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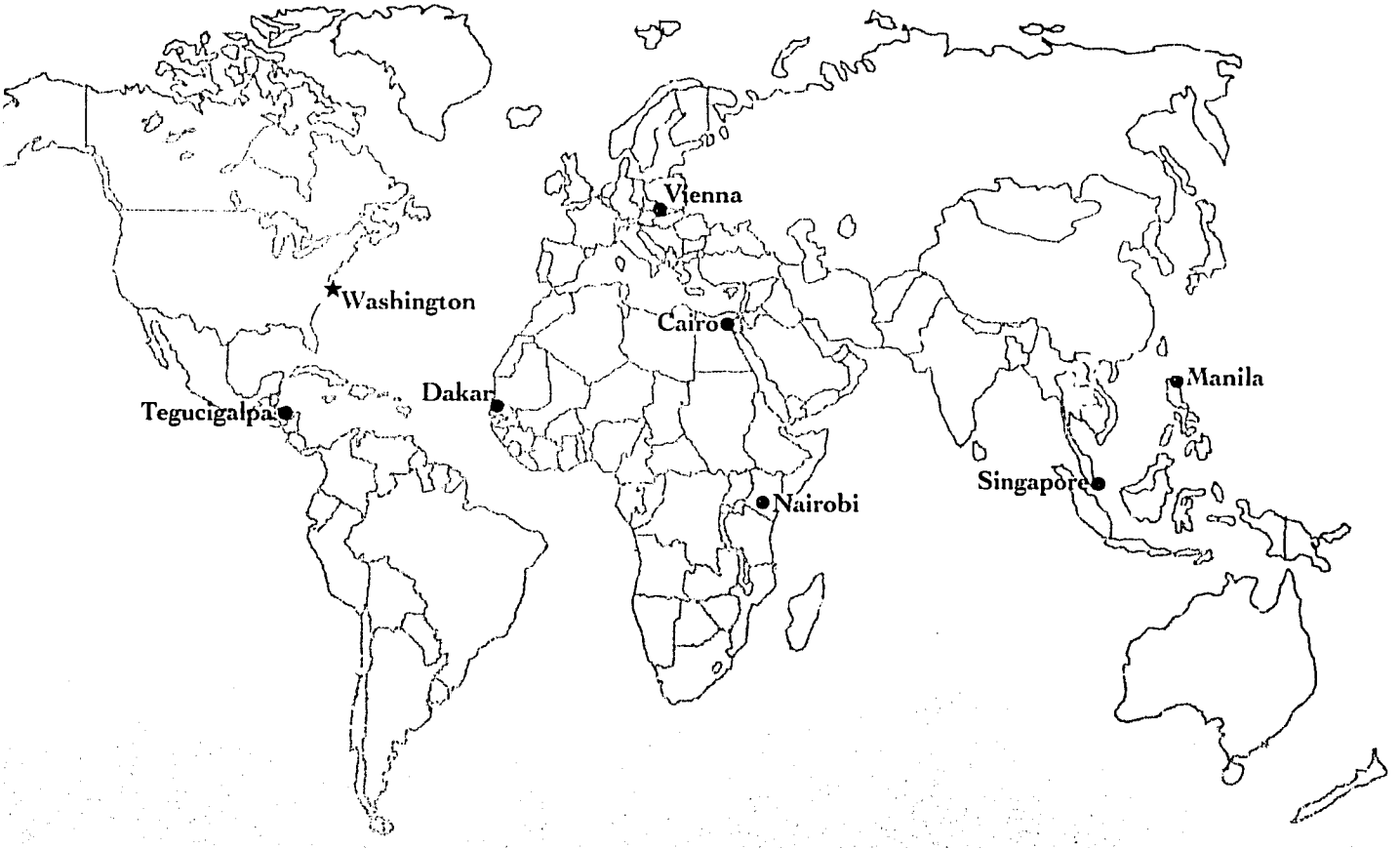
Regional Inspector General for Audit
Bonn

Audit of Activities to Improve Crop Storage Systems in the New Independent States (Project No. 110-0006)

Report No. 8-110-94-014
August 31, 1994



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U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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August 31, 1994

MEMORANDUM FOR DAA/ENI/PA, Barbara Turner

FROM: RIG/A/B, John P. Competello

SUBJECT: Audit of Activities to Improve Crop Storage Systems in the New Independent States (Project No. 110-0006), Audit Report No. 8-110-94-014

This is our final report on the subject audit. In preparing the report we carefully considered the comments your staff provided to the July 25, 1994 draft report. We have included the comments in their entirety as Appendix II

Based on your actions we have closed part three of the report's recommendation and consider parts one and two resolved. We will close parts one and two upon receipt of documented evidence that they have been fully implemented. Additionally, the amount of cost savings resulting from this audit has been mutually agreed to be $450,000. Until we have closed parts one and two of the report's recommendation, please provide us with monthly status reports on any additional information related to actions planned or taken to implement these two.

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

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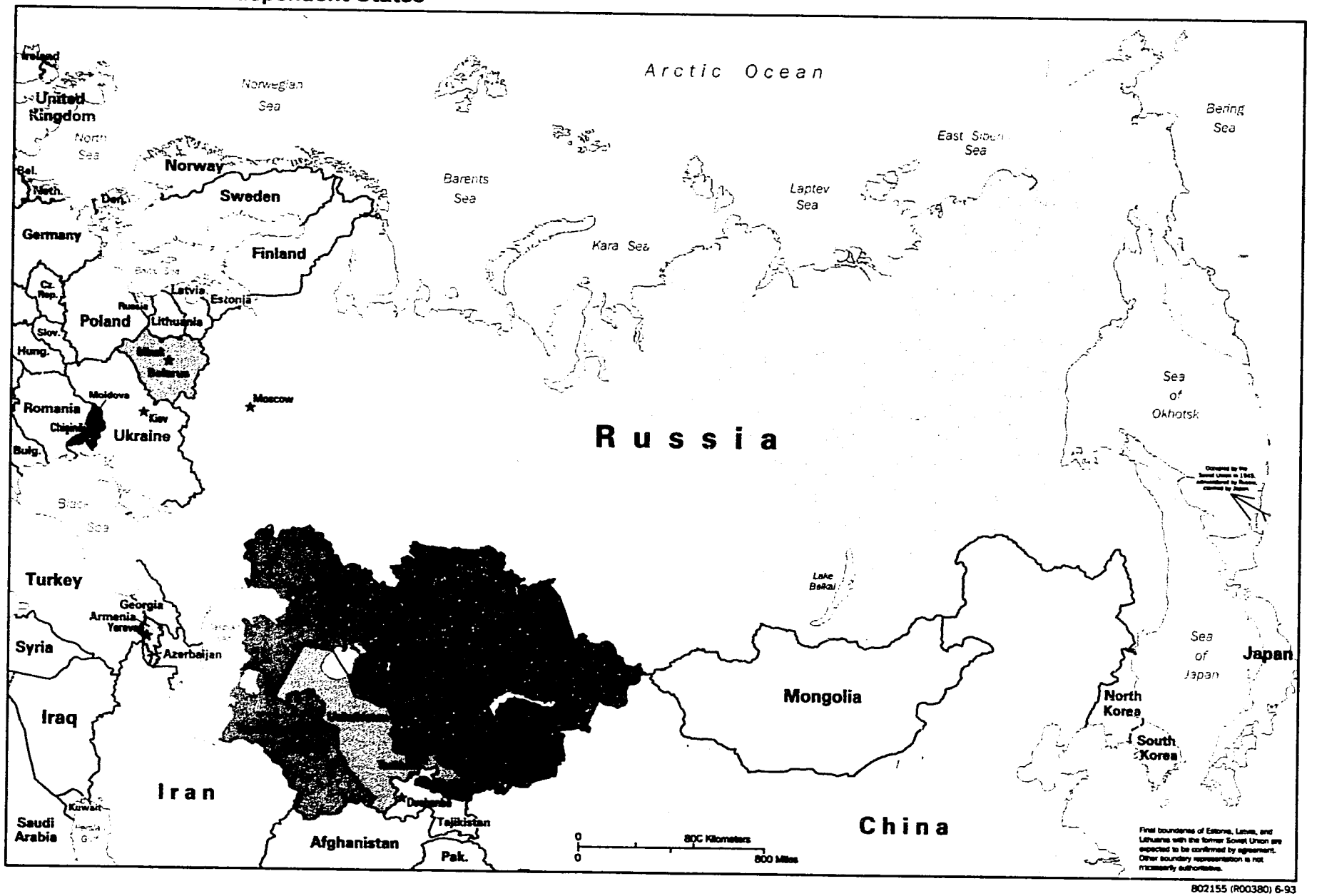

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EXECUTIVE SUMMARY

In May 1992 the United States Agency for International Development (USAID) authorized the Food Systems Restructuring Project (No. 110-0006). The purpose of this project is to help ameliorate food shortage problems in the Newly Independent States of the former Soviet Union (NIS) through the introduction of improved methods of producing, harvesting, storing, processing, transporting, and marketing agricultural products. As of March 31, 1994 USAID had spent about $13.7 million of the project's $43.4 million in obligations.

This audit covers storage activities which were to provide emergency assistance in reducing post-harvest losses of grains and potatoes in Russia, Ukraine, and Kazakhstan. USAID had spent about $3.1 million of the project's $3.7 million in obligations for this component. These funds have been used to assess storage needs in the NIS, and to procure, deliver and partially install crop storage facilities. The funds were also used to provide storage-related technical assistance and training to project beneficiaries. Of these various activities, the greatest expense at the time of the audit had been associated with the procurement and delivery of grain and potato storage facilities.

The project's storage component was included in the Office of the Inspector General's fiscal year 1994 annual audit plan primarily because of its tangible aspects. The audit was designed to determine if the Bureau for Europe and the New Independent States (ENI) managed the storage systems activities to ensure that USAID-financed inputs were provided as agreed, and resulted in planned outputs; and if the outputs contributed to achieving the storage system's purpose of reducing grain and potato post-harvest storage losses.

The audit revealed that the ENI Bureau generally managed the storage systems component to ensure that USAID-financed inputs were provided as agreed; however, these inputs did not result in planned outputs. For example, USAID obligated approximately $2.4 million for the purpose of installing a total of 80 emergency grain and 2 potato storage systems in Russia, Ukraine, and Kazakhstan by the 1992 (grain) and 1993 (potato) winters. However, after spending approximately $2.3 million as of March 1994, only one grain storage system was fully installed and the agreements covering these activities between USAID and U.S. based companies had expired. The project had not progressed as planned due to a series of errors and lapses in judgement beginning with the decision to characterize crop storage problems in the NIS as an "emergency" even though no emergency existed. As a result, the incomplete storage facilities have had only negligible, if any, effect on reducing storage losses in the NIS (page 4).

In an attempt to re-invigorate the project, ENI planned to spend an additional $1.2 million and up to two more years to complete more storage facilities. However in May 1994, after considering the preliminary results from this audit, the Assistant Administrator/ENI believed a better course of action would be to bring all storage component activities to an orderly termination by November 30, 1994. Curtailing storage activities is estimated to result in cost savings of $450,000 (page 10).

To correct the causes of the problems ENI encountered, we are recommending that ENI prepare and disseminate a "lessons learned" document to record for institutional purposes the pitfalls encountered and the lapses in judgement which occurred under the storage component to include guidance regarding NIS Coordinator Office directives and the limitations to be placed in resorting to "emergency" funding procedures per Agency guidance and sound management practices. We are also recommending that ENI make a formal determination and report on how it plans to dispose of the U.S. components for the 18 grain storage facilities now slated to be constructed in Kazakhstan, and ensure that the USAID General Counsel provides to the Inspector General Legal Counsel its response to the issues raised and questions posed in our discussion draft of this report (page 12).

The audit also found that ENI did not design the project to include a system for measuring project results because of ENI's haste to implement the project. As a result, USAID had no appropriate system to measure the effect, if any, that the completed storage systems would have had on reducing storage losses. However, since project activities will be terminated by November 30, 1994, and because of the late stages in project implementation, we do not believe it cost effective to establish a measuring system at this point. Nevertheless, we have included a discussion of the condition and have suggested that USAID monitor the storage systems as closely as possible for future use (page 14).

USAID generally agreed with the findings and recommendation, although took exception with portions of the report's narrative. ENI provided us with appropriate documentation of its actions to close part three of the report's recommendation. Parts one and two of the report's recommendation are considered resolved and we will close them on receipt of written evidence that they have been appropriately implemented.

Office of the Inspector General

Office of the Inspector General
September 1994

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INTRODUCTION

Background

In May 1992, the United States Agency for International Development (USAID) authorized the Food Systems Restructuring Project (No. 110-0006). The purpose of this project is to help ameliorate food shortage problems in the Newly Independent States of the former Soviet Union (NIS) through the introduction of improved methods of producing, harvesting, storing, processing, transporting, and marketing agricultural products. As of March 31, 1994 USAID had spent about $13.7 million of the project's $43.4 million in obligations.

This audit covers the project's storage component which was to provide "emergency assistance" in reducing post-harvest losses of grains and potatoes in Russia, Ukraine, and Kazakhstan. USAID had spent about $3.1 million of the $3.7 million in obligations under this component. These funds have been used to assess storage needs in the NIS, and to procure, deliver, and partially install storage facilities. The funds were also used to provide storage-related technical assistance and training to project beneficiaries. Of these various activities, the greatest expense at the time of the audit had been associated with the procurement and delivery of the grain and potato storage facilities.

On September 30, 1992 USAID awarded two contracts totaling $1.5 million to North American Agricultural (NAA) to procure and assist in the installation of eighty 2,000-metric-ton emergency grain storage systems, of which 50 were planned for Russia, 15 for Ukraine, and 15 for Kazakhstan. All of the systems were to be ready for use by December 1992. NAA signed several agreements with two private Russian organizations to help complete and install the facilities; however, USAID's contracts with NAA expired before all of the storage component's activities were completed. Subsequently, USAID/Washington delegated authority to USAID/Moscow to complete the project in Russia and Ukraine, but retained authority for completing the project in Kazakhstan. On April 29, 1994 USAID/Moscow awarded a $897,600 grant to Citizens Network for Foreign Affairs (CNFA), a private voluntary organization working with USAID/Moscow on other projects, for the purpose of completing the grain storage component of the Food Systems Restructuring project.

With regard to the potato storage facilities, on January 15, 1993, USAID awarded a $920,000 cooperative agreement to Global Steel, Inc. to provide two 5,000-metric-ton potato storage facilities, one each in Russia and Ukraine, in time for the Fall 1993 potato harvest. However, USAID's agreement with Global Steel, Inc. expired before the

storage units were completed. In June 1994 USAID extended Global Steel's agreement and provided an additional $283,372 to complete the facilities.[1]

The Department of State NIS Coordinator, an office established by the FREEDOM Support Act to ensure maximum coordination within the Executive Branch on United States support and assistance for Russia, Ukraine and the other newly independent states of the former Soviet Union, actively participated with USAID in the decision to undertake the storage activities. USAID's Bureau for Europe and the New Independent States (ENI) has primary management and oversight responsibility for the storage activities. However, as previously mentioned, USAID/Moscow has now been assigned responsibility for completing the grain storage systems delivered to Russia and Ukraine.

Audit Objectives

The audit was made to determine if: (1) USAID-financed storage commodities and technical assistance (inputs) were provided as agreed; (2) the inputs resulted in planned grain and potato storage facilities (outputs); and (3) the outputs achieved the desired project purpose (outcome). These activities were included in the Office of the Inspector General's fiscal year 1994 annual audit plan primarily because of their tangible aspects. Specifically, the audit was designed to answer the following objectives:

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

- **Did the outputs help reduce post-harvest grain and potato storage losses?**

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

[1] The CNFA grant and agreement with Global Steel, Inc. were in the process of being revised based on a decision made by the Assistant Administrator for the Bureau for Europe and the New Independent States to discontinue storage activities. This decision was reached after considering preliminary audit information. The CNFA grant termination date was shortened by 17 months from April 30, 1996 to November 30, 1994 (see pages 10 through 12 for more detail).

REPORT OF AUDIT FINDINGS

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

For the most part, the Bureau for Europe and the New Independent States (ENI) managed the storage systems activities to ensure that USAID-financed inputs were provided as agreed; however, ENI did not manage the inputs to ensure the accomplishment of planned outputs.

ENI generally ensured that USAID-financed inputs were provided as agreed. For example:

- Grants totaling $588,400 were awarded to Kansas State University's Food and Feed Grains Institute (KSU) and the University of Idaho Postharvest Institute for Perishables (PIP) to assess grain and potato storage needs in the NIS. The assessments were performed and the institutions delivered their reports to USAID;

- Two contracts totaling $1.5 million were awarded to North American Agricultural to procure and deliver U.S. components for the construction of 80 emergency grain storage facilities, and assist in the installation of the facilities. The components were delivered to Russia in 1992 and 1993;

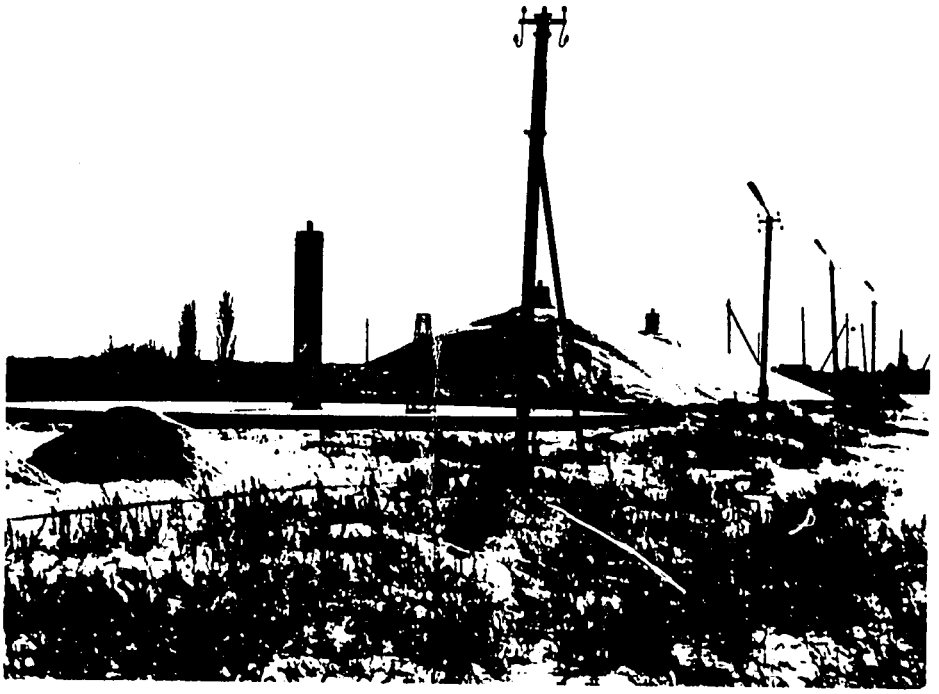
- A $920,000 cooperative agreement was awarded to Global Steel, Inc. to deliver the materials and expertise to construct two potato storage facilities. The materials were delivered by August 1993; and

- A $645,000 cooperative agreement was also awarded to PIP to provide technical assistance and training to address problems relating to potato harvesting in the NIS. The technical assistance and training was being provided.

However, despite the delivery of the materials and expertise necessary to construct the storage facilities, the audit disclosed that almost none of the facilities had been completed as planned. A discussion of the problems contributing to this condition follows.

ENI Needs to Ensure That
Pitfalls Be Avoided in the Future

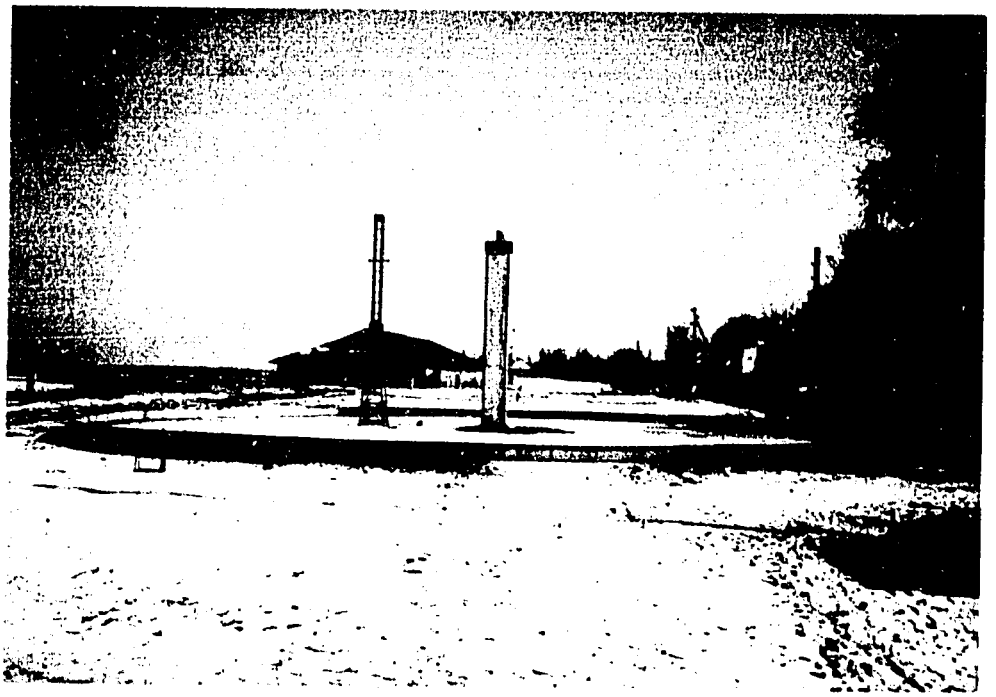
On September 30, 1992 USAID awarded two contracts totaling $1.5 million to North American Agriculture (NAA) to procure and assist in the installation of a total of 80 emergency grain storage systems; 50 in Russia, 15 in Ukraine and 15 in Kazakhstan. Private farmers were to be the recipients of the storage facilities and other equipment. According to the two contracts, NAA was to coordinate the production and shipment of components produced by U.S. corporations as well as assist in the installation and filling of the storage systems. The systems were to be fabricated by December 1992, partly in the U.S. and partly in Russia. To accomplish this, NAA entered into sub-agreements with two private Russian organizations, Gosniti Institute and Agroproduct.[2]



Grain storage system at demonstration site near Volgodonsk, Russia. One system consists of four, 500-metric-ton bins. (February 1994)

[2] According to the sub-agreements these organizations were responsible for, among other things, the identification of sites for placement of the storage facilities, as well as the production of components in Russia, and the warehousing and distribution of the storage system components. The two organizations were to assume the expenses connected with completing the grain storage facilities with Russian fabricated parts. Additionally, they were to provide storing, transportation, and installation and related technical services.

However, the audit found that after spending approximately $1.4 million as of March 1994,[3] only one grain storage system was fully installed and the agreements covering these activities had expired. Specifically, the audit found that: (1) not 50, but 57 systems were in Russia, of which 1 was fully installed and the remaining 56 were in different stages of completion; (2) only 5 of the 15 systems were delivered to Ukraine, and they were in varying stages of completion; and (3) not 15, but 18 systems were reportedly delivered to Kazakhstan. The audit did not pursue the reasons for the differences between the actual and planned deliveries of the storage facilities to specific locations, rather the audit concentrated on determining why the 80 complexes were not installed by December 1992.

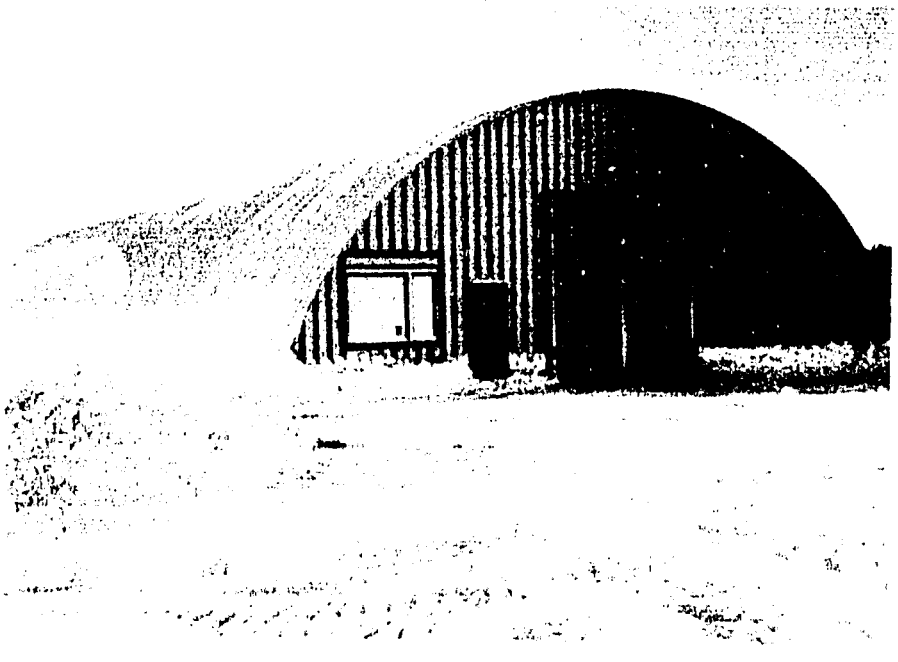


Incomplete grain storage system near Volgodonsk, Russia (February 1994).

[3] Besides the $1.4 million contract between USAID and NAA for the delivery of the U.S. components to the grain storage facilities, USAID also contracted with NAA and provided approximately $100,000 for installation and advisory services. NAA was to be paid on a turn-key basis after NAA provided certification that the installation was complete and the advisory services provided. Because of NAA's failure to complete the activities within the agreed upon time, USAID has not fully paid NAA under this contract.

On January 15, 1993 USAID awarded a $920,000 cooperative agreement to Global Steel, Inc. to provide two 5,000-metric-ton potato storage systems, one to be located in Russia and the other in Ukraine. The systems were to be fabricated partly in the U.S. and partly in Ukraine and Russia in time for the 1993 Fall potato harvest. However, the audit found that after spending $920,000 as of March 1994, neither of the two systems had been completed to the point where they could be used to store potatoes.

The 5,000-metric-ton potato storage facility consists of two 2,500-ton storage units. This facility was constructed on a State-owned farm outside Kiev, Ukraine. At the time of the audit, the facility still lacked foam insulation and other materials before it could be used. (February 1994)



The potato storage facility installed in Russia was divided into two smaller units. This sub-unit was constructed on a farm outside Vladimir, Russia. Like the facility in Ukraine, the building needed foam insulation before it could be used. A location for the other half of the storage facility had yet to be selected. (February 1994)

The grain and potato storage facilities had not been completed as planned because of various problems experienced by ENI and its U.S. contractors in designing, implementing, and monitoring project activities. For example:

- The project was not designed with a clear objective as to the intended beneficiaries of the storage systems or exactly what contributions were required from the intended beneficiaries. With respect to the grain storage facilities, this lack of clarity resulted in USAID rejecting NAA's original list of potential beneficiary farms. USAID felt the majority of the farms on NAA's list were large State-owned farms, whereas USAID preferred to place the facilities on smaller private farms. The rejection of the original farms further delayed the installation of the facilities.

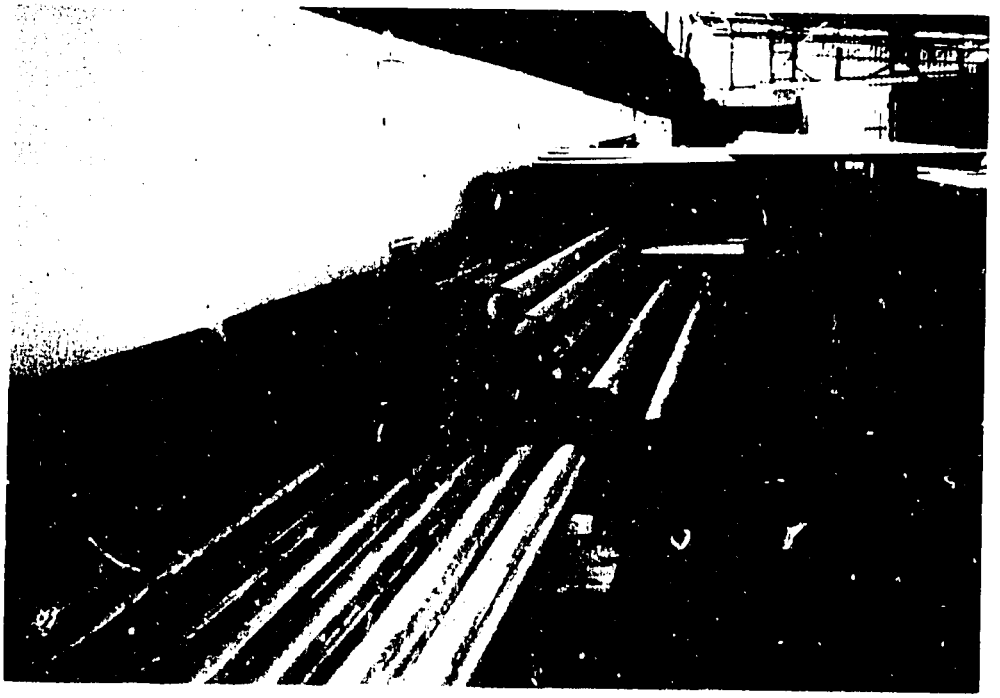
  The decision to focus on smaller, private farms surfaced another problem which also was not addressed during the project's design. The audit revealed that NAA's Russian partner, Agroproduct, required the project recipients to pay at least the U.S. dollar equivalent of $3,000 for the storage facility. However, USAID's contracts with NAA were silent as to what, if any, contributions were expected from the recipients. This fact led to confusion as to whether the level of payments made were appropriate, or even feasible, for the smaller, private farm. Subsequently, USAID has stated that they had intended that recipients would have to pay, but they did not specify this in early project documentation.

- The problems experienced with project implementation can also be linked to ENI not taking adequate steps to mitigate the high risks associated with relying on a contractor in poor financial condition,[4] and using two unknown Russian partners. We believe ENI could have done more to minimize these risks by reviewing and approving the various agreements entered into between NAA and its Russian partners to ensure implementation responsibilities were clearly defined and USAID had remedies for non-performance. In an attempt to determine the Russian partners' legal responsibilities under the various agreements, we requested the Inspector General's Legal Counsel to review the agreements. This review concluded that the agreements provided only a cursory outline of the three parties' responsibilities under the agreements. Furthermore, the

[4] According to ENI, USAID's Office of Procurement advised ENI of NAA's adverse financial condition and inherent risks that it may encounter financial problems in carrying out the proposed program. The Office of Procurement, therefore, could not make a positive determination regarding NAA's responsibility, as required by the Federal Acquisition Regulations, as a precondition for contract award. Nevertheless, ENI exercised "notwithstanding" authority, permitted under the FREEDOM Support Act, in order to award NAA the contract and justified their actions on the basis that time was of the essence and NAA was uniquely qualified for the procurement.

agreements did not contain explicit provisions stating what work must be completed, and what remedies existed for failure to perform.

ENI did not conduct any site visits, and USAID's field Missions conducted very limited site visits to the proposed grain and potato sites in Russia and Ukraine, and to the factory and warehouse in Russia that was fabricating certain grain storage components and storing the facilities prior to their installation. ENI also did not ensure that NAA submitted quarterly progress reports, as specified in its contract with USAID. Particularly with respect to NAA's poor financial condition, USAID should have been more involved in closely monitoring NAA's activities. Had ENI or the field Missions conducted site visits, and had they been kept informed through the contractor's reports, as required, many of the problems encountered during implementation of this component could have been detected in time to take corrective action.



Augers for lifting grain at the storage facilities warehoused in Krasnodar, Russia awaiting distribution eighteen months after the project began (February 1994).

Tarps for the grain storage systems are hand sewn using one of the two sewing machines provided by NAA. Problems in sewing the tarps have contributed to the project delays. (Krasnodar, Russia--February 1994)

While these problems contributed to the conditions found, in our opinion, the root cause can be traced to USAID managements' decision to characterize the storage problems in the NIS as an "emergency." This characterization was not supported by the USAID-financed assessments of the storage conditions in the NIS. For example, in August 1992, Kansas State University (KSU) assessed the grain storage problems in Russia and Ukraine and reported its findings and recommendations to USAID. According to the assessment report, KSU concluded that while there was no question that modern grain storage and handling systems were needed by the private sector on or near the farm, "...**THE LACK THEREOF IS NOT GOING TO HAVE AN EFFECT ON THE FOOD SUPPLY FOR THE 92-93 WINTER, AND PROBABLY NOT FOR THE 93-94 WINTER.**"[5] Likewise, according to the Postharvest Institute for Perishables (PIP) assessment of potato storage needs, "...there were no signs of a shortage of potatoes in the foreseeable future for either Russia or Ukraine..." Therefore, although the agricultural experts concluded that there were no emergency storage needs at the time, ENI still decided to fund the procurement of the storage facilities as "emergency assistance." During our fieldwork in Russia, we also interviewed the Minister-Counselor for Agricultural Affairs at the U.S. Embassy in Moscow regarding the storage situation in the NIS. Basically, he agreed with the assessment's overall conclusion that there was no crisis situation in the NIS at that time.

[5] The original text was in bold and all capital letters. The statement has been quoted exactly as it was presented in the assessment report.

While ENI officials have readily characterized this project as ill-conceived and flawed in its design, they also stated that their actions were in direct response to pressure exerted by the Department of State's NIS Coordinator to procure and implement the storage systems as quickly as possible. According to the original project officer for the storage systems component, the then NIS Coordinator wanted something done immediately and emphatically told the project officer during a meeting that this project must go forward. Based on the urgency of their directive, ENI evidently felt there was no option but to proceed with the project, notwithstanding the conclusions reached by KSU and PIP. The foregoing notwithstanding, characterizing a situation as an emergency in the face of expert advice that no emergency existed merely to justify the waiver of standard operating procedures and controls clearly was not warranted, and in our view, led directly to the situation that now needs to be addressed.

The end result of all the activities since their inception in May 1992, is that the implementation of the grain and potato storage systems is far behind schedule and to date the incomplete storage facilities have had negligible, if any, effect on reducing storage losses in the NIS.

USAID has approved additional funds
to complete the grain and potato storage systems

Due to the problems experienced with the North American Agricultural and its Russian partners, USAID decided to allow NAA's contract to expire on September 30, 1993. While USAID was weighing its options about what to do with this project, USAID/Moscow received a proposal from another U.S. contractor, the Citizens Network for Foreign Affairs (CNFA), to complete the grain storage project in Russia and Ukraine over two years at a cost of approximately $900,000. On February 7, 1994 ENI authorized USAID/Moscow to approve and manage this proposal. Prior to awarding the grant, USAID/Moscow had CNFA perform a preliminary assessment, develop a plan, and identify the location of the U.S.-made and locally-made grain storage components. In April 1994, USAID reported that CNFA had accounted for all 57 of the complexes for Russia and the 5 for Ukraine. USAID/Moscow also reported that CNFA confirmed that the locally produced components for the 18 complexes slated for Kazakhstan were shipped from Russia; however, CNFA was unable to determine where the U.S. components for the 18 complexes were being held. With respect to the potato storage facilities, notwithstanding the fact that the facilities had yet to be used to store potatoes, ENI believed that the delays were beyond the control of the U.S. contractor, Global Steel, Inc, and were considering extending its agreement.

Since the new grain storage award proposal was being considered at the time of this audit, the regional contracting officer requested the auditors to review and comment on its merit. Accordingly, the regional contracting officer stated in a letter to CNFA that although USAID intends to award the grant to CNFA, "the final program may be changed based on the recommendations from IG/A [Inspector General/Audit]." We then

issued a memorandum to the Acting Deputy Assistant Administer for ENI on March 25, 1994 which, among other things, suggested that no additional funds be spent on the storage activities until ENI had identified and addressed essential questions and concerns affecting these activities. Our memorandum and subsequent April 8, 1994 audit discussion draft listed many of these concerns. Similar comments were also conveyed by the Inspector General in an April 8, 1994 memorandum to the Assistant Administer for ENI (our concerns and ENI's response to them are found in exhibit A.).

On April 29, 1994, prior to responding to our position, USAID/Moscow awarded a grant of $897,600 to CNFA effective through April 30, 1996. Also, on June 1, 1994, ENI amended Global Steel, Inc's. agreement to complete the potato storage facilities at an additional cost of $283,372. In response to the Inspector General, ENI officials stated that they had already marshalled substantial staff resources to examine the 17 issues that we had brought to their attention, analyzed the options, and reached conclusions with regard to these activities. However, ENI noted that the USAID General Counsel was still considering five related legal issues, and ENI had not yet made a final decision on the disposition of the 18 grain storage systems slated for Kazakhstan. Nevertheless, the Assistant Administer for ENI decided that the most prudent, most cost-effective and most efficient approach for all purposes was to undertake a prompt and orderly termination of all storage component activities by November 30, 1994. Some of the main determinative factors for this decision included:

- USAID received a discussion draft of this report which was deemed severely critical. Continuation of the activity and the expenditure of additional funds with no certainty of achieving the project's objective in these circumstances could result in additional scrutiny;

- the rationale for this activity was to provide emergency systems for the 1993 grain and potato harvests, yet only one grain complex has been erected to date;

- the continued implementation of this project will require the additional expenditure of scarce resources on an activity that has been overly troublesome, continues to be highly risky, and for which no assurances exist that all 80 grain storage complexes will be available for use in the 1994 grain harvest; and

- at a time of shrinking staff resources and budgets, the Agency cannot afford to continue activities that are fraught with difficulties and demand extensive management oversight.

Accordingly, USAID/Moscow notified CNFA of USAID's decision to effect a prompt and orderly termination of all grain storage activities in Russia and Ukraine by November 30, 1994. USAID/Moscow is also in the process of negotiating the necessary revisions

to the CNFA's grant agreement of April 29, 1994, including its budget, program description, and timetable. Based on this decision to terminate the storage activities sooner than originally planned, we estimate that USAID will realize an estimated cost savings of $450,000. USAID has determined that the most expeditious approach is to terminate the project as follows:

- Assembly will only occur at sites in Russia and Ukraine where the complexes can be fully constructed and completed by November 30, 1994;

- for the complexes in Russia and Ukraine which cannot be completed, the U.S. components will be granted to the beneficiary farms;

- USAID will immediately undertake a review of current issues relating to the disposition, completion or liquidation of the 18 grain complexes slated for Kazakhstan; and

- all potato storage units will be constructed, completed or granted by November 30, 1994. If construction cannot be completed, any materials will be liquidated.

In conclusion, the Bureau for Europe and the New Independent States obligated approximately $2.4 million to install a total of 80 emergency grain and 2 potato storage systems in Russia, Ukraine, and Kazakhstan by the 1992 and 1993 winters. However as of March 1994, after spending approximately $2.3 million, only one grain storage system was fully installed while the agreements covering these activities had expired. The project had not progressed as planned due to a series of management mistakes beginning with the decision to characterize the storage problems in the NIS as an "emergency" even though no emergency existed. Bureau project managers claim that this crucial decision was made in response to pressure exerted by the Department of State NIS Coordinator to implement the project as quickly as possible. As a result, the incomplete storage facilities have had negligible, if any, effect on reducing storage losses in the NIS. In an attempt to re-invigorate the project, the Bureau planned to spend an additional $1.2 million and up to two more years to complete more of the storage facilities, but only in Russia and Ukraine. The Bureau has not made a final decision regarding the grain storage systems delivered to Kazakhstan. However in May 1994, after considering preliminary audit results, the Assistant Administrator/ENI instructed Bureau staff to bring all project activities to an orderly conclusion by November 30, 1994. Curtailing project activities is estimated to result in cost savings of $450,000.

Recommendation No. 1: We recommend that the Bureau for Europe and the New Independent States:

1.1 prepare and disseminate a "lessons learned" document to record for institutional purposes the pitfalls encountered and the lapses in judgement

which occurred under the storage component to include guidance regarding the Department of States NIS Coordinator's Office directives and the limitations to be placed in resorting to "emergency" funding procedures per Agency guidance and sound management practices;

1.2 make a formal determination and report on how it plans to dispose of the U.S. components for the 18 grain storage facilities now slated to be constructed in Kazakhstan; and

1.3 ensure that the USAID General Counsel provide to the Inspector General Legal Counsel its response to the issues raised and questions posed in our discussion draft of this report (issues and ENI's responses are at Exhibit A).

Management Comments and Our Evaluation

The Bureau for Europe and the New Independent States (ENI) generally agreed with the report's findings and recommendation. However, ENI requested that the narrative be revised to better reflect the urgency felt by the Department of State and USAID to respond to immediate needs in the NIS, and USAID's knowledge of the 18 grain storage complexes slated for Kazakhstan. We made minor modifications to the discussion to reflect ENI's concerns. The Bureau also believed that there was a great deal more monitoring and management of the storage program than indicated in the draft report. In their comments, ENI stated that given the limited number of staff available in ENI and the field, they did as much as they could. While we recognize ENI's staffing constraints, given the high risks involved with this project--using a U.S. contractor with an adverse financial condition and unknown Russian partners to implement a complex project with design flaws--necessitated ENI and the field to take extraordinary measures to properly monitor the project.

The Bureau provided RIG/A/B with appropriate documentation of its actions to close part three of the report's recommendation. ENI has agreed and provided assurances that it will implement parts one and two of the report's recommendation. These two parts are considered resolved. We will close part one upon evidence that a separate "lessons learned" document has been prepared to include guidance on procedures to follow when receiving directives from the Department of States NIS Coordinator's Office and limitations to be placed in resorting to "emergency" funding procedures. Part two will be closed upon receipt of an Action Memorandum carrying out disposition activities for the U.S. components of the 18 grain storage facilities slated for Kazakhstan.

Did the outputs help reduce post-harvest grain and potato storage losses?

The storage component outputs have contributed little, if anything, to reducing grain and potato storage losses in the NIS.

Neither of the two potato storage facilities has yet to be used to store potatoes, and only one of the 80 grain storage facilities has been completed. Furthermore, even if the activities resulted in planned outputs, we would not be able to quantify the once completed storage facilities' contribution to reducing storage losses because USAID did not establish baseline data or other indicators to measure their effect.

ENI Should Not Finance Activities Without First Establishing A System To Measure Their Effect

USAID policy requires that a project's design provide a basis for the assessment of performance. Due to the emergency justification under which this project was undertaken, ENI did not include a system to measure its performance, and has yet to do so. Consequently, after having spent nearly $3.1 million as of March 31, 1994, and faced with an estimated additional $750,000 in expenditures, USAID will not be able to measure the impact of the project as it relates to reducing grain or potato storage losses. Since ENI has decided to terminate the storage system activities by November 30, 1994, we do not believe it would be cost effective to recommend that they establish a system for measuring the potential effect of the USAID-financed storage facilities once they become operational. Nevertheless, we would encourage USAID to monitor the activities as close as possible for future use.

According to Handbook 3, a project's design should provide a basis for the assessment of performance. In order to verify whether the project purpose is being achieved, USAID management needs to do the following: (1) the project purpose should be quantified so it is measurable; (2) baseline data needs to be developed indicating the condition at the start of the project; and (3) a management information system needs to be developed for gathering quantified data for measuring project results. Our review of the project's design found that the storage systems component's objective was never quantified, baseline data for the beneficiary farms were never developed, and a management information system to gather quantified data for measuring grain and potato storage loss reductions was never designed.

We also reviewed both USAID contracts with NAA and the cooperative agreement with Global Steel, Inc. and noted that while project target dates were included for completion of the storage systems--specific benchmarks were absent. While target dates are essential to gauge timeliness toward project outputs, benchmarks are critical to measure the

progress of reducing storage losses. USAID has recognized that this activity was incomplete in its design because of the haste with which it was approved and implemented. The result is that after having spent nearly $3.1 million as of March 31, 1994 -- and faced with an estimated additional $750,000 in expenditures -- USAID will not be able to measure the impact of the project as a whole or by individual location.

In summary, ENI should not have spent any funds on storage activities until it first had established an appropriate system to measure the effect of the activities it was financing. Nevertheless, since the majority of storage facilities are not yet fully operational, USAID should monitor the activities as close as possible for future use.

ENI's July 8, 1994 response to questions raised by the Office of the Inspector General in an April 8, 1994 discussion draft of this report

1) What were USAID's specific objectives in regard to these activities?
2) What are USAID's current specific objectives in regard to the remaining project activities?
3) Based on the answer to No.2, USAID needs to clearly specify the eligibility requirements of the intended recipients.

1) In January 1992, one of the first assistance activities announced for the NIS by the then Secretary of State was the erection of "emergency storage facilities" to respond to what was viewed as an impending severe winter and a resultant food crisis. After the announcement, USAID's NIS Task Force sent out an assessment team and determined that the situation was not as perilous as originally thought. In full recognition of the assessment findings, the Department of State made a political decision to honor the commitment of the then Secretary of State, i.e. the erection of emergency storage facilities. USAID objected but was overruled and was left to implement the decision in a manner in which made the most development sense. Because our aims in the NIS were to encourage the emergence of a market economy (initially through privatization activities) and the development of a vibrant private sector, it was decided that we would implement the grain storage activity so that it would adhere to the overall objectives of the assistance program.

Thus, the original focus of these activities was to "ensure that an increasing number of storage facilities will be decentralized and under the control of private farmers, cooperatives, and businesses, and overall losses attributed to storage will begin to decline". The NIS Task Force (there were no field Missions at that time) agreed that while this was the primary focus, the project should ensure the sustainability of the emerging private farms to the extent possible. We were aware that the farms were, and continue to be, in a state of transition. Most of the former state and collective farms have now "privatized" and/or become joint stock companies. Some are run as truly private farms and others are private in name only. For many of these farms privatization is a matter of degree. Most of the truly private farms are small ones and received land from the state or broke off from the collectives. In approving the farms to receive grain storage complexes, we were willing to consider only private farms, those into the process of privatization or joint venture partnerships with U.S. agribusinesses.

North American Agricultural, Inc. (NAA) and Agroproduct originally proposed state farms and/or joint stock companies as storage recipients. To give private farms the opportunity to obtain the complexes, and to remain within the objectives of the overall U.S. assistance program, i.e. to promote a market economy, we directed NAA to seek out private farms. When they reported difficulties, we suggested that they assess, and if appropriate, include private farms or farmer associations proposed by AKKOR (the Association of Peasant Farms and Cooperatives). At that time, it appeared that AKKOR represented an indigenous association that was committed to help newly emerging private or privatizing farms transition to a market economy.

On the technology front, we were initially quite concerned that the complexes proposed by NAA (2,000 metric tons storage systems) were inappropriate for the smaller, private farms that the project was aiming to reach. However, it was later determined that these systems could be broken down into individual units and provided with additional augurs, thus resulting in storage units that were more tailored to the requirements of the individual private farms.

2) USAID's current specific objectives are, as described in Attachment I*, to effect an orderly termination of all grain storage activities in Russia, Ukraine and Kazakhstan and potato storage activities in Russia and Ukraine by November 30, 1994.

The Citizens Network for Foreign Affairs continues to provide technical assistance and a limited amount of training to facilitate the installation of the 62 possible grain storage complexes in Russia and Ukraine. With regard to those which cannot be fully constructed and completed by the target date of November 30, 1994, the U.S.-made components will be a Grant-in-Aid to the beneficiary farms. As to the remaining grain storage complexes, USAID/Moscow and USAID/Almaty continue to discuss resolution of the disposition of the units.

As to the potato storage activities in Russia, USAID/Moscow has recently provided its approval for the construction of the second potato storage site. We are confident that both storage units will be foamed and completed well within the stipulated timeframe. In Ukraine, Global Steel is procuring the necessary chemicals to foam the potato storage unit.

3) The eligibility requirements for the intended recipients under the ongoing orderly termination phase are the same as stipulated since the inception of the grain and potato storage program. These are that the recipients must be private farms, farms in the process of privatization or joint venture partnerships with U.S. agribusinesses.

*Attachment I is ENI's Action Memorandum dated 5/20/94, which we have not included in this report.

4) Did USAID intend for project recipients to pay or contribute to the facilities, if so, how much?

Adhering to the principles of a market economy, USAID intended for project recipients to contribute to the cost of the facilities. For the potato storage units the recipients were expected to provide site preparation services, including necessary concrete foundation and electrical work, manpower to assist with construction, equipment for use in the construction process and various other services. These contributions are detailed in the protocols signed between Global Steel and the Ukrainian Potato Institute and the Russian firm "Concern Roskar".

Similarly, the grain storage construction program was based on an expectation of contributions by the recipient farms. As set out in the NAA proposal, Agroproduct was to coordinate the production, warehousing, and distribution of the locally-manufactured components while field installation of the storage units was to be performed by designated entities in Russia, Ukraine and Kazakhstan. USAID intended for the grain storage recipients to pay for the Russian-produced components, the transportation from the Krasnodar warehouse and Volgodonsk factory to the farm sites, and the costs of site preparation and erection of the complexes.

For the potato storage units no value was assigned to the expected recipient contributions. The expected contributions of the grain storage participants was not specified in early project documentation. However, a ruble equivalent cost of $3,000 to cover the Russian-produced components, storage and administrative costs was to be charged to each farm in Russia, Ukraine and Kazakhstan prior to delivery of the storage complex. The payment of $3,000 did <u>not</u> include transportation or installation costs which the recipient farms could undertake on their own. Likewise, the recipients had the option to procure a turnkey operation.

5) What legal recourse does USAID have, if any, against North American Agriculture?

North American Agricultural, Inc. has asserted claims against the Agency under one of the contracts in question (CCS-0006-C-00-2083-00). These claims could result in litigation. In response to the audit and these claims, the General Counsel's Office of USAID (GC) has researched the factual and legal issues posed by this question. The legal analysis and conclusions resulting from this research represent the work product of GC and are thus inappropriate for disclosure. Therefore GC is not providing the results of its research and analysis as a part of this response

to the audit, but will furnish a copy of those results to the Legal Counsel of the USAID Inspector General for its information and comment.

6) What leverage or other means might USAID take to influence NAA to participate in completing the project without additional funding?

Non-legal measures (if such exist) which USAID might take to have NAA complete the project at no additional cost would be not be in the interest of USAID or the United States Government, as NAA has not demonstrated the capacity to perform the tasks necessary to complete the project.

7) What legal recourse does USAID have, if any, against the Russian participating agent, Agroproduct?

USAID's determination of its rights and responsibilities vis-a-vis Agroproduct is closely related to or may affect USAID's rights and remedies with respect to NAA. Thus, the answer to this question is the same as stated in the response to Question #5.

8) What leverage or other means might USAID take to influence Agroproducts to participate in completing the project without additional funding?

While USAID could attempt to bring non-legal leverage to bear upon Agroproduct to further participate in the project, it is questionable whether this would be desirable given Agroproduct's performance to date. In fact, the ENI Bureau has sought to minimize the role of Agroproduct in completion of the project because of Agroproduct's past record.

9) Does USAID have any legal responsibility, i.e., to complete construction, provide training, etc., to any party involved with the activities including project recipients? Does responsibility differ under any of the following scenarios:

- **storage units not yet sold,**
- **storage units sold or assigned, but not yet delivered to the recipient,**
- **storage units sold and delivered, but not fully constructed,**
- **storage units sold, delivered, and constructed.**

USAID's legal responsibility, if any, to complete construction, provide training, etc., relates to or may affect USAID's rights and remedies with respect to NAA. Thus, the answer to this question is the same as the answer to Question #5.

10) Does USAID have any legal liability under the project to any party involved with the activities including project recipients? Does liability differ under any of the following scenarios:

- **storage units not yet sold,**
- **storage units sold or assigned, but not yet delivered to the recipient,**
- **storage units sold and delivered, but not fully constructed,**
- **storage units sold, delivered, and constructed.**

USAID's legal liability under the project, if any, to any party involved with the activities relates to or may affect USAID's rights and remedies with respect to NAA. Thus, the answer to this question is the same as the answer to Question #5.

11) Who has legal title to these units and what, if any, significance does this have?

The status of legal title to these units may affect USAID's rights and remedies with respect to NAA. Therefore, the answer to this question is the same as to Question #5.

12) What legal recourse does USAID have, if any, against Global Steel?

Global Steel is still performing its cooperative agreement with USAID (CCN-0006-A-00-3031-00). The time for performance will expire on October 31, 1994. Should Global Steel fail to perform by that time or otherwise breach its duties, GC at the request of the ENI Bureau will research the legal recourse available against Global Steel.

13) What leverage or other means might USAID take to influence Global Steel to participate in completing the project without additional funding?

We are not aware of any non-legal leverage USAID would have to influence Global Steel to complete the project without additional funding, other than pursuant to the terms and conditions of the cooperative agreement as amended.

14) What is the possibility of using Ukrainian Potato Institute employees, already trained to construct such facilities by Global Steel, to complete both the Ukrainian and Russian potato facilities?

We do not believe this is a viable option. The Ukrainian Potato Institute was unable to complete construction and foaming of their unit, with the assistance of Global Steel, in a timely

their unit, with the assistance of Global Steel, in a timely manner during the summer of 1993. Nor are we yet completely convinced they will be able to apply the insulation needed to complete the unit in Ukraine. Relying on a group with such a performance record to complete the second Russian facility without outside assistance does not make good management sense. We want to have storage units that are completed as designed. Additional funding for Global Steel to finish the units in Russi is the preferred option.

15) What USAID office would be in the best position to monitor and manage existing project activities?

USAID/Moscow has been delegated authority to manage the grain storage activity in Russia and Ukraine. USAID/Moscow will be responsible for the completion of the grain complexes at the qualified sites, grant-in-aid of the remainder of the U.S.-made components, and liquidating all other remaining U.S. components. USAID/Moscow will have the discretion to enter into such contracts as would be appropriate and necessary to wind up the grain storage activities. Other specific directions are include in Attachment I.*

16) Instructions defining the NIS field Mission's monitoring and oversight responsibilities for project activities should be issued.

See Attachment I.*

17) Immediate action should be taken to ensure that the 18 grain storage systems shipped to Kazakhstan are in fact there and make a determination as to the final disposition of the systems.

A team with members from USAID/Kazakhstan, USAID/Russia and Citizens Network for Foreign Affairs visited Uralsk in Western Kazakhstan in late February and verified that the Russian manufactured components for the 18 grain storage complexes were sent to Kazakhstan. Fifteen sets were delievered to AgroTechServe and three to a Joint Stock Company. Agroproduct also shipped 12 sets of the U.S. manufactured components to Kazakhstan - 3 to the Joint Stock Company and 9 to AgroTechServe (the arrival of these items was confirmed in June by USAID/Moscow via telephone calls with AgroTechService). The remaining six sets of U.S. components are still being retained in Russia by Agroproduct.

A final determination on the disposition of the systems is presently under consideration taking into account local capability to erect the complexes, additional costs that might be involved and the amount of time required to complete construction.

* See footnote on p.2.

SCOPE AND METHODOLOGY

Scope

We audited USAID's storage systems activities under the Food Systems Restructuring project (Project No. 110-0006) in accordance with generally accepted government auditing standards. As of March 31, 1994, approximately $3.1 million had been disbursed for these activities. Audit work sufficient to answer the audit objectives was conducted primarily in Moscow, Russia and Kiev, Ukraine. The audit was conducted from February 1, 1994 through June 24, 1994, and consisted of:

- reviewing project documentation, cooperative agreements, grants, contracts, quarterly progress reports, technical assessments, and other documentation relating to storage system activities in Russia, Ukraine and Kazakhstan;

- contacting USAID officials in Washington, D.C. responsible for implementing and overseeing the storage system activities in the NIS, and discussions with USAID/Moscow, USAID/Kiev and USAID/Almaty officials familiar with the storage system activities in their region;

- interviewing NIS participating organizations to ascertain the status of the project, and interviewing other NIS-based, U.S. and Russian agricultural technical experts to get their input into the storage system activities;

- site-visits to the factory in Volgodonsk, Russia and warehouse in Krasnodar, Russia to determine safeguards over storage systems and site-visits to the grain storage facility demonstration site outside Volgodonsk, Russia and another farm nearby to speak with recipients and determine status of proposed grain storage site, also visited farm in Kahovka, Ukraine to determine same; and

- site-visits to both potato storage facilities in Russia and Ukraine to determine progress made in their construction, and speak with recipients of technical assistance and training.

Methodology

The methodology for each audit objective follows.

Audit Objective One

To accomplish the first objective, we reviewed project documentation to determine what project inputs (technical assistance, training, purchase, delivery and installation of facilities and equipment) were to be provided by the contractors, sub-contractors and grantees, and what were the expected results (outputs) of these inputs. We then compared planned inputs and outputs against actual and investigated the causes for any variances. This investigation included an assessment of applicable internal controls and compliance with laws and regulations. With regard to determining if all the storage system components had been in fact delivered to the NIS, we did not perform an inventory of all the grain and storage system components. Instead, we relied on various contractor documentation, interviews with USAID personnel, and site visits to both of the potato storage facilities and two of the farms which were to receive 5 of the 80 grain storage facilities. We then determined responsibility for managing the component and what criteria the responsible person was operating under. Then, through interviews with USAID staff responsible for monitoring/overseeing activities, organizations implementing the agreements, recipients receiving the technical assistance, other donor organizations, and end-use checks at the locations where storage facilities have been installed, we determined if USAID managed the project to ensure that project inputs were provided as agreed and resulted in planned outputs.

Audit Objective Two

For the second audit objective, field work assessed if the project outputs contributed to achieving the project's goal of reducing storage losses. To accomplish this we ascertained if USAID had established an appropriate system to measure the extent to which project outputs contributed to the overall goal of reducing storage losses. We reviewed project documentation to determine if baseline data and progress indicators to be used to measure an increase in the efficiency of the food storage systems had been developed. Additionally, we made site visits to farms where the storage systems had been erected to determine what, if any, impact these systems had on individual participating farms. We also interviewed USAID officials responsible for project monitoring and other knowledgeable parties to determine if the project outputs contributed to achieving the project's goal of reducing storage losses.

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM

TO: RIG/A/BONN, John Competello

FROM: DAA/ENI, Barbara Turner

SUBJECT: Draft Audit Report of the Storage System Component under the Food Systems Restructuring Project (Project No. 110-0006)

We have reviewed the subject draft audit report and appreciate the opportunity to respond to its contents. There is no disagreement on the Bureau's part with the recommendations. As indicated in your cover memorandum of July 25, 1994 for the draft audit report, we concur in an estimated $450,000 in cost avoidance due to the Assistant Administrators's decision to terminate all storage system project activities by November 30, 1994.

Regarding Recommendation No. 1 in the draft report, our comments follow.

Recommendation No.1: WE (RIG/Bonn) recommend that the Bureau for Europe and the New Independent States:

1.1 prepare and disseminate a "lessons learned" document to record for institutional purposes the pitfalls encountered and the lapses in judgement which occurred under the storage component to include guidance regarding the Department of States NIS Coordinator's Office directives and the limitations to be placed in resorting to "emergency" funding procedures per Agency guidance and sound management practices;

I have instructed the Office Directors in the ENI Bureau to review the audit report for the Storage Systems Component of the Food Systems Restructuring Project (FSRP). This action is intended to institutionalize the contents of the audit report and provide the Bureau's senior managers an understanding of the problems that arose during the design, implementation and monitoring of the storage activity. I have also asked that Office Directors provide the audit report to appropriate staff involved with project planning and management to assure that the

information contained in the report can be applied by a broad range of ENI staff for overall program management. A copy of the Memorandum disseminating the audit report is included as Attachment I.

1.2 make a formal determination and report on how it (ENI Bureau) plans to dispose of the 18 grain storage facilities now slated to be constructed in Kazakhstan;

The ENI Bureau has decided to dispose of the 18 grain storage facilities slated for Kazakhstan by November 30, 1994. The Bureau is preparing a plan and an Action Memorandum will be executed to carry out the disposition activities.

1.3 ensure that the USAID General Counsel provide the Inspector General Legal Counsel its response to the issues raised and questions posed in our discussion draft of this report (issues and ENI's responses are at Exhibit A)

Under separate cover, the Assistant General Counsel for ENI has submitted directly to the IG Legal Counsel an analysis of the legal questions posed by RIG/Bonn related to the grain storage component under the Food Systems Restructuring Project.

I trust that the above comments and the documents attached or referred to in this cover memorandum are sufficient to close parts one and three of Recommendation No. 1 contained in the draft audit report. If there are any questions or if further discussion is required, please contact me. We are prepared to work closely with you and your staff to close this audit.

As the above indicates, we anticipate closing the audit soon. I would also like to include in our response to the draft audit report comments to clarify several sections. These comments are provided in Attachment II.

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM FOR OFFICE DIRECTORS, ENI

FROM: DAA-PA, ENI, Barbara N. Turner

SUBJECT: Audit of Storage Systems Component-Food Systems Restructuring Project (FRSP) Project No. 110-0006

Attached for your review is an audit report prepared for the Storage Systems Component under the Food Systems Restructuring Project. I consider this report required reading for all Office Directors and professional staff. The findings of this Audit Report present several important lessons learned that can be used in the design, implementation and monitoring of current and future projects. In particular, the shortcomings in developing attainable outputs at the design stage, assuring that grants and contracts contain realistic time frames for completing activities, and closely monitoring the procurement and delivery process must be avoided in the future. I am requesting that Office Directors encourage all appropriate staff to incorporate the report's contents into our planning, implementation and overall management of the Bureau's Program.

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

ATTACHMENT II

Clarifying Comments

The last full paragraph on P. 9 states "While ENI officials have readily characterized this project as ill-conceived and flawed in its design, they also stated that their actions were in direct response to pressure exerted by the Department of State's NIS Coordinator to procure and implement the storage systems as quickly as possible. According to the original project officer for the storage systems component, the then NIS Coordinator wanted something done immediately and told the project officer during a meeting that, 'by God you will do this project' ."

It should be noted in this discussion that provision of "Low Cost Food Storage" had been announced as a U.S. initiative during the Coordinating Conference on Assistance to the New Independent States opened by President Bush January 22, 1992. In his closing remarks to the Conference, Secretary Baker referred specifically to the list of U.S. initiatives, released January 23, 1992, which included a brief description of the program ..."by helping fund the installation of low-cost storage systems to reduce the amount of food wasted" (see Attachment III)*. Obviously this commitment was felt by senior State Department Officials to be a directive as reported, among other places, in U.S. News and World Report, March 29, 1993. The draft report (page 9 in particular), in our opinion, still underplays the urgency felt by State and USAID to respond to immediate needs in the NIS. We do recommend, however, that you delete the sentence on page 9, second paragraph beginning "According to the original project officer ..... Current AID/ENI management have no knowledge of this statement.

The last paragraph on page 7 which begins "ENI did not conduct...."contains narrowly accurate statements that do not completely substantiate the conclusion. ENI staff did participate on the Kansas State and University of Idaho teams which visited potential sites during July/August, 1992. Further, several USDA staff had also visited numerous potential sites. While monthly reports were not submitted by NAA, there was follow-up by ENI staff requesting the submission of required reports (See letter of June 30, 1993, Attachment IV)*. In addition the files document numerous meetings, discussions, telephone calls, e-mails and faxes which demonstrate that USAID staff both in Washington and the field were giving this activity an exceptional amount of attention. In summary, there was a great deal more monitoring and management of the storage program than the draft report indicates. Given the limited number of staff available in ENI and the field, the activity received relatively more attention than the staff resources available would normally have provided. The conclusion that corrective action could been taken overlooks the seasonality constraints, the unwillingness of NAA's Russian partner to cooperate and the difficulty in resolving field implementation problems in the NIS environment.

* Attachments III and IV are not included in this report.

ATTACHMENT II

Clarifying Comments

Paragraph one on page 10 indicates that USAID has not been able to determine what happened to the 18 complexes for Kazakhstan. In fact, 12 of the 18 units were shipped to Kazakhstan, without USAID authorization, and are in the possession of two companies, AgroTechServe and Uralsk Meat Processing Combinat. The U.S. parts for the remaining six are under the control of Agroproduct in Russia while AgroTechServe has the Russian components.