

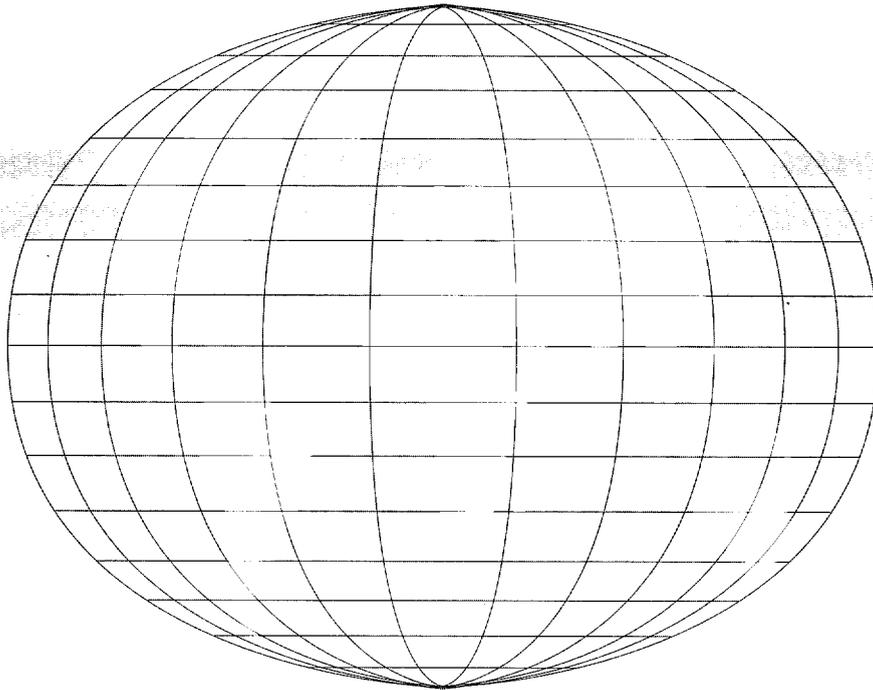
# **Report of Audit**

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## **Audit of the Bureau for Europe and New Independent States' Emergency Food Assistance Activities in the Caucasus Since Fiscal Year 1994**

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**Audit Report No. 8-110-97-001  
November 8, 1996**



**Regional Inspector General for Audit/Frankfurt**

**OFFICE OF INSPECTOR GENERAL  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**



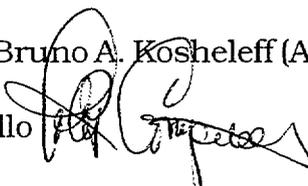
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INTERNATIONAL  
DEVELOPMENT

November 8, 1996

**MEMORANDUM**

**TO:** DAA/ENI, Donald Pressley  
USAID/Caucasus, Mission Director-Bruno A. Kosheleff (Acting)

**FROM:** RIG/A/Frankfurt, John P. Competello 

**SUBJECT:** Audit of the Bureau for Europe and New Independent States' Emergency Food Assistance Activities in the Caucasus Since Fiscal Year 1994 (Audit Report No. 8-110-97-001)

This is the final report on the subject audit. In preparing the report we considered your written comments on our draft report on this activity and have included these in Appendix II.

The report contains three recommendations. We consider recommendations number one and two to have had a management decision; thus final management actions should be submitted to M/MPI/MIC. We are awaiting management decision for recommendation number three. Please reply within 30 days of receipt of this report on your management decision on this recommendation.

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

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**Background**

The Bureau for Europe and New Independent States (ENI) is responsible for leading and coordinating USAID's response to emergency and humanitarian assistance requirements in the New Independent States (NIS). Specifically, ENI's mandate is to provide food, medicine, and shelter to address the consequences of economic and political dislocation, civil strife, and ethnic conflict. As of March 31, 1996, ENI obligated about \$307 million and expended approximately \$269 million to fund emergency humanitarian assistance activities under the NIS Special Initiatives Project (110-0001).

In carrying out overall management responsibility for USAID emergency assistance activities in the NIS, ENI uses its technical support office in Washington, the Human Resources' Emergency Humanitarian Assistance Division (ENI/HR/EHA), to support its planning, defining and responding to emergencies. Also, ENI/HR/EHA provided technical support in carrying out the emergency programs, such as providing food monitors and general oversight of the activities. In addition, ENI has given USAID/Caucasus distinct responsibilities for these activities; that is, USAID/Caucasus is responsible for monitoring the host government performance and reporting as required on overall program progress.

This audit focuses on ENI and USAID/Caucasus' response to the food emergencies in Armenia and Georgia which worsened considerably in the last half of 1993. In Armenia, the cumulative effects of years of economic crisis, blockade, and war continued to adversely affect food security for vulnerable groups. In Georgia, the Abkhazia conflict and subsequent rebellion in Mengrelia (western Georgia) triggered a serious displaced person crisis, compounding the country's economic deterioration.

In recognition of these conditions, Foreign Assistance Legislation for Fiscal Year 1994 appropriated funds for U.S. agricultural commodities for the primary benefit of children and pregnant/lactating women. A decision was also made to provide 200,000 metric tons (mt) of wheat from the Food Security Wheat Reserve (FSWR)<sup>1</sup> because of critical food gaps in both Armenia and Georgia. This audit covers the following two activities:

- (1) the provision of U.S. agricultural commodities to vulnerable mothers and children in four countries—Armenia, Azerbaijan, Georgia and Tajikistan<sup>2</sup> through a cooperative agreement (including its modification) with CARE and interagency agreements with the United States Department of Agriculture's Commodity Credit Corporation (CCC); and

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<sup>1</sup> The USDA Commodity Credit Corporation is responsible for the wheat in the FSWR used to bolster existing food aid programs (PL-480, Title II). PL-480, Title II authorizes the donation of food for developmental, nutritional, and urgent or extraordinary relief purposes. Within the FSWR provision, only the U.S. President can authorize the release of wheat from the Reserve. In response to USAID's request to use the FSWR, President Clinton authorized the drawdown of 100,000 mt of wheat for Georgia and 100,000 mt for Armenia. These commodities are administered by USAID as Title II emergency resources.

<sup>2</sup> As the majority of funding was provided to Armenia and Georgia, fieldwork was not performed in Azerbaijan or Tajikistan.

- (2) the procurement, transportation and distribution of 200,000 mt of wheat from the FSWR distributed to the Georgian and Armenian civilian population in need through the governments' bread ration programs.

The following table summarizes the total funds programmed as of March 31, 1996 for the two emergency food assistance activities audited.

Description	Commodities (millions)	Transportation and Monitoring (millions)	Total (millions)
<b>Agricultural commodities to vulnerable mothers and children</b>			
CARE	\$ 0.0	\$9.0	\$ 9.0
USDA-CCC	\$33.0	\$3.0	\$36.0
Sub-Total	\$33.0	\$12.0	\$45.0
<b>Food Security Wheat Reserve (FSWR)</b>			
USDA-CCC	\$27.0	\$ 0.0	\$27.0
USAID	\$ 0.0	\$20.0	\$20.0
Sub-Total	\$27.0	\$20.0	\$47.0
<b>Grand Total</b>	<b>\$60.0</b>	<b>\$32.0</b>	<b>\$92.0</b>

Under the cooperative agreements with CARE, as of March 31, 1996, USAID spent nearly \$8.1 million of the \$9.0 million obligated. The procurement of commodities provided to CARE was accomplished through two interagency agreements with the United States Department of Agriculture's Commodity Credit Corporation (CCC). Under these agreements, USAID spent approximately \$33 million to buy flour, dry whole milk, beans, oil, and farina, and spent an additional \$3.0 million to transport the commodities.

Concerning the \$47 million FSWR activity, USAID entered into government-to-government agreements in 1994 with Georgia and Armenia for the distribution and monitoring of 100,000 mt of wheat to each country. In doing so, ENI coordinated its actions with the Bureau for Humanitarian Response/Food for Peace (BHR/FFP), who has overall oversight responsibility within USAID for Title II activities. BHR/FFP assisted ENI and USAID/Caucasus in the process of developing the agreements with the appropriate governments and approving the proposed emergency Title II programs. USAID did not obligate or expend

funds for the wheat (valued at \$27 million), as the CCC is responsible for replenishing the wheat. However, all ocean and inland transportation costs (estimated at \$20 million) was to be funded by USAID. USAID incorporated its standard provisions for PL-480, Title II programs into the respective government-to-government agreements.

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## **Audit Objective**

This audit was conducted as part of the Office of Inspector General's worldwide audit of the effectiveness of USAID's response to disasters and emergencies. Specifically, this audit was designed to answer the following audit objective:

**Did the Bureau for Europe and New Independent States and USAID/Caucasus ensure that commodities reached the intended beneficiaries?**

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

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## **Audit Findings**

The Bureau for Europe and New Independent States (ENI) and USAID/Caucasus generally ensured that commodities reached the intended beneficiaries. However, under the FSWR (Title II) program, at least 4,600 metric tons of wheat valued at about \$1.1 million was re-exported to Azerbaijan contrary to the agreement. In addition, an even larger amount of wheat—estimates ranged between 28 to 50 percent of the total wheat supplied from the FSWR for use in Georgia— may not have reached the intended beneficiaries. Also for this program, the audit found that USAID/Caucasus failed to ensure that the Government of Armenia either (1) deposited about \$1.1 million in local currency to address the causes of the emergency as required under its agreement with USAID, or (2) formally require and ensure that the necessary policy reforms in the area of bread pricing were implemented.

ENI, in conjunction with USAID/Caucasus, generally ensured that the food transported, distributed and monitored under the cooperative agreement with CARE reached the intended beneficiaries. Also, although ENI and USAID/Caucasus did not adequately monitor the wheat provided under the FSWR to Georgia, permitting diversions and misuse, the audit confirmed reported examples of accomplishments under both activities, such as:

- ▶ According to reports and records prepared by CARE, they distributed emergency food assistance to about 850,000 beneficiaries (children and pregnant/lactating women in Armenia, Azerbaijan, Georgia and Tajikistan) during the period May 1994 through June 1995, and they will complete the distribution in additional emergency food assistance to about 157,000 beneficiaries by October 1996.
- ▶ A March 1996 evaluation of the CARE program found that USAID-funded commodities are reaching the target persons, and the food assistance program is being properly implemented.<sup>3</sup> Also, in both countries we visited (Armenia and Georgia), host government officials, USAID officials, CARE representatives and the recipients emphasized that the supplemental food was of great assistance to the beneficiaries.
- ▶ In Armenia and Georgia, ENI/HR's food monitors reported, and host government officials and recipients confirmed to us, that the emergency food assistance was instrumental in helping millions of beneficiaries through a crucial time.

The audit identified the following issues requiring management action pertaining to the wheat distributed to Georgia and Armenia under the FSWR. The audit did not identify any significant issues regarding the commodities reaching the intended beneficiaries in the two programs carried out by CARE.

#### **USAID Should Ensure Recovery for Wheat Diverted to Azerbaijan**

In August 1994, the USG and the Government of Georgia (GOG) signed an agreement for 100,000 mt of PL-480, Title II wheat for Georgia, which required the wheat to be used to supply bread or wheat flour to the civilian population "in need" through the government bread ration program. The agreement also specifically excluded the re-export of the commodities. Furthermore, USAID Regulation 11, which is incorporated in the agreement, requires the GOG to properly handle and distribute the wheat

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<sup>3</sup> Draft evaluation of the USAID/NIS Vulnerable Group Food Programs in Armenia, Azerbaijan, Georgia, and Tajikistan, dated May 13, 1995, was conducted by BHM International, Inc. under a USAID contract. One of its objectives was to evaluate the implementation of CARE activities including accountable handling of commodities and whether USAID commodities are reaching/have reached targeted beneficiaries.

to intended beneficiaries and to pay to the USG the value of the commodities lost, damaged or misused.

In December 1994, ENI/HR/EHA's food monitor in Georgia reported that substantial amounts—in excess of 50 percent—of the wheat delivered to Georgia did not reach intended beneficiaries (the Georgian public) as either subsidized bread or flour. The monitor concluded that losses occurred at all levels of the chain of distribution. Substantial amounts of wheat were sold, both as bread and flour, on the commercial market, and the monitor stated that the country's military establishment was among the beneficiaries, even though the terms of the agreement specifically excluded the military as a beneficiary. In addition, approximately 4,600 mt were re-exported to Azerbaijan, contrary to the agreement which specifically excluded re-exportation of the wheat.

In response to the ENI/HR/EHA food monitor's report, both the Department of State NIS Coordinator (S/NIS/C) and ENI/HR/EHA sent personnel to investigate the findings. The S/NIS/C official reported that the lack of controls within the grain distribution system created opportunities for abuse. Further, the ENI/HR/EHA official analyzed the delivery and distribution records and estimated that at least 28 percent of the wheat (28,000 mt valued at \$6.6 million) was misused. To arrive at this figure, the ENI/HR/EHA official determined the amount of wheat re-exported to Azerbaijan and the amount delivered to the 14 flour mills in Georgia. He then estimated losses at each of the flour mills using the ENI/HR/EHA food monitor's records from 8 of the 14 flour mills previously visited. He also estimated losses at the bakeries after performing a number of spot checks. Based on our review of the ENI/HR/EHA official's methodology for calculating the loss, we considered his estimate of 28 percent as reasonable and, in the draft audit report, used this percentage as the amount of misused wheat to be accounted for by USAID management.

During the audit we also met with USAID/Caucasus, U.S. Embassy, host government and World Food Program (WFP)<sup>4</sup> officials. These officials believed that misuse of the wheat was inevitable due to the political instability and deteriorating economic conditions in the country at the time. Further, the lack of sufficient in-country monitoring by USAID was a major problem. Everyone we spoke with agreed that one ENI/HR monitor could not possibly oversee the distribution of 100,000 mt of wheat to 14 flour mills and scores of bakeries and bread shops scattered throughout the

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<sup>4</sup> WFP is receiving and distributing large quantities of food in Georgia and the region.

country. Thus, the ENI Bureau failed to carry out its responsibility to ensure that USAID/Caucasus had the resources to implement and monitor the food activities effectively.

Concerning the 4,600 metric tons of Title II wheat re-exported to Azerbaijan, we found that although the U.S. Embassy had sought restitution, it had not followed up with the GOG to ensure that the wheat was actually restored. In fact it was not until we asked for confirmation of repayment, that the USAID representative in Tbilisi wrote the GOG requesting action be taken to resolve the matter. The Ministry of Trade and Foreign Economic Relations of Georgia informed the USAID/Caucasus representative in Tbilisi that they requested the State Bread and Poultry Corporation to inform USAID/Caucasus immediately about the dates of purchase of the replacement wheat and to prove its usage in accordance with the terms of the agreement. At the time of completion of our audit fieldwork, the State Bread and Poultry Corporation had not responded to USAID/Caucasus.

In the draft audit report issued to ENI/HR/EHA we recommended that they coordinate with the ENI Bureau to recover from the GOG both the 4,600 metric tons of wheat valued at about \$1.1 million which was re-exported to Azerbaijan, and the approximate 23,400 metric tons of wheat valued at about \$5.5 million, which we estimated as a reasonable approximation of the degree of misuse of wheat in Georgia.

The DAA/ENI replied to our draft audit report stating that the Bureau, not ENI/HR/EHA which is a technical support office within the Bureau, had overall management responsibility for USAID assistance activities within its regional scope. The DAA/ENI stated that it had contacted BHR/FFP in Washington, D.C. concerning its response. The DAA/ENI pointed out several misunderstandings in the draft audit report, including one which concerned the amount of recovery which could be sought from the GOG. He said that it was the ENI Bureau's understanding that although there were allegations of misuse in Georgia, only the diversion of approximately 4,600 metric tons could be substantiated. According to the Bureau, this decision was made after reviewing the report of the food monitor and an analysis of this report by an ENI/HR/EHA staff member.

As previously stated, in our draft report we had used the estimate of 28,000 metric tons (28 percent) which was contained in the ENI/HR/EHA's staff members' report for the total loss under the program. This amount was less than the on-the-ground food monitor's earlier estimate of possibly more than 50 percent as having been misused. Because of the critical need to better validate the ENI/HR/EHA's staff member's analysis for our draft audit report, we attempted on at least several occasions during the audit

to contact this staff member. While he acknowledged receipt of our inquiries and gave us some information, he did not totally respond to our requests for information. This situation went on for over five weeks where we received insufficient feedback on our requests. Therefore, at the time of the draft report, we used his estimate which, based on our review of the methodology he had used in compiling the report, we considered as reasonable.

During the time that the draft report was with management for comments, the ENI/HR/EHA staff member sent the auditors a memo which reported misunderstandings with our use of his report. He provided some of the details surrounding his computations of loss and stated: ". . . it is clear that some of my statements [concerning the extent of wheat misused] were too strong at best, or inaccurate at worst." For example, although his report had stated that the methodology of the food monitor (whose estimate was that possibly more than 50% of wheat had been misused) seemed valid, the staff member stated that this was now not accurate. He stated that a better choice of words would have been that the methodology was understandable, for there were a number of problems with the methodology. The final conclusion of the memo, provided ten weeks after having been requested by the auditors, was that there was little basis for actual recovery from the GOG for other than the 4,600 metric tons re-exported to Azerbaijan.

In conclusion, the weight of evidence strongly suggests that the amount of wheat misused was significantly more than the 4,600 metric tons re-exported to Azerbaijan. However, without a more reliable basis for estimating this amount at this time, we do not consider it useful to reopen the issue for additional study. However, it is clear to us that the ENI Bureau did not sufficiently ensure that all of the wheat got to the intended beneficiaries in Georgia. Certainly, the lack of monitoring resources at USAID/Caucasus contributed significantly to this problem. In addition, we believe that the Bureau did not take sufficient action at the time of the food monitors' report of the situation to more clearly identify the extent of the loss and thus be able to seek restitution from the GOG.

Recognizing the problem with seeking recovery from the GOG for anything more than the 4,600 metric tons of wheat re-exported to Azerbaijan, the DAA/ENI said in his comments to the draft report, that the recommendation should be limited to this amount. Accordingly, we have changed the audit recommendation to the following:

**Recommendation No. 1: We recommend that USAID/Caucasus, in coordination with the U.S. Embassy in Tbilisi and with the Office of**

**Food for Peace (BHR/FFP), verify that the Government of Georgia has properly repaid the approximately 4,600 metric tons of Title II wheat or its value of approximately \$1.1 million, which was diverted to Azerbaijan in 1994.**

The DAA/ENI reported that USAID/Caucasus and U.S. Embassy Tbilisi are working closely together to resolve this matter with the GOG. Letters have been sent to the relevant officials and follow-up work is proceeding. We consider the above action as constituting a management decision. Final management actions should be reported to M/MPI/MIC.

**USAID Needs to Ensure that Policy Reforms Are Established and Complied With by Government of Armenia**

USAID's Regulation 11 permits the generation of local currency when; (1) the country receiving the assistance is undertaking self-help measures, (2) the specific purposes for which the foreign currencies are to be used are set forth in a written agreement between the United States and the recipient country, and (3) such agreement provides that the currencies will be used for increasing the effectiveness of the programs of food distribution and increasing the availability of food commodities provided under this title to the neediest individuals in recipient countries.

According to the transfer agreement between the United States Government (USG) and the Government of Armenia (GOAM), the host government was to open an interest-bearing account in a mutually agreed upon commercial bank and deposit into this account 450,000,000 Armenian drams (approximately \$1.1 million U.S. dollars at the current exchange rate). This amount represented what the GOAM was expected to receive from the subsidized sale of either bread or flour. Further, the agreement called for the funds deposited, together with the interest earned thereon, to be used to support activities of the GOAM that address the causes of the emergency, to be mutually agreed upon in writing by both parties

The audit found that the GOAM did not open the interest-bearing account required by the agreement. In our discussions with USAID/Caucasus and U.S. Embassy officials, they did not have an explanation as to why the account was never opened by the GOAM. As a result, a significant source of funds was not made available to support activities of the GOAM that address the causes of the emergency.

Our draft audit report recommended that USAID/Caucasus request the GOAM to establish the local currency account equivalent to \$1.1 million

and to establish procedures on the use of these funds. In responding to the draft audit report, the DAA/ENI provided additional information relative to the reason(s) why the special account had not been established. He stated that almost immediately after the transfer authorization was signed, there were concerns raised by the International Monetary Fund (IMF) over the potentially inflationary impact of the provision to establish the special account. Additionally, the GOAM proved willing to move forward more quickly than expected on key policy reforms in the area of bread pricing and subsidies.

He further stated that in order to avoid the potentially negative effect of the special account and to take advantage of the potential for policy reform, a letter amendment to the transfer authorization was drawn up by USAID/Caucasus and sent to BHR/FFP for review. This amendment would have deleted the requirement for the special account and commit the GOAM to reduce the subsidy for processing bread according to a specific schedule. Although the letter amendment was never submitted in final to the GOAM, the policy reforms were implemented by the GOAM. The DAA/ENI stated that to require the GOAM to establish the originally envisioned special account at this time would have highly negative effects on the reform efforts of this cash-strapped government. He suggested that we revise the recommendation deleting the requirement for the special account and requiring policy reform instead. We concur with the DAA/ENI proposal but are dividing these requirements into two recommendations.

**Recommendation No. 2: We recommend that the USAID/Caucasus, in coordination with BHR/FFP, complete the negotiation of an amendment for the FY 1994 Title II Transfer Authorization with the Government of Armenia deleting the requirement for a special account, and instead requiring policy reforms in the area of bread processing subsidies.**

**Recommendation No. 3: We recommend that the USAID/Caucasus, in coordination with BHR/FFP, ensure that the policy reforms included in the amended Transfer Authorization with the Government of Armenia (1) include a specific schedule for bread processing subsidies, and (2) ensure that such schedules are met.**

On the basis of the DAA/ENI's comments to our draft report, we consider a management decision to have taken place for recommendation number 2. Final management action should be reported to M/MPI/MIC. We are awaiting a management decision for recommendation number 3. Please advise us of your actions within 30 days of the date of this report.

## SCOPE AND METHODOLOGY

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### Scope

As part of an Office of Inspector General's worldwide audit, the Regional Inspector General's Office in Frankfurt audited the Bureau for Europe and New Independent States' (ENI) emergency food assistance activities in Georgia and Armenia, in accordance with generally accepted government auditing standards. The fieldwork took place from May 31 through June 21, 1996, and included work at USAID/Caucasus in Yerevan, Armenia, and at the USAID Representative's office in Tbilisi, Georgia. Work was also performed at the offices and warehouses of the USAID recipient (CARE) in Yerevan, Armenia; Tbilisi and Kutaisi, Georgia; and at various Armenian Government and Georgian Government offices and food distribution centers.

The audit covered the Bureau for Europe and New Independent States and USAID/Caucasus' management of emergency food assistance provided to the Governments of Armenia and Georgia through (1) USAID's 1994 cooperative agreement (and its modification) with CARE, and (2) the 1994 agreements between USAID and the Governments of Armenia and Georgia. With regard to the cooperative agreements with CARE, as of March 31, 1996, USAID obligated approximately \$9.0 million to CARE for the transport, distribution and monitoring of approximately \$33.0 million in U.S. agricultural commodities provided to four NIS countries<sup>5</sup> (Armenia, Azerbaijan, Georgia and Tajikistan). With regard to the assistance provided under the agreements between USAID and the Governments of Armenia and Georgia, USAID was to spend approximately \$20.0 million to transport the 200,000 mt of wheat, valued at \$27.0 million, distributed throughout Georgia and Armenia.

In addition to the methodology described in the following section, we have requested written representations from ENI/HR management confirming information that we consider essential for answering our audit objective.

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<sup>5</sup> Audit fieldwork was performed in only two (Armenia and Georgia) of the four countries provided assistance under the CARE agreement.

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**Methodology**

In answering the audit objective we met with USAID officials in the Bureau for Europe and New Independent State's Office of Human Resource's Emergency Humanitarian Assistance Division (ENI/HR/EHA) and the Bureau for Humanitarian Response/Food for Peace (BHR/FFP) to assess the implementation of the emergency food assistance. We maintained frequent communication with officials in these offices during the course of the audit.

For the assistance provided under the cooperative agreement with CARE, we met with USAID/Caucasus officials in Yerevan, Armenia and Tbilisi, Georgia to assess the implementation of the emergency food assistance. In addition we met with CARE officials in both Yerevan, Armenia and Tbilisi, Georgia. We made site visits to the CARE warehouses and distribution centers in Yerevan, Armenia and Tbilisi and Kutaisi, Georgia to assess the adequacy of storage facilities and to observe actual distribution to beneficiaries. We also judgementally selected and visited a sample of twenty beneficiaries in Armenia and twenty beneficiaries in Georgia to confirm they were receiving the USAID-funded food assistance as intended.

We also reviewed the cooperative agreement and modifications with CARE, quarterly progress reports, site visit reports, and other germane USAID and CARE documentation. We also obtained a copy of the draft evaluation performed of CARE activities. We assessed the evaluation and found it accurately reported on the CARE activities. Therefore, we relied on the work performed in conducting the evaluation, and accordingly, reduced the amount of testing performed.

For the wheat provided under agreements between USAID and the Governments of Armenia and Georgia, we met with Embassy and USAID officials in both Yerevan, Armenia and Tbilisi, Georgia. We also met with officials from participating organizations such as the Ministry of Bread in Armenia and the State Bread and Poultry Corporation in Georgia to ascertain their role in the implementation of the assistance. We met with World Food Program officials in both Armenia and Georgia to obtain additional information on the issues related to emergency food assistance in these two countries.

In order to confirm that wheat provided was delivered to the flour mills and distributed to state-owned bakeries, we made site visits to flour mills and bakeries in Sevan and Yerevan Armenia and in Tbilisi and Gori, Georgia.

At these mills and bakeries we judgementally sampled their records, and toured the facilities. We reviewed the agreements and other relevant documentation at the U.S. Embassies and USAID missions in both countries visited. We also reviewed relevant records at the Ministry of Bread in Armenia and the State Bread and Poultry Corporation in Georgia, as well as the relevant documentation at the flour mills and bakeries visited.

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U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

SEP 13 1996

MEMORANDUM

TO: RIG/A/Frankfurt, John P. Competello

FROM: DAA/ENI, Donald Pressley 

SUBJECT: Draft Report - Audit of the Bureau for Europe and New Independent States' Emergency Food Assistance Activities in the Caucasus Since Fiscal Year 1994

This is in response to your memorandum dated August 1, 1996, transmitting the subject draft report and inviting written comments. I am answering the draft report because the ENI Bureau had overall management responsibility for USAID assistance activities within its regional scope. We have contacted the Food for Peace Office in Washington D.C. concerning this response.

The draft audit's two recommendations deal with the 1994 Title II wheat deliveries to Georgia and Armenia. The ENI Bureau, its regional mission in Yerevan, and the Bureau for Humanitarian Response/Food for Peace (BHR/FFP) each had distinct responsibilities for these programs.

BHR/FFP had Title II food aid oversight responsibility, including the process of developing the agreements with the appropriate governments with USAID/Caucasus and approving the emergency Title II programs proposed by the governments and USAID/Caucasus.

ENI Bureau responsibilities included reviewing and clearing the proposed Title II activities and ensuring that the USAID/Caucasus had the resources to implement or monitor food aid activities effectively.

USAID/Caucasus was responsible for working with the host governments to develop the proposals for emergency assistance, negotiating the agreements with BHR/FFP, monitoring the host government performance under the programs, and reporting as required on overall program progress.

The monitoring plan for the FY 94 Georgia and Armenia Title II Emergency Wheat programs was developed by BHR/FFP in conjunction with USAID/Caucasus. The resources required for this plan were provided by the ENI Bureau. One of the lessons learned from this activity is that additional monitoring resources are necessary for programs of this type.

Draft Audit Report Recommendation No. 1: We recommend that the Office of Human Resources' Emergency Humanitarian Assistance Division, in coordination with the Bureau for Europe and New Independent States, initiate action to recover from the Government of Georgia the \$6.6 million of wheat which was misused.

This recommendation contains three misunderstandings which would suggest rephrasing the recommendation:

1. The Office of Human Resources' Emergency Humanitarian Assistance Division (ENI/HR/EHA) is a technical support office and did not have management responsibility for the Title II wheat program.
2. Our understanding of the situation is that after reviewing the report of the wheat monitor and an analysis of this report by an ENI/HR/EHA staff member, the relevant decision makers and technical specialists, USAID/Caucasus, S/NIS, and BHR/FFP, came to the conclusion that although there were allegations of misuse in Georgia, only the diversion of 44 rail cars (approximately 4,600 MT) of wheat to Azerbaijan could be substantiated. In fact, after the debrief by the monitors in Washington, with IG in attendance, IG did not believe that a RIG team needed to investigate at that time.
3. According to 22 CFR 211.9(d) (Regulation 11), compensation for misused commodities may include replacing the lost commodities with similar commodities of equal value. Replacement is not limited to monetary payment.

The draft audit should be revised accordingly. We propose the following revised recommendation:

Recommendation No. 1: We recommend that USAID/Caucasus, in coordination with the U.S. Embassy in Tbilisi and with the Office of Food for Peace (BHR/FFP), verify that the Government of Georgia has properly repaid the approximately 4,600 MT of Title II wheat or its value, which was diverted to Azerbaijan in 1994.

USAID/Caucasus and U.S. Embassy Tbilisi are working closely together to resolve this matter with the Government of Georgia. Letters have been sent to the relevant officials and follow-up work is proceeding. Once USAID/Caucasus has evidence of repayment, this recommendation could be closed.

Draft Audit Report Recommendation No. 2: We recommend that the USAID/Caucasus request the Government of Armenia to establish the special account in the amount of local currency equivalent of \$1.1 million and establish procedures between USAID/Caucasus and the Government of Armenia on the use of these funds.

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Almost immediately after the Armenia Transfer Authorization was signed, there were concerns raised by the IMF over the potentially inflationary impact of the provision to establish a special account. Additionally, the Government of Armenia (GOAM) proved willing to move forward more quickly than expected on key policy reforms in the area of bread pricing and subsidies.

In order to avoid the potentially negative effect of the proposed special account and to take advantage of the opportunity to hasten genuine policy reform, a letter amendment to the Transfer Authorization was drawn up by USAID/Caucasus and sent to BHR/FFP for review. This amendment would have deleted the requirement for the special account and which committed the GOAM to reducing the subsidy for processing bread according to a specific schedule. BHR/FFP transferred the body of the letter amendment into a formal document.

The formal amendment was never submitted in final to the GOAM. The policy reforms were, however, implemented. To require the GOAM to establish the originally envisioned special account at this time would have highly negative effects on the reform efforts of this cash-strapped government.

The draft audit should be revised accordingly. We propose the following revised recommendation:

**Recommendation No. 2:** We recommend that USAID/Caucasus, in coordination with BHR/FFP, complete the negotiation of an amendment to the FY 1994 Title II Transfer Authorization with the Government of Armenia deleting the requirement for a special account and instead, requiring policy reforms in the area of bread processing subsidies.

Although this revised recommendation cannot be closed at this time, BHR/FFP and USAID/Caucasus believe that the above approach is the most workable and we are confident that it will be closed out soon.