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Report to the Ranking Minority Member, Subcommittee on Agriculture, Rural Development and Related Agencies, Committee on Appropriations, House of Representatives

September 2000

FOREIGN ASSISTANCE

U.S. Food Aid Program to Russia Had Weak Internal Controls

GAO

Accountability * Integrity * Reliability

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Abbreviations

PVO private voluntary organization

GAO
Accountability * Integrity * Reliability

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National Security and
International Affairs Division

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September 29, 2000

The Honorable Marcy Kaptur
Ranking Minority Member
Subcommittee on Rural Development,
Agriculture, and Related Agencies
Committee on Appropriations
House of Representatives

Dear Madam Kaptur:

In December 1998, the United States responded to a request by the Russian Federation for food aid that was triggered by the twin effects of one of the lowest Russian grain harvests in decades and a severe financial crisis. The United States agreed to provide 3.7 million metric tons of food aid in fiscal year 1999,[1] at a cost of approximately $1.1 billion (including commodity and freight costs). Most of the food aid was sold by the Russian government to regional mills and processors and is expected to raise about $353.2 million for the Russian Pension Fund and $2.3 million for agricultural projects in Russia.[2] A small portion of the U.S. food aid was donated to Russian social institutions to feed some of the most needy people. The fiscal year 1999 program, which is administered by the Department of Agriculture's Foreign Agricultural Service, was one of the largest food aid programs to a single nation in the history of U.S. food aid.

Out of concern over the size and complexity of the U.S. food aid program, as well as the well publicized allegations of corruption and misappropriation of government resources in Russia, you requested us to evaluate how the Foreign Agricultural Service monitored the distribution of U.S. food aid commodities and funds generated from their sale. A key factor in helping managers achieve program objectives and minimize operational problems and risk of fraud and abuse is the implementation of appropriate internal controls. This report focuses on the internal controls used by the Foreign Agricultural Service in its management of the fiscal

[1]The U.S. food aid agreements with the Russian government were initiated in fiscal year 1999. Food aid shipments began arriving in Russia in fiscal year 1999 and are projected to be completed in fiscal year 2001.

[2]Dollar amounts in this report are based on an exchange rate of 28 rubles per U.S. dollar.

year 1999 government-to-government food aid programs to Russia.[3] We specifically examined (1) the adequacy of internal controls used to monitor the distribution of food aid commodities, (2) the adequacy of procedures for monitoring collections and deposits of funds derived from the sale of food aid commodities, and (3) the extent to which procedures for determining the price to sell U.S. food aid commodities in Russia were followed.

To address these issues, we went to Russia for 2 weeks in November and December 1999 to meet with U.S. and Russian government officials involved with the implementation of the fiscal year 1999 food aid program. We also conducted a detailed analysis of 237 reports documenting the results of site visits to regional food aid recipients by U.S. monitors, reviewed 19 months of minutes recording decisions made at weekly meetings between U.S. and Russian officials, reviewed hundreds of key logistical reports, and tested a database used to track commodity distribution. As the basis for evaluating the program's internal controls, we used the standards for internal control in the federal government.[4] Appendix I provides detailed information on our scope and methodology.

Results in Brief

The Foreign Agricultural Service did not adequately implement internal controls designed to direct, track, and verify how food aid was delivered at the regional level in Russia. As a result, the Foreign Agricultural Service cannot provide reasonable assurance that the food aid was delivered in agreed upon amounts to the intended regions as was designated in commodity distribution plans approved by both governments. We found that for most of the commodity distribution plans, less than one-quarter of the targeted regions received a tonnage amount that was equivalent to or near their planned allotment. The lack of timely reporting on commodity distribution by the Russian government combined with weaknesses in the Foreign Agricultural Service's tracking systems for monitoring commodity deliveries to regional recipients limited the agency's ability to effectively manage the distribution process, identify discrepancies, and minimize the

[3]Ninety-seven percent of the total U.S. food aid tonnage provided to Russia in fiscal year 1999 was provided under a government-to-government program. The remaining 3 percent of the food aid tonnage was distributed in Russia through private voluntary organizations.

[4]*Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, Nov. 1999) provides a foundation for internal controls for federal entities.

potential for fraud and abuse. U.S. monitors who visited regional sites to verify commodity deliveries often did not have reliable information concerning the quantities of commodities expected to be delivered. Thus, they were unable to make this determination and investigate discrepancies effectively. Moreover, they made few visits to determine whether wheat intended to be distributed to needy populations reached social institutions such as orphanages and hospitals. Officials from the Foreign Agricultural Service told us that their ability to effectively implement internal controls was constrained by limited staff resources and the need to implement a large and complex program in a short time period. In addition, U.S. and Russian officials told us that while a few cases of alleged abuse had been reported and investigated, the cases were not substantiated and were aware of no significant claims of commodity diversion or fraud in the food aid program.

The Foreign Agricultural Service did not establish adequate procedures to monitor the collection and deposit of funds derived from the sale of fiscal year 1999 U.S. food aid commodities in the Russian regions. The procedures were also inadequate for minimizing the risk of unintended commodity diversions and shortfalls in deposits to the Russian Pension Fund. The Foreign Agricultural Service did not begin to systematically track total payments due and reconcile this information with data from Russian records on total payments collected until May 2000—13 months after the first commodity shipments arrived in Russia. Also, the Foreign Agricultural Service did not receive information on a regular basis regarding the status of regional payments and delinquencies. Foreign Agricultural Service officials generally regarded regional payment data to be unnecessary because they viewed the Russian government as being ultimately responsible for making up shortfalls. In June 2000, the Russian government reported that $293 million had been collected of $309 million that was due at that time. However, this report also reflected the fact that about half the regions were delinquent, owing $26 million, while the remaining regions had paid $10 million in advance. Without regular information on the amounts due and paid by region, the Foreign Agricultural Service was impeded in its ability to influence Russia to take collection actions, including suspending food aid distributions to delinquent regions. It also could not effectively use regional payment information to help confirm regional receipt of the food aid commodities.

Officials from the Foreign Agricultural Service established and followed a formal procedure for setting commodity prices for food aid sold in Russia, but they did not adequately document their analysis or the basis for how

the final price decisions were reached. The prices set were used to calculate the amount to be deposited into the Russian Pension Fund for a given commodity shipment. The U.S. and Russian governments attempted to set commodity prices at a "golden middle" that would facilitate the quick sale of food aid commodities and help to counteract inflationary pressures but would not disrupt local markets. Because prices are not always readily available in Russia's emerging market economy, officials from the Foreign Agricultural Service and the Russian government consulted a variety of sources to set program prices. However, Foreign Agricultural Service officials did not prepare written market analyses or summaries of their conversations with market experts and trade organizations assessing market conditions. Moreover, our analysis of several commodities shows that in some cases U.S. food aid prices were significantly below market prices in Russia. Without documentation of its independent assessments of market conditions when making price-related decisions, the Foreign Agricultural Service was unable to demonstrate the reasonableness of final food aid commodity prices, which in turn, determines the amount of funds deposited into the Russian Pension Fund.

In order to strengthen the program's internal controls, we recommend that the Secretary of Agriculture take certain actions to better monitor the distribution of U.S. food aid commodities as well as the funds generated from their sale under the existing and any future government-to-government food aid programs in Russia. We also recommend that the Secretary of Agriculture take steps to improve the transparency of key decisions concerning changes to distribution plans and the establishment of prices for U.S. food aid commodities sold in Russia. The Foreign Agricultural Service stated in its agency comments that it appreciated our recommendations to improve internal controls and will seek to implement them where appropriate. However, the agency disputes our conclusion that because of these internal control weaknesses, the Foreign Agricultural Service cannot reasonably assure that the food aid was delivered in agreed upon amounts to the intended regions and that the Russian Pension Fund will continue to receive timely deposits that equal the full value of the food aid sold in Russian markets. Agency officials stated that the bottom-line objectives for the program—delivery of commodities to the regions of Russia as planned and achieving the targeted goal for payments to the Russian Pension Fund—were achieved as no substantiated reports of fraud or diversion of commodities or funds have been confirmed. While we agree that conducting a food aid program in Russia was a difficult challenge, we continue to believe that implementation of appropriate internal controls is essential to prevent and detect fraud and abuse. Without adequate controls

and documentation of key decisions the agency cannot provide reasonable assurance that its objectives are being met.

Background

The United States provided the Russian government with 3.6 million metric tons of food aid commodities, such as wheat, corn, soybeans, rice, poultry, and pork under its largest government-to-government food assistance package in fiscal year 1999.[5] Half of this food aid tonnage was donated to the Russian government and half was sold on concessional terms.[6] The Russian government, in turn, sold about 90 percent of the food aid tonnage to regional processors and donated about 10 percent to social institutions. In addition to the government-to-government programs, the United States also donated another 97,000 metric tons in food products that were for direct distribution to vulnerable groups such as hospitals and orphanages throughout Russia by five private voluntary organizations. Food aid commodities began arriving in March 1999, and over 95 percent of the food aid had arrived via 235 different vessel shipments by June 2000. See appendix II for detailed information on U.S. food aid programs to Russia for fiscal year 1999 and the arrival of U.S. food aid commodities.

In addition to the grain shortages and financial crisis, Russia's request for food assistance came at a time when its Pension Fund was 4 months in arrears in some regions.[7] There was also a shortfall of government support for social institutions, and a concern for potential food shortages and hunger, especially in the Northern and Eastern areas of Russia. The request also came during a period of surplus U.S. and global agricultural production and low commodity prices.

The U.S. goals for the fiscal year 1999 U.S. food aid program to Russia were to help the Russian government stabilize food prices and supply food to vulnerable groups. To avoid past problems of mismanagement and waste

[5]The next largest government-to-government food assistance packages provided by the United States in fiscal year 1999 were the approximately 790,000 metric tons of food aid provided to North Korea under a multilateral assistance program and about 660,000 metric tons of food aid provided to Indonesia under a bilateral agreement.

[6]The concessional terms of the food aid sale were a 5-year grace period, 16 installment payments in approximately equal amounts, and an initial interest rate of 2 percent.

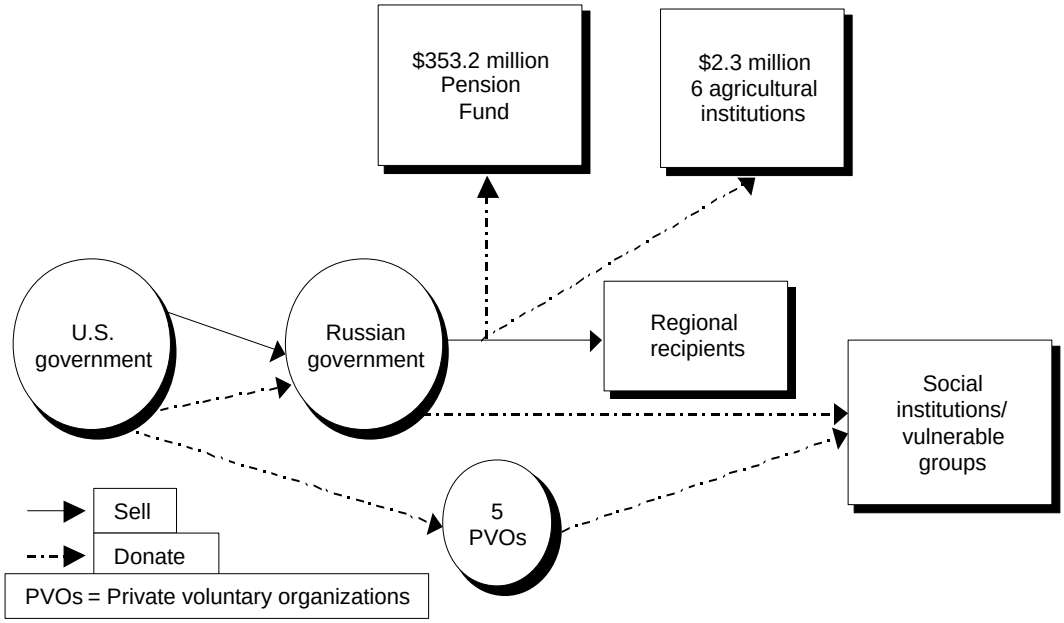
[7]The Russian Pension Fund is a "pay-as-you-go" Russian government pension system, funded in part by employers and workers, which serves as the principal social security safety net for the elderly.

that occurred in U.S. food aid programs to the Former Soviet Union in the early 1990s, the Foreign Agricultural Service designed a simple program to expedite the distribution of a large quantity of food aid and minimize the opportunity for fraud and abuse. By selling most of the food aid within Russia, the United States hoped to raise substantial funds for the Russian Pension Fund to reduce pension arrears and alleviate poverty. The highly visible Pension Fund was also selected to simplify the monitoring requirements needed to minimize risk of fraud related to the use of the sale proceeds. The small amount of funds derived from the sale of donated seeds was provided to five agricultural research institutions and one rural credit agency.[8]

Integral to the food aid program were commodity distribution plans that allocated quantities of each type of commodity to target regions based on need. These plans, later implemented through detailed work plans, were mutually agreed upon by both governments and incorporated into the food aid agreements. The program relied on former state entities to sell food aid, capitalizing on the existing food distribution network. U.S. surplus wheat was also donated on a regional basis and intended to benefit selected orphanages, hospitals, and other social institutions serving needy segments of the population. The five private voluntary organizations also directly distributed donated food to vulnerable groups in Russia. Figure 1 provides a flow chart of U.S. food aid commodity distribution and beneficiaries.

[8]See *Foreign Assistance: Donation of U.S. Planting Seed to Russia in 1999 Had Weaknesses* (GAO/NSIAD-00-91, Mar. 9, 2000).

Figure 1: Flow Chart of Food Aid Commodity Distribution and Beneficiaries, Fiscal Year 1999 Program



Source: GAO.

In order to minimize the potential for fraud and abuse in the distribution and sale of commodities, the Foreign Agricultural Service incorporated internal control provisions into the food aid agreements with Russia. According to federal standards, internal controls serve as the first line of defense in safeguarding assets, preventing and detecting errors and fraud, and providing reasonable assurance that an organization's objectives are being achieved. In addition to the standard reporting and compliance requirements usually found in food aid agreements with other countries, the Foreign Agricultural Service also established weekly Bilateral Working Group meetings between senior U.S. and Russian government officials to discuss operational and logistical issues and resolve problems.[9] It also used commodity distribution plans to direct and account for the distribution of food aid to targeted regions. In addition, the Russian government was required to prepare more detailed logistical reports on the movement of

[9]Members of the Bilateral Working Group included U.S. officials from the Foreign Agricultural Service and Russian representatives from the ministries of Agriculture, Finance, Customs, Trade, and Internal Affairs; and Russian distribution agents.

food aid commodities. These and other reports were used to create a database to track commodities from purchase through shipping and arrival at the final destination. A small number of U.S. monitors also were sent to Russian regions to verify the arrival of food aid commodities at local facilities. These procedures were also being used by the Foreign Agricultural Service to manage the U.S. food aid program to Russia in fiscal year 2000 that is expected to provide for delivery of 520,000 metric tons of food aid commodities.[10] See appendix III for a summary of the major internal controls, their purpose and specific procedures.

Internal Control Weaknesses Impair U.S. Ability to Ensure Proper Distribution of Food Aid Commodities

While the Foreign Agricultural Service established internal controls to direct, monitor, and verify food aid delivered to the regions, it cannot provide reasonable assurance that the food aid commodities were distributed as intended and that wheat intended to be distributed free to social institutions was donated rather than sold to the regions. We found significant differences between planned and actual commodity distributions to the regions and we were unable to determine whether the differences were due to intended or unintended re-routings. The commodity distribution plans were not updated and the minutes of the Bilateral Working Group meetings do not document reasons for or approval of changes. In addition, key logistical reports on shipment status were not submitted on a timely basis and contained inaccurate and incomplete information, which limited the effectiveness of the commodity tracking system. Moreover, the Foreign Agricultural Service made improvements to its tracking system too late to provide useful information to manage the fiscal year 1999 food aid program. While the Foreign Agricultural Service undertook an extensive effort to visit regional recipients and verify that commodities had been delivered as expected, its U.S. monitors often did not have reliable information on the quantities scheduled to be distributed when they visited the regional sites. As a result, they could not effectively verify the amounts actually delivered to the designated recipients. These internal control weaknesses also affected the Foreign Agricultural Service's ability to provide reasonable assurance that the regions and social institutions received their expected share of the wheat intended for

[10]For fiscal year 2000, the United States agreed to provide Russia with 300,000 metric tons of wheat intended for donation to social institutions and 20,000 metric tons of seeds for sale in Russia, the latter whose revenues are to be deposited into a special account designated for a rural credit agency. The United States also donated 200,000 metric tons of food commodities for distribution by eight private voluntary organizations.

donation to vulnerable groups because its tracking system did not distinguish between wheat intended for sale versus donation and the U.S. monitors made few site visits to social institutions. Foreign Agricultural Service officials told us that although their ability to effectively implement internal controls was hindered by limited staff resources and the need to quickly implement a large and complex program in a short period of time, there were not substantiated claims of significant commodity diversion or fraud in the food aid program.

Inadequate Implementation of Commodity Distribution Plans Impeded Ability to Ensure Food Aid Deliveries to Regions as Intended

Although the commodity distribution plans were designed to help track the progress of U.S. food aid deliveries to regional recipients in Russia and trace discrepancies to a particular step or agent, the Foreign Agricultural Service did not use commodity distribution plans as a control mechanism to help ensure that commodities reached their intended regional destination. U.S. food aid commodities were delivered to 79 of the 89 regions of the Russian Federation under the fiscal year 1999 program. Under the terms of the bilateral agreements, the Russian Ministry of Agriculture was required to submit detailed distribution work plans to the Foreign Agricultural Service prior to its commodity purchases that allocated the commodities to regions by type and tonnage based on need. Recognizing the need to respond to changing conditions such as sudden regional food shortages, the Russian government was permitted to revise these work plans. However, changes to the distribution work plans had to be approved by the U.S. Minister Counselor based upon requests of the Bilateral Working Group.

We found that the commodity distribution plans were not implemented in a way so as to provide reasonable assurance that the commodities were delivered in agreed upon amounts to the regions as intended. The commodity distribution plan data were not entered into the database and used as a baseline for determining whether the commodities reached the intended regions. Moreover, mutually approved commodity distribution plans covering about 90 percent of the food aid tonnage were not updated

to reflect changes in planned deliveries.[11] For example, the Russian government's original plan was to buy and deliver 120,000 metric tons of beef to 26 regions; however, according to shipment and distribution reports, it purchased and distributed less than 50,000 metric tons of beef to 13 regions. We found no records indicating that the Russian government submitted a revised distribution plan addressing these changes. We also found little evidence in the minutes of the Bilateral Working Group to indicate that proposed changes in commodity distribution plans were presented to and received approval by the U.S. Minister Counselor. Instead, the U.S. Minister Counselor received and accepted final reports of actual commodity deliveries made to regional recipients. In this manner, the actual distribution became the planned distribution. According to officials from the Foreign Agricultural Service, they did not enforce the requirement that the Russians submit revised distribution plans when changes were made in order to expedite the distribution of the food aid commodities. These officials told us that the European Union experienced problems in distributing food aid to the regions as well as making timely deliveries.[12] They attributed this in part to the amount of time required to prepare and approve changes to the commodity distribution plans.

Although the Foreign Agricultural Service reported to the House Agriculture Committee in April 2000 that its monitoring system had confirmed that commodities reached the intended regions according to the distribution plans, our analysis of the distribution records for the 10 commodities provided under the government-to-government food aid program showed that significant differences occurred between planned and actual deliveries at the regional level. For seven commodities whose distribution plans represent about 71 percent of the food aid tonnage provided in this program, less than one-quarter of the targeted regions received an amount that was equivalent to or near their planned allotment, that is, within 10 percent of their planned deliveries (see figure 2). Corn was distributed to targeted regions somewhat more in line with planned deliveries though less than one-half of them received an amount that was

[11]We found an update of distribution plans for wheat that was to be donated to regions rather than sold. This wheat represented about 10 percent of the food aid tonnage.

[12]The European Union provided 1.85 million metric tons of agricultural products (including 1 million metric tons of wheat) valued at approximately $478 million (.9834 euros per U.S. dollar). The European Union food aid was to be sold in Russia with 80 percent of the funds going to the Russian Pension Fund and the remaining 20 percent going to support selected social causes.

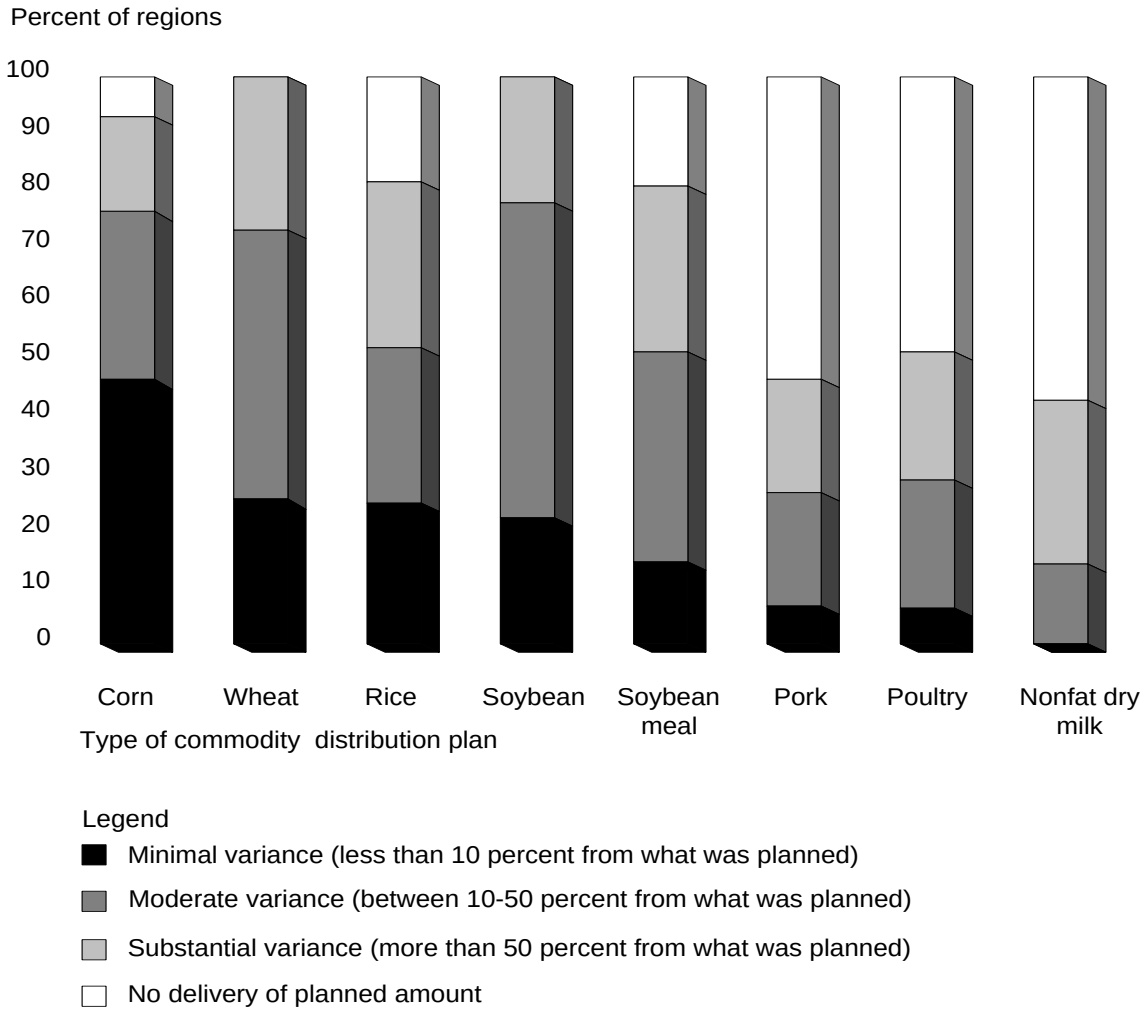
equivalent to or near their planned allotment.[13] Corn represented about 28 percent of the food aid tonnage.

We found also that numerous instances of regions receiving commodities even though they were not listed as intended recipients in the commodity's distribution plans. We did not analyze the difference between planned and actual deliveries of beef because a revised distribution plan for this commodity did not exist. We recently reported on seeds deliveries under the food aid program to Russia and our separate review also showed that seed distribution in Russia did not follow the original distribution plans and the reasons for changes were not fully documented.[14]

[13]Distribution data for corn was not available at the time of our review for an estimated 426,000 metric tons of corn shipped to Russia in April-May 2000, comprising 45 percent of the total shipments for this commodity.

[14]See *Foreign Assistance: Donation of U.S. Planting Seed to Russia in 1999 Had Weaknesses* (GAO/NSIAD-00-91, Mar. 9, 2000).

Figure 2: Percent of Russian Regions With Differences Between Planned and Actual Deliveries of Food Aid Commodities, Fiscal Year 1999 Program



Source: GAO-generated based on Foreign Agricultural Service data.

Weaknesses in Reporting and Tracking Systems Impeded Management of Commodity Deliveries

The Foreign Agricultural Service did not effectively track commodity shipments made under the fiscal year 1999 food aid program to Russia because of significant weaknesses in its reporting and management systems. Key logistical reports that were intended to provide an audit trail of shipments from point of departure in the United States to distribution in the Russian regions were not submitted on a timely basis. The delinquent

reporting hindered the ability of the Foreign Agricultural Service to monitor the progress of commodity deliveries and to conduct timely monitoring visits. The logistical reports also contained inaccurate and incomplete information.

A key logistical report was designed by the Foreign Agricultural Service to provide a full accounting of each vessel shipment from point of departure in the United States to final commodity sale or distribution in Russia.[15] The Foreign Agricultural Service prepares the first version of the logistical report providing basic control data for each shipment and the Russian government submits two follow-on versions of the report for each shipment at the points of discharge and distribution. Our review of these reports in November 1999 and later in May 2000, however, found that they were chronically late—less than 10 percent of these reports were submitted on time (see table 1 below). We also noted that the percentage of reports over 60 days late doubled from 20 percent in November 1999 to 40 percent by May 2000.

[15]These key logistical reports are officially called Shipment, Arrival, Distribution, and Status of Funds reports.

Table 1: Timeliness of Key Logistical Reports on Status of Shipment, Discharge, and Distribution of U.S. Food Aid Commodities, as of November 1999 and May 2000

	Total number of reports received as of		Percent of reports meeting reporting deadline as of		Percent of reports submitted up to 60 days past deadline as of		Percent of reports submitted 60 days or more past deadline as of	
Version of Key Logistical Report	**11/99**	**5/00**	**11/99**	**5/00**	**11/99**	**5/00**	**11/99**	**5/00**
Shipment data: departure date, commodity type, and tonnage by vessel[a]	94	207	7	5	86	74	7	21
Discharge data: date, commodity type, tonnage, and condition by vessel[b]	82	149	5	3	89	67	6	30
Distribution data: commodity type and tonnage by regional recipient[c]	76	145	5	3	75	57	20	40

[a]The number of days within which the Foreign Agricultural Service must provide the Russian government with this report is not specified in the bilateral agreements. For purposes of our analysis, we used 14 days after the vessel's departure date as a reasonable notification period.

[b]The Russian government must provide the Foreign Agricultural Service with this report within 2 days of the vessel's port discharge.

[c]The Russian government must provide the Foreign Agricultural Service with this report within 14 days of the vessel's port discharge.

Source: GAO-generated based on Foreign Agricultural Service data.

We also found many logistical reports that did not fully account for the quantities of commodities that were shipped, discharged, or damaged. In addition, the reports did not distinguish between wheat that was to be sold in Russia versus that which was to be donated to social institutions. This reduced the Foreign Agricultural Service's ability to more closely monitor deliveries of 411,400 metric tons of donated wheat to help ensure that (1) it went to the intended regions, (2) mills did not pay for the donated wheat, and (3) social institutions actually received the donation.

The Foreign Agricultural Service in Moscow used the reports and other vessel shipment data to build and maintain a computerized database and a separate spreadsheet called the Master Travel Matrix. Both systems were used to generate management reports and plan monitoring visits. We found, however, they contained erroneous data and lacked important information. For example, in December 1999, we reviewed the information systems and found numerous input errors in quantities shipped, discharged, and distributed, and formula errors that caused totals of columns and rows not to add up correctly. We also noted the omission of two vessels carrying

about 27,000 metric tons of corn and 35,000 metric tons of wheat.[16] In addition, the systems did not contain information on the commodity distribution plans by region, impairing the ability of the Foreign Agricultural Service to determine whether commodities were delivered to the regions as expected. Nor did the systems track when shipments reached their final destination in the regions, which is supposed to be one of the measures used to trigger when payments from commodity sales are to be paid to special accounts of the Russian government. Further, the Master Travel Matrix did not provide individual columns to track estimated deliveries separately from actual deliveries. Mingling the data on estimated deliveries with actual deliveries impeded the ability to verify actual deliveries and destroyed the audit trail it was designed to create.

In December 1999, the Foreign Agricultural Service, with the aid of a private contractor, developed a new database in response to increased problems with accounting for meat shipments and, in part, as a result of our review. The new database, called the Food Aid to Russia Monitoring System, became operational in May 2000 after virtually all of the fiscal year 1999 food aid commodities had been discharged in Russia. Our review of the new database in May 2000 found considerable improvement over prior systems and enhancement of the Foreign Agricultural Service's ability to track commodity shipments, deliveries, and payments.[17] While we noted that many past data entry errors had been corrected, the reliability of the management reports generated from the new database was still hampered by the quality and timeliness of the key logistical reports. In addition, the new system still does not compare actual deliveries to commodity distribution plans or track dates when the food aid reached regional recipients. Also, the new system continues to mingle actual deliveries with estimates of expected deliveries. Although notable improvements have

[16]The corn shipment was a data entry error and was later added to the database after we brought it to the attention of the Foreign Agricultural Service. We learned that the wheat shipment was purposely omitted; however, this omission was not indicated in any form of an audit trail. The wheat shipment was originally destined for Russia, but due to unloading problems in Novorossysk, it was re-routed to the Newly Independent State of Georgia for use under another U.S. food aid program. The food aid wheat shipment to Russia was later replaced.

[17]In May 2000, we reviewed information and reports generated by the new database, but we did not review supporting documents in Russia. Database improvements included more complete tracking of commodity shipments and more useful management reporting on the status of individual commodities, shipments, pricing data, amounts due and collected on commodities sold, regions visited and monitored, results of monitoring visits, and overall program statistics.

been made, the new system was established too late to provide much useful information to manage the fiscal year 1999 food aid program.

U.S. Monitoring Visits Inadequate to Detect Variances From Intended Distribution

According to the Foreign Agricultural Service, one of the primary purposes of the monitoring visits was to ascertain whether food aid recipients received all the commodities expected. However, the Foreign Agricultural Service did not effectively verify the amounts actually delivered and detect discrepancies. About six officials from the Department of Agriculture were detailed to Russia at any one time throughout the program to serve as U.S. monitors responsible for visiting ports and regional food aid recipients, among other duties. According to a June 30, 2000, program report, U.S. monitors had prepared 288 site visit reports, covering 879 recipients such as mills, processors, and storage facilities. Recipients in 11 of the 79 regions that received food aid in fiscal year 1999 were not visited because of safety-related travel restrictions imposed by the U.S. government. Program reports show that as of June 30, 2000, the monitors reported that 67 percent of the total tonnage was monitored. At each visit, the monitors collected pertinent documents and later completed a site visit report that contained information on the facility visited, the quantities received based on documents, and the prices paid.[18]

While the U.S. monitors made numerous site visits, they often conducted these visits without reliable data on how much of a commodity they were expected to find, thus they were unable to verify the delivery amounts or identify and investigate discrepancies at the time of the visit. For example, several site visit reports mentioned that the recipient had expected more food aid than had arrived, but, at the time, the monitors could not tell if the discrepancies were due to changes in distribution plans or unintended re-routings. In most cases, the monitors' site visit reports and database reports provided no indication of follow-up or attempt to reconcile the differences. U.S. officials reported that only a few cases were referred to Russian authorities for further investigation based on indication of potential abuse, but that upon investigation the allegations were not substantiated. In addition, our contacts with U.S. and Russian officials told us they were aware of no significant claims of commodity diversion or fraud.

[18]Site visit reports are officially called Compliance Review Reports.

The monitoring program was also limited in its ability to independently gather and assess information on program performance. Monitors relied primarily on documents supplied by regional recipients to determine the quantity and quality of the commodity received. Only in a few cases did monitors report seeing the commodities at the regional facility. Because it was difficult to time for logistical reasons, few monitors made site visits to actually observe the vessel discharge or transfer of food aid commodities to regional recipients. Occasionally, the monitors did not make actual site visits but relied on documents sent to them—a distinction that was not captured in the management reports. The independence and deterrent value of the visits was further limited by the fact that they were not conducted on a surprise basis, but pre-arranged with the assistance of the Russian distribution agents and local officials. However, security officials from the U.S. and Russian governments told us that the extensive presence of the U.S. monitors in the regions probably served as a deterrent to fraud and abuse, although they also believed that at least some surprise visits would have improved the effectiveness of the monitoring program.

The Foreign Agricultural Service did not prepare a comprehensive report comparing results of monitoring visits to reported deliveries by region and regional recipient until May 2000, when the contractor had implemented the new database. According to the database, the U.S. monitors found that most regional recipients received the exact quantities that were reported as delivered in reports prepared by the Russians. However, our analysis of 237 site visit reports questions the accuracy of the database. We found that about one-third of the site visit reports recorded types and/or quantities of commodities that were significantly different from the types and/or quantities reported as monitored in the database.[19]

For example, one site visit report indicated that 4,400 metric tons of corn and 4,200 metric tons of soybean meal were delivered to a region. However, the database does not list corn as one of the commodities verified by the U.S. monitors, but instead lists 11,250 metric tons of soybean meal as verified by the monitors as well as 6,748 metric tons of wheat as verified (although this commodity was never mentioned in the site visit report). In other cases, we found that the site visit reports did not include information on entire vessel shipments that, according to the database, were

[19]We reviewed 237 site visit reports prepared during the period April 1999 through May 2000. We did not verify the amounts that the monitors reported they found during their site visits to the underlying documents and receipts they collected from recipients.

supposedly verified. For example, one site visit report verified that 7,500 metric tons of wheat had been delivered via two vessel shipments, yet the management report also includes an additional 1,370 metric tons of wheat delivered via a third vessel shipment—this shipment was never mentioned in the site visit report.

Internal Controls Do Not Ensure Distribution of Free Wheat to Intended Regions and Social Institutions

The Foreign Agricultural Service did not effectively monitor the progress of the free wheat distribution to obtain reasonable assurance that each region received the expected amounts and that the free wheat was not sold. Under the fiscal year 1999 food aid agreements, the Russian government was obligated to donate 411,400 metric tons of the overall 1.7 million metric tons of food aid wheat to needy segments of the Russian population. This portion of the food aid wheat was called “free wheat” because it was distributed without charge rather than being sold to regional recipients. A distribution plan, attached to the food aid agreement, allocated specific quantities of free wheat to 49 regions. The free wheat was processed at regional facilities and then distributed in the form of flour or bread to hundreds of social institutions such as orphanages, shelters, and hospitals. For each region, the Russian government was expected to provide a list of the individual social institutions expecting to receive free wheat. Since the wheat was not sold to recipients, there were no sale receipts to verify delivery to the intended regional recipients. The distribution of free wheat was, thus, more vulnerable to fraud and abuse.

Although the shipments of free wheat began arriving in April 1999, the Foreign Agricultural Service did not know which shipments included free wheat because its key logistical report to track commodity shipments did not specify whether the wheat was intended for sale or donation. While the Russian government announced at a November 1999 meeting of the Bilateral Working Group that all the free wheat had arrived in-country and been delivered to its regions, it did not provide a comprehensive report with information on the arrival, regional destinations, mills, and quantities of free wheat provided until February 2000. Our review of the 115 monitoring reports covering the delivery of wheat to regional recipients from April 1999 through May 2000 found only 10 instances where the reports mention that free wheat was delivered to the mills they had visited.

The Foreign Agricultural Service also had limited knowledge regarding the delivery of free wheat to social institutions. It did not receive a complete listing of social institutions receiving free wheat from the Russian government until February 2000. Based on our review of the monitoring

reports, we could find evidence of monitoring visits to 10 social institutions receiving free wheat. In December 1999, the Foreign Agricultural Service's contractor conducted a telephone survey to determine if the social institutions had received their expected quantities of free wheat. The consultant contacted 62 social institutions in 10 of 59 regions that received free wheat and concluded that 41 of these social institutions "had benefited" from the free wheat. However, the survey provided little assurance that the designated social institutions received the quantity of free wheat or other commodities and/or cash of commensurate value. For example, there were many cases where the institution reported receiving food products and/or cash in lieu of free wheat, but the survey did not attempt to reconcile the estimated value of these benefits with the estimated value of the free wheat. Twenty-one institutions reported that they received no free wheat or commensurate benefit at all.

Inadequate Internal Controls to Monitor Collections of Sale Proceeds

About $353.2 million is expected to be deposited into the Pension Fund and $2.3 million for six agricultural projects by the time the fiscal year 1999 program is expected to end in fiscal year 2001. The Russian government provided the Foreign Agricultural Service with information on the total amount deposited into Special Accounts and disbursement to intended beneficiaries as required by the food aid agreements. However, the Foreign Agricultural Service did not systematically track total amounts due and reconcile this information with data from Russian reports until May 2000 even though the first payments were collected in May 1999. Without regular reconciliation, it could not verify that the proper amounts were disbursed to the Russian Pension Fund on a timely basis. Additionally, the Foreign Agricultural Service did not receive regular information from the Russian government on the status of regional payments due. Foreign Agricultural Service officials generally regarded regional payment data to be unnecessary because they viewed the Russian government as being ultimately responsible for making up shortfalls. In June 2000, the Russian government reported that $293 million had been collected of the $309 million that was due at that time. However, the true financial position of the Russian Pension Fund was not clear because the Russian government also reported that about one-half of the regions were delinquent, owing $26 million, while the remaining regions had paid $10 million in advance. Without regular information on the amounts due and amounts paid by region, the Foreign Agricultural Service could not track the distribution of food aid commodities to the intended regions using payment as proof of receipt, nor could it influence the Russians to

take collection action against delinquent regions, including suspending commodity distributions.

Procedures for Monitoring the Collection and Disbursement of Sale Proceeds

The food aid agreements and procedures issued by the Foreign Agricultural Service established financial controls designed to ensure that the proceeds from the sale of U.S. food aid commodities in Russia would be collected in a timely manner and used for their intended purposes. The controls include the creation of Special Accounts in the Russian Ministry of Finance for the sole purpose of receiving payments from the sale of U.S. food aid commodities. The food aid agreements also required that deposits into the Special Accounts be made within 120 days of the arrival of the shipment at the Russian border.[20] The Russian government was required to submit to the Bilateral Working Group a bi-weekly financial report accounting for total payments into, and total disbursements from, the Special Accounts for transfer to the Russian Pension Fund and six agricultural projects. The Bilateral Working Group must approve disbursements from the Special Accounts. Although not required to do so, officials from the Russian Pension Fund reported at the meetings the total amount of funds received from the Special Accounts and the total amount disbursed to pay pensions. The agreements do not require the Foreign Agricultural Service to track the funds beyond the disbursement from the Special Accounts to the intended institutions. For example, the Foreign Agricultural Service was not expected to track disbursements of funds from the Russian Pension Fund to individual pensioners.

The food aid agreements permit the United States access to all documents regarding the receipt, deposit, and disbursement of sale proceeds. The agreements also called for the two governments to conduct a joint audit of the sales proceeds during the fourth quarter of calendar year 1999. However, the joint audit was postponed until the fourth quarter of calendar 2000, when it is expected that most of the U.S. food aid commodities to Russia will have been sold and distributed. The fiscal year 1999 food aid agreements place ultimate responsibility on the Russian government to make full payment into the Special Accounts for the total value of the food aid tonnage sold in Russia. In practice, the Russian Federation holds the

[20]The agreements also required deposits to be made within 30 days of the commodity's arrival at the point of destination in the region if this date came before the 120-day criteria. However, the Foreign Agricultural Service did not track when the regional recipients received the commodities.

regional governments responsible for the amount due to the Special Accounts if the regional recipients (e.g., mills and processing plants) fail to make payments for the food aid commodities they purchased. However, at the end of the fiscal year 1999 program, the Russian government is eventually obligated to make up any shortfalls. To ensure implementation of the food aid agreements' 120-day criteria, the Russian government decreed that regions must make payments within 70 days of receiving wheat and rice and within 90 days for other food aid commodities.[21]

Lack of Systematic Reports Impaired Ability to Assess the Financial Position of Accounts

Food aid commodities for sale in Russia began arriving in March 1999 and deposits to the Special Accounts were first made in May 1999. However, during our visit to Moscow in December 1999, we found that the Foreign Agricultural Service did not systematically track or report on the total amounts due for deposit into the Special Accounts and reconcile the information with Russian reports on the amount of funds deposited. Instead, the Foreign Agricultural Service made calculations and comparisons of the data on a sporadic basis, and it did not maintain any records or reports that would provide a history of amounts due and paid. Without regular reconciliation, it could not verify that the proper amounts were disbursed to the Russian Pension Fund on a timely basis. We discussed this internal control weakness with officials from the Foreign Agricultural Service and its contractor during our site visit and they reported in May 2000 that the new Food Aid to Russia Monitoring System database was correcting this weakness. However, this correction occurred after the bulk (about 85 percent) of the tonnage shipped had been discharged in Russia. Reports issued by the new database in June 2000 indicate that the Foreign Agricultural Service was now systematically tracking and reporting on amounts due and comparing them with Russian reports on amounts deposited based on quantities of commodities discharged by vessel.[22]

[21]Resolution of the Russian Federation No. 130, Feb. 5, 1999.

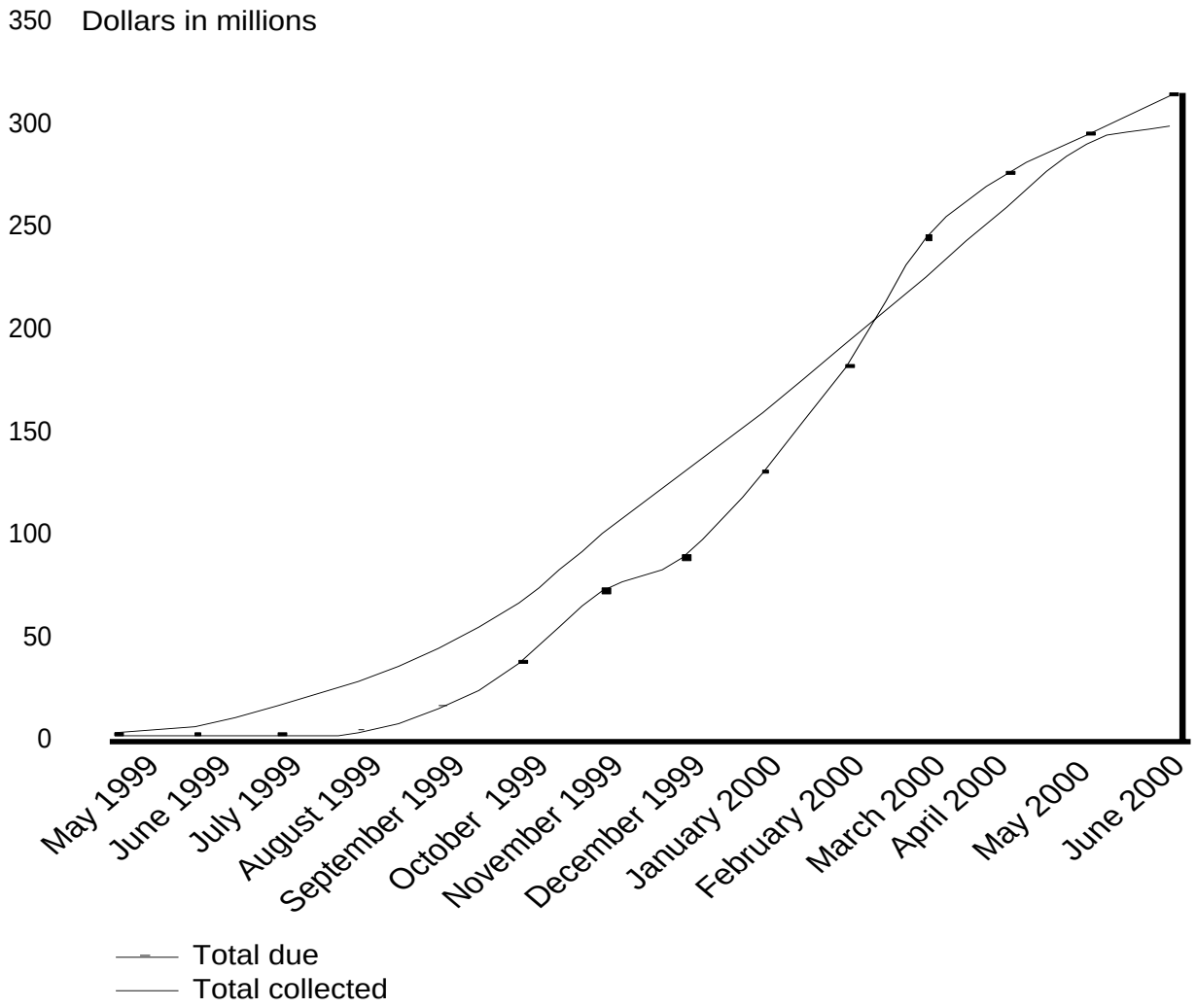
[22]The new database tracks the payment due dates using the criteria that payments will be made within 120 days of the date of a shipment's final discharge at Russia's border.

Information on Regional Payments Was Inadequate to Provide a Complete Account of Financial Status

The Foreign Agricultural Service did not receive regular information on the status of payments by each region that received food aid, nor did it require such information from the Russian government. Officials from the Foreign Agricultural Service told us that they were less concerned about the status of regional than with aggregate payments because ultimately the Russian government is obligated to make up any shortfall between the total amount due and total deposits made to the Special Accounts. Although it was not required to do so under the terms of the food aid agreements, the Russian government provided a few reports on the status of regional payments. However, without regular reports, the Foreign Agricultural Service cannot accurately assess the financial position of the Special Accounts since advance payments by some regions do not reflect the fact that others are delinquent. Regular reports of payments by region would provide additional assurance that individual regions received the food aid, whereas reports of nonpayment could indicate the possibility of unintended diversions. Inadequate information on regional payments impeded the Foreign Agricultural Service's ability to effectively influence the Russian government to take early action to limit or suspend shipments to delinquent regions.

According to a new report produced by the new monitoring system database, the total amount of payments deposited into the Special Accounts exceeded total amounts due until the end of February 2000, when amounts due began to exceed payments collected as indicated in figure 3.

Figure 3: Financial Status of the Special Accounts, as of June 27, 2000



Source: GAO-generated from Foreign Agricultural Service data.

While the aggregate statistics appear reassuring, our analysis of two Russian reports on the status of regional payments showed that about half of the regions were past due on payments based on the Russian criteria. A Russian report dated June 23, 2000, showed that about $309 million was due from the regions and about $293 million had been paid into the Special

Accounts for the benefit of the Pension Fund and six agricultural projects.[23] According to this report, about half of the regions that had received food aid commodities were past due on their payments, owing about $26 million. However, the remaining half of the regions had paid in advance about $10 million, resulting in a net delinquency of about $16 million. Many of these delinquent regions had continued to receive food aid commodities even after they had been identified as delinquent in an earlier report.[24]

At the December 9, 1999, Bilateral Working Group meeting we attended, the Russian government was considering several actions to obtain payments from delinquent regions, including:

- sending the region a warning letter from the Prime Minister,
- cutting off future commodity shipments until payments were current,
- redirecting commodities to other regions able to provide advances or guarantees,
- withholding other Russian government payments to the region, or
- assessing fines.

The Bilateral Working Group minutes indicate that the Russian government required several delinquent regions to report to the Deputy Prime Minister for Agriculture and account for their financial status, but the minutes do not indicate that any of the proposed actions listed above were implemented. An audit of the food aid program by the Russian Chamber of Accounts dated December 24, 1999, reported that no sanctions were applied against delinquent regions.[25]

[23]The Russian government further reported that as of that date the Russian Pension Fund had received regular disbursements from the Special Accounts totaling $291 million.

[24]A Russian report dated November 10, 1999, indicated that about $76 million was due and about $78 million had been paid into the Special Accounts. According to this report, about half of the regions that had received food aid commodities were past due on their payments, owing about $10 million. However, the remaining half of the regions made payments in advance totaling about $12 million, resulting in a net advance of about $2 million.

[25]The Russian Chamber of Accounts is an audit organization of the Russian government.

Little Documentation to Support Reasonableness of Food Aid Pricing Decisions

The U.S. and Russian governments agreed to a formal methodology and procedure for jointly determining the selling prices for the U.S. food aid commodities in Russia based on Russian and international prices. Officials from the Foreign Agricultural Service told us that they followed this methodology using data and analysis provided by Russian authorities as well as information gathered through frequent verbal contact with Russian government and private sector officials. However, the Foreign Agricultural Service provided little documentation demonstrating how the methodology was applied and how it supported the pricing decisions. Our review of seven commodity pricing decisions found that in four of the five cases where pricing data was available, the prices for U.S. food aid commodities were substantially below reported wholesale prices in Russia.[26] Without documentation to support its assessments and final pricing decisions, the Foreign Agricultural Service cannot support the reasonableness of its pricing decisions, which in turn, determine the amount of funds made available to the Russian Pension Fund and other beneficiaries of the sales proceeds.

Methodology for Setting Sale Price of U.S. Food Aid Commodities in Russia

Under the terms of the food aid agreements, the Bilateral Working Group was to recommend to the U.S. Minister Counselor for Agricultural Affairs in Moscow the ruble value for each food aid commodity sold in Russia. Once approved, the price was to be used to calculate how many rubles were to be made available to the Russian Pension Fund and other beneficiaries for a given commodity shipment. According to the methodology, the Bilateral Working Group was to set the value for each commodity shipment by examining price information gathered by the Russian Ministry of Agriculture and Food, including domestic and international wholesale prices. In addition, the methodology required that the Bilateral Working Group take into account information from in-country private sector sources on wholesale and import prices as well as market conditions. The commodity selling price was to represent an average, fair, wholesale market price for a given commodity when normal, domestic, and

[26]The total tonnage of the seven cases represented 20 percent of the total food aid tonnage in fiscal year 1999 and 35 percent of the total sales proceeds expected to be generated from the sale of U.S. food aid (note: this excludes 411,400 metric tons of free wheat).

commercial charges were added to this value.[27] The value of a particular food aid commodity could change with each shipment depending on the conditions of the internal market in Russia.

According to officials from both the Foreign Agricultural Service and the Russian government, the goal of the Bilateral Working Group was to set selling prices somewhat below market prices. Officials told us that, ideally, prices for U.S. commodities were to fall within a "golden middle" range—prices that, once transportation and other costs were included, were not so low as to severely undercut local producers or importers, but sufficiently low so as to facilitate the quick sale of commodities and help to counteract inflationary trends in Russian food prices.

According to Foreign Agricultural Service officials, the Russian Ministry of Agriculture and Food, in cooperation with the former Ministry of Trade, suggested a value for a given commodity and provided wholesale price information as required, including high, low, average, national, and regional prices along with price information for commercial imports of commodities. Because prices are not always readily available in Russia's emerging market system, the Foreign Agricultural Service then reviewed the suggested prices with in-house staff, private traders, retail price surveys, and discussions with U.S. trade associations. It also took into account the prices at which food aid commodities provided by the European Union were sold in Russia. Based on this review, the Foreign Agricultural Service either concurred with the Russian's suggested price or requested an adjustment at the Bilateral Working Group meetings.

Inadequate Documentation to Support U.S. Food Aid Pricing Decisions

Foreign Agricultural Service officials reported that they followed the agreed methodology used to determine commodity prices, but they provided little documentation of their analysis in support of their pricing decisions. We asked for the documents these officials used to make their pricing decision as well as for any documentation of their analysis justifying the pricing decision for seven different commodity shipments (wheat, corn, rice, soybean meal, seeds, pork, and poultry). The officials from the Foreign Agricultural Service provided us with the wholesale price information for five of the seven commodities (the prices of soybean meal

[27]The food aid commodity price does not include, but takes into account, customs' duties, value-added tax, or any other taxes or costs associated with transportation to the final region.

and planting seed were the exceptions) collected by the Russian government. They also provided some analyses carried out by the Russian Ministry of Agriculture for particular markets at select periods, but this was not provided for all seven of the pricing decisions.[28] The Foreign Agricultural Service, however, did not provide us with documentation of its in-house reviews, external consultations, or independent assessments. Instead, through interviews these officials provided us with verbal recollections of the rationale for their pricing decisions. In some cases, they recalled discussions they had with experts regarding the pricing decisions. The discussion and approval of pricing decisions were not well documented in the minutes of the Bilateral Working Group.

For example, we requested documents used by Foreign Agricultural Service to support the decision made in April 2000 to sell the third shipment of soybean meal at 2,800 rubles per metric ton, a price lower than the previous shipment of U.S. food aid soybean meal. The Foreign Agricultural Service provided us with (1) Russian data of the average monthly wholesale price of soybeans (but not soybean meal) during the first quarter of 2000 and (2) a Russian analysis that described factors in the animal feed markets and price trends that supported the Russian request to reduce the price of U.S. food aid soybean meal from 3,400 to 2,800 rubles per metric ton. While the Russian analysis contained some price information for soybean meal, the document date is December 1999—4 months before the decision was made to lower the price of the U.S. food aid soybean meal. Officials from the Foreign Agricultural Service told us that they corroborated the findings of the Russian document with internal and external experts. However, we were not given any documents that indicated that the Foreign Agricultural Service conducted an independent review and assessment of the Russian price information and analysis in the months between the date of the report and the decision to lower the price of U.S. soybean meal.

Similarly, the Foreign Agricultural Service provided little documentation to support its decision to change the price of U.S. food aid pork after it had already arrived in Russia and was partially distributed. Originally, the U.S.

[28]At the time of the pricing decisions, the information on the wholesale prices of agricultural commodities supplied by the Russian government was typically 2 to 4 weeks old because current data were not available due to the standard lag in collecting market data. The Russian analysis of particular markets includes information on trends in prices and anticipated impact of factors such as domestic harvest, food aid from the European Union, etc.

and Russian governments set the price of the U.S. shipment of bone-in picnic ham at 29,000 rubles per metric ton in September 1999. By the beginning of the year 2000, 25,000 metric tons of U.S. food aid pork had arrived in Russia, and our review of the Bilateral Working Group minutes shows that the price of bone-in picnic ham was the subject of discussion from February through April 2000. The Foreign Agricultural Service argued that the price suggested by the Russians for a metric ton of bone-in picnic ham needed to be reduced to 25,000 rubles to avoid storage costs and to move the pork quickly. When asked to provide information and analysis behind their request to lower the price of bone-in picnic hams in the Spring of 2000, officials from the Foreign Agricultural Service referred us to Russian price information from 1999 that shows an increasing rather than a decreasing trend in pork prices.[29]

In our earlier review of the donation of U.S. planting seed under the fiscal year 1999 food aid program, we also found inadequate documentation of the price determination process for seeds.[30] The Department of Agriculture did not provide us with data on the prices of planting seed in Russia, nor any analyses of price trends or documentation of conversations with seed importers or local producers confirming selling prices. Officials from the Department of Agriculture also did not provide documentation of their analysis of the effect of market conditions nor of how they applied the methodology used to determine the selling prices for U.S. corn and vegetable seed.[31]

[29]We note that the European Union and Russia also disagreed over the selling price of European Union food aid pork. A review of the price determination for European Union food aid pork revealed that when the Russians proposed a decrease in the price of this pork, European Union analysts documented evidence from independent sources that the price of pork was increasing in Russian and international markets.

[30]*Foreign Assistance: Donation of U.S. Planting Seed to Russia in 1999 Had Weaknesses* (GAO/NSIAD-00-91, Mar. 9, 2000).

[31]In the fiscal year 2000 program, the Foreign Agricultural Service initially used an auction to try to sell U.S. planting seed donated under a food aid agreement. The documentation provided by the Foreign Agricultural Service shows that its calculations of base prices based on local average market prices were too high, but that the seed auction was beneficial in that it allowed market forces to test the price levels. Using the information gleaned from the auction process, the Foreign Agricultural Service adjusted the selling prices for U.S. planting seed in the fiscal year 2000 program.

Lack of Documentation Precludes Assessment of the Reasonableness of Food Aid Prices

Our review of seven commodity pricing decisions found that in four of the five cases where pricing data was available, the prices for U.S. food aid commodities were substantially below reported wholesale prices in Russia. When we compared the average wholesale price reported in Russia for the month prior to the pricing decisions for these shipments, we found that the sale price of U.S. food aid rice was approximately 50 percent less than the average wholesale price reported. The prices of U.S. food aid corn and wheat were set at approximately 60 percent of Russian wholesale prices of these products reported in the month prior to the price setting decision. The Foreign Agricultural Service did not provide us with wholesale price information for soybean meal or for planting seed for the month prior to the pricing decision for the shipments we reviewed. Similarly, we had insufficient information to judge whether the prices charged for U.S. food aid pork cuts were similar to average producer prices. In interviews in Russia, private sector traders, food processors, and government officials provided examples of cases where U.S. food aid wheat, soybeans, corn, and planting seed were sold at prices substantially below market. Some program participants reported that the U.S. food aid program had a detrimental impact on local Russian producers.

In response to our query about how they assessed the reasonableness of food aid prices, officials from the Foreign Agricultural Service said they were confident that U.S. food aid commodities were not priced too low because they had received few complaints from importers or Russian producers. They also believe that because the commodities sold quickly for the most part (avoiding expensive storage and risk of spoilage), there is sufficient evidence that the prices were not too high. Also, officials from the Foreign Agricultural Service said the European Union experienced delays in the distribution of some of its food aid, in part because it set prices too high. Moreover, they relied on their expertise and knowledge of the Russian agricultural markets to set prices.

Given that Russian food and commodity markets are not transparent or efficient, price information does not always fully reflect changing market conditions in Russia, particularly in different regions of the country. Thus, verifying and assessing the Russian price information through alternative, independent sources was included as part of the methodology adopted by the Foreign Agricultural Service to determine the selling prices of the U.S. food aid commodities. However, because the Foreign Agricultural Service did not sufficiently document its assessment process, it cannot demonstrate the reasonableness of food aid commodity prices. Prices that are set too low, in turn, reduce the amount of funds that are made available

to the Russian Pension Fund and other beneficiaries of the sales proceeds. Moreover, low food aid prices create opportunity for windfall profits.

Conclusions

Internal controls provide an important means for the Foreign Agricultural Service to reasonably ensure that U.S. food aid objectives in Russia are being achieved. However, we found that the internal controls designed and implemented by the Foreign Agricultural Service to monitor the distribution of U.S. food aid and the deposit of sale proceeds in the Russian Pension Fund were inadequate. Commodity distribution plans were not updated and compared with actual distribution; the databases did not separately track estimated and actual deliveries; the databases and key logistical reports did not distinguish between wheat that was intended for sale versus donation; U.S. monitors had unreliable information on the types and quantities of commodities they were expected to find; and information on the status of regional payments was not collected on a regular basis. Officials from the Foreign Agricultural Service told us that limited staff resources and the need to quickly carry out a large and complex program in a short time period impeded their ability to effectively implement the internal controls. Nevertheless, the implementation of appropriate internal controls is essential to help achieve program objectives and minimize fraud and abuse. Because of weaknesses in the Foreign Agricultural Service's implementation of its internal controls, the agency cannot provide reasonable assurance or documentation that the Russian regions received the appropriate amounts of food aid, that social institutions received the benefits of the donated wheat, and that the Pension Fund will continue to receive timely deposits that are equal to the full value of the food aid sold in Russian markets.

Support for key decisions and actions concerning the distribution and sale of food aid commodities in Russia was not transparent. The Foreign Agricultural Service provided little documentation of its analysis in support of its pricing decisions. The minutes of the Bilateral Working Group did not adequately document the basis for and approval of its pricing decisions and changes to the commodity distribution plans. Without better documentation of key decisions, it is difficult to determine if prices charged were reasonable, whether the sale of U.S. food aid commodities could have generated more proceeds for the Russian Pension Fund, or whether changes to the commodity distribution plans served to reach needy populations.

Recommendations

To help ensure that remaining shipments of U.S. food aid commodities are delivered as intended under existing programs, as well as shipments under any future government-to-government program in Russia, the Secretary of Agriculture should undertake efforts to improve the internal controls used to monitor the distribution of food aid as well as the collection of sale proceeds. We recommend that the Secretary of Agriculture direct the Foreign Agricultural Service to take the following actions:

- Improve the effectiveness of its management information system by (1) incorporating information from commodity distribution plans on quantities expected to be delivered to regions, updating the plans as changes are made, and preparing progress reports on a regular basis that compare updated plans with records of actual distribution for each region and commodity as well as quantities found by U.S. monitors; (2) keeping separate track of estimated and actual shipment/delivery data as commodities move through the distribution cycle to recipients providing an audit trail and a better basis for verification by monitors; and (3) tracking separately in key logistical reports those commodities that will be sold versus commodities that will be given free to social institutions.
- Conduct fewer, but higher quality monitoring visits by (1) undertaking more physical inspections at regional sites and at times of discharge, transfers, or deliveries; (2) performing some unannounced visits in addition to prearranged visits; (3) recording the type and amount of commodities expected to be found and the actual amount monitored as well as the date the commodities were received; and (4) distinguishing between U.S. food aid commodities that will be sold versus donated to social institutions when assessing the types and quantities of commodities delivered.
- Collect on a regular basis information on funds due by region, amounts paid, and status of delinquencies by requesting the Russian government to provide the United States with its reports on the status of regional payments for U.S. food aid commodities.

To provide transparency behind actions taken and key decisions made regarding the management of the U.S. food aid program in Russia, we recommend that the Secretary of Agriculture direct the Foreign Agricultural Service to take these actions.

- Fully document the information and analysis used by both the U.S. and Russian governments in determining the prices for U.S. food aid commodities sold in Russia and any subsequent price adjustments.
- Record in the minutes of the Bilateral Working Group, the results and rationale behind key decisions involving changes to distribution plans and price setting of U.S. food aid commodities sold in Russia as well as how issues raised by the monitoring visits are resolved.

Agency Comments and Our Evaluation

We received comments from the Department of Agriculture's Foreign Agricultural Service. The Foreign Agricultural Service stated that it appreciated our recommendations to improve internal controls and will seek to implement them where appropriate. However, the agency disputes our principal conclusion that it cannot provide reasonable assurance that the food aid was delivered in agreed upon amounts to the intended regions and that the Russian Pension Fund will continue to receive timely deposits that equal the full value of the food aid sold in Russian markets because of weaknesses in the agency's implementation of its internal controls. The agency did not provide information to refute our finding that, at times, the Foreign Agricultural Service did not follow its own internal controls. The comments instead explain the challenges the agency faced in implementing its internal controls and highlight improvements made to the food aid program during the course of our review.

The Foreign Agricultural Service states that it has delivered food aid commodities to the regions as planned and is achieving the targeted goal for payments to the Russian Pension Fund based on the fact that there were no substantiated reports of fraud or confirmed diversions of commodities or funds. However, without adequate implementation of internal controls, the agency cannot provide reasonable assurance that the objectives are being met. For example, the internal controls designed by the Foreign Agricultural Service require changes in planned commodity distribution to be documented in revised distribution plans and submitted by the Bilateral Working Group to the U.S. Minister Counselor for approval. Except for an update on free wheat distribution, our review found no revisions to plans or record of U.S. approval. We found that less than one-quarter of the targeted regions received a tonnage amount that was equivalent or near their planned distributions. Because the Foreign Agricultural Service did not document revisions and approval for changes to the commodity distribution plans, it cannot demonstrate that changes in the distribution plans were planned and approved or whether any of the changes were the result of unintended diversions. In addition, internal

controls required U.S. monitors to visit regional recipients of food aid to verify that they had received the expected amounts. However, U.S. monitors did not have reliable information on the amount and types of commodities that they were expected to find, thus they were not in a position to know if any discrepancies found were due to changes in plans or possible unintended diversions. While we agree that conducting a food aid program in Russia was a difficult challenge, we continue to believe that implementation of appropriate internal controls is very important to preventing and detecting fraud and abuse. Without adequate controls and documentation of key decisions the agency cannot provide reasonable assurance that its objectives are being met. The comments of the Foreign Agricultural Service appear in full, along with our evaluation of them, in appendix IV.

As arranged with your office, unless you publicly announce the contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies to interested congressional committees and the Honorable Dan Glickman, Secretary of Agriculture; the Honorable J. Brady Anderson, Administrator of the U.S. Agency for International Development; and the Honorable Madeleine K. Albright, Secretary of State. Copies will also be made available to others upon request.

If you or your staff have any questions about this report, please contact me on (202) 512-4128. Other GAO contacts and staff acknowledgments are listed in appendix V.

Sincerely yours,

Susan S. Westin

Susan S. Westin, Associate Director
International Relations and Trade Issues

Scope and Methodology

We obtained information on the fiscal year 1999 U.S. food aid program to Russia from U.S. government officials at the Departments of Agriculture, State, Transportation, and Treasury, as well as officials from the Agency for International Development, the National Security Council, and the Office of Management and Budget. In addition, we met with officials of a private U.S. government contractor responsible for the development and implementation of a food aid commodity distribution reporting and tracking system. We also gathered information from Russian government officials, including representatives of the Agriculture, Finance, Trade, and Internal Affairs ministries, the Pension Fund, and the Russian Chamber of Accounts. We interviewed officials of the European Union, the World Bank, and U.S. and Russian trade associations, and we met with representatives of the five private voluntary organizations engaged in humanitarian food aid distribution in Russia. We also interviewed Russian officials representing processing plants, social organizations, and seed research institutions. We conducted our review in Washington, D.C., and in the Russian cities of Moscow, St. Petersburg, and Voronezh.

Our review addressed the general internal controls governing the distribution of all the food aid commodities distributed under the government-to-government fiscal year 1999 programs. As the basis for evaluating the program's internal controls, we used the standards for internal control in the federal government. We did not examine internal controls designed for tracking the distribution of meat because we did not receive the distribution reports for these commodities. We did not examine the internal controls governing the distribution of food aid in Russia managed by private voluntary organizations. Nor did we review the efforts made by the Russian government to monitor the distribution of U.S. food aid because the Foreign Agricultural Service (not the Russian government) has primary responsibility to safeguard the use of U.S. assets and provide reasonable assurance that the food aid reached intended recipients. However, despite these limitations and others as noted in the following paragraphs, we were able to perform sufficient audit work based on information and data gathered to evaluate the implementation of the program's internal controls.

To examine the adequacy of internal controls to ensure that food aid commodities were properly distributed to the regions and its recipients according to distribution plans, we reviewed the bilateral food aid agreements, work plans on tonnage and distribution to regional recipients, commodity purchase information, and minutes of the Bilateral Working Group. We also examined and tested available Shipment, Arrival,

Distribution, and Status of Funds reports, databases based on these reports, Shipment Status reports, and the Master Travel Matrix spreadsheet as of December 6, 1999, during our visit to Russia. We obtained the Food Aid to Russia Monitoring System database electronically as of May 31, June 15, and June 30, 2000, and performed an analysis of information and various reports for accuracy and completeness. However, we did not perform detailed tests of this database and its supporting data located in Moscow. We attended the December 1 and December 9, 1999, meetings of the Bilateral Working Group to observe its activities and met with the U.S. Ambassador to Russia. We reviewed 237 site visit reports prepared by U.S. monitors for visits made between April 1999 and May 2000. We did not examine the documents collected during these U.S. monitoring visits (they were prepared mainly in Russian) and compare them with information contained in the site visit reports. We interviewed Foreign Agricultural Service officials, staff, and monitors in Moscow and Washington, D.C., and officials from the agency's database contractor. We met with the Deputy Prime Minister of Agriculture of the Government of the Russian Federation and interviewed senior Russian officials from the Ministries of Agriculture, Finance, Trade, and Internal Affairs and from the Russian Chamber of Accounts. We also interviewed senior officials of the two Russian distribution agents who were responsible for the movement of food aid commodities within Russia from the port of discharge to the regional recipients.

Our assessment of the financial status of the Special Accounts and transfers to the Russian Pension Fund and six agricultural projects was based on Russian government reports. We did not conduct an independent audit of the Russian government financial reports. To examine the adequacy of procedures for monitoring the collection and deposits of funds derived from the sale of food aid commodities, we interviewed senior officials of the Russian Ministry of Finance, the Russian Pension Fund, and two agricultural projects and the rural credit agency that received funds from the sale of U.S. food aid. We reviewed an audit report prepared by the Russian Chamber of Accounts on the 1999 food aid program. We also reviewed reports on amounts due, paid, and delinquent from regional recipients, and disbursements to the Special Accounts, and amounts received by the Russian Pension Fund. We reviewed a Food Aid to Russia Monitoring System database status report on commodity shipments and payments due and paid as of June 30, 2000, and a report on the current value of fiscal year 1999 food aid shipments to Russia. However, we did not perform detailed tests of the database and its supporting data located in Moscow.

To examine the process for determining the price to sell U.S. food aid commodities in Russia and the extent that the procedures were followed, we reviewed documents that described the price determination methodology and interviewed senior officials of the Foreign Agricultural Service and Russian Federation who participated in the food aid agreement negotiation process and established the price determination methodology. We interviewed Russian and U.S. participants of the Bilateral Working Group meetings and reviewed the minutes of these meetings to document the procedures followed to establish prices for commodities. We also used these interviews and documentation to investigate how disagreements over prices were resolved. To assess the adequacy of documentation supporting pricing decisions, we selected seven commodity shipments (including planting seed) for different products that were distributed at different times. These shipments represented 20 percent of total tonnage and the proceeds generated from the sale of these seven commodity shipments represent 35 percent of total funds expected to be deposited in the Special Accounts. To facilitate our effort, we requested that the Foreign Agricultural Service provide us with the information used to make price suggestions and decisions. We also interviewed and obtained pricing related information from officials of the World Bank and the European Union as well as from U.S. and Russian trade associations in Moscow and Washington, D.C.

We conducted our review from October 1999 through August 2000 in accordance with generally accepted government auditing standards.

Background on Fiscal Year 1999 U.S. Food Aid Program to Russia

The fiscal year 1999 U.S. food assistance package to Russia consisted of a combination of food aid provided on a government-to-government basis and food aid provided through private voluntary agencies in Russia. Commodities and funding for the food assistance package to Russia were provided under three U.S. food aid programs:

1. Public Law 480, title I, provides U.S. financing for sales of U.S. agricultural commodities available through long-term credit at low interest rates.

2. Section 416(b) of the Agricultural Act of 1949, as amended, provides humanitarian assistance overseas by donating surplus commodities owned by the Department of Agriculture's Commodity Credit Corporation.

3. Food For Progress Act of 1985, as amended, provides agricultural commodities on credit terms or on a donation basis to countries that are emerging market-oriented economies and have made commitments to introduce or expand free enterprise elements into their agricultural economies.

The Department of Agriculture's Foreign Agricultural Service administered and negotiated agreements under these programs.[1] Under the title I agreement, signed in December 1998 and later amended, the United States provided about 1.8 million metric tons of various commodities that were sold to the Russian government on concessional loan terms. The section 416(b) program agreement, also signed in December 1998 and amended in March 1999, provided 1.7 million metric tons of wheat to the Russian government on a donation basis. A Food For Progress agreement was added in February 1999 that shifted 80,000 metric tons of two commodities (non-fat dry milk and pork) from the Public Law 480 title I sales program to the donation program and also donated 15,000 metric tons of seeds.

All of the commodities were to be sold to raise funds for the Russian Pension Fund and six designated agricultural projects, except for 411,400 metric tons of wheat, which were to be donated to Russian social

[1]Consistent with U.S. food aid law provisions, actions taken under the agreements must avoid disrupting international markets, hindering the development of agricultural markets inside Russia, or reducing incentives for Russian farmers. Food aid agreements must also be consistent with U.S. policy promoting sustainable economic and agricultural development and privatization of agriculture.

institutions to feed the most needy. In addition, the Foreign Agricultural Service selected five private voluntary organizations to distribute about 97,000 tons of various donated ready-to-eat commodities throughout Russia under the Food For Progress and section 416(b) programs. A summary of the tonnage, U.S. cost, and value of the proceeds expected to be generated by the sale of commodities distributed under these programs is presented in table 2.

Table 2: Statistics on Fiscal Year 1999 U.S. Food Aid to Russia by Program and Commodity

Dollars in millions

		U.S. cost			
Program/commodity	**Tonnage being distributed (000)**	**Commodity**	**Freight[a]**	**Total[a]**	**Russian sale proceeds**
Government-to-government:					
Public Law 480, title I sales:					
Corn	1,009.5	$96.4	$54.6	$151.0	$50.7[d]
Soybean meal	422.6	71.6	24.3	95.9	48.5
Soybeans	191.9	35.3	14.1	49.4	17.2
Beef	44.1	83.7	9.4	93.1	39.3
Rice	100.6	32.5	12.2	44.7	22.6
Poultry	74.0	39.5	17.3	56.8	47.9
Subtotal	**1,842.7**	**$359.0**	**$131.9**	**$490.9**	**$226.1**
Section 416(b) donation:					
Wheat (for sale)	1,281.2	$157.7	$88.4	$246.1	$63.8
Wheat (for social institutions)	411.4	50.6	28.4	79.0	0
Subtotal	**1,692.6**	**$208.3**	**$116.8**	**$325.1**	**$63.8**
Food For Progress donation:					
Nonfat dry milk	29.9	$68.3	$5.2	$73.5	$19.7
Pork	49.2	88.5	19.5	108.0	43.6
Seeds	15.0	17.9	3.8	21.7	2.3
Subtotal	**94.1**	**$174.7**	**$28.5**	**$203.2**	**$65.6**
Total	**3,629.4**	**$742.0**	**$277.2**	**$1,019.2**	**$355.5**
Private voluntary organizations (PVOs):					
Food For Progress donation[b]:					
Rice	14.3	$5.5	$3.2	$8.7	$0
Salmon	3.0	6.9	1.2	8.1	0
Lentils and peas	15.5	6.7	4.3	11.0	0
Navy beans	3.0	1.6	0.8	2.4	0
Soybeans	8.0	1.5	0.5	2.0	0
Vegetable oil	17.5	12.4	4.3	16.7	0
Subtotal	**61.3**	**$34.7**	**$14.1**	**$48.8**	**$0.0**

(Continued From Previous Page)

Dollars in millions

		U.S. cost			
Program/commodity	**Tonnage being distributed (000)**	**Commodity**	**Freight[a]**	**Total[a]**	**Russian sale proceeds**
Section 416(b) donation[c]:					
Wheat flour	27.0	$5.3	$7.7	$13.0	$0
Nonfat dry milk	8.5	20.3	2.7	23.0	0
Subtotal	**35.5**	**$25.6**	**$10.4**	**$36.0**	**0**
Total	**96.8**	**$60.3**	**$24.5**	**$84.8**	**$0**
Administrative cost[d]				$2.5	
Program totals	**3,726.2**	**$802.2**	**$301.8**	**$1,106.5**	**$355.5**

Note: Totals may not add due to rounding.

[a]Includes ocean freight differential totaling $122.1 million for shipments made under cargo preference requirements of the Merchant Marine Act of 1936, as amended, and the Food Security Act of 1985, as amended. This cost, borne by the United States for all food aid programs.

[b]Participating agencies are Feed the Children; American Red Cross; Project Aid Siberia, International Orthodox Christian Charities; and Global Jewish Assistance and Relief Network.

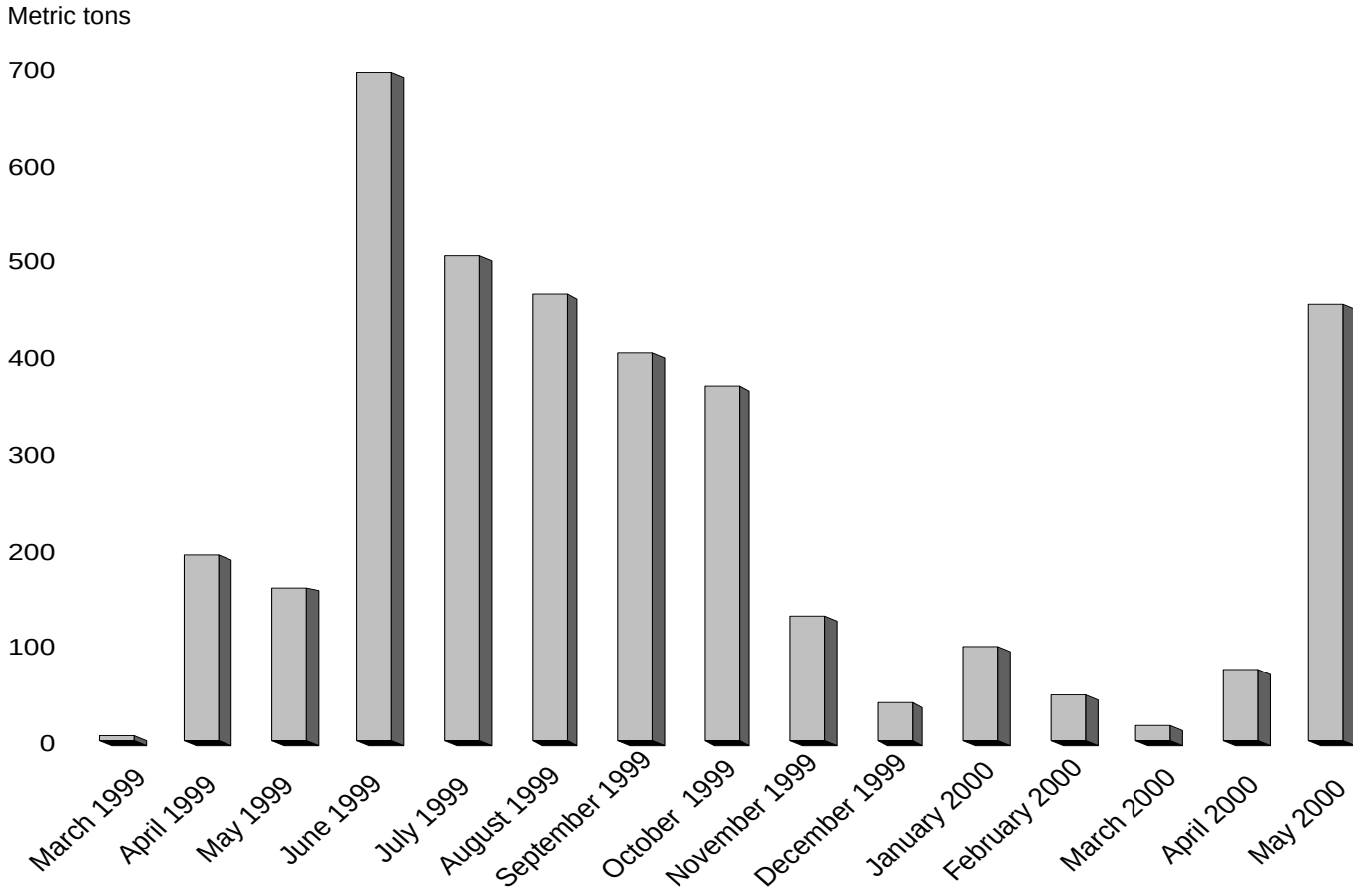
[c]Includes the same participating agencies as listed above except for Feed the Children.

[d]Estimated.

Source: GAO-generated based on Foreign Agricultural Service data.

Most of the commodities arrived in Russia during mid-1999, with the seeds arriving first in March-April 1999, followed by the bulk grains during the summer and early fall months and subsequently by the meats during the late fall and winter months into early 2000. Corn that was substituted for earlier planned beef purchases arrived in late spring 2000. Figure 4 depicts the monthly arrival of U.S. food aid commodities in Russia by tonnage until May 2000.

Figure 4: Arrival of U.S. Food Aid Commodities in Russia Under the Fiscal Year 1999 Program



Source: Foreign Agricultural Service.

Key Internal Controls for Monitoring the Distribution of U.S. Food Aid Commodities in Russia

Internal controls help to ensure that program operations are conducted effectively and efficiently. They also have a vital role in safeguarding assets and preventing and detecting errors and fraud. In table 3, we describe the internal controls for the fiscal year 1999 Russian food aid program. They are set out in the bilateral agreements as well as in procedures issued by the Foreign Agricultural Service specifically for this program.

Table 3: Key Internal Controls for the Bilateral U.S. Food Aid Program to Russia

Key internal control	Purpose	Procedures
Bilateral Working Group	To provide the U.S. and Russian governments with a forum to discuss operational and logistical issues and resolve problems.	The Bilateral Working Group was to meet weekly in Moscow to deal with issues concerning the purchase, shipment, and distribution of commodities. U.S. officials were to take minutes of the meetings, which were translated into Russian and became the record for decisions and outstanding issues. The Foreign Agricultural Service was to review the minutes to ensure that all issues are resolved. Members included the U.S. Minister Counselor for Agricultural Affairs; U.S. embassy officials and monitors; and Russian officials from the Ministries of Agriculture, Finance, Trade, Customs, and Internal Affairs; Russian internal security agencies; and the Russian Pension Fund and distribution agents.
Commodity distribution plans	To create a system of accountability that tracks by region the types and tonnage of commodities to be delivered so that any discrepancies can be traced to a particular step or agent.	Initial distribution plans were to set out the commodities and quantities intended for each region over the course of the program and are to be attached to the food aid agreements. Prior to purchase and shipment of the commodities from the United States, the Russian government was to submit to the U.S. Minister Counselor for Agricultural Affairs, for his approval, detailed commodity distribution plans (work plans) within each region. The U.S. Minister Counselor was to approve any changes, based upon the request by the Bilateral Working Group.
Shipment, Arrival, Distribution, and Status of Funds reports	To collect distribution data by vessel on the type and quantity of commodities loaded and discharged, their condition at arrival, and their final destination.	For each vessel shipment, the Foreign Agricultural Service was to provide the Russian Ministry of Agriculture with an initial version of a Shipment, Arrival, Distribution, and Status of Funds report that includes a vessel control number and information on the types and quantities of commodities on board, although no time limits were specified. Prior to the vessel's arrival, Russian distribution agents were to prepare a vessel spreadsheet indicating the intended regional recipients and their expected quantities based on the commodity distribution plan. Within 2 days of the vessel's discharge at the Russian port of entry, the Russian government was to update the initial shipment report with information on the types, quantities, and condition of commodities received. Finally, within 14 days after the vessel's discharge, the Russian government was to further update the report with information on the recipients of the vessel's commodities. These updates were to be provided to the U.S. Minister Counselor as the definitive Russian accounting for the distribution of commodities by destination, type, and quantity.

(Continued From Previous Page)

Commodity tracking systems	To establish a management information system and audit trail that tracks details of commodity distribution through all stages of the delivery process and quantities monitored.	Information from reports such as the Shipment, Arrival, Distribution, and Status of Funds report, their updates, and the vessel spreadsheets were initially compiled into a single spreadsheet called the Master Travel Matrix. This matrix became the primary document used to track commodities through the various phases of distribution and to plan travel to the regions by the U.S. monitors. In May 2000, the Foreign Agricultural Service brought online a new database (the Food Aid to Russia Monitoring System), which expanded the reporting capacity that was previously available under the initial Master Travel Matrix.
U.S. monitoring visits to Russian regions	To verify deliveries of commodities at Russian ports and regional sites, investigate allegations of fraud or mishandling of the commodities, and visit with press and local officials to promote the program.	U.S. monitors were to travel to ports, storage facilities, processors, and social institutions in the regions to ascertain whether the site had received the expected quantities and types of commodities and whether the price paid was the same as that agreed to by the Bilateral Working Group. Upon arrival at the site, the monitors were to inquire whether all the expected commodities had arrived, review documents provided by the recipients and, whenever possible, copy these documents. Upon completion of the site visit, the monitors were to record their findings in a Compliance Review Report. Issues identified by the monitors were to be brought to the U.S. Minister Counselor for Agricultural Affairs. Additionally, any suspicious circumstances discovered during a site visit were to be immediately brought to the attention of the Ministry of Internal Affairs.

Source: GAO-generated based on Foreign Agricultural Service data.

Comments From the Foreign Agricultural Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USDA

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Farm and Foreign Agricultural Services

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September 26, 2000

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and International Affairs Division
U.S. General Accounting Office
441 G Street, N.W. - Room 4039
Washington, D.C. 20548

Dear Mr. Hinton:

I am pleased to provide the Foreign Agricultural Service's (FAS) formal response to the draft GAO report entitled, "Foreign Assistance: U.S. Food Aid Program to Russia Had Weak Internal Controls".

See comment 1.

We have carefully reviewed the draft report and strongly dispute its principal conclusions. We firmly believe that the bottom-line objectives for the program -- delivery of commodities to the regions of Russia as planned and achieving the targeted goal for payments to the State Pension Fund -- were achieved and that the program has been a major success. This major undertaking was a first for USDA. Nonetheless, we appreciate the recommendations made by the GAO to improve internal controls over existing and future programs of this kind and will seek to implement them where appropriate.

We would like to make three general comments and have several specific recommendations for your consideration in preparing the final report.

First, while the Bilateral Food Aid Agreements concluded by the U.S. Department of Agriculture (USDA) and the Russian Ministry of Agriculture and Food in December 1998 provided a broad outline for establishing controls to insure the integrity of the program, they did not describe the kind of monitoring that would be undertaken nor the operating procedures and process that would be developed to help ensure that the commodities reached the intended regions and buyers, and that the sale proceeds were deposited into the Special Accounts. Additionally, there was no similar model anywhere else in the world. The monitoring and tracking system and various controls and associated forms and documents had to be developed within an extremely short time frame (three months) taking into account that U.S. monitoring personnel would be operating in a country that heretofore considered such foreign activities a risk to national security. Indeed, the current Prime Minister, when Deputy Minister of Finance,

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stated that he viewed the open access afforded the U.S. monitoring personnel under the terms of the Bilateral Agreements as invasive and an affront to Russia's sovereignty.

Also, in developing this endeavor, FAS consulted with and incorporated suggestions from the representatives of USDA's Office of Inspector General, who visited Russia during the early stages of the program and reviewed the monitoring procedures established by the FAS staff in Moscow.

Second, the process was not designed to provide absolute control, but rather to reflect the realities of implementing this unprecedented program in a country twice the size of the United States with national and regional authorities and program participants who had little understanding of monitoring activities. Our goal was to keep the process simple yet effective in helping us ensure that the primary objectives of the program were being met. The monitoring personnel were not accountants nor internal auditors but personnel selected to visit the regions, meet with regional officials and buyers, collect the appropriate supporting documentation and follow the guidelines developed for them to verify the receipt of the commodities. It was the constant presence of these people in the various regions of Russia visiting with the buyers, often on more than one occasion, that was a major deterrent to any diversion or fraud, and that helped ensure that both the Russian government's agents and the regional officials met their commitments.

See comment 2.

Third, as this was a bilateral program, the Prime Minister of the Russian government in a decree dated March 5, 1999, charged the principal Russian security and control agencies to "provide for a strict control" over the receipt, distribution and sale of the commodities, and payments to the Special Accounts and State Pension Fund. We note that GAO did not review nor take into account the process used by the GOR to implement this program. However, the active role of the Russian Ministry of Internal Affairs, Foreign Security Service, State Customs Committee, Ministry of Finance and seven other major Russian state organizations in the food aid program contributed substantially to the success of the program.

In terms of the specific content of the report and the recommendations, we offer the following:

See comment 1.

1. The primary finding appears to be, "…the Foreign Agricultural Service cannot provide reasonable assurance that the food aid was delivered in agreed upon amounts to the intended recipients as was designated in commodity distribution plans approved by both governments." This statement demonstrates the unfortunate fact that after more than one year of studying this program, GAO still does not accurately understand USDA's own goals in implementing the food aid agreements.

These goals, clearly defined in the original Process Model (a business process document drafted in the early months of 1999), were twofold: "(1) to provide contributions to the

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Russian pension fund through the sale of U.S. commodities in Russia . . . and (2) to provide food directly to the most needy groups." Therefore, the stated purpose of monitoring the distribution of food aid was "to minimize the potential for fraud and abuse" that could hinder these goals. It was not meant to ensure that the food aid commodities were delivered according to some rigid, pre-approved distribution plan. In fact, strictly adhering to the distribution plans as GAO would have us do would have been contrary to USDA's own stated program goals if some of the regions listed in the original plan were no longer needy, or if the region failed to meet its financial obligations to the Special Accounts.

See comment 3.

Comparing the distribution plans attached to the original agreements to the actual distribution results may highlight differences between the two, but it does not provide any useful information, and cannot logically demonstrate that USDA somehow "lost" food aid commodities in Russia. If the main finding of GAO's report is that changes were made to the distribution plans for food aid, one has to wonder why a GAO audit was even necessary because this fact was known from the beginning and accepted as a natural consequence of administering such a large and complex food aid program in a country as enormous as Russia. In fact, the Food Aid Agreements clearly allow that flexibility and give the FAS Minister Counselor the authority to approve those changes.

The original distribution plans were designed to make the Russian government think about its distribution plans ahead of time. As has been repeatedly stated, it is unrealistic to believe that these plans would not change over the life of the program. In practice, these documents can, do, and must change according to a variety of circumstances. Fiscal Year 1999 food aid is still arriving in Russia almost two years after the original distribution plans were approved[1]. During that period many factors have changed which could alter the list of recipients.

See comments 3 and 4.

2. The GAO report is critical of the fact that not all distribution plan changes were reflected in the working group minutes. In most cases, time and resources were short and operational efficiency sometimes meant we could not wait for the weekly Working Group meeting to approve the changes. Therefore, in practice the Russian government was given leeway in making adjustments to the original plans. None of this, however, limited the monitors' ability to track these commodities or to verify that they were received by appropriate needy regions and individuals. They were aware of these adjustments and made modifications to travel schedules based on them. These adjustments are quite normal and do not by themselves indicate that anything was lost or stolen. It simply means that when a monitor arrives at a recipient location he or she may discover documents indicating that more or less commodities have arrived than

[1] One final vessel of corn under the FY 1999 program is planned to arrive in Russia in Autumn 2000.

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were expected. The result of such a visit would be that the documents are taken back to Moscow, reviewed with the State Agents, and any necessary adjustments to the database are made at that time. Information in the database is constantly updated. The revised Work Plans were approved by the Working Group and final Work Plans showing the total amount of commodities delivered to each region/buyer exist or will exist for all commodities delivered to Russia to date.

See comments 3 and 4.

As a result of this flexible and adaptive process, the lack of which has hampered the European Union in meeting its Pension Fund goal, USDA can state with absolute assurance that it has accurately tracked the distribution of more than 3.5 million metric tons of food aid commodities across a country that spans more than 11 time zones, and that after more than 230 actual site visits, no instances of inappropriate commodity diversion or fraud have been found. We note that GAO reported no such diversions or fraud in its report.

See comments 3 and 4.

3. The GAO report criticizes FAS in its conclusion for not separately tracking estimated and actual deliveries. While it is true that the database does not distinguish between the two, if one considers adjustments to be a natural part of this process then there is no compelling reason to maintain separate fields for the data. If a monitor finds that the estimated delivery quantity for a particular region is in fact not accurate, and they verify the new quantities through a documentary audit and follow-up discussion with the state agents, then keeping the data in the database does not improve one's ability to accurately account for all of the food aid.

See comment 5.

Likewise, GAO's argument that the database does not distinguish between free wheat and wheat that is for sale is not accurate. It is true that the original Travel Matrix did not distinguish between the two. However, this information was received from the Russian side early this year and was incorporated into the FARMS database. It is currently possible to receive a report on the distribution of free wheat, and it is a regular part of the process that monitors go through when selecting sites for visits. In addition, each regional governor that requested free wheat and the facility receiving the free wheat were aware of their allotment. Each region provided the Ministry of Agriculture and Food with a list of the recipients that would benefit from this free wheat, information available to FAS/Moscow. The active dissemination of information to the local regional media of the amount of commodities to be received by each region, including free wheat for social institutions, helped ensure that free wheat would not be sold. Monitoring personnel regularly met with representatives of the local media to keep them abreast of deliveries to the regions they visited. It should be noted that regional media reports on the food aid program were on the whole positive and appreciative of the U.S. assistance. In addition, to ensure transparency and an open process, all the information on the food aid program is available on the Internet and updated daily. Never before has so much information and detail been available to the public about a program of this kind.

See comment 6.

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4. The GAO report accurately states that in the beginning the Russian Ministry of Agriculture was late in providing some of the SADS reports to the Embassy. However, there is a simple reason for those delays. When the Process Model was developed and the SADS procedures established, they assumed a level of technical sophistication and resources that did not exist within the Ministry of Agriculture and Food. Only one person in the Ministry was assigned the task of entering all the data from each shipment for both the US and EU programs. The Ministry's computer hardware and software were inadequate for the complexity of the task. Although they made every effort to live up to their obligations, the Ministry could not meet the time requirements laid out in the agreements. Also, the time requirements established in the agreements were the best estimation of the time that would be required to complete these reports. The reality proved different. Although late in some cases, we have received all the required reports from the Ministry of Agriculture confirming the delivery of the U.S. commodities.

See comment 7.

5. The GAO report suggests that the monitors should have made surprise monitoring visits to various locations. Surprise visits may sound like a good idea, but anyone familiar with Russian society knows these are all but impossible to implement in Russia. General Directors/Managers of Food Corporations and other large companies are hard to contact at their facility and the accountants need a few days advance notice to get the necessary paper work together for review by the Food Aid monitors. The Russian accounting system is different from that of the U.S. and, therefore, finding all relevant information can be very time consuming. Additionally, accountants would not reveal any information to an American unless directed to do so by the General Director/Manager or directly by the Russian Government officials.

See comment 8.

6. The argument that FAS did not begin to systematically track total payments due in the Special Accounts and reconcile this information with data from Russian records on total payments collected until May 2000 is similarly flawed. FAS was tracking amounts due to the special account in a spreadsheet document known as the SADS Status Report. Whenever necessary, it was possible for FAS to compare the total amounts due with the information on deposits received at each Working Group meeting from the Ministry of Finance. GAO itself admits that there was little reason to account for this systematically prior to February 2000 because up to that point deposits had always outpaced the amount due.[2] The Ministry of Agriculture and Food reported on payments made into the Special Accounts, the Ministry of Finance confirmed what was deposited into the Special Accounts and transferred to the State Pension Fund and the Fund verified receipt of the deposit to its account in the Treasury.

More recently the Ministry of Finance has put in place an auditing system in all the regions to check on their payments to the Special Accounts. In October they will be focusing on all regions with debts of more than 20 million rubles and imposing penalties.

Now on p. 25.

[2] p. 29

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In November, the remaining debtor regions will be targeted for review and action. There are ten letters in the Ministry awaiting approval that would withhold funds from the regions for credit to the Special Accounts. This is not an easy thing for the GOR to do given the dependence of many depressed or political unstable regions on budget transfers. For example, Dagestan owes 105 million rubles. Withholding these funds will affect health care, education and other important social services. To date, the Special Accounts have overdue payments of 200 million rubles for non-grain commodities and 300 million rubles for grains. More than 9.1 billion rubles have been deposited into the Special Accounts with nine billion rubles transferred to the State Pension Fund -- 95 percent of the project target -- and these rubles have been distributed to pensioners throughout the Russian Federation. The State Pension Fund is now current in its pension payments to pensioners.

See comment 9.

7. FAS has made significant improvements in the way it tracks food aid in Russia during the last year and a half. One of the most important developments has been the creation of the FARMS database, which GAO singles out several times for commendation. It is not accurate to say that these improvements were made too late to provide useful information to manage the FY 1999 program. To this day, USDA monitors continue to track the distribution of food aid from this program, and the information provided by the database is extremely helpful to them. With the database, it is possible to account for the complete distribution of all of the food aid commodities.

See comment 10.

The remarks about the inaccuracy of the database are unfounded. The discrepancies on which GAO based its allegations can be easily explained. After several months of monitoring food aid, after the total number of reports had exceeded one hundred, FAS/Moscow conducted its own internal audit of all report documents. The purpose of the audit was to gauge the accuracy and consistency of the original food aid monitors. Since several of the original monitors were no longer in Russia, the audit relied mostly on the supplementary documents brought back to Moscow by the monitor. If the number of documents differed from what the monitor had shown in the report, only that which could be documented was entered into the database. This means that the information in the database is the most accurate, verifiable data available. Because GAO did not consider these supporting documents during its audit, it was not able to recognize this fact for itself.[3]

8. Regarding the value set for the commodities, this was done after a careful review of the information provided by the Russian Ministry, including regional and national price information provided by the ARIS market price project established by the World Bank. FAS/Moscow consulted with American and Russian traders and others to ascertain that the value set by the Working Group would not result in serious damage to market prices for private traders. For each recommendation on the value to set for a given commodity,

Now on p. 19.

[3] See footnote, p. 22.

See comment 11.

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including increases or decreases in values, the Russian Ministry of Agriculture and Food, in cooperation with the former Ministry of Trade, provided wholesale price information to the Bilateral Working Group. This information, in table form, showed the average wholesale price for the country, as well as the regional prices, including the high and low prices, for selected commodities. These prices included VAT and, where applicable, import duties. The information the Ministry provided included price information gathered by the regional agriculture departments, the ARIS market price information program, and commodity exchange product price offerings, where operational, etc. FAS/Moscow reviewed these recommended prices with in-house staff, private traders or after discussion with resident cooperators. The value agreed to between the Ministry and the European Union also limited or influenced the value agreed to in the U.S.-Russia Working Group. Finally, the values set at the Working Group had to be approved by the Food Market Stabilization Commission of the Russian Government.

In addition, the value for grains reflected what the Russian government believed was the best possible value that could be set for grains that would result in a fair and reasonable sale price to the final buyer -- livestock or poultry farms for feed grains and Russian consumers for the bread made from the wheat flour. Unfortunately, the price the livestock farmers could pay for grains is rarely recovered in the prices they are paid by meat processors who, in turn, are limited by what the average Russian can afford. Mindful of the difficulty the Russian agricultural sector and consumers have faced since the August 1998 crisis, the Russian government tried to use food assistance to moderate price increases for food without damaging the domestic processing industry. Due to regional price differences, this was not an easy task. Meat and milk production continued to decline, due in large measure to the inability of livestock farms to obtain and pay for feed grains, or to fully recover their input costs. Agricultural output has fallen 35 percent since 1991 while the sector's share of GDP has fallen from 16.4 percent to 7.5 percent according to the World Bank.

Although Russia has achieved the "basic elements" of a market-based agricultural sector, it is by no means a market-driven economy in the Western sense. According to the World Bank, regionalization of power and policy, disruption of trading relations, poor tax policies, a lack of any meaningful credit program for the sector, inadequate restructuring of large farms, the absence of any private land ownership rights and the lack of an effective, integrated market infrastructure work against market-driven forces, as does administrative price controls (mostly in the regions) and trade barriers. As a result, the agricultural sector has remained largely a non-cash, barter-driven economy with many farm enterprises lacking the cash or credit to cover their operating costs.

It should be noted that prices for grains continued to rise since the delivery of food assistance and, in fact, farm gate prices grew by 91 percent in December 1999 when compared to December 1998. Unfortunately, agricultural input prices grew faster -- by

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130 percent -- for the same period. In 1999, farm gate prices grew faster than consumer prices for foodstuffs, food industry prices and the inflation rate.

There was not always agreement on what the value should be. For example, regarding the price for the first tranche of poultry, the Ministry initially recommended a value of R26 per k/g. After checking on the wholesale price for chicken leg quarters in the Moscow market, we determined that a value of R18 per k/g would be a more reasonable and fair value as the wholesale price, which included VAT and duties for imported poultry, was then R20-21. Regarding the pork price for picnics received by the Russian agent, the value was established as R29 per k/g for boneless picnics, whereas bone-in picnics were purchased and shipped. When the Russian agent experienced difficulty selling the bone-in picnics, there was discussion on several occasions as to whether the value should be lowered to correspond to the value for bone-in ham (R25 per k/g). Ultimately, the Ministry decided to hold to the higher price with the expectation that meat prices would rise and the picnics would be sold. Wholesale meat prices have gone up and the agent expects to move these picnics at the initial price. However, this delay has led to some of the arrears in the Special Account for U.S. products handled by the Russian meat agent (Rosmyasomoltorg).

8. The GAO report notes that the program was implemented at a critical time when Russia was experiencing severe economic problems resulting from the collapse of its banking sector, and following the worst harvest in fifty years. As Russians saw their wages devalued by more than 400 percent, they also were faced with higher prices and reducing supplies of imported food products. The Russian Association of Private Farmers (AKKOR), as well as most American and Russian companies involved in the food business in Russia, informed FAS/Moscow that the food aid program either had no negative impact at all on their prices (AKKOR) or it did not seriously impact their pricing structure. The primary factor impacting exports to and market prices within Russia was the financial crisis of August 1998 and the meltdown of the Russian ruble, not the US food aid program. Overall, the total volume of food aid commodities shipped to Russia represented no more than 5 percent of Russia's total demand. Before the economic crisis of August 1998, almost 45 percent of the food consumed in Russia was imported. As a result of the economic collapse, imports virtually shut down overnight and, in fact, have still not recovered to the pre-crisis level.

See comment 12.

Moreover, as stated in the Bilateral Agreements, the value set for the commodities had to take into account market prices in the regions where the commodities were to be sold. As one value was established by the Working Group for each commodity, by tranche, for the entire country, conditions in the more depressed regions of Russia, and the economic hardship being experienced by most Russians after the August 1998 crisis, were major considerations in determining the value of the commodity for the State Pension Fund. The GOR had no incentive to recommend a value that would result in reduced funds for

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the Pension Fund nor result in a sale price for a commodity that would lead to a major disruption in its domestic food market.

See comment 13.

9. The GAO report addresses the issue of the lack of documentation on the decision-making process to set prices. While some of the documentation was provided to the GAO team, they felt that the information provided by FAS on this subject was not adequate. We believe that it is more important to be able to say with a great degree of certainty that the prices set for the commodities did not have a negative impact on commercial trade and domestic production in Russia. GAO fails to commend the quality of the process and the reasonableness of the actual prices set for the sale of these commodities under the Russian economic conditions, and bases its criticism on inadequate written documentation. Many of the price checks done through phone conversations and personal discussions with the trade did not necessarily warrant the generation of a new piece of paper if it supported the prices that were already available from other sources. Moreover, traders expect that we protect the confidential nature of the information they provide us about the market, a long-standing practice in the FAS.

See comment 14.

10. The GAO report states that the Russian government has not submitted a revised distribution plan for the reduced purchase of US beef. In fact, since the adjustment in quantity was made, FAS/Moscow has had in its possession a revised Work Plan addressing these changes as reflected in the amendment to the Bilateral Agreements signed in October 1999.

11. The GAO report states that "Officials from the Foreign Agricultural Service told us that their ability to effectively implement internal controls was constrained by limited staff resources . . . " The statement was meant to show that we had successfully implemented a large and complex program in spite of this limitation and not that the controls were weak due to this constraint. While resources to meet the standard of 100 percent monitoring were constrained, after repeated checks and audits by the USDA monitors, the IG, the GAO, the Russian security agencies, and the Russian Chamber of accounts, no one has detected any fraud or diversion of the commodities or proceeds. We believe that controls were in fact more than adequate and that we were able to implement the controls and program given existing staff allocations. FAS officials did state to the GAO auditors that we had limited resources and time to implement the program.

12. The GAO report states that according to U.S. and Russian officials, although there were a few cases of alleged abuse (in fact, four), none was substantiated after investigation by Russian security officials and agents. The GAO team itself visited Russia, went to various sites and interviewed a number of players in the implementation of the program and reported to the Ambassador during their meeting with him in December 1999 that they did not find any evidence of fraud or diversion of commodities.

See comment 15.

13. Finally, the GAO's use of the term "reasonable assurances" throughout this draft

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report is vague. The program objectives were successfully met. As stated in the beginning of this response, no substantiated reports of fraud or diversion of commodity or funds have been confirmed, and FAS confident that the internal controls and monitoring process established were responsible for the successful implementation of a massive relief effort in a most challenging environment.

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

TIMOTHY J. GALVIN
Administrator

The following are GAO's comments on the letter from the Foreign Agricultural Service, dated September 26, 2000.

GAO Comments

1. The Foreign Agricultural Service disputes our principal conclusion that it cannot provide reasonable assurance that the food aid was delivered in agreed upon amounts to the intended regions and that the Russian Pension Fund will continue to receive timely deposits that equal the full value of the food aid sold in Russian markets because of weaknesses in the agency's implementation of its internal controls. These controls were designed to direct, track, and verify how the food aid was delivered at the regional level. Agency officials stated that the bottom-line objectives for the program—delivery of commodities to the regions of Russia as planned and achieving the targeted goal for payments to the Russian Pension Fund—were achieved since no substantiated reports of fraud or diversion of commodities or funds have been made. While we agree that conducting a food aid program in Russia was a difficult challenge, we continue to believe that implementation of appropriate internal controls is very important to preventing and detecting fraud and abuse. Without adequate controls and documentation of key decisions, the agency cannot provide reasonable assurance that its objectives are being met.

2. As described in the Scope and Methodology section of our report, we focused our review on the Foreign Agricultural Service's implementation of internal controls it designed to manage the government-to-government fiscal year 1999 food aid program to Russia. Internal controls are a governmentwide requirement intended to serve as the first line of defense in safeguarding assets, preventing and detecting errors and fraud, and providing reasonable assurance that an organization's objectives are being met. As we noted in our Scope and Methodology section, we made no assessment of the Russian government's effort to implement and monitor the food aid program because the Foreign Agricultural Service (not the Russian government) has primary responsibility to safeguard the use of U.S. assets and provide reasonable assurance that the food aid reached intended recipients.

3. Commodity distribution plans were one of the key internal controls established by the Foreign Agricultural Service to track the progress of U.S. food aid deliveries to regional recipients in Russia. As our report states, this internal control allowed for the revision of commodity

distribution plans, recognizing the need to respond to changing conditions such as sudden regional food shortages. According to the internal controls, changes in planned commodity distribution were supposed to be documented in revised distribution plans and submitted by the Bilateral Working Group to the U.S. Minister Counselor for approval. Except for an update on free wheat distribution, our review found no revisions to plans or record of U.S. approval. Rather than implement its internal controls and complete the process of updating and approving changes in commodity distribution plans, the Foreign Agricultural Service accepted the Russian government's record of actual deliveries as commodity distribution plans. It is by this acceptance that the Foreign Agricultural Service can state with full assurance that commodities were delivered according to plan. However, we found that less than one-quarter of the targeted regions received a tonnage amount that was equivalent or near their planned distributions. Because the Foreign Agricultural Service did not document revisions and approval for changes to the commodity distribution plans, it cannot demonstrate that changes in the distribution plans were planned and approved or whether they were the result of unintended re-routings.

4. As we stated in our report, the U.S. monitors made numerous site visits, often without reliable data on the amount and types of commodities that they were expected to find. If monitors found differences between expected and actual amounts, they were not in a position to know if it was due to changes in plans or possible diversion. According to the agency's comments, its response to these discrepancies was to modify the database using documents collected by U.S. monitors rather than reconcile the differences identified in the monitor's site visit report. We believe that the procedure of modifying the database rather than reconciling the differences means that the Foreign Agricultural Service does not have an adequate basis for its claim of "absolute assurance" that it has accurately tracked the food aid distribution.

5. During the time period that free wheat was being delivered to regional recipients, the database only captured information on total wheat delivered (and did not distinguish between wheat to be sold to processors or distributed free to social institutions). The new database, operational in May 2000, incorporated historical information provided by the Russians on the distribution of free wheat. However, the database still is incapable of tracking the distribution of free wheat on a real-time basis because Foreign Agricultural Service's key logistical

report that tracks the distribution of commodities from point of discharge to final delivery does not distinguish between commodities that are to be sold versus commodities that will be given to social institutions. Our analysis of 115 monitoring reports covering the delivery of wheat did not indicate that free wheat was a factor in selecting site visits. We found only 10 instances where the reports mention that free wheat was delivered to the mills that the monitor had visited and we could find evidence of monitoring visits to only 10 social institutions receiving free wheat.

6. While we found that the Foreign Agricultural Service did post useful program information on its web site, it was by no means complete or always current. For example, we found that only two-thirds of the commodity work plans (showing recipient data) were ever presented on its web site; updates of meat distribution plans were discontinued in December 1999 even though much of the meat had still not arrived in Russia; and shipment status reports were issued irregularly and did not cover meat commodities.

7. The agency's comments describe what transpires in preparation for a planned site visit and illustrate the need for unannounced monitoring visits. To overcome some of the described difficulties in arranging surprise visits, the Foreign Agricultural Service could coordinate with Russian government counterparts responsible for monitoring the food aid program. A Foreign Agricultural Service contractor, in response to a request to assess the agency's monitoring plan, stated in a draft report that "surprise, unannounced visits, even if relatively few in number, would add significantly to the deterrence value inherent in site visits and would significantly increase the quality and effectiveness of this aspect of the program." The Foreign Agricultural Service deleted this conclusion from the draft version of the contractor's report.

8. The Foreign Agricultural Service's comment that the SADS Status Report tracked amounts due to the Special Account does not refute our finding that the Foreign Agricultural Service did not systematically track payments with amounts that were due until May 2000. The SADS Status Report tracked amounts and dates due for individual shipments but did not produce a consolidated report that provided managers with information to track the total amounts due at any point in time. As stated in our report, officials from the Foreign Agricultural Service told us that it prepared financial status reports on an as needed basis. But until the new database became operational, the limited documentation

that the agency provided us regarding payment information did not demonstrate a history that payments regularly exceeded amounts due. Therefore, we do not conclude, as the Foreign Agricultural Service states in its comments, that there was little reason to systematically account for total payments due prior to February 2000.

9. While we believe, as stated in our report, that the new database (FARMS) represents significant improvements over the earlier database, it was implemented too late to significantly enhance the Foreign Agricultural Service's ability to track commodity shipments, deliveries, and payments under the fiscal year 1999 program. In May 2000, when the new database became operational, virtually all of the food aid tonnage shipped under this program had been discharged in Russia.

10. This is the first time that the Foreign Agricultural Service has informed us about an internal audit of its monitoring report documents and, in its comments, the agency did not provide a date as to when this was performed. We cannot comment on the audit's scope and methodology; however, based on the Foreign Agricultural Service's description of its audit, there does not appear to be any effort to reconcile the differences between documents collected during the site visit with amounts reported as verified by U.S. monitors in their individual monitoring reports.

11. We requested the Foreign Agricultural Service to provide us with contemporaneous documentation used by the Bilateral Working Group to establish prices and Foreign Agricultural Service documents that reflected the Foreign Agricultural Service's analysis of proposed commodity prices. The Foreign Agricultural Service did not provide us with the tables used for making price decisions referred to in its comment on our draft report even though they are precisely what we requested. Rather, the Foreign Agricultural Service primarily referred us to monthly regional and national price information for agricultural commodities published after the decisions were made. We cannot know from the documentation provided what price information was available and used when the Bilateral Working Group made pricing decisions. Ex-post price documentation contributes little to show how decisions were made or what analysis the Foreign Agricultural Service undertook regarding proposed prices. This lack of documentation is not surprising as the U.S. Minister Counselor told us that there was a "paucity" of

documentation prepared by the Foreign Agricultural Service related to establishing program prices.

12. Establishing prices was an important part of administering the food aid program. If the price was set too high, the U.S. product would sell slowly, storage costs would be incurred, and the U.S. food aid would not contribute to controlling food price inflation in Russia. If prices were set too low, domestic Russian producers would face reduced income due to the lower prices, competing imports would be crowded out, and revenue to the Russian Pension Fund would not be maximized. In addition, low prices would create opportunities for windfall profits by the government-selected recipients of the food aid. For example, if a mill buys U.S. food aid corn at prices significantly below market prices, the buyer could realize windfall profits when it sells the processed corn. Representatives of a Russian agricultural association told us that the lack of price adjustment in the program created such profit opportunities. According to the World Bank, incomes of distribution agents and other intermediaries grew at the expense of Russian government revenue. Because Russian government officials and distribution agents determined the distribution of the food aid product, they also controlled the distribution of potential windfall profit opportunities. According to a U.S. trade association representative, the low prices made the food aid distributor very powerful, even if the distributor was not corrupt. Another association representative explained that government control of distribution with low prices created opportunities for corruption.

13. The issue under review is not simply whether the Foreign Agricultural Service had adequate documentation (it did not), but whether it can demonstrate the reasonableness of its decisions. While our report does not contain an evaluation of whether the program's prices had a negative impact on commercial trade and domestic productions in Russia, we do report that U.S. program prices were substantially below Russian wholesale prices for the cases we could review. We report that the U.S. program price for food aid rice was about half of the average domestic prices at the time it was set. Similarly, the prices of U.S. food aid corn and wheat were set at about 60 percent of Russian wholesale prices. These price differences raise questions about the level of proceeds that could have been generated by the food aid program for the Russian Pension Fund. For example, the three shipments of these commodities we examined generated sales of $36 million. If, for example, sales had taken place at prices 20 percent higher, the sales

would have generated $7.2 million more for the Russian Pension Fund. A U.S. trade association pointed out that low prices for food aid resulted in the Russian Pension Fund receiving less money than it should have. While we are not in a position to know whether sales at higher prices were desirable or feasible, the Foreign Agricultural Service provided no documentation or analysis that demonstrated that they considered these issues.

14. During our trip to Moscow in December 1999, we requested and received copies of the final commodity distribution plans for all commodities. The distribution plan we were given for U.S. beef did not reflect the reduced amount of U.S. beef purchased by Russia under the food aid program from 120,000 metric tons to less than 50,000 metric tons. As recently as June 2000, we have requested an updated distribution plan for U.S. beef and have been told by agency officials that the original distribution plan represented the final plan.

15. The term “reasonable assurance” that we used throughout our report is a fundamental concept found in Standards for Internal Control in the Federal Government. This concept recognizes that internal controls, once in place, provide reasonable, not absolute, assurance of meeting agency objectives. This term is also part of the Office of Management and Budget Circular No. A-123 guidance regarding management accountability and control of federal government program and operations. This circular applies to the Department of Agriculture and the Foreign Agricultural Service.

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