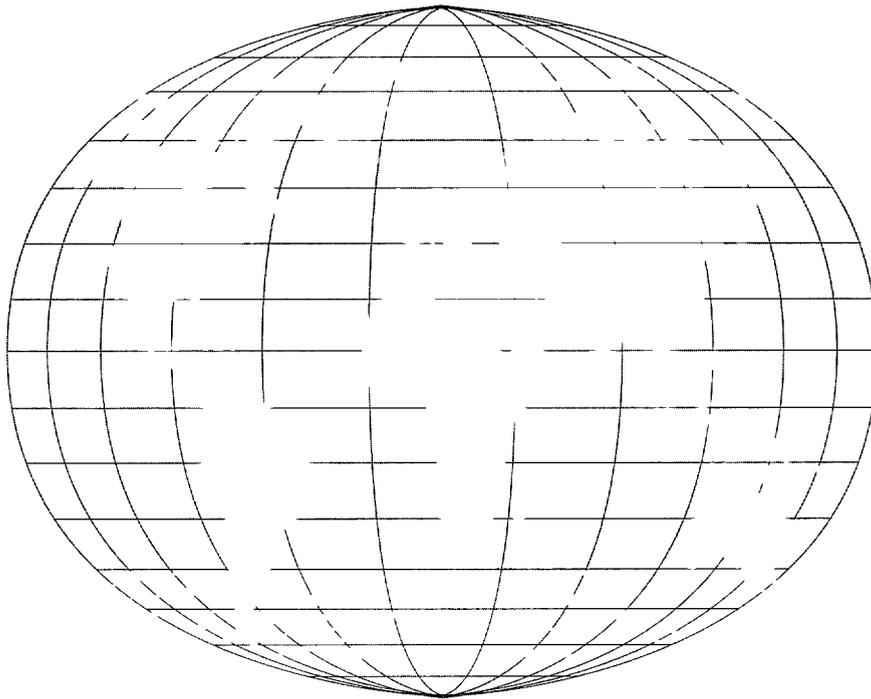


Report of Audit

Audit of the 1996 Emergency Wheat Assistance Program in Armenia

**Audit Report No B-111-00-002-P
December 10, 1999**



**Regional Inspector General
Budapest, Hungary**

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

**Audit of the 1996 Emergency Wheat Assistance Program
in Armenia**

**Audit Report No. B-111-00-002-P
December 10, 1999**



UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL
BANK CENTER GRANIT TOWER 5TH FLOOR
SZABADSAG TER 79 1944 BUDAPEST HUNGARY
TELEPHONE 36 1 475 4603
FACSIMILE 36-1 475 4633

December 10, 1999

MEMORANDUM

TO USAID/Armenia Director, Dianne Tsitsos
FROM RIG/Budapest, James R. Bonnell
SUBJECT Audit Report No B-111-00-002-P, Audit of the 1996 Emergency Wheat Assistance Program in Armenia

This is our final report on the subject audit. The report concludes that USAID/Armenia was unsuccessful in its efforts to implement, manage, and monitor the 1996 Emergency Wheat Assistance Program. The Government of Armenia complied with virtually none of the conditions and terms set forth in the program's Memorandum of Agreement or the Memorandum of Understanding. The report makes three recommendations, including recommending the recovery of a portion of the funds allocated for the wheat program.

The findings and recommendations contained in this report are very similar to those resulting from our audit of the 1996 Natural Gas Import Program in Armenia and reported in A/R No B-111-99-005-P, dated September 7, 1999.

In finalizing this report, we considered your comments on the draft report and included them in their entirety in Appendix II. You concurred with our recommended recovery amount of the local currency equivalent of \$16,022,830 contained in Recommendation No. 1. You also advised that despite the Mission's best efforts it is possible the Government of Armenia's budget will not provide sufficient development activities to liquidate the amounts owed within a reasonable period of time. In that case, USAID/Armenia will consult with the OIG and the Europe and Eurasia Bureau on alternative recovery methods.

Based on your response, we consider that management decisions have been reached on all three audit recommendations with sustained savings of \$16,022,830. Please contact M/MPI/MIC when final action is taken on these recommendations.

Thank you for the assistance and courtesies extended to my staff during the audit.

EXECUTIVE SUMMARY

On June 14, 1996, USAID and the Government of Armenia signed a Memorandum of Agreement to deliver \$20 million in wheat to Armenia. The Government of Armenia was to use the monetized proceeds from the sale of the USAID-procured wheat to purchase additional wheat or natural gas. The funds generated from the sale of the additional wheat or natural gas were to be used to support the Government of Armenia's budget.

The audit found that the Government of Armenia did not comply with most of the terms of the Memorandum of Agreement and the subsequent Memorandum of Understanding that established specific procedures for the FY 1996 USAID Emergency Wheat Assistance Program.

- USAID was not provided with financial records
- Minimum deposit requirements to the Program's special accounts were not met
- Wheat was sold at excessive price and all sales proceeds were not deposited to a special account
- Use of the funds in the special accounts was not adequately accounted for (See Appendix III)

The Government of Armenia's financial difficulties and large debt service requirements were both factors contributing to its noncompliance. However, the choice of using a monetization program in an environment where previous similar efforts had failed appeared to be the biggest factor. (See pages 5 through 6)

Both the Mission and the U.S. Embassy in Armenia attempted to monitor and manage the Program, however, both were unsuccessful in obtaining the Government of Armenia's compliance with the terms of the Memoranda. The Mission and the Embassy used various methods to achieve compliance, including direct written requests, a newly-created Monetization Implementation Unit, modification to the Memorandum of Understanding, and attempts to arrange a financial audit of the Program. However, at least partly as a result of the Program, several state-owned flourmills and bakeries were privatized. (See pages 6 through 9)

The Government of Armenia's failure to comply with the terms of the Memoranda included insufficient deposits to the Program's special accounts and an inability to adequately account for the use of the funds that were deposited. Therefore we are recommending the recovery of the local currency equivalent of \$16,022,830 from the Government of Armenia. This amount includes

- \$68,493 in unaccounted for interest earned in one of the special accounts
- \$1,611,394 for local currency never deposited to the special account for the initial USAID-procured wheat shipment
- \$2,060,274 for local currency earned from wheat sold at prices above the Program's minimum price
- \$871,991 in unsubstantiated wheat purchases
- \$2,565,718 in unsubstantiated natural gas purchases
- \$286,158 for unsubstantiated costs of shipping additional wheat purchased under the Program
- \$4,977,000 for unaccounted for sales proceeds of the additional wheat purchased
- \$3,581,802 for costs associated with a second USAID-procured wheat shipment for which sales proceeds were either never deposited to a special account as required, or the use of the funds cannot be accounted for
(See page 10)

We are further recommending that a special account be established to deposit any local currency amounts repaid by the Government of Armenia and that such funds only be used for purposes agreed to by USAID/Armenia and the Government of Armenia (See page 10)

The Mission advised they do not intend to monetize future programs. However, should the issue of monetization resurface, we are recommending that USAID/Armenia, prior to undertaking any future monetization program, establish certain conditions that the Government of Armenia should meet. One such condition would be that the Government of Armenia makes satisfactory progress towards repaying the local currency equivalent of \$16,022,830 associated with the 1996 Wheat Program (See page 11)

The Department of State was actively involved with the 1996 Wheat Program. However, it is not clear from Mission files that the Embassy and USAID/Armenia were working cooperatively toward monitoring the Government of Armenia's compliance. Mission officials indicated there was no assignment of duties and responsibilities between the organizations. If a monetized program is implemented in the future, we would encourage USAID/Armenia to reach agreement with the Embassy on specific responsibilities (See page 11)

USAID/Armenia agreed with our findings and recommendations and it concurred with our calculation of the local currency equivalent of \$16,022,830 owed by the Government of Armenia. However, the Mission advised that Government of Armenia officials now contend that the auditors did not receive complete information and that unaccounted-for funds can be documented. The Mission has requested that the Government put this contention in writing and provide it with the missing documentation.

The Mission further advised that it would first present appropriate Government of Armenia officials our audit findings and request them to develop a repayment schedule to collect the local currency equivalent of approximately \$16 million. However, the Mission noted that despite its best efforts it is possible the Government's budget will not provide sufficient development activities to liquidate the amounts owed within a reasonable period of time. In that case, USAID/Armenia will consult with the Office of Inspector General and the Europe and Eurasia Bureau on alternative recovery methods (See pages 12 and 13).

Based on USAID/Armenia's comments, RIG/Budapest considers that management decisions have been reached on all three audit report recommendations.

Office of Inspector General
Office of Inspector General
December 10, 1999

Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY	1
INTRODUCTION	1
Background	1
Audit Objective	2
REPORT OF AUDIT FINDINGS	3
Did USAID/Armenia implement, manage, and monitor the 1996 Emergency Wheat Assistance Program to ensure the Government of Armenia's compliance with the conditions and terms set forth in the Program Memorandum of Agreement?	3
GoA Noncompliance with Program Memorandum of Agreement	3
Factors Contributing to GoA Noncompliance	4
GoA Debt Service Requirements	5
Inability by GoA In Prior Years To Implement a Monetization Program	5
U S Government Management and Monitoring Efforts	6
Immediate Noncompliance with MOA	6
MOU Establishes Tighter Requirements	7
Attempt To Modify Program's MOU	7
Poor Documentation Of Monitoring	7
Creation Of A Monetization Implementation Unit	8
Correspondence From The Ambassador	8
Final Monitoring Attempts	9

Conclusion	9
Management Comments and Our Evaluation	12
APPENDICES	<u>Number</u>
Scope and Methodology	I
Management Comments	II
Summary of Audit Results Concerning Compliance With The Program Memorandum of Agreement	III

INTRODUCTION

Background

On June 14, 1996, USAID and the Government of Armenia (GoA) signed a Memorandum of Agreement (MOA) to deliver \$20 million in wheat to meet critical food needs and support the economic restructuring of the food sector of Armenia. This initiative responded to the GoA's request that a portion of the \$85 million earmark in the fiscal year 1996 assistance budget be allocated to purchase wheat. The MOA set forth the general responsibilities of both sides, and also the specific procedures for the first of two tranches of wheat deliveries under the FY 1996 USAID Emergency Wheat Assistance Program (hereafter referred to as the Emergency Wheat Program). The MOA also included requirements for the privatization of certain state-owned entities in the country's food sector. A Memorandum of Understanding (MOU) signed on June 26, 1996 provided additional requirements for the implementation of the Program. Amendment 1 to the MOA, dated December 16, 1996, set forth the understandings in support of the second tranche of wheat deliveries, however, these provisions generally corresponded to the provisions for the first tranche detailed in the MOA.

Under the Emergency Wheat Program, USAID procured and shipped two tranches of wheat to Armenia via Georgia. In Armenia, the wheat was sold to state-owned flourmills by Armgrain, then the state-owned grain distribution enterprise.

The central feature of the Emergency Wheat Program was the monetization of the local currency generated by the sale of the wheat to purchase additional wheat and/or natural gas. The proceeds of that wheat's sale to the state-owned flourmills were to be deposited into a special local currency account. After deposit, these funds were to be converted into U S dollars and deposited into a special U S dollar account to

- Purchase additional wheat
- Procure natural gas
- Uses as USAID and the GoA agreed to in writing

Local currency proceeds from the sale of the additional wheat and natural gas were to be put into a third special local currency account and, upon completion of all deposits, the entire balance was to be transferred to the general funds of the GoA.

The Emergency Wheat Program's first tranche of wheat—approximately 48 000 metric tons valued at \$15,696,960 including shipping costs—arrived in port in Georgia on May 24, 1996. By June 5, 1996—before the MOA had been signed—the wheat had been distributed and sold to five state-owned flourmills located throughout Armenia. The second tranche of wheat—approximately 16 000 metric tons valued at \$4,082,264

including shipping costs—had been unloaded in Georgia by October 11, 1996, and subsequently transported to Armenia and similarly distributed

The first tranche of wheat was to have generated sales proceeds of at least the local currency equivalent of \$10,416,000 and the second tranche was to have produced sales proceeds of at least the equivalent of \$3,581,802. There were no minimum restrictions on the sale price of additional wheat and natural gas purchased with proceeds from the initial two tranches of wheat

Audit Objective

This audit was conducted by RIG/Budapest to answer the following audit objective

Did USAID/Armenia implement, manage, and monitor the 1996 Emergency Wheat Assistance Program to ensure the Government of Armenia's compliance with the conditions and terms set forth in the Program Memorandum of Agreement?

The audit was requested by USAID/Armenia¹ officials after their attempts to have the GoA arrange an audit of a similar program by a public accounting firm were unsuccessful. It should be noted that the U.S. Embassy and the Office of the Coordinator of U.S. Assistance to the New Independent States also had substantial participation in implementing, managing, and monitoring the program. The Bureau for Europe and the New Independent States (now called the Bureau for Europe and Eurasia) participated in the design of the Program (preparation of the MOA) but was not involved in managing and monitoring the Program. The audit focused on the financial aspect of the Program and USAID/Armenia's efforts to ensure that the Government of Armenia deposited proceeds from the sale of wheat into special accounts to be used for agreed upon purposes.

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

¹ During the program's implementation, USAID had a small mission in Yerevan that was not only responsible for USAID activities in Armenia, but also in Georgia and Azerbaijan.

REPORT OF AUDIT FINDINGS

Audit Findings

Did USAID/Armenia implement, manage, and monitor the 1996 Emergency Wheat Assistance Program to ensure the Government of Armenia's compliance with the conditions and terms set forth in the Program Memorandum of Agreement?

USAID/Armenia was unsuccessful in its efforts to implement, manage, and monitor the 1996 Emergency Wheat Assistance Program. As discussed in detail in Appendix III, the Government of Armenia (GoA) complied with virtually none of the conditions and terms set forth in the Program's Memorandum of Agreement (MOA). In particular, documentation shows that insufficient deposits were made to the Emergency Wheat Program's special accounts, and the GoA cannot account for the use of most of the funds that were deposited. Factors contributing to noncompliance included the GoA's financial difficulties but of even greater importance appeared to be the choice of using a monetization program in an environment where previous efforts had failed. Although efforts by USAID/Armenia to produce change in the GoA's performance were unsuccessful in this environment, some monitoring and management measures could have been more aggressively pursued.

GoA Noncompliance with Program Memorandum of Agreement

Appendix III summarizes our audit results concerning the degree of GoA compliance with 11 key elements of the Program MOA and Memorandum of Understanding (MOU). The results show GoA compliance with only one facet of the Program—an effort toward privatization of Armenia's food sector—and either total noncompliance or only partial compliance with other provisions of the Memoranda. Specifically, we found

- USAID or the U S Embassy were not provided with Program financial records
- Timely deposits were not made to the special local currency accounts
- Interest was not paid on any of the special accounts
- Insufficient deposits were made to the special local currency account for proceeds from the sale of the first tranche of USAID-procured wheat
- Wheat was sold at prices above the minimum required and the "surcharges" were not deposited to the special local currency account

- Insufficient deposits were made to the special local currency account for the proceeds from sale of the second tranche of USAID-procured wheat
- The special U S dollar account was never established
- The GoA cannot adequately account for the use of funds generated by the sale of USAID-procured wheat
- The third special local currency account was not established
- An independent audit was not performed nor were funds reserved to pay for an audit

For example, available documentation shows that, only \$8.8 million of the \$10.4 million required by the Program MOA was actually deposited in the Program special account for the first tranche of wheat. In addition, there is clear evidence that the GoA actually sold the wheat for more than the established program price, and diverted these funds to non-program accounts. For the second tranche of wheat, it is impossible to determine how much of the required \$3.6 million was ever actually deposited into the Program special account because mills and bakeries deposited wheat sales proceeds into multiple bank accounts instead of the special account called for in the Program MOA. In some instances deposits were made to Armgrain accounts instead of to the Ministry of Finance special account. Also, with only one exception, there is no documentation to support additional purchases of wheat and gas with proceeds from the USAID-procured wheat. In the one exception \$916,158 in Program funds is still unaccounted for.

During the audit, RIG/Budapest auditors encountered the same problem USAID/Armenia had faced earlier—a lack of documentation provided by the GoA to allow a review of the flow of funds through the special accounts and other bank accounts that were used. Although it is understandable that two- to three-year old documents might be difficult to locate, many of these records were supposed to have been provided to USAID/Armenia during the implementation of the Program, and they were requested from the GoA months before the audit began.

It should also be noted that the key documentation needed to conduct a review of these accounts are bank statements and bank debit/credit memos, which should have been readily available from the banks—including the Central Bank of Armenia.

Factors Contributing To GoA Noncompliance

Before summarizing the management and monitoring efforts of USAID/Armenia and the U S Embassy in Armenia, it should be noted that USAID/Armenia officials suggested two major factors in the unsuccessful monetization of the Program's sales proceeds: (1) major GoA cash shortfalls and financial difficulties, including significant debt service obligations, and (2) the choice of using a monetization program when there was a

demonstrated inability or unwillingness by the GoA in prior years to implement a USAID monetization program

1 GoA Debt Service Requirements

Some USAID/Armenia and Embassy officials emphasized the Government of Armenia's severe financial predicament and tremendous International Monetary Fund (IMF) debt service requirements and stated that the temptation to use wheat sales proceeds to pay other commitments may have been too difficult for the GoA to overcome. In fact, according to the Embassy's Special Assistant for Humanitarian Assistance, in the spring of 1997 the American Ambassador informally gave the Ministry of Finance permission to borrow approximately \$3 million from the special accounts to meet IMF or World Bank commitments²

Although such financial difficulties certainly affect the ability to successfully implement a monetization program, USAID has similar programs in many countries with IMF and World Bank commitments and with similar financial problems. Although perhaps a contributing factor to the unsuccessful implementation of the monetizing effort, we believe it should also have been viewed as a condition that should have required USAID/Armenia and the U S Embassy to intensify monitoring efforts and take precautionary steps before proceeding with a monetization program.

2 Inability by GoA in Prior Years to Implement a Monetization Program

There is no documentation at either USAID/Armenia or the U S Embassy to fully explain why a monetization program was used to deliver wheat assistance to Armenia. However, USAID/Armenia officials and the Department of State's Special Assistant for Humanitarian Assistance based at the U S Embassy stated that USAID had approved the use of a monetization program under pressure from the Department of State. The lack of success in two prior USAID wheat monetization programs and an internal USAID assessment did not support the selection of a monetization program for wheat imports in 1996.

For example, a similar monetization program in Armenia less than two years before encountered many of the same problems experienced in the 1996 program. A memorandum to the Deputy Assistant Administrator, ENI Bureau from ENI/HR, dated August 10, 1995, pointed out that the Mission "had prior experience in monetizing and tracking local currency in Armenia, in connection with the donation of 100 000 metric tons of wheat from the Food Security Wheat Reserve in the fall of 1994. This experience was not totally positive, due to the difficulty in determining the total amount of local currency generated and in tracking proceeds into the Special Account." To correct these problems the memorandum claimed that a new system would be implemented for a 1995

² USAID/Armenia's program records do not document any USAID participation in this decision and USAID/Armenia officials do not recall being advised of this decision.

wheat monetization program that clearly linked currency generation and currency disbursement

However, the 1995 wheat monetization program demonstrated little progress in accountability. USAID/Armenia staff described a program that was never audited, where the amount of special account deposits could not be determined, and the use of the funds could not be tracked into the GoA budget. An internal USAID/Armenia assessment, dated October 13, 1995, evaluated the accounting systems and internal control environments of GoA wheat flour facilities shortly after the 1995 program began. The assessment contains five findings describing various internal control weaknesses that would impact on successful implementation of a future USAID monetization program, including the inability to tie remittances from bakeries to flour mills with specific deliveries of flour. The assessment also notes that nearly two months after the program began, the GoA had not opened an interest-bearing bank account for deposit of wheat sales proceeds. We found no documentation indicating that these problems were corrected before the 1996 wheat monetization program was initiated.

U S Government Management and Monitoring Efforts

USAID/Armenia and U S Embassy documentation concerning the 1996 Emergency Wheat Assistance Program shows evidence that efforts were made to monitor the GoA's Emergency Wheat Program performance and to obtain compliance with the Memorandum of Agreement. The official documents, however, do not summarize telephone conversations and meetings with GoA officials, although Mission and Embassy officials stress that there were many. Although some monitoring and management measures could possibly have been more aggressively pursued, the total lack of compliance by the GoA with the Program's requirements suggests additional efforts would have had only marginal success at best.

■ ***Immediate Noncompliance with MOA***

Almost immediately the GoA was not in compliance with the MOA requirements. The initial tranche of wheat had been sold and distributed throughout Armenia by June 5, 1996, although inexplicably the MOA outlining the GoA's responsibilities under the Program was not finalized and signed until nine days later on June 14, 1996. Although USAID/Armenia appeared to have closely monitored the distribution of the wheat, there is no evidence that the Mission or Embassy intervened with the GoA to enforce the deposit of sales proceeds by June 26, 1996, as required by the MOA. Based on discussions with Mission and Embassy officials the GoA was not expected to be able to make the required deposits within the time frames of the MOA. They cited the length of time it takes sales proceeds to move from the public into the bakeries and flourmills and finally into the special accounts. It is not clear why the MOA included a key provision that could not be met and apparently would not be enforced.

■ ***MOU Establishes Tighter Requirements***

The Program Memorandum of Understanding (MOU), executed on June 26, 1996, tightened the requirements under the program and called for the special local currency account to be opened within 5 days—apparently acknowledging that the MOA requirements already breached were unrealistic. The special account was to be placed in a bank jointly chosen by the GoA and USAID and reports were to be made on the account every 10 days after the first deposit. The MOU also required that \$350,000 be reserved for a financial audit of the program. The GoA also never complied with these MOU provisions. USAID was not consulted on the choice of a bank, did not receive reports at ten-day intervals, and an audit was never performed.

■ ***Attempt to Modify Program's MOU***

Although the GoA had still not provided any information on the special account as required by the MOA and MOU, USAID/Armenia officials, on August 23, 1996, drafted an MOU modification to strengthen the existing provisions. Proposed changes included USAID's direct participation in approving special account disbursements and identifying specific documents to support additional wheat purchases made with program funds. However, all of the required GoA approvals for the modification were never obtained.

■ ***Poor Documentation of Monitoring***

There is no written evidence of inquiries or contacts between USAID/Armenia and the GoA on the special account's status between June 26 and December 2, 1996, when an internal e-mail refers to a meeting with the Minister of Finance planned for the next day. We were told there were numerous meetings and discussions with GoA officials. Besides the MOU modification, which supports that some active monitoring was taking place, there are e-mail references implying contacts with GoA officials and an awareness that the GoA was not complying with Program requirements. USAID/Armenia officials who were monitoring the milling of the wheat into flour did submit internal reports, and noted that special account deposits made as of November 1, December 1, and December 16 had been insufficient.

Another example of inadequate documentation of Emergency Wheat Program monitoring is the reported agreement between the American Ambassador and the GoA allowing the GoA to "borrow" funds from the Program special account for short term GoA budget support. According to the Department of State's Special Assistant for Humanitarian Assistance, this agreement was made either during a telephone call or a meeting. However, no documentation of such a request or agreement was ever located and USAID/Armenia officials stated they were unaware of the request or the agreement.

■ ***Creation of A Monetization Implementation Unit***

With the GoA clearly not complying with the MOA and MOU reporting requirements, USAID/Armenia established a Monetization Implementation Unit in December 1996 to assist the Ministry of Finance in collecting information on the Emergency Wheat Program that USAID/Armenia needed. USAID/Armenia hired a contractor to prepare a report based on the documentation obtained by the Unit. This report, dated March 25, 1997, presented information on specific special account deposits of sales proceeds for the first tranche of wheat and some documentation on a specific purchase of additional wheat bought with these proceeds, but the report raised more questions than it answered.

No information was reported on other purchases of wheat and natural gas using first tranche sales proceeds or on deposits from sales of the second tranche of wheat. More importantly, available information clearly showed GoA noncompliance with much more than just the reporting requirements of the MOA and MOU. First, special local currency account funds were supposedly transferred for purchases of wheat and gas without conversion to U.S. dollars and deposited into a special U.S. dollar account. Second, interest earned on the first tranche account could not be accounted for. Third, actual source documentation on the special account was not made available. But the most significant act of noncompliance confirmed in the report was the direct transfer of 790.2 million drams (approximately \$1,885,441) to the GoA budget instead of the special account.

■ ***Correspondence from the Ambassador***

On March 25, 1997, in response to the transfer of funds, the American Ambassador sent a letter to the Minister and Chief of Staff of the GoA pointing out that the transfer was a breach of the MOA and requested clarification of this action. In addition, the letter requested information on the monetization of the second tranche of wheat delivered five months earlier and stated awareness of only one purchase of additional Program wheat approved by USAID. The letter emphasized the U.S. Government's concern with the GoA's noncompliance. Furthermore, it stated "USAID's ability to sign future agreements for the purchase and transport of wheat to Armenia will depend on the Government of Armenia's fulfillment of its previous commitments." In addition to the Ambassador's letter, USAID/Armenia followed up with GoA officials to obtain additional Program documentation.

The Minister of Finance responded to the Ambassador in a letter faxed on April 14, 1997, but only partially answered the Ambassador's inquiries. Here again, the information provided raised even more questions. The Minister reported that some proceeds from the second tranche sales also had not been deposited to the special account, but rather transferred directly to Armgrain for another purchase of 15,600 metric tons of wheat. No information was provided on (1) the

purchase price or vendor of that wheat, (2) the distribution of the wheat, or (3) the amount collected from the sale of the wheat. Also, no further information was provided on the first tranche sales proceeds.

■ *Final Monitoring Attempts*

Although we were told that additional correspondence followed up on this GoA response, no documents were located. Neither the Mission nor the Embassy had on file any additional information on the reported 15,600 metric ton wheat shipment. We did locate a letter dated June 2, 1997, from the Ministry of Finance to the Mission Director with more details on the transfer of the 790 million drams from the first tranche. This suggests that there had been some continued communication on at least this issue.

Until the Mission began pressuring the GoA to have the Emergency Wheat Program audited as required, in mid-1998—approximately one year later—there was no further information on file concerning any attempts to obtain information about deposits and transfers from the special accounts. It should be noted that despite earlier U.S. Government suggestions that future wheat programs were in jeopardy, the 1997 USAID Wheat Import Program did go forward, although it did not include monetization.

Conclusion

Prior to the 1996 Emergency Wheat Program, the Government of Armenia had demonstrated an inability or unwillingness to implement a USAID monetization program. Despite this, the U.S. Government moved forward, and the emphasis on expediency rather than caution in setting up the 1996 Emergency Wheat Assistance Program is clearly illustrated in the lack of a signed Memorandum of Agreement establishing program requirements before the wheat was distributed throughout the country. With the Government of Armenia's track record in implementing a monetization program, firm program requirements and an active and mandatory management role for USAID should have been in place before the Program began if the MOA was to have any chance of being followed. USAID/Armenia and the U.S. Embassy did attempt to monitor and manage the Program once it began, but documentation of their efforts is insufficient to fully understand exactly what was done.

Regardless, available documentation indicates the Government of Armenia did not comply with the terms of the Memorandum of Agreement or Memorandum of Understanding, and it is unlikely that any level of effort would have resulted in greater compliance. Accordingly, we are recommending that USAID/Armenia recover a portion of the funds allocated for the Program.

Recommendation No 1 We recommend that USAID/Armenia, in coordination with the Government of Armenia, develop a repayment schedule to collect the local currency equivalent of \$16,022,830 from the Government of Armenia consisting of

- 1 1 \$68,493 in interest earned on the special account for sale of the first tranche of wheat,
- 1 2 \$1,611,394 for local currency never deposited to the special account for the sale of the first tranche of wheat,
- 1 3 \$2,060,274 for local currency associated with sales of the first tranche of wheat at prices in excess of \$217 per metric ton,
- 1 4 \$871,991 for local currency transferred from the first tranche special account to Armgram in December 1996 for an unsubstantiated wheat purchase,
- 1 5 \$2,565,718 for local currency transferred from the first tranche special account to Dvin Concern and Armgazard for unsubstantiated natural gas purchases,
- 1 6 \$286,158 for local currency withdrawn from the first tranche special account in excess of the costs of purchasing and shipping an additional shipment of wheat,
- 1 7 \$4,977,000 for a first tranche special account purchase of additional wheat for which the sales proceeds were never transferred to a special account or otherwise accounted for, and
- 1 8 \$3,581,802 for local currency either never deposited to a special account for the sale of the second tranche of wheat or deposited but the use of the proceeds cannot be explained This includes \$350,000 that should have been reserved for an independent financial audit

Recommendation No 2 We recommend that a special account be established to deposit any local currency amounts repaid by the Government of Armenia in response to the above recommendation and that such funds only be used for purposes agreed to by USAID/Armenia and the Government of Armenia

The Mission has indicated that it does not intend to monetize any programs in Armenia at this time. However, should the issue of monetization resurface in the future, we suggest incorporating measures that would provide USAID/Armenia with additional controls over the funds generated and their subsequent use. Such measures should include, but not be limited to (1) assigning responsibility to select the banks to USAID/Armenia, (2) establishing special accounts with USAID/Armenia officials designated as signatories

prior to the program's start, (3) including the bank as a party to the agreement and requiring it to submit reports, monthly account statements, and debit/credit memos directly to USAID/Armenia, and (4) setting realistic deadlines for depositing the proceeds into the special accounts. In addition, before undertaking any monetization program we believe that there must be evidence that the Government of Armenia has made a concerted effort to repay funds identified in Recommendation No 1. Accordingly we are making the following recommendation:

Recommendation No 3 We recommend that USAID/Armenia, prior to undertaking any future monetization programs

- 3.1 require that the Government of Armenia make satisfactory progress towards meeting the repayment schedule developed in response to Recommendation No 1, and**
- 3.2 establish other conditionality terms such as (a) assigning USAID/Armenia responsibility to select participating banks, (b) designating USAID/Armenia officials as signatories prior to the program's start, (c) ensuring that any Armenia bank selected to participate in the program be a party to any program agreement and be required to submit reports, monthly account statements, and debit/credit memos directly to USAID/Armenia, and (d) establishing realistic deadlines for depositing proceeds into the special accounts**

Both Embassy and USAID/Armenia officials stress the Department of State's active involvement in this Program. However, it is not clear in Mission files that the Embassy and USAID/Armenia were working cooperatively toward monitoring the GoA's compliance with the Program's conditions and there was no official assignment of duties and responsibilities between the organizations. The lack of a clear division of responsibilities may have led to each party pursuing separate avenues of monitoring without consulting or communicating with the other. Although a joint, coordinated approach toward monitoring the Program may have impacted the GoA's level of compliance, it is unlikely that it would have ensured total compliance. If a monetized program is implemented in the future, we would encourage USAID/Armenia to reach agreement with the Embassy on specific responsibilities.

Management Comments and Our Evaluation

USAID/Armenia agreed with the findings and recommendations and it concurred with our calculations of the local currency equivalent of \$16,022,830 owed by the Government of Armenia. However, the Mission advised that officials of the Government of Armenia, in conversations dealing with our audit report claiming refunds in connection with the audit of the gas program³, stated that the Government can produce additional documentation for both audits. According to USAID/Armenia, Government of Armenia officials contend that the auditors did not receive complete information and that the unaccounted for funds can be documented. USAID/Armenia has requested that the Government put this contention in writing and provide it with the missing documentation.

With respect to Recommendation No. 1, USAID/Armenia advised that it would first present appropriate Government of Armenia officials our audit findings and request them to develop a repayment schedule to collect the local currency equivalent of \$16,022,830 and/or explanations/corrective actions regarding the local currency for which it has been unable to account. Assuming that the Government of Armenia will be unable to make an immediate dollar or local currency refund of the amounts owed, USAID/Armenia will propose converting all or part of the claim into development activities using local currency equivalent provided by the Government.

Concerning Recommendation No. 2, USAID/Armenia advised that in the event its comes to agreement with the Government of Armenia on a method of repayment, the Mission and the Government will determine the development activities eligible for funding from the special account and agree upon amounts to be budgeted for them. USAID/Armenia will take the necessary actions to ensure that the Government establishes the special account and will devise a monitoring system, including the hiring and training of appropriate USAID personnel, to implement the program. However, USAID/Armenia advised that despite its best efforts it is possible the Government's budget will not provide sufficient development activities to liquidate the amounts owed within a reasonable period of time. In that case, USAID/Armenia will consult with the Office of Inspector General and the Europe and Eurasia Bureau on alternative recovery methods.

Concerning Recommendation No. 3, USAID/Armenia stated it has already informed the Government of Armenia that it will not undertake any further monetization programs and that this decision was fully supported by the U.S. Embassy. USAID/Armenia further advised that if the Government of Armenia makes additional requests for monetization programs in the future it will refuse unless and until sufficient progress has been made on repayments and the Government has demonstrated its ability and willingness to track monetization proceeds and to adhere to all conditions in program agreements.

³See A/R No. B-111-99-005-P, dated September 7, 1999 "Audit of the 1996 Natural Gas Import Program in Armenia"

Based on USAID/Armenia's response we consider that management decisions have been reached on all three audit report recommendations with sustained cost savings of \$16,022,830 USAID/Armenia will need to contact M/MPI/MIC for a determination that final action has been taken on these recommendations

SCOPE AND METHODOLOGY

Scope

We audited USAID/Armenia's management of the 1996 Emergency Wheat Assistance Program in accordance with generally accepted government auditing standards. Audit fieldwork was conducted in Yerevan, Armenia from January 26 through March 29, 1999.

USAID/Armenia's Memorandum of Agreement, signed on June 14, 1996, and a subsequent amendment resulted in the importation of approximately 64,000 metric tons of wheat valued at \$19,779,224 including shipping costs into Armenia. A Memorandum of Understanding dated June 26, 1996 provided additional requirements. Our audit focused on the financial aspect of the Program and USAID/Armenia's efforts to ensure that proceeds from the sale of this wheat and the sale of commodities purchased with these proceeds were deposited into special accounts by the Government of Armenia and used for agreed upon purposes. The Memorandum of Agreement also provided for the privatization of several state-owned entities in the food sector of Armenia and we included these requirements in our audit coverage.

Methodology

The audit objective was to determine whether USAID/Armenia implemented, managed, and monitored the 1996 Emergency Wheat Assistance Program to ensure the Government of Armenia's compliance with the conditions and terms set forth in the Program Memorandum of Agreement (MOA). To accomplish this objective we obtained and reviewed the MOA, subsequent amendment, and the Memorandum of Understanding (MOU) between USAID and the Government of Armenia. We interviewed Mission officials and reviewed available records, reports, and other USAID documents to determine how the Mission monitored the cash flows generated from the sale of Program wheat, including how these funds were used and their eventual disposition. Similarly, we interviewed the Department of State's Special Assistant for Humanitarian Assistance based at the U.S. Embassy in Armenia concerning the Embassy's substantial involvement in the implementation of the Program, and reviewed its Program documents. We also reviewed documentation at USAID/Armenia and International Business and Technical Consultants, Inc. in Yerevan, an independent entity maintaining a database of privatized Armenian entities, to determine compliance with privatization requirements in the MOA.

Officials at the Ministry of Finance, Ministry of Agriculture, Armgrain, Baghranian Flour Mill, and the Yerevan Flour Mill, were interviewed, and copies of Program records, including listings of how the wheat was distributed to individual flourmills and how much local currency was deposited to the special account in connection with the sale of

the first tranche of wheat, were reviewed. We were unable to verify deposits to or withdrawals from any other special accounts—or whether they were ever established—because we were unable to obtain adequate explanations of financial transactions or account statements from the banks, the Ministry of Finance, Armgrain, USAID/Armenia, or the U S Embassy in Armenia

USAID/Armenia Comments



USAID/ARMENIA MEMORANDUM
Office of Financial Management

TO James Bonnell, RIG/A/Budapest
FROM Dianne Tsitsos, Mission Director
DATE November 29, 1999
SUBJECT Mission Comments on Draft Report of Audit of
USAID/Armenia Wheat Monetization Program

Thank you for the opportunity to review subject draft report. Based on information available and in the absence of evidence to the contrary, the Mission accepts RIG/Budapest calculations of the local currency equivalent of \$16,022,830 owed by the Government of Armenia (GoA) to be accurate. However, we note for your attention that officials of the Government of Armenia, in conversations following their receipt of our letter and audit report claiming refunds in connection with the audit of the gas program, have stated that they can produce additional documentation(s) for both audits. The officials (Minister of Economy Darbinian and Minister of Finance Barkhudarian) contend that the auditors did not receive complete information and that the unaccounted-for funds can be documented. I have requested that they put this contention in writing and provide us with the missing documentation(s). We will forward the additional document(s) to RIG/B when received from GoA for review and adjustment of refund amount, if found appropriate.

Nevertheless, in the absence of the letter or documentation, we are proceeding with actions based on both reports of audit findings which we now have in hand. We will inform the RIG/B if and when additional information is received.

Comments on each recommendation follow.

Recommendation No 1. We recommend that USAID/Armenia, in coordination with the Government of Armenia, develop a repayment schedule to collect the local currency equivalent of \$16,022,830 from the government of Armenia.

The Mission agrees with the findings and the recommendation and will undertake the following steps:

The Mission will first present appropriate Government of Armenia (GoA) officials with the Report findings and request to develop a repayment schedule to collect the local currency equivalent of \$16,022,830 and/or explanations/corrective actions.

regarding the local currency for which it has been unable to account. A meeting, with the Minister of Finance will be requested in the month of December 1999. Based on the findings of the Report and any additional materials presented by the GoA, the Mission Director will determine whether the government is in a position to repay the \$16,022,830 or the local currency equivalent.

Assuming that the GoA will be unable to make an immediate dollar or local currency refund of the amounts owed, the Mission will propose converting all or part of the claim into development activities using local currency equivalent provided by GoA (see Recommendation No. 2 and comments).

Recommendation No. 2. We recommend that a special account be established to deposit local currency amounts repaid by the government of Armenia in response to the above recommendations and that such funds only be used for purposes agreed to by USAID/Armenia and the Government of Armenia.

In the event that USAID and the GoA come to agreement on this method of repayment, the Mission and GoA will determine the development activities eligible for funding from the special account and agree upon amounts to be budgeted for them. USAID will take the necessary actions to ensure that the GoA establishes the special account and will devise a monitoring system, including the hiring and training of appropriate USAID personnel, to implement the monitoring program.

Despite the Mission's best efforts, however, it is possible that the Government of Armenia's budget will not provide sufficient development activities to liquidate the amounts owed within a reasonable period of time. In that case, the Mission will consult with the RIG and the Europe and Eurasia Bureau on alternative recovery methods.

Recommendation No. 3. We recommend that USAID/Armenia, prior to undertaking any future monetization programs, require that the Government of Armenia make satisfactory progress towards meeting the repayment schedule developed in response to Recommendation No. 1, and establish other conditionality terms (as described in the draft report).

The Mission has already informed the GoA that it will not undertake any further monetization programs. That decision was fully supported by the U.S. Embassy. If the GoA makes additional requests for such programs in the future, the Mission will refuse unless and until sufficient progress has been made on repayments and the GoA has demonstrated its ability and willingness to track monetization proceeds and to adhere to all conditions in program agreements.

Cc: Bob Wallin, Armenia Desk Officer
Gloria Steele, Director, E&E Office of Operations and Management

Clearance: KDelaney KD

**SUMMARY OF AUDIT RESULTS CONCERNING
COMPLIANCE WITH THE
PROGRAM MEMORANDUM OF AGREEMENT**

Summarized below are our audit results concerning the degree of compliance or non-compliance by the Government of Armenia (GoA) with eleven key elements of the Program Memorandum of Agreement and Memorandum of Understanding. These results are key to answering the audit objective which concerned USAID/Armenia's (with the U S Embassy) implementation, management, and monitoring of the 1996 Emergency Wheat Assistance Program. Although some monitoring and management measures could possibly have been more aggressively pursued, the total lack of compliance by the GoA with the Program's requirements, as detailed below, suggests additional efforts would have had only marginal success at best.

Result No. 1

USAID or the U S Embassy was not provided with Program financial records

Requirement Under the Memorandum of Agreement (MOA), the Government of Armenia (GoA) agreed to give USAID "access to all records pertaining to the local currency generated and used." Both the Program MOA and the Memorandum of Understanding contain several specific requirements of reports and information to be provided by the GoA (primarily the Ministry of Finance) to USAID/Armenia. The Program memoranda require the GoA to provide

- Bank account numbers
- Monthly bank statements
- Reports showing dates and sources of deposits
- Interest rates and amounts of interest earned

GoA's Noncompliance The Government of Armenia (GoA) has not given USAID adequate access to records—particularly financial records—pertaining to the FY 1996 USAID Emergency Wheat Assistance Program. As discussed throughout this report, our review of USAID/Armenia and U S Embassy records showed that the GoA (and Armgran) provided only limited financial information that was never timely and often incomplete. Documents were usually not source documents but merely summaries prepared by a GoA ministry. Our own attempts to obtain reliable

documentation—specifically bank statements for the various special accounts—were not much more successful. As of this report date, we have received what is reported to be a bank statement for only one special account. Verbal explanations of various financial transactions, when provided at all, have often been incomplete, illogical or contradictory.

Result No 2

Deposits to the special local currency accounts were not timely

Requirement The Memorandum of Agreement (MOA) required that (1) \$7 million of the \$10,416,000 in local currency equivalent to be generated by sales of the first tranche of wheat be deposited into a special local currency account within 30 calendar days of the initial delivery of wheat to Armenia and (2) the remaining \$3,416,000 was to be deposited within 21 calendar days following the final delivery of wheat. Accordingly, since the wheat was distributed within Armenia between May 27 and June 5, 1996, all local currency sales proceeds should have been deposited to the special account by June 26, 1996.

Amendment No. 1 to the MOA concerned sales proceeds from the second tranche of wheat, and required deposit within 60 days after the final delivery of wheat. Records provided by the Department of State's Special Assistant for Humanitarian Assistance at the U.S. Embassy only show that the second tranche of wheat had been unloaded in Georgia by October 11, 1996. It was distributed during unspecified days in October 1996. A conservative estimate would be that the deposits should have been completed by December 31, 1996.

GoA's Noncompliance As of June 26, 1996, no deposits had been made to the special local currency account (Ardshinbank Account 12100000517) for sales of the first tranche of wheat. The first deposit by a mill was not made until July 30, 1996, and the final deposit not made until December 29, 1996. As discussed under Result No. 4 below, the required amount of deposits was never made.

However, deposits from sales of the second tranche of wheat should have been deposited by December 31, 1996. A report from Armgrain, dated April 1, 1997, indicated that only 830.4 million of the 1,540 million drams (54 percent) had actually been deposited to the special account by March 1, 1997. We were unable to obtain additional information to determine when or if the remaining deposits were eventually made.

Result No 3

Interest was not paid on any of the special accounts

Requirement The Memorandum of Agreement (MOA) and Amendment 1 to the MOA required that the special local currency accounts be interest-bearing accounts.

GoA's Noncompliance During the audit, Ministry of Finance officials stated the special accounts were all interest-bearing, and we found that the special local currency account for sale proceeds from the first tranche of wheat had, in fact, been in a commercial bank. However, a summary of account activity prepared by the Ministry of Finance, along with a summary reported to be a bank statement, shows no interest earned or paid. Ministry staff could not explain why the summary/statement contained no entries for interest. The Monetization Implementation Unit created in December 1996 at USAID/Armenia's suggestion to work with the Government of Armenia (GoA) in collecting information on the program's implementation received verbal information that the first tranche special account had a seven percent interest rate and earned 30 million drams in interest (approximately \$68,493 at the 1996 yearend exchange rate). But no documents were ever produced to confirm this or the disposition of the interest. Using an estimated annual interest rate of seven percent, we calculated that the account either earned or could have earned the local currency equivalent of approximately \$70,522 during its five months of existence—basically the same amount of interest verbally reported to the Monetization Implementation Unit, which confirmed the reasonableness of this estimate.

According to the Armgrain April 1, 1997, report, funds from sales of the second tranche of wheat were deposited as of March 1, 1997 in Account 103001012766. During discussions with officials of one of the state flourmills we learned that this account is actually a Ministry of Finance account at the Central Bank of Armenia and, accordingly, is probably not an interest-bearing account. In addition, officials at the same flourmill provided evidence that, at the direction of the Ministry of Finance, some of the flourmills' deposits for the second tranche were actually deposited into two commercial bank accounts—Ardshinbank Account 606302 and Armeconombank Account 8609022. We have been unable to obtain bank statements for these accounts to determine whether they earned interest.

Result No. 4

Insufficient deposits were made to the special local currency account for proceeds from the sale of the first tranche of USAID-procured wheat

Requirement The Memorandum of Agreement (MOA) stated that for the first tranche of wheat deliveries, "The Government of Armenia (GoA) shall cause to be deposited into a special, non-commingled, interest-bearing local currency account the larger of (1) all of the funds collected from the sale of the assistance wheat delivered under this program to the state mills, or (2) the local currency equivalent of not less than \$10,416,000."

GoA's Noncompliance Armgrain provided a list detailing how it distributed the wheat among five state flourmills, each of which was supposed to pay the equivalent of \$217/metric ton in Armenian drams to a Ministry of Finance special account. In March 1997, the Ministry of Finance finally provided a list it created of deposits and withdrawals from an account (Ardshinbank Account 12100000517) that purported to show details of the transactions in the required local currency special account. During the audit, the Ministry also provided a printout described as a bank statement.

The mills' deposits to the account (and also one deposit of 65 5 million drams advanced to the account by the Ministry of Finance) only total 3,691 million drams with a U S dollar value (when deposited) of \$8,804,606 This is \$1,611,394 less than the minimum required by the MOA The list included a Ministry explanation that an additional 790 million drams (approximately \$1,885,441 using the same average exchange rate) had been received from the mills but had been transferred directly to the GoA's general budget rather than to the special account—contrary to MOA requirements A letter dated June 2, 1997, from the Ministry of Finance to the USAID/Armenia Mission Director explains the 790 million drams was transferred to the GoA general budget from an Armeconombank account However, whom that account belonged to, the account number, and the origin of the funds was not identified It is not clear why a second account may have existed for the first tranche sales proceeds, and why no information on financial transactions made through this account was provided

Result No 5

Wheat was sold at prices above the minimum required and the “surcharges” were not deposited to the special local currency account

Requirement As discussed above under Result No 4, the Memorandum of Agreement (MOA) requires that all funds collected from the sale of the assistance wheat (and at least the equivalent of \$10,416,000 or approximately \$217 per metric ton) be deposited to the special local currency account

GoA's Noncompliance Ministry of Finance, Ministry of Agriculture, and Armgrain officials reported during the audit that the program wheat was sold to the flourmills for 89,500 drams per metric ton, an amount equivalent to \$217/ton, which was the minimum price required under the MOA However, officials of one flourmill we visited provided documentation that Armgrain assessed an additional 15,500 drams per ton (approximately \$38) to be deposited directly to an Armgrain bank account Mill officials also reported that they were similarly directed to pay an extra 20,000 drams per ton for wheat received under USAID's 1995 wheat import program Mill officials refused to pay this surcharge and eventually complained to the Ministry of Finance The Ministry's response, in a letter dated August 17, 1998, informed the mill that the surcharges were in accordance with Armenian law and were intended to raise 902 4 million drams for the Government of Armenia's general budget The Ministry also reported that it had already collected the 902 4 million drams (\$2,060,274 at 1996 yearend exchange rate) from Armgrain However, according to the MOA provisions, these funds should have been deposited to the program special account to purchase additional wheat or natural gas

Result No 6

Insufficient deposits were made to the special local currency account for the proceeds from the sale of the second tranche of USAID-procured wheat

Requirement Amendment No 1 to the MOA stated that for the second tranche of wheat deliveries "The Government of Armenia (GoA) shall cause to be deposited into a special, non-commingled, interest-bearing local currency account the larger of (1) all of the funds collected from the sale of the assistance wheat delivered under this program to the state mills, or (2) the local currency equivalent of not less than \$3,581,802 "

GoA's Noncompliance Armgrain provided a list of how the second tranche of wheat was distributed among the mills and how much each mill was to deposit into the special account As discussed in Result No 2 above, Armgrain reported that 830 4 million of 1,540 million drams had been deposited by the mills into the special account (a Ministry of Finance account in the Central Bank of Armenia) as of March 1, 1997 However, the Ministry of Finance has not provided any information regarding the account or how much local currency in total might have eventually been deposited into the account

In another indication the sales proceeds were not fully deposited to the account, officials of the Yerevan Flour Mill provided information indicating that the mill deposited only 543 million drams out of the 733 4 million drams it was supposed to have deposited for the wheat received from the second tranche In addition, mill officials told us that the mill's deposit of 543 million drams was made to *three* different bank accounts These accounts included two commercial accounts at Ardshinbank and Armeconombank and one account at the Central Bank of Armenia The deposits were all made in December 1996 and the mill had been directed to use these bank accounts Bank statements on these commercial bank accounts were not made available After completion of audit fieldwork, the Ministry of Finance responded to our request for information about these accounts They provided documentation that a total of 355 million drams had been deposited by various mills to the Armeconombank during December 1996

Additional evidence that the required level of deposits were never made to a special account is contained in a Ministry of Finance letter (faxed on April 14, 1997), which states that a portion of the sales proceeds from this tranche were transferred or deposited directly to an Armgrain account in Haiagrobank Account 142010012359, reportedly to purchase an additional 15 600 metric tons of wheat No other information on this account (or the wheat purchase) was available

Result No 7

The special U S dollar account was never established

Requirement The Memorandum of Agreement (MOA) and Amendment 1 to the MOA directed that proceeds from the special local currency account(s) should, within 30 days of deposit, be converted to U S dollars and deposited into a special, non-commingled, interest-bearing U S dollar account. It should be noted that the local currency in the special account(s) has to be converted into U S dollars (or another hard currency) so that these sales proceeds can be used to purchase additional commodities in international markets.

GoA Noncompliance During the audit, Ministry of Finance officials stated that a special U S dollar account had been established but never provided any evidence that such an account existed. Information that was made available shows that most of the funds from the special local currency accounts were apparently transferred directly to entities responsible for purchasing additional wheat and gas in international markets. Information on those entities and subsequent conversion of dram transfers to U S dollars was not available. The remaining funds in the special local currency accounts were reportedly transferred directly to the Government of Armenia's general budget account.

Result No 8

The GoA cannot adequately account for the use of funds generated by the sale of USAID-procured wheat

Requirement The Memorandum of Agreement (MOA) calls for the sales proceeds from the first tranche to be used for the purchase of additional wheat at a cost not to exceed \$7 million, with the balance of the funds to be used for the procurement of natural gas or other uses as the parties may agree to in writing. For the second tranche of wheat, all of the sales proceeds were to be used for either the purchase of additional wheat or other uses as agreed to in writing. The MOA and Amendment 1 to the MOA stated that the use of the sales proceeds were to be jointly programmed by USAID and the Government of Armenia (GoA), and that the GoA was to provide to USAID "full and timely information concerning the GoA's utilization of the proceeds from the sale of the commodities donated under this Agreement."

GoA's Noncompliance The Ministry of Finance liquidated the special local currency account for the sale of the first tranche of wheat by transferring

- 2.2 billion drams (approximately \$5,263,158) on October 30, 1996, for the purchase of additional wheat
- 382 million drams (approximately \$871,991) in December 1996 and January 1997 to Armgrain for the purchase of wheat

- 309 million drams (approximately \$739,234) to a "bartering company" called Dvin Concern, reportedly to buy natural gas
- 800 million drams (approximately \$1,826,484) to Armgazard, the state-owned gas company at that time, to buy natural gas

Evidence was only provided to support that the 2.2 billion drams transfer cited above may have been used to buy additional program commodities. No information was made available concerning the other transfers, including how much wheat or gas may have been purchased, when it was purchased, the purchase price, or the price used when it was resold in Armenia.

For example, the transfer of 382 million drams to Armgrain took place in three separate withdrawals in late December 1996 and early January 1997 but no one in Armgrain could provide any information on how the funds were used. Ministry of Finance officials could not explain why a bartering company was reportedly used to purchase natural gas for resale under this program when a GoA decision of December 10, 1996, selected Armgazard, the state-owned gas distribution enterprise, as the entity to handle Program gas purchases. In the case of the 800 million drams transferred to Armgazard (also known as Armgazprom) to buy natural gas, the Ministry of Finance eventually reported during the audit that Armgazard simply applied these funds to existing debt.

The 2.2 billion drams (\$5,263,158) withdrawn from the account was reportedly directly transferred to the Paris account of an Italian firm (rather than transferred to Armgrain first) on October 30, 1996, ostensibly for the purchase of 21,000 metric tons of wheat from that company. The price of this wheat (including shipment to Georgia) was \$4,347,000 and documentation shows it was delivered and distributed among the mills in Armenia. There is no explanation for the excess payment of \$916,158 to the Italian firm if it did actually receive the entire \$5.26 million (assuming the funds from this account were actually used to pay for this wheat). The Department of State's Special Assistant noted that the handling and transport costs to get the wheat to Armenia would be approximately \$30 per metric ton but that it was very unlikely this firm was responsible for handling and transporting the wheat to Armenia. Regardless, these additional costs—paid to another unknown entity—could only account for \$630,000 of the \$916,158 overpayment.

Second tranche sales proceeds are similarly unaccounted for with the Ministry of Finance unable to provide detailed information on how any of the funds generated by the sale of this wheat were used. On April 14, 1997, the Ministry of Finance did report in a letter that 15,600 metric tons of wheat were purchased and delivered in December 1996 with some of these proceeds. Without supporting documentation, the purchase price and handling costs of this possible shipment remain unknown and no information was provided on what kind of sales proceeds this shipment may have generated. Interestingly, this shipment was supposed to have been procured by Armgrain but Armgrain officials told us that the only procurement of additional wheat under the program was the purchase of 21,000 metric tons from the Italian firm (discussed above).

The Ministry of Finance did provide us with information that an account in Armeconombank (Account 163008609022), one of multiple accounts used to receive proceeds from the sale of second tranche wheat, was closed out in a series of three withdrawals February 20, February 27, and March 4, 1997. No information was provided on the disposition of the 355 million drams from the account.

Result No 9

The third special local currency account was not established

Requirement The Memorandum of Agreement (MOA) required the Government of Armenia (GoA) to deposit all local currency sales proceeds from the sale of additional wheat (and other commodities purchased from the special accounts) into a third special local currency account. After all sales proceeds had been deposited, the entire balance of the account was to be transferred to the general funds of the GoA.

GoA's Noncompliance The only evidence we found that sales proceeds from additional purchases of wheat (or other commodities) were ever collected or deposited to any account came from one state-owned flourmill, Yerevan Flour Mill. Officials there reported that during January 1997 they had deposited 419 million drams (approximately \$920,801) for the wheat they had received from the "third" wheat shipment of 21,000 metric tons procured from an Italian firm (discussed under Result No 8). However, a concern is that the mill's deposits were made to the same Central Bank account (No 103001012766) used for deposits from the second tranche of wheat. Commingling the sales proceeds of the two shipments would make it difficult to ever determine how much the mills had deposited separately for either shipment. The Ministry of Finance did not provide a bank statement or any information for that account or any other account used for deposit of these sales proceeds.

No information was available to support whether any local currency from this account—or generated from the sale of the additional wheat—was ever remitted to the general funds of the GoA.

Result No 10

Steps were taken toward privatization of state-owned entities in the food sector

Requirement In the Memorandum of Agreement (MOA), the Government of Armenia (GoA) agreed to take the necessary steps to create a viable private milling and bakery sector by including the privatization of four specific flourmills and at least 25 bakeries in its Privatization Program of 1996-1997.

GoA Compliance The Government of Armenia (GoA) did include the privatization of the four flourmills and 25 bakeries in its 1996-1997 Privatization Program. As of February 1999, all four mills and 23 bakeries had, in fact, been privatized according to the database maintained by International Business and Technical Consultants, Inc.

(IBTCI) in Yerevan (4 of the 23 bakeries actually privatized as part of the 1998-2000 Privatization Program) Although the number of privatized bakeries fell slightly short of the goal and the length of time to achieve this privatization was longer than expected, the results do demonstrate a good faith effort by the GoA to privatize its food sector USAID/Armenia and Ministry of Agriculture officials also pointed out the unpredictability of the rate of privatization of these entities Some entities had been offered for sale, but had no potential buyers

Result No 11

An independent financial audit was not performed nor was \$350,000 reserved for the audit

Requirement The Memorandum of Understanding (MOU) states that \$350,000 will be reserved in the special dollar account for an independent financial audit of the Program's activities

GoA's Noncompliance There is no evidence that \$350,000 was reserved in any account for an independent financial audit, and an audit was never performed