourage maximum participation in the process of economic reform. The ENI Bureau agreed with this objective while recognizing the risks involved and took other steps to assist in the restructuring process, such as initiating capital market projects.

Also, the ENI Bureau stated that 51 percent of new capital generated through cash auctions of the 20 percent of shares still held by the GoR will be allocated to the respective enterprises. Cash auctions were to begin after July 1, 1994; however, as of January 1, 1995, cash auctions had not yet taken place.

Compounding these problems is the fact that public disclosure of financial information is still limited. Given these shortcomings, newly privatized enterprises are at a disadvantage in finding investors and lenders willing to participate in the restructuring of an enterprise in order to become economically viable. However, according to the ENI Bureau, because of work completed under USAID-funded projects, an increasing number of market participants, including privatized firms and licensed voucher investment funds, are required to disclose critical information.

- ▶ **How near are most newly privatized entities to becoming economically viable?** It was unclear at the time of audit how soon most new entities would become economically viable. Many obstacles impede the progress of these enterprises, although they are being identified and worked on by the GoR and USAID. These impediments, such as: lack of access to capital and technical assistance, inequitable taxation and a non-conducive regulatory environment, as well as other disincentives, all make it difficult to measure how far the new enterprises have come or still have to go before they could be considered economically viable.

The ENI Bureau stated that the initial objective of quickly transferring a massive number of properties from state to public ownership had been a resounding success, and that program emphasis has now shifted to assisting the GoR to identify and correct structural impediments to the economic viability of these newly privatized enterprises.

### **Status of Restructuring Activities**

The GoR has also reported progress in identifying and correcting impediments to the economic viability of the newly privatized properties; however, progress to date has not been nearly as pronounced. The audit did not attempt to determine the extent of restructuring that had occurred due to time that this effort would require. However, the audit noted many positive actions. Besides working with the GoR on land privatization and capital market issues as mentioned earlier, USAID has also funded technical advisors to help draft Russia's new Civil Code. The Code deals with issues such as sales, negotiable instruments, and letters of credit. USAID has also reportedly been instrumental in developing shareholders' rights committees in some of Russia's largest companies, as well as voucher

investment funds, which has resulted in managers agreeing to establish and implement internationally accepted principles of corporate governance and shareholder rights. The ENI Bureau stated that its focus was now directed at assisting the GoR to correct the impediments to the economic viability of the enterprises that were privatized during the program's initial phase.

### **Controversial Consequences of Massive and Rapid Change**

While the mass privatization effort has been the cornerstone of the GoR's economic reform program, only time will tell if the GoR's aggressive privatization program was the best approach. Whereas this approach may have been successful in supporting reformers and stifling opponents from dividing the country, the urgency to quickly demonstrate tangible accomplishments in order to build public support was not without cost. The rapid transfer of ownership of state properties occurred in the absence of fully developed underlying support systems and controls. These conditions have created opportunities for criminal elements to engage in activities counterproductive to market reforms. Newspaper reports of "mafia" influence and the failure of the MMM pyramid scheme,<sup>5</sup> for example, have increased, suggesting a negative or high-risk business environment in Russia. While it is impossible to determine whether a different approach would have reduced opportunities for criminal activity, the image of criminal influences could deter private investment in Russia and significantly impede, if not undermine, the privatization process.

The ENI Bureau commented that the weaknesses in the underlying support systems in Russia is a real concern; however, its current assistance activities are designed to overcome these difficulties. The ENI Bureau has implemented projects including capital markets development, legal and regulatory reform, development of oversight/regulatory organizations, as well as public and private sector businesses. According to the ENI Bureau, these projects will encourage transparency, disclosure and sound corporate governance.

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<sup>5</sup> According to information provided by USAID: "MMM is an investment fund that sells shares to private citizens with a promise of high dividends and buyback at an elevated price. MMM advertised heavily in Russia to attract millions of small investors, guaranteeing annual returns of up to 3000 percent. However, MMM does not use shareholders' funds primarily to invest in Russian companies... the most recent investors' money pays off earlier investors. Growing demand for shares in the fund -- and manipulation by the fund's managers -- stimulated a steep increase in the fund's share prices, making very high returns possible in the short run... When investors begin to lose confidence new funds dry up; a rush to withdraw triggers a run on the fund and a collapse of the share price. In the case of MMM, the collapse followed government warnings about the fund's dealings, including false advertising and possible tax evasion."

Another related problem caused by the decision to move quickly was a proliferation of activities that the ENI Bureau is now responsible for managing. We identified a total of 93 USAID-financed privatization and restructuring activities in Russia that had been implemented during the past two years whose linkage to one another was not always clear. The large number of privatization and restructuring activities was noted by the USAID Administrator in a July 1993 report, prepared after visiting the NIS. He stated that the most notable success in USAID-funded assistance to the NIS was USAID's support for the Russian privatization program. However, he also stated that he was "struck by the piecemeal nature of USAID programs." The Administrator believed that many of the activities were "individually strong, but they are not always linked to strategic or sectoral objectives." He also believed that USAID's current and future efforts must be designed to avoid contributing to further fragmentation.

In conclusion, USAID and other donor assistance has helped the GoR to transfer a large number of state properties to private ownership, and to identify and address structural constraints to these newly privatized enterprises. While the numbers reported appear impressive, questions remain about their accuracy and significance. Until these questions are settled, care should be used in describing accomplishments so as not to mislead interested parties and decision-makers. During the time remaining in the assistance program, the ENI Bureau needs to focus its attention on ways to maximize the impact of its assistance to Russia.

### **Management Comments and Our Evaluation**

In responding to the draft audit report, the ENI Bureau stated that this section of the report did not accurately set forth the goals, projects and accomplishments involved in privatization and voucher sales. Specifically, the ENI Bureau stated that the draft report incorrectly stated that the GoR planned to convert 25,000 medium and large-scale enterprises to private ownership. The ENI Bureau maintained that the benchmark established by the GoR for the privatization program was 5,000 enterprises and that the privatization program exceeded expectations by approximately 300 percent.

The 25,000 planned privatizations stated in the draft report was based on reports by the World Bank and the cooperative agreement between USAID and the Harvard Institute for International Development. The reports did not clearly define the time-period associated with the 25,000 privatizations; however, we believe the period was from the fall of 1992 through July 1994. In lieu of debating what was intended to be accomplished, we modified the report to better focus on the significance and meaning of the reported accomplishments. We also modified the report to disclose that the ENI Bureau quoted target of 5,000 enterprises was a GoR target slated for 1993. The 1992 GKI annual report containing this target does not state a GoR

**target for the entire privatization program. We also disclosed the numbers to highlight the difficulty in interpreting statistics in Russia and the problem with data reliability, so that care would be taken by users of information when quoting the statistical significance of Russia's privatization program.**

**The ENI Bureau also requested that the narrative be revised to better reflect that the GoR and USAID have worked toward creating an effective market environment to support newly privatized enterprises. Also, the ENI Bureau believed that the report painted a one-sided picture of the negative consequences of massive and rapid change in the Russian privatization program. We modified the discussion to reflect these concerns and noted many positive actions taken by USAID to create an effective market environment in Russia.**

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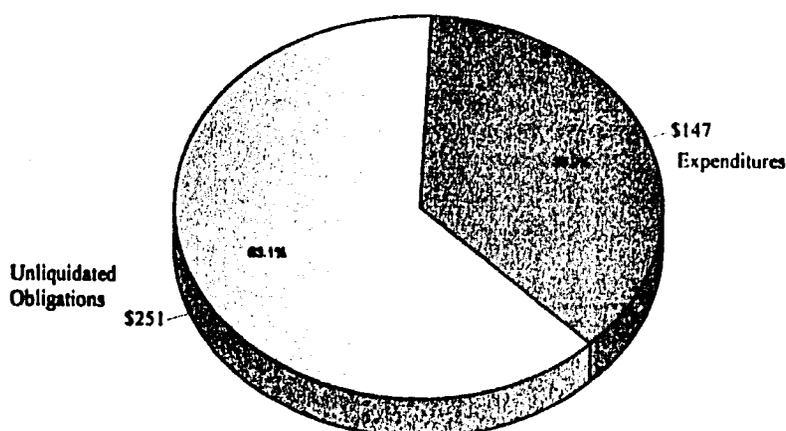
## Does the Bureau for Europe and the New Independent States have a strategy for effectively managing its privatization and restructuring activities in Russia?

The ENI Bureau follows an overall United States Government strategy for accomplishing economic reform objectives in Russia which has resulted in the rapid implementation of a significant number of discrete privatization and restructuring activities in Russia. These activities may be found in all but one of the ENI Bureau's 13 NIS regional/sectoral projects. The ENI Bureau did have a strategy for managing the privatization and restructuring activities under one of these projects, but not for the aggregate of such activities in its entire portfolio of projects.

The ENI Bureau responded quickly and visibly to the mandate to assist the Government of Russia (GoR) to implement its aggressive privatization program. Although a formal United States strategy document was not signed until May 1994, the ENI Bureau's basic strategy since 1992 has been to rapidly mobilize and deliver technical assistance to Russia to help the GoR move state-owned enterprises to private ownership and to remove from or lessen domestic constraints on these newly privatized enterprises.<sup>6</sup>

The audit identified 93 activities included in 12 of ENI's 13 projects which directly or indirectly supported Russia's privatization and restructuring objectives. These activities totaled approximately \$398 million in obligations, of which \$147 million had been spent as of June 30, 1994.

Total Unliquidated Obligations and Expenditures for 93 Activities  
(amounts in millions -- unaudited)

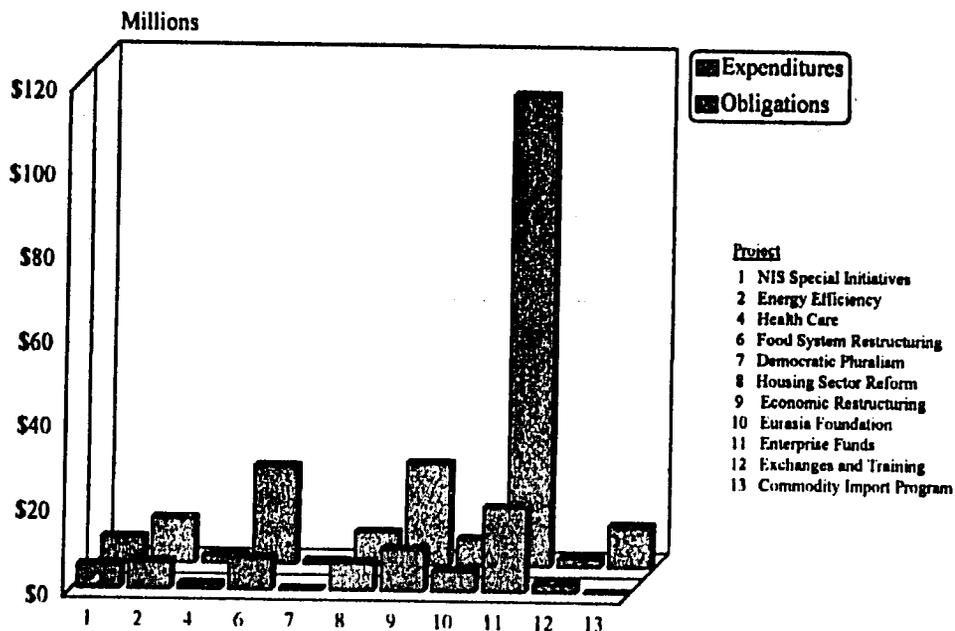


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<sup>6</sup> The U.S. Government's overall strategy for implementing economic reforms in Russia, including privatization activities, was a joint effort among USAID and the Department of State's Coordinator of U.S. Assistance to the New Independent States, as well as most other U.S. government agencies providing assistance to Russia. The culmination of this effort produced a strategy document titled, United States Assistance And Economic Cooperation Strategy for Russia, dated May 19, 1994.

In addition to the overall United States Government strategy, the ENI Bureau established a "two stream" management strategy which it said provided a framework for its privatization and restructuring activities in Russia. The strategy's two streams coincide with the objectives of Russia's privatization program. The first stream includes activities aimed at the rapid transfer of properties from state to private ownership. The second stream includes activities designed to ensure the commercial viability of privatized enterprises. However, the strategy is limited to the activities initiated under Project No. 110-0005. It does not cover the 38 privatization and restructuring-related activities in the other 11 NIS regional projects. As of June 30, 1994, the obligations for the activities not covered by the strategy for Project No. 110-0005 totaled \$206 million, of which \$63 million had been spent.

Obligations and Expenditures for 38 Privatization and Restructuring Activities Not Covered By Project No. 110-0005's Strategy (unaudited)



While the ENI Bureau does not directly manage the use of all the resources associated with these activities -- for example, those allocated to the Enterprise Funds under Project No. 110-0011 -- it should be at least considering how to optimize the potential contribution of the aggregate of these resources in achieving Russia's privatization and restructuring objectives. By having a management strategy that encompasses the activities under Project No. 110-0005 only, the ENI Bureau, in our opinion, runs the risk of not obtaining optimum impact from the aggregate of privatization and restructuring activities.

The ENI Bureau has established systems for quickly delivering technical assistance to Russia. It is now at a juncture at which it needs to establish systems to better ensure that the assistance delivered is being effectively

coordinated and used to achieve as much as possible during the time remaining in the program.<sup>7</sup> The ENI Bureau could improve its management of privatization and restructuring-related activities by: (1) establishing specific objectives and quantifiable and qualitative indicators by which to plan and measure progress, especially with respect to the components that make up the restructuring objective; (2) establishing adequate information systems to facilitate management; and (3) assigning adequate staff resources to oversee and coordinate these activities.

### **The ENI Bureau Needs to Establish Clear and Measurable Restructuring Objectives for Russia**

Clear and specific objectives are fundamental to effective and efficient use of project resources. Without them, managers cannot make informed decisions for planning, implementing, and monitoring project activities. Consequently, section 621A(b) of the Foreign Assistance Act requires that USAID establish management systems that include quantifiable indicators to measure progress in accomplishing foreign assistance objectives. The need to know what the United States Government is specifically accomplishing with its tax dollars is becoming more prominent each year as the United States Government wrestles with ways to control its sizeable budget deficit. For example, Vice President Gore's September 1993 Report of the National Performance Review discusses the importance of strategic planning and performance measurements, and the need for each federal agency to begin to implement them.

The audit did not identify any specific quantifiable targets associated with Russia's privatization and restructuring-related objectives, apart from those established by the GoR as briefly discussed in the previous section. Neither the May 1994 overall United States Government strategy for Russia nor the ENI Bureau's "two stream" strategy for activities under Project No. 110-0005, in our opinion, provides the specificity needed for effective management. For example, according to the overall United States Government strategy, the economic objective for Russia is to foster the emergence of a competitive, market-oriented economy in which the majority of economic resources are privately owned and managed, so that economic decisions are based primarily on individual choice. However, the strategy lacks sufficient indicators which would allow an objective measurement of progress in achieving this objective.

ENI Bureau's strategy for Project No. 110-0005 also did not describe objectives in adequate detail. In regard to transferring properties from state

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<sup>7</sup> According to the Department of State NIS Coordinator, the Russian privatization program probably would not receive any new funding beyond fiscal year 1998.

to private ownership, the ENI Bureau stated that it did not set any targets, but used those set by the GoR. Bureau officials believed that the GoR targets for transferring properties have been accomplished; thus, they were shifting their attention from this aspect of Russia's privatization program to one of achieving the program's restructuring objective. However, neither the GoR nor the ENI Bureau had established a clear and measurable objective for the restructuring effort.

Establishing quantifiable and qualitative targets for the restructuring objective in Russia, in our opinion, is more problematic because of the diverse nature of its components. Under this umbrella objective, the ENI Bureau is addressing issues pertaining to legal reforms, capital markets, taxes, banking and other areas related to establishing a conducive regulatory and commercial environment. In our opinion, each one of these areas should be developed as a separate sub-objective with its own quantifiable and qualitative progress indicators. In addition, each of the sub-objectives should have its own priority-ranking based on its importance or contribution to achieving the overall restructuring objective. Establishing targets and priorities now takes on greater importance as the ENI Bureau shifts its attention to, and increases its expenditures on, restructuring-related activities.

It appears that due to the urgency to mount an assistance program quickly, the Bureau paid less attention to documenting specific objectives and strategies than to establishing an approach to quickly deliver technical assistance to Russia. The Bureau stated that the contractors who provided the technical assistance were made aware of the ENI Bureau's objectives for Russia through the contracting process. The task orders written under the contracts were to further elaborate on the objectives that were to be achieved, and how the work performed under each task order was to contribute to this process.<sup>8</sup> The ENI Bureau also stated it was in the process of implementing a new monitoring, reporting and evaluation system. According to the Bureau, this system, once implemented, will include indicators appropriate to USAID assistance activities and targets to be achieved with the assistance. ENI Bureau staff are also identifying the specific assistance activities that contribute to the achievement of the specific targets.

In conclusion, the ENI Bureau could improve its management of restructuring activities in Russia by establishing specific objectives for each of the diverse components covered by the overall restructuring objective, including establishing both quantitative and qualitative indicators by which

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<sup>8</sup>The contract/task order approach used by the ENI Bureau to deliver technical assistance to Russia under Project No. 110-0005 was covered by a separate RIG/A/B audit. "Audit of Selected Privatization and Restructuring Activities in Russia," Audit Report No. 8-118-95-007, March 10, 1995.

to plan and measure their progress. Without specificity and measurable indicators, the ENI Bureau is less able to accurately evaluate progress or identify the component(s) included in the restructuring objective that may require immediate management attention. Thus, there is a greater risk of the inefficient use of program funds.

**Recommendation No. 1: We recommend that the Bureau for Europe and the New Independent States establish specific objectives for the individual components that make up the restructuring program in Russia, as well as quantifiable and qualitative indicators for measuring progress toward achieving these objectives.**

### **Management Comments and Our Evaluation**

In responding to the draft audit report, the ENI Bureau stated that it shared RIG/A/B's concerns that there be agreed objectives and indicators in the Russia privatization and restructuring program. The Bureau said its new monitoring, reporting, and evaluation system would help alleviate these concerns. It stated that the core of its new system is a set of 14 objectives under ENI's 3 strategic assistance areas -- economic restructuring, democracy, and social sector restructuring/quality of life. It stated that 6 of the 14 program objectives are included in the economic restructuring area. These are: transfer of state-owned assets to the private sector; establishment of a policy, legal and regulatory framework conducive to broad-based competition on and private sector growth; stimulation of the development of private sector enterprises; promoting fiscal reform; development of a competitive, efficient private financial sector; and promoting sustainable use of natural resources. It added that each objective would have indicators for the purpose of measuring progress toward attainment of the strategic objective.

RIG/A/B modified the discussion to better focus attention on the need for the ENI Bureau to better specify what should and can be done in the area of economic restructuring during the time remaining in the program. Based on the Bureau's comments and actions, we consider the recommendation closed as this recommendation will be addressed upon successful completion of action under Recommendation No.1 in RIG/A/B Audit Report No. 8-000-95-002.

### **The ENI Bureau Needs to Enhance and Complete Its Management Information System**

Basic to effective project management is the need for complete and reliable

**financial and performance information to assist managers in monitoring implementation, identifying real and potential problems, and determining cost-effectiveness. The audit found that the ENI Bureau did not have a system capable of reporting consolidated information on the multitude of privatization and restructuring activities in Russia included in 12 of its 13 NIS regional projects.**

**The level of reporting, in our opinion, was inadequate for effectively managing privatization and restructuring-related activities. We found it overly cumbersome to attempt to gather information by specific activity in Russia. For example, in order to develop a listing of the privatization and restructuring-related activities in Russia, it was necessary to interview personnel in each office within USAID/Moscow and several offices in the ENI Bureau. To obtain basic financial information (obligations and expenditures) for these activities, we had to review no fewer than five separate financial reports produced by multiple computer-based information systems. None of the reports provided compatible information that could easily be reconciled. Moreover, although we identified 93 activities totalling approximately \$398 million in obligations and \$147 million in expenditures in 12 of the ENI Bureau's 13 projects, we could not assure ourselves that we had a complete listing of USAID's awards to contractors, grantees and other U.S. government agencies performing privatization and restructuring-related work in Russia.**

**The ENI Bureau stated that privatization and restructuring were fundamental elements of the United States' economic assistance program to Russia and, as a result, these elements are included in more than just the Private Sector Initiatives Project (No. 110-0005). While vertical information systems were established to provide financial and performance data on activities within a project, the ENI Bureau had not established integrated systems to facilitate accessing information from among the different NIS regional projects. The need for such a system was apparently not identified at the outset of the assistance program. However, given the proliferation of privatization and restructuring-related activities in its portfolio of projects and the significant amount of unliquidated obligations associated with them, the need for such a system is quite evident.**

**As a result of not having an integrated information and reporting system, the ENI Bureau did not have an effective way to identify the scope and nature of all of its privatization and restructuring activities in Russia which, in turn, impeded the Bureau's ability to effectively manage and coordinate these activities in the aggregate. Thus, there was a greater-than-average probability that these activities were not collectively yielding the benefits that they potentially could.**

**Recommendation No. 2: We recommend that the Bureau for Europe and the New Independent States establish an integrated management information system to facilitate the coordination and management of the aggregate of privatization and restructuring-related activities within the 13 regional NIS projects.**

### **Management Comments and Our Evaluation**

In responding to the draft audit report, the ENI Bureau took exception to parts of the discussion and, especially, the examples used to demonstrate the potential types of problems that could result from not having a better information system. Nevertheless, the ENI Bureau agreed that a better information and reporting system was needed. The Bureau stated that it was implementing a new monitoring, reporting, and evaluation system and anticipated that, once fully operational, this new management information system would improve its ability to monitor all the activities in its portfolio. Among other things, the new system will identify the results expected from each activity and will report progress against them. This information will be included in the ENI Bureau data base which also is to include obligation and expenditure information for each activity. The ENI Bureau contends that when the system is completed, they anticipate that it will be possible to compare expenditures to progress in achieving targets and program objectives.

RIG/A/B modified the text and removed the specific examples which the ENI Bureau found objectionable. Their removal, however, did not diminish the Bureau's need for better information, which it readily concedes. Based on the ENI Bureau's comments and supporting documentation, we consider the recommendation closed as this recommendation will be addressed upon successful completion of action under Recommendation No. 1 in RIG/A/B Audit Report No. 8-000-95-002. We will assess the Bureau's system in the future to ensure that the condition found in this report has been dealt with.

### **The ENI Bureau Needs to Assess the Level of Staff Needed to Manage Project Activities**

Clear objectives and appropriate information systems are important controls, but without adequate staff to manage them, their value is greatly diminished. The audit showed that there was insufficient staff assigned to monitoring privatization and restructuring activities in Russia. The principal office responsible for managing the bulk of the privatization and restructuring-related activities is USAID/Moscow's Private Enterprise and Economic Restructuring Office (PEER). At the time of the audit, this office consisted of six technical staff persons including: two U.S. direct hires;

three U.S. personal service contractors; and 1 foreign service national. In addition to the PEER Office, USAID/Moscow recently established a two-person Program and Project Office whose responsibility, among others, was project monitoring.

Irrespective of the reasons why USAID/Moscow staff complement did not keep pace with the programs growth, USAID/Moscow and the ENI Bureau agreed that USAID/Moscow was not adequately staffed. An ENI official stated that although a large staff is not needed, "a technically qualified staff of highly skilled individuals could provide the necessary project oversight and management, and have sufficient credibility to ensure that the design and implementation process is not consultant driven." Further, the ENI Bureau believed that the staff should have "sufficient clout" to move USAID away from constantly focusing on process rather than substance.

The ENI Bureau stated that subsequent to our audit field work, staff levels at USAID/Moscow had been increased to 25 persons, including several specialists. Also, the Bureau stated that more ENI Bureau staff positions had been filled. The ENI Bureau believed these additions coupled with its new monitoring and reporting system would result in closer and more effective monitoring of project activities.

**Recommendation No. 3: We recommend that the Bureau for Europe and the New Independent States reassess the level of staff needed in USAID/Washington and USAID/Moscow to effectively manage project activities and take appropriate action to remedy staffing deficiencies.**

### **Management Comments and Our Evaluation**

In responding to the draft audit report, the ENI Bureau stated that it agreed with the finding and recommendation and, as noted in the revised text, had already taken action to resolve staff shortages. The actions taken to resolve the staff shortages satisfies the recommendation and, therefore, we consider it closed.

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## **SCOPE AND METHODOLOGY**

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### **Scope**

We audited ENI's strategy for managing its privatization and restructuring activities in Russia in accordance with generally accepted government auditing standards. As of June 30, 1994, we estimated, through this audit, that these activities totaled 93 in number with total obligations and expenditures of about \$398 million and \$147 million, respectively. We conducted the principal audit work from March through October 1994. Most information used during the audit was obtained from the ENI Bureau in Washington, D.C. and the USAID/Moscow field office. Field work in Moscow was conducted during April and May 1994. Follow-up information was primarily obtained via electronic communication with USAID project officials. However, certain information, mainly pertaining to the status of Russia's privatization program, was updated during a January 19, 1995 meeting with ENI Bureau officials that covered privatization work in Russia as well as in the Central Asian Republics of the former Soviet Union.

To develop a listing of privatization-related activities in ENI's portfolio, we relied on information obtained from interviews with personnel in each office within USAID/Moscow and several offices of the ENI Bureau, and from five financial reports generated from multiple computer-based information systems. The financial information used was unaudited and the scope of this audit did not include testing its accuracy or validity. The purpose of gathering information on the number of activities was to determine the magnitude of ENI's privatization and restructuring-related activities in Russia, and if ENI had a system which was capable of effectively accessing information on these activities to facilitate their management. We did not conduct in-depth evaluations of the 93 activities, but focused on the Bureau's "strategy for managing" them.

For the purpose of this audit, when the term "privatization" activities is used it refers to activities associated with the transfer of properties from state to public ownership. The term "restructuring" or "restructuring-related" activities refers to activities associated with correcting impediments in the regulatory/commercial framework, as well as the specific enterprise,

in order to ensure that newly privatized enterprises can fairly compete. We also relied heavily on information reported by the State Committee of the Russian Federation for the Management of State Property (GKI) and World Bank, and information provided by the ENI Bureau, for the purpose of determining Russia's privatization program approach, goals, and accomplishments. The scope of this audit also did not entail determining the accuracy or validity of numbers reported by these sources. Finally, the objectives of this audit did not allow for sufficient testing to comment on the overall adequacy of ENI Bureau and USAID/Moscow internal controls. Therefore, we did not prepare a separate report on internal controls. Likewise, the audit was not designed to perform sufficient testing to comment on the Bureau's or USAID/Moscow's compliance with laws and regulations. Therefore, we did not prepare a separate compliance report.

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### **Methodology**

The purpose of the first audit objective was to report on the status of the privatization program in Russia. To answer this objective, we gathered and reviewed pertinent World Bank and GKI reports, USAID's cooperative agreement with the Harvard Institute for International Development, and other project documents. To verify information in these sources, we interviewed GKI and Russian Privatization Center officials, as well as officials from the ENI Bureau, USAID/Moscow and the World Bank. We also visited two newly privatized enterprises in Russia and the National Auction Center in Moscow, Russia to verify their existence and status.

The purpose of the second audit objective was to determine if the ENI Bureau had a strategy for effectively managing its privatization and restructuring activities in Russia. To answer this objective, we first gathered ENI Bureau-generated project and financial information related to federal awards and interagency agreements for the implementation of privatization and economic restructuring activities in Russia. A key beginning document was USAID's December 31, 1993 "Project Summary" report, which gave a brief description of all activities under the 13 NIS regional projects. Second, from this report we identified those activities which appeared to fall under one of the four categories that we classified as privatization or restructuring-related, that is, transferring properties from state to private ownership, correcting impediments in the regulatory

framework, commercial framework, and enterprises specific restructuring. In some cases, the Project Summary's description of the activity related specifically to one of the four categories, in other cases the description related to two or more categories. Through this process we identified 93 activities that appeared to be directly or indirectly related to Russia's privatization and restructuring program. We then matched our listing of 93 activities to USAID prepared financial reports in order to estimate the funding levels for each of the activities as of June 30, 1994. We allocated funds to each specific activity in the following manner. If the activity fell under only one of the four categories then we allocated the total funding to it. However, if one of the activities related to more than one component, then we allocated the funding evenly among the components.

In developing criteria for this objective, we reviewed relevant USAID Inspector General and U.S. General Accounting Office audit reports, USAID policy and procedures, ENI Bureau guidance to project officers, National Performance Review reports, and other criteria as deemed appropriate. Then we assessed the ENI Bureau's strategy for managing the privatization and restructuring-related activities in Russia against this criteria through interviews with; 1) USAID staff responsible for managing activities, 2) representatives of organizations implementing agreements relating to privatization and restructuring activities, 3) recipients receiving the technical assistance, 4) officials of Russian host government organizations, 5) U.S. Embassy officials familiar with privatization activities in the Russia, and 6) representatives of other donor organizations.

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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, Barbara Turner 

**Subject:** Draft Audit Report on ENI's Strategy for Managing Its Privatization and Restructuring Activities in Russia

**Summary of USAID Response:** This memorandum and its attachments transmit ENI Bureau and USAID/Moscow comments on the draft report of 1-18-95. We appreciate the opportunity to comment on this report. We share the auditors' concerns that there be agreed objectives and indicators in the Russia privatization and restructuring program; a capable management information and tracking system; and appropriate levels and qualifications of staff, in both USAID/Washington and USAID/Moscow, to manage privatization and restructuring activities. However, in our opinion, the draft report does not adequately reflect actual USAID practice and progress in meeting these concerns about program design, management systems and staff resources.

Our current approaches to program objectives, indicators and management information are being improved by the Bureau's new monitoring, reporting and evaluation system. As previously reported, this system will help improve all ENI programs alike. Staffing requirements have been reassessed and acted upon, as further detailed below.

The ENI Bureau and USAID/Moscow are concerned that the report appears to call into question, unwittingly perhaps, the goals and achievements of the Russian Government in the privatization arena. It would be unfortunate if some of the report's less carefully noted observations become misappropriated by anti-reformist interests within Russia seeking to undermine the progress and accomplishments of these programs.

**Recommendations**

The first two recommendations are: (1) to establish specific objectives for privatization and restructuring activities in

Russia, along with quantifiable and qualitative indicators; and (2) establish a management information system capable of producing integrated financial and programmatic data on privatization and restructuring activities implemented via each of the 13 NIS projects. In the following sections of this memorandum, we comment on our current approach to objectives and activity indicators for the privatization and restructuring program. We also provide summary data on information systems in use.

In this connection, the ENI Bureau's overall monitoring and evaluation system is being improved and installed. This system was described in our recent response to Audit Report No. 8-000-95-002. As mentioned, the system provides for (1) Monitoring and Reporting on Individual Activities, (2) Evaluating and Reporting on Achievement Towards Assistance Objectives and (3) Monitoring and Analysis of Progress Towards Country Targets. This system will cover and integrate all Bureau projects and activities. In effect, the Bureau is standardizing best practice approaches to all ENI assistance. Although the system will not separate privatization and restructuring activities for exceptional treatment - beyond that accorded other program activities - we believe the system will improve our current practices and that it will satisfy the intent of both recommendations one and two. Attachment B provides an update on this new ENI system

Recommendation 3 concerns staffing levels. We also agree with this recommendation and, as described below, believe appropriate staffing additions have been made to satisfy the recommendation.

Following are our detailed comments and suggestions on the draft report of 1-18-95.

### **Background**

The draft report's Background Section does not adequately convey the extraordinary circumstances under which the Private Sector Initiatives Project was conceived. Attachment A contains appropriate background and introductory material - which more completely describes the unusual context of this program - for use in the report.

Page 2, paragraph 2 of the draft report mischaracterizes the number of enterprises the Government of Russia (GoR) initially slated for privatization. The report should be amended to express the initial objective: the GKI's 1992 Annual Report states that the GoR slated some 5000 medium and large-scale enterprises for privatization - through the voucher auction - by the end of 1993.

Central to the draft report's criticism of USAID and GoR performance is the establishment of a benchmark against which performance could be measured. The auditors have incorrectly established that the benchmark for the privatization program was

25,000 enterprises and therefore conclude that progress was questionable. However, ENI maintains that the benchmark was 5,000 enterprises and that program performance far exceeded expectations.

According to the Russian Voucher Auction database, 16,315 large and mid-size firms had been privatized by October 3, 1994. This number was not available at the time of the audit (as the mass privatization program was still being conducted at that time), but it is consistent with the GOSKOMSTAT (State Statistical Committee) report on 8-1-94 that 14,659 enterprises had been privatized. (See Attachment A for further analysis of GoR goals.)

#### **Report of Audit Findings: Status of Transferring Ownership**

In this section, the draft report looks at the following three questions: (1) "What was the total number of state-owned enterprises in Russia?; (2) How do newly privatized enterprises differ from existing state-owned enterprises?; (3) How near are most newly privatized entities to becoming economically viable?"

We do not agree with draft report's finding that "it appears the GoR has yet to reach its initial target of privatizing 25,000 large and mid-size firms " (page 13). As stated above, the GKI - the Russian Ministry responsible for implementing privatization had as its goal 5,000 enterprises. Having privatized 16,315 medium and large enterprises by 10-3-94, the GoR greatly surpassed its target.

We believe the draft report's discussion of question 2 on page 13 mistakenly suggests that the GoR and USAID have not worked toward creating an effective market environment to support newly privatized enterprises. In fact, the fundamental objective of the USAID program is to support the GoR's transition to an effective market economy. Please see Attachment A for a detailed response regarding the issues of land title and collateral, the GoR's remaining 20% shareholding, capital constraints, and public disclosure of financial information.

#### **Status of Restructuring Activities**

We believe the draft report (page 15) paints a one-sided picture of the "negative consequences of massive and rapid change" in the Russian privatization program. In our opinion, and the view of other donors as well, the imperative to demonstrate tangible accomplishments was inescapable. Decisive steps away from the collapsed system had to be taken. USAID's early support to the GKI was able to devise skillful means for mass privatization to meet the imperative. The draft report should be balanced by expressing this part of the picture, particularly the effectiveness of the USAID/GKI partnership - as assisted through

the HIID cooperative agreement - in the initial phases, and USAID's successful collaboration with other donors, including the World Bank, International Finance Corporation and the British Know How Fund.

The program is very much in process. Accordingly, the report should also express that USAID continues support for an enabling environment, including capital market development, legal and regulatory reform, development of oversight/regulatory organizations as well as public and private sector business. By encouraging transparency, disclosure and sound corporate governance, our assistance strategy is working to overcome the type of difficulty mentioned on page 15, e.g. newspaper reports of a failed pyramid scheme or the presence of criminal elements. Despite the draft report's comments that "This image could deter private investment in Russia and significantly impede, if not undermine, the privatization process," it should be noted that the privatization process has not deterred foreign investors from investing in select Russian securities at the rate of \$700 million per month, as representatives of US investment firms told USAID officials in early October 1994 (or at the rate of \$500-600 million as the GoR maintains).

Here, of course, only the host country can provide the long-term staying power needed to sustain the policies and practices best suited to the public interest. The principal imperative now is for Russia to demonstrate systemic success in support of continuing appropriate action in reform.

In this connection, it is useful for clarity to distinguish between the two "streams" of USAID support for privatization and restructuring in Russia. One stream is transferring state-owned assets to the private sector, while the other is establishing a business environment supportive of private sector growth.

#### **ENI Strategy for Managing Privatization and Restructuring Activities in Russia**

Page 16 of the draft report states "The ENI Bureau follows an overall US strategy for accomplishing US economic reform objectives in Russia which has resulted in the rapid implementation of a significant number of discrete privatization and restructuring activities in Russia through 13 regional projects, each with a different sectoral emphasis." We agree with this statement, but would like to clarify the matter of "different sectoral emphasis" among our 13 regional projects. The first thrust of privatization activity under Project 0005 is to transfer state-owned enterprises to the private sector so they may be owned and managed for profit. In sectoral terms, these for profit firms are diverse; some are in the industrial sector, some are in the agricultural, commercial, service, or other sectors.

Project 0005 comprises the core of USAID privatization assistance to Russia. The privatization of enterprises principally mentioned in the draft report, e.g. in the Status of Transferring Ownership section, occurred under Project 0005. In fact, some 16,315 medium and large enterprises and approximately 60,000 small businesses were privatized with support from funds allocated under Project 0005.

These for-profit firms are distinct from entities restructured or privatized under other USAID sectoral projects such as Energy Efficiency and Market Reform (0002), Health Care Improvement (0004), Housing Sector Reform (0008). Restructuring and privatizing activity carried out under such sectoral projects is generally incidental to broader sectoral purposes, e.g. increase energy efficiency or improve health care management. (The need to restructure or privatize arises in nearly all sectors of Russia's economy, due to the past all-inclusive state sector.)

These project and enterprise distinctions help explain how USAID has organized itself to manage the large, multi-sectoral Russia program. They show that the strategy for managing and evaluating privatization and restructuring activities in the program is always particular to, and *embedded within*, each sectoral project. The draft report should take this reality into account and modify language (e.g. pages 16 and 18) suggesting the lack of and need for a "strategy for...the aggregate of such activities spread throughout the 13 projects". If such strategy would be additional to the sectoral strategies embedded in the respective projects, we would be unsure how to build it.

We believe the sense of this suggestion is that lateral USAID communication, across sectors and organizational lines, is especially important in the restructuring area to assure that best-practices are followed. We agree and are taking steps to encourage such cross-communication and exchange.

#### **Privatization and Restructuring Objectives in Russia**

Page 18, paragraph 2 misrepresents USAID's privatization and restructuring goals in Russia. The two streams of USAID support referred to above set out USAID's objectives for Russia. They provide the framework. Furthermore, all the Omnibus contractors are aware of these objectives as they were clearly stated in the Omnibus Privatization RFP. The implementation strategy requires that each Task Order be specifically designed to include objectives and specific deliverables that would promote the transition of the Russian economy and lead toward the overall objectives. The Task Orders also have very specific indicators and deliverables. As noted previously, the NIS Privatization approach has been to begin with pilot activities which, if successful, are followed by task orders that expand the

activities nationally (roll-outs). Appropriate indicators are determined during the pilot phase.

Page 20, top paragraph includes data which misrepresents the benchmarks by which the success of the privatization program should be measured. The report misquotes ENI officials as having set a goal of 90 percent of state-owned enterprises for the success of privatization. USAID did not set any such targets and in fact has used the data and targets of the GKI.

Page 21, bottom paragraph and subsequent text mistakenly asserts that quantified indicators are not sufficient to measure the success of USAID programs. As indicated above, the Task Order deliverables and indicators are carefully reviewed every six months as a prerequisite for further work in any area or activity. These deliverables are meaningful in that they provide opportunities to test strategies, regulations and laws. All have objectives and deliverables which relate them to indicators. The draft report seems to ignore, on pages 20 and 21, the financial tracking systems and management information systems USAID has established to monitor its programs.

Page 22, top paragraph states the lack of an information system may result in ENI's financing of activities that may (1) not be consistent with the overall US strategy for Russia, (2) duplicate other activities, and (3) allow activities to proceed without demonstrating results. Besides ignoring the information and management systems already in place, the draft report offers no evidence that any such result has occurred on the ground. Our more detailed response to these assertions follows.

(1) "Activities may not be consistent with US strategy for Russia." The paragraph beginning on page 21 questions whether USAID programs are consistent with US strategy for Russia because their effect has gone beyond a few selected regions. To the extent the program has reached nearly all of Russia's 89 regions, this success is not inconsistent with objectives to focus USAID direct activities on a few regions. Because the privatization program supports fundamental structural reform, it affects systems which cover the whole country. As the GKI-coordinated activities are rolled-out across Russia, they are, in any event, increasingly implemented by Russians. The concentration of USG activities in five regions is a relatively recent phenomenon which cannot retroactively justify criticism of programs initiated to have systemic impact. To support its argument, the report charges that USAID is funding the support of 20 local privatization centers (page 24). In fact, USAID is assisting with the financing and establishment of 10 LPCs, not 20. The policy of concentrating assistance in selected regions was intended to be a guideline with flexibility to go beyond these regions as specific programmatic circumstances demanded.

(2) "Activities with potential for duplication if not closely monitored." Page 23 cites two activities in public information, a large and important element of our program. The report offers no evidence of duplication of these separate but complementary activities yet asserts "close coordination of the two activities could enhance their overall impact." When there is no duplication or other issue in activity design, we do not understand how their closer coordination in house by USAID can enhance their overall impact on the ground in Russia. Unless evidence of actual duplication is shown, this and other cases mentioned should be deleted from the report.

Page 23 mentions "discussions with USAID staff revealed that they were not aware that the contractors could be potentially working in similar areas". No evidence of actual duplication or mis-use of resources is presented, however, so we again believe this material should be deleted from the report.

Attachment A provides comments concerning the report's assertions about "legal reform work with natural monopolies".

(3) "Activities allowed to proceed without demonstrating results." This section misrepresents USAID's track record in monitoring the performance of its contractors. Although the report credits USAID for properly recognizing and addressing a problem with one of its contractors, it misuses that case to criticize other activities USAID manages in the Russian Federation, purportedly because some have been run out of Washington while others have been run by the Moscow Mission. As no evidence is offered for this conclusion, it should be stricken from the report. In turn, such an unsupported conclusion, about the locus of management responsibility, does not support the recommended investment in a new "reporting system" (p. 27).

#### **Staff to Manage Project Activities**

The draft report does not reflect the progress USAID has made in staffing its office and the Mission in Moscow. When the audit was conducted, the PEER office was staffed by six persons, including a Russian-speaking US lawyer with extensive private sector and Russian experience. Since the audit, however, the PEER office has been increased to 25 persons, including one Project Development Officer, an additional US PSC lawyer to serve as a Privatization Officer, a US Capital Markets Specialist, as well as several Russian professionals. Therefore, USAID/Moscow's staff appear to be adequate for effectively monitoring this large, important program of more than \$212 million.

Similarly, ENI staff positions have been filled to enhance program oversight and coordination. Recent staff arrivals, for instance, include capital market specialists (2), financial specialist, senior project development officer as well as new

support staff. Taken together, we believe new staff assignments in both Moscow and ENI will allow USAID to more closely and effectively manage project activities.

**Attachments**

- A. Detailed Comments on Draft Audit Findings
- B. Update on Bureau Monitoring and Evaluation System

ATTACHMENT A

Detailed Comments on Draft Audit Findings  
of ENI's Strategy for Managing Its Privatization  
and Restructuring Activities in Russia

**Background**

We feel the draft report fails to reflect the rapidly changing circumstances under which the Private Sector Initiatives Project was conceived. The following text is proposed to provide the report with the appropriate context. (page 1)

USAID recognized the collapse of the Soviet Union as an historic opportunity for a more peaceful and stable international order as well as the opening of the world's largest untapped market and natural resource base for competitive international trade and investment. Following a series of action plans developed in conjunction with a January 1992 Coordinating Conference, USAID began to implement the Private Sector Initiatives Project (110-0005) which had as its primary purpose "[t]o facilitate the economic transformation of the Newly Independent States (NIS)..." See Project Memorandum - New Independent States: Private Sector Initiatives (110-0005) (Authorized 4/22/92), Page 3.

On August 19, 1992, one year to the day after the collapse of the failed coup against Mikhail Gorbachev, President Yeltsin announced his Government's plan to embark on the largest attempt in history to convert a centralized command economy into a market economy based on private property ownership, entrepreneurship and the free market. The GKI's goal was to privatize approximately 5,000 large and medium sized enterprises and millions of owners thereof (See GKI 1992 Annual Report, Page 5).

The GOR intended to finance technical assistance for its nationwide privatization program with \$150 million from proposed World Bank and EBRD loans. These loans had been scheduled to begin disbursing in January 1993. When it became clear that the Russian Supreme Soviet would not approve the loans, the GOR, at the highest levels, made an urgent request to the United States for immediate assistance (bridge financing) to implement basic elements of its privatization program. No other sources of financing were available and, in the GOR's eyes, the fate of economic and democratic reform hung in the balance. The USG recognized that privatization had become the driving force behind economic reform as well as the broader social and political transformation taking place in Russia and concluded that the

rapid and effective implementation of Russia's privatization program was indispensable to the successful transformation of the Russian economy and the avoidance of what otherwise were likely to be major economic and social crises. The implementation of the privatization program thus became fundamental to United States foreign policy (see, e.g., Moscow 2895 (2/1/93)).

USAID entered into a number of "bridge" contracts with firms critical to the effective implementation of the Russian privatization program, and amended the Private Sector Initiatives Project Memorandum to "provide the [Private Sector Initiatives Project] with sufficient flexibility to respond to a revolutionary situation." See Action Memorandum for the Director, NIS Task Force (Private Sector Initiatives (110-0005) Line Item Budget Adjustment (9/28/92)).

In order to mobilize and make available to the GOR the broadest possible range of expert U.S. providers of technical assistance, USAID incorporated its strategy for effective privatization assistance programs into an RFP. The Work Statement, found in Section C of the RFP specifically stated that USAID privatization initiatives would concentrate on two streams of focus: (i) privatization policies, programs and transactions which move government-owned assets and services from government to private ownership and/or private control, taking into account the potential need to reorganize or restructure enterprises to achieve effective privatization (hereinafter "Stream I Activities" and (ii) complementary initiatives to ensure the commercial viability of privatized enterprises (hereinafter "Stream II Activities"). See Statement of Work (FA/OP/CC/N-93-01) which sets forth the modalities, focus, and specific tasks expected to be performed.

In the most heavily subscribed competition in USAID history, awards were made to 13 prime contractors and more than 90 subcontractors. This mechanism, which streamlined the USAID administrative process, is known as the "Omnibus."

Under the NIS Privatization Omnibus, consultants were fielded under previously negotiated and signed contracts based on a Task Order. "The Task Order is a specific mechanism to authorize mobilization of a team to either (1) carry out a discrete privatization task or (2) develop an action-oriented Work Plan for a comprehensive country privatization program." The Privatization Project Officer, together with the Mission, will assure that the Task Order includes: a) a brief description of the proposed work objectives; b) a list of the technical skills expected to be necessary for implementation of the Work Plan; c) an estimate of the total level of effort to complete the Task Order; and d) specific instructions regarding the development of the Work Plan. (Action Memorandum dated April 21, 1993 approving the Privatization Task Order System). In Russia, most task

orders were collaboratively written by USAID and the GKI or RPC and prepared to produce tangible results within six month time periods.

At the time the Omnibus contracts were negotiated, there was still no basis to believe that privatization would proceed as quickly, or as widely, as it in fact has, or that the privatization technical assistance support expected from the World Bank and the EBRD would fail to materialize. Nor was there any expectation that the United States would offer the level of assistance that it did at the Vancouver and Tokyo Summits. Currently, the NIS life-of-project funding for privatization is \$430 million. Fortunately, the Omnibus mechanism was sufficiently flexible to accept this infusion and allocate contractual resources efficiently.

### **Status of Transferring Ownership**

Pages 11 and 12 do not accurately set forth the goals, workscope, projects and accomplishments involved in privatization and voucher sales.

Page 12 discusses a question - "What was the total number of state-owned enterprises in Russia?" - and notes apparent inconsistencies in the data. We agree that obtaining perfectly accurate and complete data is difficult. But, as one would expect with a system undergoing refinement, variance in information falls away through the use of it over time. For example, the discrepancy cited between GKI and Goskomstat estimates of the number of small enterprises (100,000 and 470,000, respectively) can be largely explained by a look at balance sheets. GKI's 1992 Annual Report explains that the difference is due to the fact that GKI shows only enterprises having independent balance sheets (such that a group of firms with one balance sheet is counted as a single enterprise). Goskomstat, on the other hand, disaggregates multiple firms appearing on a single balance sheet and considers them to be separate and independent entities. In brief, such discrepancies are workable.

In implementing the privatization program, the GOR with USAID assistance focused first on a wave of small scale privatization in which enterprises involved in trading, and food and household goods/services were sold locally, for cash. A second wave, involving the transfer of majority ownership in medium and large scale enterprises (mostly industrial) both to managers and employees and, through a series of voucher auctions, to the public at large, was first laid out in July, 1992.

### **Small-Scale Privatization**

#### **A. How Many Enterprises Were Targeted?**

The GKI 1992 Annual Report states that privatization targets were established by the 1992 Privatization Program which, depending on sector and region, tended to range from 40 to 60 percent. The Report further notes that property committees and property funds throughout the country thought these targets were "overambitious" and that "similar experiences in Eastern Europe suggest that such goals are nearly impossible to fulfill." (GKI Annual Report, Page 6).

According to GKI statistics, there are 96,956 small-scale enterprises in Russia. See "Otchet o khode maloi privatizatsii po territoriyam Rossiiskoi Federatsii na 9/1/94" (Report on the Progress of Small Privatization by Territory of the Russian Federation as of September 1, 1994). This twenty page document provides, for each of the three sectors privatized under the GOR's "small privatization" privatization program (trade, food goods/services, and household goods/services), the number of enterprises subject to privatization, the number of enterprises that were in fact privatized, the aggregate opening and selling prices (in millions of rubles), and the percentage of enterprises in each sector that were privatized, for each of Russia's 90 administrative regions. In addition, this document provides, for each of the three sectors and ninety administrative regions, the exact numbers showing disposition (sale, auction, lease, etc.) and purchaser (workers' collective, juridical entity, individual purchaser).

#### Medium- to Large-Scale Enterprises

##### A. How Many Enterprises Were Targeted?

The GKI's 1992 Annual Report states that "some 5,000 large and mid-size enterprises are slated for privatization" during the voucher auction program. The exact number, 4948, was determined with reference to Presidential Decree #721 of July 1, 1992, of the President of the Russian Federation "On Organizational Measures for the Reorganization of State Enterprises, Associations of State Enterprises into Joint-Stock Companies" and is reflected on Page 4 of "[name of document not released by GKI for public disclosure]", draft dated October 3, 1994.

##### B. How Many Enterprises Were Privatized?

As of October 3, 1994, according to the GKI/Russian Privatization Center Voucher Auction Database, 16,315 large and mid-size firms had been privatized. These privatized enterprises are located in 86 of Russia's 89 regions and account for 21,718,000 (74.8 percent) of an estimated 29 million employees in the Russian industrial workforce. This is reported on page 4 of "[name of document not released by GKI for public disclosure]", draft dated October 3, 1994.

This document further indicates that for each of the 88 regions in which companies were sold or bids were made, various data including the number of medium- and large-size enterprises subject to privatization, the number of enterprises that were in fact privatized, and the total charter capital for both categories above. (The footers to this document note that the August-October 3 data incorporated therein is preliminary and incomplete, and as such, it may be reasoned, may understate actual results. This document is marked for restricted use by authorized persons. USAID/Moscow has received permission to divulge this document for this purpose.)

See also "Rezultaty chekovykh auktsionov po otraslyam: Otchet 6" (Voucher Auction Results by Sector: Report 6), dated October 3, 1994. This two page chart indicates, for each of 36 sectors of the Russian economy, various data including the distribution of the 16,315 privatized enterprises, average charter capital per company, the percent of share capital auctioned to the Russian public, the number of workers employed in privatized companies, as well as the percentage distribution of vouchers.

It should be noted that GOSKOMSTAT's statistics, as reported by ITAR-TASS on October 6, 1994, are in full accord with GKI's statistics: GOSKOMSTAT found that 14,659 enterprises had been privatized as of August 1, 1994. Using the GKI statistics, which appear to be in conformity with GOSKOMSTAT, it is clear that the GOR overfulfilled its expectations by more than 300 percent, a margin that is directly attributable to the leadership of the GOR, the willingness of average Russians to change and the technical assistance provided by USAID.

C. How Many Vouchers Were Used?

As of July 14, 1994, the GOR maintained that 144,500,000 vouchers, or approximately 97 percent of the vouchers distributed, had been collected in the privatization process.

Pages 13 and 14 discuss other questions: "How do the newly privatized enterprises differ from existing state-owned enterprises?"; and "How near are most newly privatized entities to becoming economically viable?" We believe the report is misleading when it states (page 13) that "the privatization program could be seen as merely accomplishing a change in the 'title' of the enterprise while basic rights and responsibilities have not changed." We do not believe this statement has been validated with new enterprise owners in Russia. Accordingly, the statement should be eliminated from the report. Additionally, the auditors are not taking into consideration all the privatization initiatives and "stream 2" activities that address the overall business environment so that privatized enterprises can become commercially viable.

This section (pages 13 & 14) seems to suggest that the GOR continues to inhibit the development of a market economy and exert control over new enterprises in the following ways:

1. The GOR controls privatized enterprises through its effective holding of enterprises' land.

It is true that enterprises generally do not own their land and that various GOR decrees, drafted with USAID-funded technical assistance and authorizing privatization/purchase and sale of enterprise land are not being implemented properly (e.g., Presidential Decrees # 1535 "On the Fundamental Provisions of the Privatization Program of State and Municipal Enterprises in the Russian Federation after July 1, 1994," (dated July 22, 1994), as well as #631 "On Approval Procedure for Land Plots Sale in the Course of the Privatization of State and Municipal Enterprises, in the Course of New Construction and Development Carried Out by These Enterprises, and for the Sale of Commercial Land Plots Allocated to Citizens and Associations of Citizens" (dated June 14, 1992)). However, problems with implementation of these Decrees are due not to the privatization process, but to tremendous bureaucratic interference and resistance to change. In fact, the privatization process is credited by the GOR with having created a strong constituency of enterprises and shareholders who, seeking to maximize enterprise value, have engaged in spontaneous land sales on the basis of these decrees in regions such as Karelia and Irkutsk.

2. It has also been observed that those enterprises that do not yet truly own "their" land are unable to use it as collateral for raising needed capital.

There is no doubt that the Russian law on pledge is dysfunctional in this regard. For this reason, it has been identified as a priority by the President's Legal Office and State Duma and is being redrafted for submission to the Duma under USAID's Legal Reform Project.

3. The GOR retained a controlling stake in ownership by retaining 20 percent of the stock.

Notwithstanding this limited retained stake, the World Bank found that, as of October 1993, nearly 90% of privatized companies had held their shareholders meetings. The implication, drawn by the World Bank on the basis of its survey was that "[i]t will take a while before shareholders begin to realize their power,

and see the connection between corporate performance and dividend payment; over time markets in shares will have to be developed, corporate takeovers and strategic investments will ensue, board membership will change and managerial behavior will respond to shareholder pressure." According to GOR pronouncements, this has begun to occur: approximately 1 in 10 general directors have already been replaced by shareholder meetings. Moreover, shareholders will see further gains as a result of work performed under an Omnibus task order to develop shareholders rights committees. For example, managers of Russia's largest companies, including industrial giants such as LOMO, Gazprom and Lukoil, as well as leading voucher investment funds such as Moscow Realty and First Voucher Fund, signed the National Declaration on Shareholders Rights on October 5, 1994, thereby agreeing to establish and implement internationally accepted principles of corporate governance and shareholder rights. This Declaration can be seen as sending a positive message to investors that privatized companies expect long-term benefits from observing shareholders rights, including long-term profitable growth.

4. Privatized firms have little chance of restructuring as no new capital was generated for the enterprises through the auction process because of the use of vouchers.

The GOR made a deliberate decision that vouchers were to be distributed free of charge in order to encourage maximum participation in the process of economic reform. USAID agreed with this and recognized that there was a risk and actively took other steps to ensure that restructuring was possible, such as in the capital markets projects. Not only would it have been impossible to capture the value Russia's assets to be privatized (even if such value could be determined), but charging the population that amount, or even a symbolic sum would have led to charges that privatization favored the wealthy ab initio. Under the GOR's Program for the Privatization of State and Municipal Enterprises in the Russian Federation after July 1, 1994, 51 percent of new capital generated through cash auctions of the 20 percent of shares still held by the state will be allocated to the respective enterprise.

5. Public disclosure of financial information is still limited but it is likely that criminal elements have largely benefitted from the process.

The rapid transfer of assets without a proper

legislative/regulatory framework may have created opportunities for criminal elements to engage in activities counterproductive to market reforms. However, because of work implemented under USAID-funded projects, an increasing number of market participants, including privatized firms and licensed voucher investment funds, are required to disclose critical information. For example, licensed voucher investment funds are required to publish quarterly reports including their balance sheets (see Supplement 2 "Position on Specialized Investment Funds Accumulating Privatization Checks of Citizens" to Presidential Decree 1186, Chapter 7, on Reporting (Article 4))). Moreover, USAID-funded capital markets activities have, among their objectives, development and acceptance of other disclosure requirements designed to make the marketplace more transparent, including adoption of listing standards for companies seeking to access the capital markets.

With regard to the question "How near are most newly privatized entities to becoming economically viable?" the draft report does not mention the restructuring progress being shown by privatized Russian enterprises. An October 1993 survey by the World Bank contains the indicators and information supplied below. We feel the draft audit should be modified accordingly.

#### 1) Enterprise Performance

- 65% able to cover cash costs
- 22% have increased production volume in the last 3-4 months
- 43% have had production declines (34% have had steady production)

According to the World Bank, these and other data imply that "[b]anks and investors must choose carefully in this uncertain and rapidly changing environment; a sizable number of business failures seems inevitable, but there are prospects for recovery and growth led by the 'winners', provided the economy stabilizes, and financial and other support is available for those who deserve it; 'good' lending prospects for banks are a minority of enterprises."

#### 2) Enterprise Restructuring/Adaptation

- 60% of firms have laid off workers in the past year
- 47% have changed their product mix
- 57% have changed the means of employee reward
- 50% plan to invest in the short term, 66% in the next 2-3 years

According to the World Bank, these data imply that "[m]any

firms can and will restructure on their own; others will need incentives and support, financial and otherwise; the more adaptable firms are more attractive prospects for banks and investors--less flexible and weaker firms are greater risks for business failure, with the resulting unemployment impact."

### 3) Technical Assistance Needs

- 34% of firms report needing marketing assistance
- Virtually all firms wanted practical, "how-to" information and guidance, primarily short-term, from private-sector experienced specialists
- Most firms were willing to pay part of the costs

### Legal Reform Work with Natural Monopolies

The section on legal reform work (pages 24-25) contains several inaccuracies. Reference interviewee stated the coordination problems occurred during the initial phase of USAID law reform assistance efforts. Interviewee also stated we have entered a second phase of these types of activities and their coordination at the USAID level has greatly improved such that the current activities are highly complementary. The Mission insists that contractors - e.g. those working on specific sections of the civil code - keep each other informed as appropriate. The fact that we have an overall coordinating mechanism has prevented "potential" overlaps and conflicts from becoming a reality. In brief, in such a large program, there is always the potential or chance for duplication; one can never be absolutely assured that everything is being reported at all times. But the implication that the chance of duplication is a significant problem is not an accurate representation of what the interviewee said nor an appropriate conclusion from his statements.

## Attachment B

### Update on Bureau Monitoring and Evaluation System

The core of the system is a set of 14 program objectives under ENI's three strategic assistance areas, economic restructuring, democracy, and social sector restructuring/quality of life. These objectives are common to all country programs, although the emphasis placed on the 14 objectives may differ in different countries. Six of the program objectives are included in the economic restructuring area. These are: transfer state owned assets to the private sector; establish a policy, legal and regulatory framework conducive to broad-based competition and private sector growth; stimulate development of private sector enterprises; promote fiscal reform; develop a competitive, efficient private financial sector; and promote sustainable use of natural resources.

Against each of these objectives there are a menu of indicators that can be assessed through evaluations and other means that will show whether there is progress towards the attainment of the strategic objectives. ENI field personnel, with the assistance of staff in ENI/W are completing the selection of indicators appropriate to AID assistance activities in their countries and against these indicators they are establishing targets to be achieved with the assistance. ENI staff are also identifying the specific assistance activities (contracts, grants, cooperative agreements, etc) that contribute to the achievement of the country specific targets.

To date, all but a few of the ENI field offices have submitted targets arrayed against indicators and program objectives to ENI/W for review and reviews have been completed for approximately half of the country submissions and the submissions returned to the field for necessary clarifications, primarily related to the addition of greater specific of targets (time frames, baseline information, and, where possible, more quantification of targets. This part of the overall ENI system is targeted for completion before the end of March, 1995. Current indications are that this date will be met.

Subsequently, field offices will be required to report semi-annually progress towards achieving the 14 program objectives in each country and the targets established by the field for the assistance program. The first such report will be due in the fall of 1995.

Thus, by the end of March we will have in place not only targets for privatization and restructuring objectives in Russia, but targets for all relevant objectives in all ENI countries.

It is important to understand that this level of the ENI system is not intended to show a target for each assistance activity. Rather, targets may well represent the intended end result of related activities.

However, the ENI system does provide for the identification of the results expected from each activity and for reporting against those results through the preparation of task orders and/or annual workplans for each activity. These task orders and/or workplans are to identify the program objective and target(s) to which the activity contributes, what specifically is to be accomplished by the activity (sometimes called the activity's goals or objectives) toward the target in the timeframe of the workplan, and how the accomplishments will be determined (such as through "indicators" particular to the activity). Again, there will be periodic reporting of progress in achieving the results set forth in the work plans.

Finally, this information will be included in the ENI data base which also is to include obligation and expenditure information for each activity. When the system is completed this year we anticipate that it will be possible to compare expenditures to progress in achieving targets and program objectives.

Thus, we believe that when completed this year, the ENI system will satisfy recommendations one and two in the draft audit report.