OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/GEORGIA'S ECONOMIC PROSPERITY INITIATIVE

AUDIT REPORT NO. 9-114-13-001-P
DECEMBER 26, 2012

WASHINGTON, D.C.

Office of Inspector General

December 26, 2012

MEMORANDUM

TO: USAID/Caucasus-Georgia, Mission Director, Stephen M. Haykin

FROM: IG/A/PA, Director, Steven Ramonas /s/

SUBJECT: Audit of USAID/Georgia's Economic Prosperity Initiative
(Report No. 9-114-13-001-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments and included your response in Appendix II.

The report contains 13 recommendations to help strengthen the implementation of USAID/Georgia's Economic Prosperity Initiative. The mission has taken final action on Recommendation 4 and made management decisions on the remaining recommendations. Please provide the Audit Performance and Compliance Division of USAID's Office of the Chief Financial Officer with evidence of final action to close the 12 open recommendations.

Thank you for the cooperation and courtesy extended to the audit staff during this audit.

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Abbreviations

The following abbreviations appear in this report.

ADS	Automated Directives System
COR	contracting officer’s representative
EPI	Economic Prosperity Initiative
IPR	intellectual property rights
ID	identification
OIG	Office of Inspector General
PMP	performance management plan
WEF	World Economic Forum

SUMMARY OF RESULTS

Georgia has made progress on market reforms since gaining independence from the Soviet Union in 1991. According to the Central Intelligence Agency's *The World Factbook*, the country's gross domestic product grew more than 10 percent in 2006-07. It slowed to a yearly growth rate of only 2.3 percent in 2008, according to the project's contract, after Russia invaded Georgia in August 2008. Russia unilaterally declared the independence of the Abkhazia and South Ossetia regions of Georgia, placing military forces in those regions that remain today. The economy contracted in 2009, partly because of a decline in foreign direct investment, which had been the engine of Georgia's economic growth before the 2008 Russian invasion.

USAID is one of several U.S. Government agencies implementing a billion-dollar assistance package for Georgia, pledged at an international donors' conference held in the wake of the invasion. In September 2010, USAID/Georgia launched its Economic Prosperity Initiative "to improve Georgia's overall economic competitiveness through assistance designed to improve both economic governance and private sector competitiveness." To implement the project, the mission awarded a 4-year, $40.4 million cost-plus-fixed-fee contract to Deloitte Consulting LLP. As of June 30, 2012, almost midway through the contract, the mission had obligated $37.2 million and spent $23.7 million on the project.

The Performance Audit Division of the Office of Inspector General (OIG) conducted this audit to determine whether the project was achieving the following five project goals:

1. *Increased Productivity: Semiannual increase in productivity in targeted sectors consistent with USAID-approved semiannual targets.*

2. *Increased Employment: Semiannual increase in employment in targeted sectors consistent with USAID-approved semiannual targets.*

3. *Increased Foreign Debt and Equity Invested in Georgia: Ten major international investment transactions completed and attributable to project assistance; $500 million in investment attributable to project assistance, $100 million of this in the agricultural sector.*

4. *Increased Access to Local Finance: $200 million in capital attributable to project assistance lent to enterprises operating in targeted sectors.*

5. *Increased Exports: $150 million in exports facilitated and attributable to project assistance. 100 companies in targeted sectors have significantly enhanced capacities to export products and services.*

The project has made progress on its five goals (page 4) through activities in three components: an economic governance component that targets areas for interventions selected in partnership with USAID and the Government of Georgia, and two private sector components (agricultural and nonagricultural) that target market sectors selected by the contractor. However, the audit also identified the following problems:

- Progress was difficult to attribute to economic governance interventions (page 8). The project's design makes it difficult to link work on interventions in the project's economic governance component to project goals. This fact creates an incentive to do less in that component and more in the two private sector components.

- The project's property rights effort was limited to intellectual property (page 10). Although the contract lists a broad range of issues for the contractor to address in the "Strengthen Property Rights" area that it targets for economic governance interventions, the project's action plan for this area is limited to addressing intellectual property rights. Lack of progress on other property rights issues impedes economic growth in Georgia.

- The mission did not establish a steering committee to set policy priorities (page 12). Weak coordination among Georgian Government agencies, the project, and the mission led to the project's intervening in a policy matter without the knowledge of the project's main government contact.

- Reporting on two goals was not consistent with the contract (page 13). The project cannot report whether productivity and employment increases are "consistent with USAID-approved semi-annual targets" in accordance with the contract.

- The contractor reported questionable results (page 15). The contractor counted commitments to invest in the future toward meeting its $500 million foreign investment target, and import substitution and Georgian tourism toward meeting its $150 million exports target.

- Ambiguous contract provisions led to impractical data collection (page 16). The contractor interpreted two ambiguous contract provisions to require data that were burdensome to collect and of questionable relevance.

- Some contract requirements and benchmarks were not met (page 17).

To address these problems, the report recommends that USAID/Georgia.

1. Approve a method for attributing to economic governance interventions progress toward project goals and modify the contract as necessary to enable the method to be implemented (page 10).

2. Issue in writing guidance on project design incorporating into contracts measures of success tailored to the feasibility of performance data collection and attribution for each project component (page 10).

3. Develop a written strategy for strengthening property rights that incorporates the full range of activities described on page 12 of the contract (page 11).

4. Establish a mechanism to bring Government of Georgia agencies together to prioritize interventions under the Economic Prosperity Initiative's economic governance component (page 13).

5. Approve in writing quantitative performance targets for all market sectors in which it measures productivity and employment increases attributable to the project (page 14).

6. Modify the contract to replace “USAID-approved semi-annual targets” with “USAID-approved targets set at the appropriate frequency for each market sector in which USAID measures productivity and employment increases attributable to the Economic Prosperity Initiative” (page 14).

7. Modify the contract to clarify whether the contractor may count investment commitments toward the contract’s $500 million foreign investment target, and may count import substitution and increased tourism occurring in Georgia toward the contract’s $150 million exports target (page 15).

8. Modify the contract provision on page 9 to clarify that the contractor is required to track each high-level goal by the targeted market sectors or components that can contribute to it (page 17).

9. Modify the contract provision on page 26 to clarify that the contractor can collect and submit performance indicator data to USAID/Georgia annually, if the mission agrees in writing that data cannot practically be collected and submitted twice during the fiscal year (page 17).

10. Modify the contract to either clarify or remove the requirement on page 10 that the contractor quantify the expected change in each identified World Economic Forum indicator throughout the project and as of project completion (page 18).

11. Extend by 6 months deadlines for achieving contract benchmarks for revenue increases in the Economic Prosperity Initiative’s agricultural and nonagricultural private sector components (page 19).

12. Make a written determination as to whether “(primarily 5 hectares and more)” in the first bulleted benchmark on page 16 of the contract is feasible and, if not, delete it from the benchmark (page 19).

13. Either modify the contract, if it determines that current contract requirements for calculating project overhead rates are incorrect, or determine to what extent it overpaid the contractor in noncompliance with the contract and recover any overpayment (page 19).

Detailed findings follow. The audit’s scope and methodology appear in Appendix I. Management comments appear in Appendix II, and our evaluation of them is on page 20. Appendix III shows the eight areas targeted by the contract for economic governance interventions, and associated action plans.

AUDIT FINDINGS

Project Made Progress on Its Five Goals

The project advanced its five goals through activities in the three components shown in the table below. The first is economic governance. For this component, the contractor works with the Government of Georgia and USAID to develop economic governance interventions that increase Georgia's economic governance capacity and improve the business environment. For the agricultural and nonagricultural private sector components, the contractor must select market sectors[1] to target for activities that increase competitiveness.

Economic Prosperity Initiative's Three Components

Economic Governance	Agricultural Private Sector	Nonagricultural Private Sector
Selected interventions • Trade facilitation system and customs administration reform • Tax administration reforms • Electronic identification (ID) cards • Intellectual property rights e-filing • International building code adoption • International accreditation of Georgian laboratories • Government procurement awareness raising and training	Targeted market sectors • Hazelnuts • Mandarin oranges • Heated greenhouse vegetables • Open-field (field-grown) vegetables	Targeted market sectors • Apparel • Wine tourism • Tourism related to meetings, conferences, and exhibitions • Paper packaging • Perlite products • Transport and logistics • Information and communications technology

Economic Governance. Appendix III shows each of the eight areas that the contract targets for economic governance interventions. The appendix also summarizes the work that the project and the government agreed on in action plans required by the contract. Three examples of important economic governance interventions identified by beneficiaries are described below:

- *Trade facilitation system.* The head of Georgia's Data Exchange Agency discussed that agency's work with the project to create a Web portal that enables a range of trade-related databases to link to a single access site for trade-related services, such as shipping lines, port and terminal operators, customs, banks, insurance, freight forwarders, and railways. He credited the portal with making government more transparent and accessible to trade-related businesses. Officials at Georgia's two main ports agreed. The operations manager of Batumi International Container Terminal said company representatives formerly had to wait outside for containers and stand in line for about 16 documents to be processed. With the trade portal, they now use the Internet to determine where containers are and process documents in a single online transaction. The head of information technology for APM Terminals Poti credited the portal with providing information on the type and location of

[1] We use "market sector" to mean the same as value chain, which refers to the various processes involved in producing a good or a service, starting with raw materials and ending with the delivered product.

ships' cargo and on techniques for docking, off-loading, and delivering cargo. Both the Batumi and Poti managers commented on the high quality of project experts and the key role the project played in winning the Georgian Government's support for this effort, which they see as contributing to increased productivity, exports, foreign investment, and employment.

- *Tax administration reform*. The project assisted Georgia's Revenue Service in implementing an automated, risk-based audit system that adheres to international risk-based management principles. According to the USAID/Georgia regional legal advisor, the Revenue Service has made significant strides with the project's help in countering a perception that the government could unfairly target people or businesses for an audit. A chief adviser to the Prime Minister said the government is very satisfied with the expert assistance it has received in tax administration from the project. He also expressed appreciation for the project's help in revising Georgia's tax law to conform to guidelines set by the Organization for Economic Cooperation and Development for regulating transfer pricing.[2] This effort not only helps Georgia manage tax avoidance, according to the chief adviser, but also is good for companies because it reduces uncertainty and creates a more transparent business environment. He stated that a more transparent business environment increases business generally in Georgia, leading to increased exports and employment.

- *Electronic ID cards*. The head of Georgia's Civil Registry Agency said the project helped his agency develop electronic ID cards and the infrastructure involved in using them. He said the project provided an expert consultant, helped organize a conference, and is assisting the agency as it helps companies provide electronic services via the ID card, such as self-service banking. Georgians can also use their ID card to access services on MyGov.ge and to access real estate records, driving records, and procurement-related services facilitated through electronic signature capability. The project has assisted the agency in helping companies interested in using the ID card process transactions—in particular, for electronic signature—and is helping translate the agency's Web site into English. These efforts enable businesses around the world to conclude agreements and contracts online securely. The agency head said he views the project as contributing significantly to increased productivity and foreign investment.

Agricultural Private Sector. The project primarily engaged with the hazelnut and greenhouse sectors during 2011, and assisted in developing a partnership between Georgian hazelnut producers and the global confectionery company Ferrero. In 2012, the project launched training programs for farmers growing mandarin oranges and open-field vegetables. In its June 2012 performance management plan (PMP) update, the project reported that it had provided support to 3,065 farmers and 118 agribusinesses. Two examples of important contributions under the project's agricultural private sector component are shown below:

- *Open-field vegetable training*. We visited a training site where project instructors were teaching farmers modern crop rotation methods to enhance soil quality and to improve pest management practices. According to the agricultural private sector component deputy lead, the project is helping farmers implement simple changes that are feasible and achievable with limited means, but that can produce significant improvements. For example, farmers are used to growing only one crop a year on their small plots. When they see that results of

[2] Transfer pricing is setting prices for international transactions that, because they occur between divisions of the same company, are not set by the market. Because tax rates likely differ in the countries involved, companies may shift profits to lower their taxes.

the project's new approaches can lead to two harvests a year, they are eager to learn how to achieve similar results. The project also demonstrates the importance of planting high-quality seeds and better ways to prevent pest infestation. The project official said that the good turnout of farmers for the training session we observed was typical and that the challenge has been keeping up with demand. One indication that the project is making a difference, he pointed out, is that in the first session the staff tried to convince farmers that soil testing was important before planting; since then the staff has seen a marked increase in demand for soil testing.

Project instructors train farmers in applying pesticides to crops (left) and use a field guide to help farmers identify harmful weeds (right). (Photos taken by OIG, June 2012)

- *Farmer training in Adjara.* According to Georgia's Minister of Agriculture for the Autonomous Republic of Adjara, project experts told farmers that citrus fruits were better suited to their region than the berries they had been growing. She said Adjaran farmers have benefited greatly from the project's training for citrus growers—in particular, growers of mandarin oranges—and from training in producing vegetables in greenhouses. Instructors have taught farmers how to prune their mandarin orange trees to enhance productivity. She said the project is helping processors package agricultural products to meet European standards, and is assisting with Georgia's implementation of internationally recognized certification standards for food safety. Meeting such international standards is important for increasing exports, according to this official.

Nonagricultural Private Sector. This component seeks to increase the export potential and competitiveness of targeted market sectors by enhancing productivity, promoting investment, and strengthening market links. In its second year, the project reported a broad range of contributions across the targeted market sectors identified in the table on page 4. Two examples follow.

- *Apparel*. The project helped representatives of Georgia's apparel industry participate in trade fairs in Istanbul, Munich, and Kiev and worked with Turkish consultants to promote foreign investment. According to the project's June 2012 PMP update, before receiving assistance, the Georgian apparel industry was not competitive on the international market, and apparel manufacturers lacked confidence in their ability to compete. Now they are eager to attend the trade fairs that the project introduced them to, and technical assistance has resulted in numerous new export opportunities.

Representatives from Georgia's apparel industry gave several examples of how they benefited from project assistance. The project facilitated their cooperation with clothing designers to increase interest on the part of foreign buyers. It also responded to the apparel industry's demand for qualified employees by assisting vocational schools in Batumi, Poti, Tbilisi, and Kutaisi. The project provided new sewing machines to these schools and trained 27 Georgian instructors to teach courses on sewing machine operation, mechanics, and textile inspection. The director of the vocational school in Kutaisi told us that the project's training for instructors was very good, well organized, and focused on increasing productivity. She said the project also facilitated a memorandum of cooperation between the school and textile companies to link students directly to future employment.

A vocational school in Kutaisi received new sewing machines from the project. At right a woman uses one of the machines. (Photos taken by OIG, July 2012)

- *Event tourism*. The project played an important role in identifying tourism associated with events such as conferences and exhibitions as a sector with significant potential benefits for the Georgian economy. This sector includes representatives from hotels, destination management companies, exhibition and conference facilities, and tour operators. Several such representatives gave examples of project help in identifying exhibitions and events promoting tourism, Georgian products, and Georgia as a tourist destination. Industry representatives expressed appreciation for project assistance, and the project's June 2012 PMP update states that the Georgian National Investment Agency is now dedicating significant resources to promoting event tourism. One representative said the government has been supportive of wine tourism, which takes tourists to particular vineyards, but the project is proving that event tourism can bring many Georgian wine producers together at one event and connect them to potential foreign buyers. She pointed out that this exposure potentially increases exports, foreign investment, productivity, and employment.

Progress Was Difficult to Attribute to Economic Governance Interventions

The contract specifies on page 9 that contractor resources used for the economic governance component should be roughly equivalent to those used for the two private sector components.

> Assistance will be invested approximately equally to strengthen economic governance, and increase the competitiveness of targeted agricultural and non-agricultural private sectors. Linkages between components will be exploited to leverage opportunities and developmental impact of the project as a whole.

Despite the above guidance, the project design creates an incentive for the contractor to invest less in its economic governance component than in its agricultural and nonagricultural private sector components because of the way it measures success. The contract's scope of work states that the success of the project "as a whole will be measured by the attainment of the . . . five overarching" goals, which it requires to be tracked by component and subcomponent. Such tracking is inherently more difficult for the economic governance component because the contractor cannot solicit information from beneficiaries as easily for that component as for its private sector components.

The project's contract requires the contractor to submit to the contracting officer's representative (COR) a PMP that tracks performance indicators and "results targets, milestones, and clearly-defined benchmarks including the relevant target timeframe." Preparing the plan involves developing performance indicators to use in measuring progress and collecting and analyzing performance data relating to the indicators. The methodology developed by the contractor to do this and attribute progress to its agricultural and nonagricultural private sector components is described in the project's June 2012 PMP update as follows:

> EPI [the project] is employing a data source methodology that collects data directly from its key beneficiaries, indirectly through service providers or associations, or by relying on official statistical data for the targeted sectors as provided by the Georgian National Statistical Agency, Ministry of Economy and Sustainable Development, and Georgian National Tourism Agency. [Abbreviations omitted.]

In contrast, the contractor has not completed a methodology to attribute progress made toward the project's five high-level goals to its economic governance interventions. Deloitte's June 2012 PMP update includes some data, but states on page 1 that remaining data will be included in upcoming reports. Page 3 further states:

> In April 2012, EPI [the project] also began its impact assessments of policy and business enabling environment reforms to quantify or monetize the benefits of such reforms on EPI value chains, businesses and high-level results tracked by EPI. These assessments will be completed throughout 2012.

According to the chief of party, the contractor is developing a methodology to present to USAID for quantifying the contribution of economic governance policy activities to the contract's five goals. She expressed her view that the project's ability to achieve goals, especially the contract's $500 million foreign investment target, will depend in part on whether USAID approves the project's methodology for attributing progress to interventions under its economic governance policy component.

Evidence we obtained from USAID/Georgia and project officials provides two general reasons why broad-based changes to economic governance and the business environment are inherently difficult to attribute to the project. First, the project is one of several factors that can affect Georgia's economic governance and business environment. Legislative and regulatory action, as well as government's willingness and ability to enforce the laws and regulations on the books, are perhaps the most important factors. If the government is not receptive to an economic governance intervention, the intervention is not likely to be successful, even though the project might have spent significant resources on it. On the other hand, if the government is receptive and change occurs, it can be difficult to determine whether the change would have occurred anyway without the project, or to quantify to what extent the change can be attributed to the project.

Second, even if it were possible to determine to what extent a change in economic governance or business environment was attributable to the project, it can be difficult to link that change to one or more of the project's five high-level goals. If the economic governance change does not relate directly to a targeted market sector, it probably would not make sense to ask beneficiaries in the targeted market sectors what they thought of the impact of the economic governance intervention. Without such performance data from beneficiaries, EPI lacks a key means of attributing progress toward the project's goals to economic governance interventions.

For example, the economic governance component has an intervention working with the Urbanization and Construction Department of Georgia's Ministry of Economy and Sustainable Development to adapt the International Building Code to Georgia. The project's COR noted that this intervention is widely regarded as a significant contribution to creating a level playing field for the construction industry and generally to improving Georgia's business environment, but it does not relate directly to the project's targeted market sectors under its private sector components. Therefore, it would not make sense for the contractor to ask a beneficiary in one of the project's targeted market sectors—e.g., a mandarin orange farmer or an apparel industry seamstress—how a change in building codes affected their ability to contribute to the project's five high-level goals. As a result, it is not clear how the project can attribute progress on the five high-level goals to its building code intervention.

The leader of the project's economic governance policy component agreed that the burden of measuring progress falls on the agricultural and nonagricultural private sector components, which have direct beneficiaries. This corresponds to the contract's statement on page 10 that, "The impact of improving the business environment for each targeted sector will be measured in light of attaining the intended results of components 2 [agricultural private sector] and 3 [nonagricultural private sector]." The contract appears to recognize the project design problem, however, by also stating that "some interventions to improve economic governance might not directly benefit the targeted sectors."

The project's June 2012 PMP update includes the following recommendation for crediting economic governance interventions in measuring progress toward what project and mission officials identified as the most challenging high-level goal—$500 million in foreign investment attributable to project assistance.

> EPI [the project] recommends that in cases where high-priority reforms that EPI supported were identified by the Government of Georgia and are not directly

> linked to EPI's targeted value chains or sectors, USAID considers the impact of EPI's policy and business environment reforms in the context of improvements in the overall investment climate. USAID, EPI, and the Government of Georgia can agree on the appropriate EPI attribution in total foreign investment flows to Georgia during project duration based on similar examples in other countries or other appropriate methodology.

The chief of party and the COR agreed that, unless USAID accepts a methodology for attributing progress toward goals to interventions under the project's economic governance component, the contractor has less incentive to work on that component than on the private sector components. The project's design should not provide a disincentive to pursue areas targeted by the contract for economic governance interventions, by inadvertently hindering the contractor's ability to attribute progress to such interventions. Therefore, we make the following recommendations.

Recommendation 1. *We recommend that USAID/Georgia approve a method for attributing to economic governance interventions progress toward project goals and modify the contract as necessary to enable the method to be implemented.*

Recommendation 2. *We recommend that USAID/Georgia issue in writing guidance on project design incorporating into contracts measures of success tailored to the feasibility of performance data collection and attribution for each project component.*

Property Rights Effort Was Limited to Intellectual Property

The contract lists on page 12 a broad range of issues for the contractor to address in the "Strengthen Property Rights" area that it targets for economic governance interventions.

> The contractor shall address key issues in the area of property rights, including intellectual property rights (IPR), for businesses, individuals, and investors. This assistance will include, but not be limited to, strengthening rights within legal frameworks; improving the perception and understanding of property rights by public and private sectors; and promoting broader awareness of current property rights protections to the private sector. Working with the GoG [Government of Georgia], the contractor shall also promote compliance with international property rights conventions by identifying areas of property rights concerns for businesses and individuals, and designing and implementing solutions to resolve such concerns.

However, as shown in Appendix III, the project's action plan for the "Strengthen Property Rights" area is limited to addressing intellectual property rights (IPR). Several officials commented on the importance of the project's work with Sakpatenti, the Georgian equivalent of the U.S. Patent and Trademark Office, to streamline Georgia's IPR registration process and develop an e-filing system for IPR applications. However, IPR is just a subset of strengthening property rights, as described on page 12 of the contract. Lack of progress on other property rights issues has limited the project's contributions in two other areas and impedes economic growth in Georgia.

The main reason that the action plan in this targeted area does not address other types of property rights, according to the leader of the project's economic governance policy component, is that the unclear division between state-owned and private property in Georgia is a major obstacle to doing much else. This official expressed the view that the government needs to conduct a thorough inventory of state-owned land and sort out the claims of local landowners. However, she said that the project should not get involved with such work, which she said is a political and legal quagmire best left to the government. She said lack of clarity regarding property rights has also limited the project's progress in two other areas targeted for economic governance intervention:

- *Developing a privatization system*. The task of developing and implementing an automated state property management system was transferred from the project to the Ministry of the Economy and Sustainable Development because it cannot be done without an inventory of state-owned and private land.

- *Improving the agricultural policy environment*. The Ministry of Agriculture delayed much of the action plan for a year and assumed initial responsibility for developing the improved agricultural policy, in part because of the obstacle presented by the lack of a clear division between state-owned and private property.

The project's July 2012 quarterly report states that staff conducted two focus groups in April 2012 with about 44 hazelnut producers from the Samegrelo Region "to understand major policy constraints and operation issues restraining their growth and development." The focus group discussions confirmed a "low level of understanding of the importance of land registration." The report states that most land plots are not properly registered. The Minister of Agriculture for the Adjara Region said farms in Georgia tend to be very small—often just the backyard of a farmer's home. She said experts have urged farmers to combine plots to achieve economies of scale that would help them compete internationally and lower risks, but without much success to date. Greater certainty regarding their property rights would put farmers in a better position to buy and sell land and to benefit from the economies of scale that could result from consolidating farm activities.

The difficult issue of strengthening property rights is broader than just land registration, however. Several project and mission officials said an important factor impeding progress toward the project's goals is a general perception that private property can be taken by the Georgian Government without due process and that if a business succeeds, the government might find some way to tax or penalize it or otherwise take a part of its wealth. According to the director of USAID/Georgia's Economic Growth Office, a perception that legal enforcement is not fair is a major deterrent to achieving the project's goals, especially foreign investment. The director said smaller foreign investors considering Georgia are concerned about whether they will be at a disadvantage if they are not insiders with the right connections.

Confidence in Georgia's legal infrastructure and legal enforcement is a core concern of the economic governance interventions and of the mission's work promoting the rule of law. It would be a missed opportunity, as one senior project official put it, if the expertise Deloitte has evidenced in implementing the project to date were not also brought to bear on strengthening property rights beyond intellectual property. Therefore, we make the following recommendation.

> ***Recommendation 3.*** *We recommend that USAID/Georgia develop a written strategy for strengthening property rights that incorporates the full range of activities described on page 12 of the contract.*

Mission Did Not Establish a Steering Committee to Set Policy Priorities

A significant principle of project design, as stated in USAID's Automated Directives System (ADS) 201.3.8.5, is to "promote collaboration and mutual accountability among USAID, the partner government, and other key stakeholders." This principle is reflected in the August 2010 assistance agreement between the United States and the Government of Georgia, which includes a provision to form a steering committee whose members "may include representation from the U.S. Embassy, USAID, and [Georgian ministries] to jointly coordinate and monitor activities under this Agreement."

No such committee was formed, however, for interventions under the economic governance policy component. Georgia's deputy minister of finance said he had recommended a steering committee for the project when it started, but his recommendation was not accepted. He said that as a member of a steering committee for the previous USAID/Georgia economic growth project on business climate reform, he had found the steering committee valuable in enabling the government to establish priorities.

The chief of party agreed that the steering committee suggested by the deputy minister of finance had not occurred for the project. She stated it was possible that the mission decided not to have a Georgian Government steering committee, to have stronger control itself over the activities the project would address. She noted that when the project started, everyone assumed the deputy minister of finance would be the coordinator for the Government of Georgia because he had been the coordinator for the previous project on business climate reform. He had been heavily involved with the project and had exercised significant influence in determining what activities it would address. When the project began, according to the chief of party, the mission again designated the deputy minister of finance as the point of contact, but did not want project officials meeting with him or any Georgian Government official without a USAID representative along during the project's first year.

It is unclear to what extent personnel issues discussed in the mission's Contractor Performance Assessment Report, which led to replacing the project's chief of party by the end of the project's first year, might explain why the mission did not establish a steering committee. Mission officials did not give a reason for not having a steering committee when we raised the issue at our exit conference. However, the mission director stated that it would appear to make sense to have a steering committee that would enable the Georgian Government to better coordinate the positions of its various agencies.

As a result of not having a steering committee, at least one government agency bypassed the deputy minister of finance and promoted an intervention that did not fit into any of the areas targeted by the project's contract for economic interventions. The deputy minister of finance said he did not know about the project's civil aviation policy intervention until it was drafted. The chief of party confirmed that the Ministry of Economy had advocated for the civil aviation intervention directly to the project without the deputy minister of finance's involvement. However, she and the COR expressed reservations as to whether a steering committee would be the right solution at this midpoint in the 4-year project. They agreed that a steering committee might have been useful in the first year, as the project worked to identify its economic governance interventions. However, they questioned whether establishing a steering committee at this time would be more disruptive than beneficial, given that most economic governance interventions had already been identified.

At our exit conference, the mission director said the mission's work would be easier on many fronts if the Government of Georgia could speak more with one voice regarding its priorities, and that its difficulty in doing so is a challenge that the mission has been working on across the range of its activities. To encourage such coordination, we make the following recommendation.

> ***Recommendation 4.*** *We recommend that USAID/Georgia establish a mechanism to bring Government of Georgia agencies together to prioritize interventions under the Economic Prosperity Initiative's economic governance component.*

Reporting on Two Goals Was Not Consistent With Contract

The contract states that the project's success will be measured by attaining its five goals, italicized below. For three of these, the contract specifies quantitative targets. For the first two, it states that USAID will approve semiannual targets. Each goal is followed with a brief summary of progress achieved, as reported in the June 2012 PMP update.

1. *Increased Productivity: Semiannual increase in productivity in targeted sectors consistent with USAID-approved semiannual targets*. The project reported meeting its benchmark for increases in productivity targets across all its market sectors.

2. *Increased Employment: Semiannual increase in employment in targeted sectors consistent with USAID-approved semiannual targets*. The project reported an increase of 1,408 jobs (an increase of 17 percent).

3. *Increased Foreign Debt and Equity Invested in Georgia: 10 major international investment transactions completed and attributable to assistance received from the project; $500 million investment attributable to project assistance, $100 million of this in the agricultural sector*. The project reported a total of $40.4 million in foreign investments and commitments, or 8 percent of its $500 million target, including three large transactions. The project's quarterly report for April 1–June 30, 2012, updates these numbers, reporting a total of $59.3 million in foreign investments and commitments, or 12 percent of its target, including five large transactions. The report does not update the numbers for the other four goals.

4. *Increased Access to Local Finance: $200 million in capital attributable to the project assistance lent to enterprises operating in targeted sectors*. The project reported achieving a total of $80.7 million in domestic finance available in the economy (including investments and commitments, loans, and leasing products), representing about 40 percent of its $200 million target.

5. *Increased Exports: $150 million in exports facilitated and attributable to project assistance. 100 companies in targeted sectors have significantly enhanced capacities to export products and services*. The project reported $65.7 million in exports across its targeted market sectors, representing about 44 percent of its $150 million target. It also reported providing export-focused technical assistance to 94 firms.

As shown above, the project reported progress achieved as a percentage of a target for its last three goals. However, it could not do so for its first (productivity) and second (employment) goals, contrary to contract provisions, because the mission did not approve quantitative targets at the level of those goals. Moreover, the mission did not approve semiannual targets for increased productivity and employment at any level, and so did not accord with the contract provisions shown above for EPI's first two goals.

In explaining why they did not approve semiannual targets for increased productivity and employment, mission officials said they did not know initially which market sectors the contractor would select in the agricultural and nonagricultural private sector components. Therefore, they decided to postpone setting targets until the selections were made. After the contractor made the selections and began implementation, the mission decided to set annual rather than semiannual targets to reduce the administrative burden of collecting data that are not necessarily meaningful to USAID; USAID tracks and reports performance annually.[3] Moreover, data for some performance indicators are only available annually.

As to why the project does not have a quantitative target for its productivity high-level goal, mission officials explained that "increased" is the only target possible at that high level because there is no way to aggregate performance indicators that measure improvements in productivity by market sector. For example, increased productivity for hazelnuts is measured by increased yield of crop production per hectare, while increased productivity in the transportation sector is measured by increased numbers of loaded trucks transporting goods per year. This explanation corresponds to the June 2012 PMP update, which states, "Given the different productivity measures, a cumulative productivity figure for all [project market sectors] cannot be added up."

For the project's employment high-level goal, mission officials said they did not approve a quantitative target for the agricultural private sector component because that component "has been largely focused on existing producers and helping them increase farm yields, which does not translate into employment generation." For the nonagricultural private sector component, the mission approved a Year 2 target of 637 new jobs created. The project had exceeded that target by the time it issued its June 2012 PMP update, which mentions generating 837 new jobs in the nonagricultural private sector component and 571 new jobs in the agricultural private sector component (206 in the hazelnut sector and 365 in the greenhouse sector).

Without quantitative targets for the project's productivity and employment high-level goals, mission officials said they would measure increases in productivity and employment in targeted market sectors. However, unless the mission sets targets for the increases, the project cannot report whether increases are "consistent with USAID-approved . . . targets in accordance with the contract." Therefore, we make the following recommendations.

> ***Recommendation 5.*** *We recommend that USAID/Georgia approve in writing quantitative performance targets for all market sectors in which it measures productivity and employment increases attributable to the Economic Prosperity Initiative.*
>
> ***Recommendation 6.*** *We recommend that USAID/Georgia modify the contract to replace "USAID-approved semi-annual targets" with "USAID-approved targets set at the appropriate frequency for each market sector in which USAID measures productivity and employment increases attributable to the Economic Prosperity Initiative."*

[3] Section F.5 ("Reports and Deliverables or Outputs") of the contract, however, requires the contractor to collect and submit to the mission all applicable PMP indicator data twice during the fiscal year.

Contractor Reported Questionable Results

In reporting progress on contract targets for foreign investment and exports, the contractor counted results that are questionable. Specifically, the contractor counted:

- Commitments to invest in the future, in addition to completed investments, toward meeting the contract's foreign investment target of "$500 million investment attributable to EPI assistance." The project's quarterly report for April 1–June 30, 2012, reports achieving $59.3 million in foreign investment and commitments, 12 percent of the contract's $500 million target. Of that amount, according to mission officials, completed foreign investments accounted for $25.8 million, and commitments to invest in the future accounted for the remaining $33.5 million.

- Increased tourism in Georgia, and increased Georgian production of greenhouse vegetables consumed in Georgia, toward meeting the contract's target of "$150 million in exports . . . facilitated [by] and attributable to EPI assistance." The quarterly report for April 1–June 30, 2012, reports achieving $65.7 million in exports, 44 percent of the contract's $150 million target. Of that amount, wine tourism in Georgia accounts for $33.3 million, event tourism in Georgia accounts for $18.9 million, production of greenhouse vegetables consumed in Georgia accounts for $3.7 million, and exports account for the remaining $9.8 million.

The chief of party and the COR said if project efforts result in a reasonably firm commitment to invest, the project should be able to take credit for the commitment, even though the investment itself may take years to complete.

The COR also said the project should be able to count increased tourism and increased production of greenhouse vegetables consumed in Georgia because these activities reduce the country's high trade deficit, which is one of the main challenges for its economy. According to the leader of the nonagricultural private sector component, economists generally consider tourism equivalent to exports because tourism results in consumption of Georgian goods and services that would otherwise not have occurred. This logic is taken one step further in the June 2012 PMP update, which states that because greenhouse vegetables consumed in Georgia displace predominantly Turkish imports, this import substitution constitutes an export.

The effect of including the results described above is that the majority of the $59.3 million the project reported toward meeting the contract's $500 million foreign investment target does not represent completed foreign investments, and 85 percent of the $65.7 million the project reported toward meeting the contract's $150 million export target does not represent exports to countries outside Georgia.

To clarify whether the contractor is correctly reporting progress on contract targets for increased foreign investment and exports, we make the following recommendation.

> ***Recommendation 7.*** *We recommend that USAID/Georgia modify the contract to clarify whether the contractor may count investment commitments toward the contract's $500 million foreign investment target, and may count import substitution and increased tourism occurring in Georgia toward the contract's $150 million exports target.*

Ambiguous Contract Provisions Led to Impractical Data Collection

The contractor interpreted two contract provisions as requiring it to collect data that are burdensome to gather and of questionable relevance.

- The first contract provision, on page 9, describes how the project is designed to measure success: "The success of EPI as a whole will be measured by the attainment of the five overarching [goals]. These high-level [goals] shall be tracked by component, subcomponent, and the targeted [market sectors]."

- The second contract provision, on page 26, addresses how frequently the contractor should report on all performance indicators: "The Contractor will collect and submit to USAID/Georgia all applicable PMP indicator data two times per fiscal year."

The first provision could be interpreted to mean that each of the project's five goals must be tracked by those components, subcomponents, and targeted market sectors that can contribute to it. Such an interpretation would accord with ADS 203.3.4.2, which states that performance indicators should measure changes that are clearly attributable to—i.e., that have a logical and causal effect on—the result(s) being measured.

Nevertheless, project officials and the COR said they believe the contract provision requires the project to track *each* targeted market sector, subcomponent, and component to *each* of the five high-level goals. As a result, they said they are spending a considerable amount of time and effort collecting performance data to track activities to goals that they know in advance are not applicable. For example, although the project's agriculture component is largely focused on helping existing producers increase yields, which does not increase employment, project officials and the COR interpret the contract provision as requiring them to track each agriculture market sector to each goal, including the "increased employment" goal. According to the COR, since not every targeted market sector contributes to each of the five high-level goals, this approach "creates an unnecessary data collection burden."

The second contract provision is viewed by project officials as requiring them to report two times per fiscal year on *all* performance indicators. However, it could be argued that the phrase "all applicable" in the contract provision leaves room to exclude PMP indicators for which data cannot be obtained at reasonable cost and in a reasonable time, in accordance with criteria spelled out in ADS 203.3.4.2. Also, ADS 203.3.4.7 states that during project implementation, performance indicators may need to be adjusted if the effort and cost to collect them become excessive.

Nevertheless, contractor officials and the COR view the contract provision on page 26 as requiring the project to report twice per fiscal year on all performance indicators. According to these officials, this requirement is burdensome. A senior contractor official said that staff members spend about 30 percent of their time monitoring and reporting on activities and that the project employs about 28 staff members just to collect and record data for the agricultural private sector component. Collecting semiannual data from farmers is not practical, according to this official, because most farmers are not able to discern their exact yield per hectare from one 6-month period to the next, and produce is typically grown on an annual cycle. For the agricultural component, the contractor would like to employ alternative methods of collecting data, such as sampling, surveying, or conducting focus groups. These methods would be more cost-effective while still providing meaningful data, but are generally not practical semiannually.

To clarify the two ambiguous contract provisions discussed above, we make the following recommendations.

> ***Recommendation 8.*** *We recommend that USAID/Georgia modify the contract provision on page 9 to clarify that the contractor is required to track each high-level goal by the targeted market sectors or components that can contribute to it.*
>
> ***Recommendation 9.*** *We recommend that USAID/Georgia modify the contract provision on page 26 to clarify that the contractor can collect and submit performance indicator data to USAID/Georgia annually, if the mission agrees in writing that data cannot practically be collected and submitted twice during the fiscal year.*

Some Contract Requirements and Benchmarks Were Not Met

The first three bullets below discuss contract requirements that the contractor did not meet, and the last bullet discusses a contract requirement that the mission did not meet.

- *The contractor did not set targets as required for selected indicators*. For the economic governance component, the contract requires the contractor to select 15 of 110 indicators in the annual *Global Competitiveness Report* published by the World Economic Forum (WEF). To help the contractor select the indicators, the contract provides a list of some "indicative of the areas that the Contractor might target for improvement," with a Georgia country ranking number for each indicator. The contract also requires the contractor to "quantify the expected change in each identified WEF indicator over the life of the project, and as of project completion."

  The contactor identified 15 indicators, but did not quantify the expected improvement in each. Setting targets for an indicator's country ranking would be meaningless, according to contractor officials and the COR, because the project cannot influence the ranking. The contract's use of ranking numbers is confusing, because ranking numbers change depending on the competitiveness of other countries, and Georgia's ranking could worsen just because the competitiveness of another country increased. The COR said the contract should distinguish between a country's ranking number and its "score," a number also reported in WEF's *Global Competitiveness Report* that a country can improve, even though its ranking number worsens. In any case, the contractor is currently not quantifying expected change in either score or ranking numbers for the 15 WEF indicators it selected, and so is not complying with the contract.

- *The contractor did not meet benchmarks by the contract deadline*. The contract specifies the following subcomponent benchmarks for revenue increases in the agricultural and nonagricultural private sector components:

  – *Agricultural private sector component*. Increase average revenues of 3,000 farms (primarily 5 hectares and more) and 100 agribusinesses by a minimum of 20 percent "by 18 months"; the increase must be sustainable.

– *Nonagricultural private sector component*. Increase average revenues of at least 500 small, medium-size, and large enterprises in targeted nonagricultural sectors by a minimum of 25 percent "by 18 months into the contract," and achieve a minimum annual increase of 20 percent thereafter.

As reported in its June 2012 PMP update, the project did not achieve these targets by 18 months after the contract's September 30, 2010 start date because the contractor spent the first 6 months selecting market sectors to target. The mission did not approve the selected market sectors until April 2011, according to the report, and that is when the project began to implement its work in those sectors. Therefore, the mission agreed to shift the 18-month period to begin on April 1, 2011, and run through September 30, 2012. The COR and project officials said they would like to see the contract deadlines revised to correspond to the mission's decision.

- *The contractor did not meet a contract benchmark relating to large farms*. As discussed above, the contract specifies the following subcomponent benchmark for revenue increases in the agricultural private sector component: "Average revenues across 3,000 farms (primarily 5 hectares or more) and 100 agribusinesses increased by a minimum of 20% as a result of the direct assistance received through [the project] by 18 months; the increase must be sustainable." The contractor has not generated the specified revenue increases for 3,000 farms of primarily 5 hectares or more. According to project officials, in the wake of land distribution after the breakup of the Soviet Union, the number of such large farms is too small for this benchmark to be feasible. The background section of the contract states that, according to data from the Ministry of Agriculture, in 2006 Georgia had 656,000 farms with an average size of 1.7 hectares. The COR and project officials suggested removing reference to 5 hectares in this contract benchmark, so that the project can "focus on subsistence farmers who may transition to become commercial farmers."

- *The mission did not calculate overhead rates as the contract required.* Under Section B.5, "Indirect Costs," the mission reimburses the contractor for "allowable indirect costs." These fall into three categories: (1) Fringe-Staff, (2) Overhead, and (3) General and Administrative. Each is calculated based on rates and bases specified in the contract. Overhead was supposed to be calculated as a percentage of the contractor's direct labor cost. However, the mission's regional financial controller said overhead is instead being calculated as a percentage of the contractor's direct labor cost *plus* Fringe-Staff. When asked why, the regional financial controller said he had asked and was told (he did not indicate by whom) that is the way USAID traditionally calculates overhead. Adding the Fringe-Staff category of indirect cost to the direct labor cost base before calculating overhead does not comply with the contract and, according to the regional financial controller, results in paying the contractor significantly more than the contract allows.

To address the contract noncompliance matters discussed above, we make the following recommendations.

Recommendation 10. *We recommend that USAID/Georgia modify the contract to either clarify or remove the requirement on page 10 that the contractor quantify the expected change in each identified World Economic Forum indicator throughout the project and as of project completion.*

Recommendation 11. *We recommend that USAID/Georgia extend by 6 months deadlines for achieving contract benchmarks for revenue increases in the Economic Prosperity Initiative's agricultural and nonagricultural private sector components.*

Recommendation 12. *We recommend that USAID/Georgia make a written determination as to whether "(primarily 5 hectares and more)" in the first bulleted benchmark on page 16 of the contract is feasible and, if not, delete it from the benchmark.*

Recommendation 13. *We recommend that USAID/Georgia either modify the contract, if it determines that current contract requirements for calculating project overhead rates are incorrect, or determine to what extent it overpaid the contractor in noncompliance with the contract and recover any overpayment.*

EVALUATION OF MANAGEMENT COMMENTS

In its comments on the draft report, USAID/Georgia agreed with all the recommendations. It indicated that it had taken final action on Recommendation 4 and made management decisions on the remaining recommendations. We acknowledge these decisions.

Recommendation 1. USAID/Georgia agreed to approve by the end of March 2013 a method or methods to identify the contribution of economic governance interventions to achieving project goals.

Recommendation 2. USAID/Georgia is in the process of finalizing a new mission order on project design, expected to be approved in January 2013.

Recommendation 3. USAID/Georgia agreed to document by the end of March 2013 its strategy and approach to remain engaged with the Government of Georgia on property rights.

Recommendation 4. USAID/Georgia is now actively engaged with relevant counterparts in the Government of Georgia in prioritizing interventions under the project's economic governance component, which should also help facilitate coordination between these counterparts. Accordingly, final action has been taken on this recommendation.

Recommendation 5. USAID/Georgia agreed to approve quantitative targets for all market sectors in which the project measures productivity and employment increases. These targets will be included in the project's PMP, which is submitted for approval in September of each year.

Recommendation 6. USAID/Georgia agreed to replace by the end of March 2013 contract provisions for "USAID-approved semi-annual targets" with provisions that allow targets to be set at the appropriate frequency for each market sector in which USAID measures productivity and employment increases attributable to the project.

Recommendation 7. USAID/Georgia agreed to modify the contract by the end of March 2013 to remove its $500 million foreign investment target and to clarify that the contractor may count import substitution and tourism revenues toward the contract's $150 million export target.

Recommendation 8. USAID/Georgia agreed to modify the contract by the end of March 2013 to clarify that the contractor is required to track each high-level goal by the targeted market sectors or components that can contribute to it.

Recommendation 9. USAID/Georgia agreed to modify the contract by the end of March 2013 to clarify that the contractor can collect and submit performance indicator data annually if the mission agrees the data cannot practically be collected and submitted twice during the fiscal year.

Recommendation 10. USAID/Georgia agreed to modify the contract by the end of March 2013 to clarify that the contractor will monitor and measure the change in each World Economic Forum indicator over the life of the project, and as of project completion.

Recommendation 11. USAID/Georgia agreed to modify the contract by the end of March 2013 to extend by 6 months deadlines for achieving contract benchmarks for revenue increases in the project's agricultural and nonagricultural private sector components.

Recommendation 12. USAID/Georgia agreed to modify the contract by the end of March 2013 to delete "(primarily 5 hectares and more)" from the first bulleted benchmark on page 16.

Recommendation 13. USAID/Georgia agreed to modify the contract to make it consistent with the contractor's approved Negotiated Indirect Cost Recovery Agreement.

The Audit Performance and Compliance Division of USAID's Office of the Chief Financial Officer will make a determination of final action on completion of the corrective actions. The mission's written comments on the draft report are included in their entirety as Appendix II.

SCOPE AND METHODOLOGY

Scope

OIG conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, in accordance with our audit objective. We believe that the evidence obtained provides that reasonable basis.

The objective of the audit was to determine whether the project was achieving its goals for increasing productivity, employment, foreign investment, access to local finance, and exports. USAID/Georgia is implementing the project through a $40.4 million cost-plus-fixed-fee contract awarded to Deloitte Consulting LLP. The contract is for technical assistance services across three primary components—an economic governance component that targets areas for interventions selected in partnership with USAID and the Government of Georgia, and two private sector components (agricultural and nonagricultural) that target market sectors selected by the contractor. The audit evaluated the project's progress in all three of these components. It also tested data the contractor used to measure progress toward all five of the project's goals, as described at the end of this appendix.

OIG conducted audit fieldwork in Georgia from June 21 to July 19, 2012. We conducted our fieldwork at USAID/Georgia and the implementing partner's office in Tbilisi, and at Georgian Government agencies and beneficiary sites in and around the cities of Tbilisi, Bolnisi, Kutaisi, Batumi, and Poti.

In planning and performing the audit, we gained an understanding of the project's design, principal activities, and progress toward its goals. We also assessed management activities and controls established by USAID/Georgia and the contractor, including the contract and accompanying modifications; annual work plans; PMPs; annual, semiannual, and quarterly performance reports; monthly financial reports; other monitoring reports; and portfolio reviews. We reviewed USAID/Georgia's mission order for monitoring and evaluation, its May 2011 financial review of the contractor, and its January 2012 Contractor Performance Assessment Report. In addition, we assessed the risk of potential problems related to trafficking in persons and gender inclusion, and tested data used by the contractor to measure progress toward the project's goals as described below.

Methodology

To answer the audit objective, we compared the expected results with the reported results. We tracked how USAID/Georgia and the contractor measured progress toward meeting the contract's five goals by reviewing key project documents, such as the contractor's annual work plans, PMPs, and quarterly and annual progress reports. We obtained a broad range of testimonial evidence by conducting interviews with project stakeholders. We interviewed officials from USAID/Georgia, including representatives from the program, contracting, and financial management offices, and USAID's regional legal advisor. We also interviewed the contractor's chief of party and other staff members, including component leads and those responsible for monitoring and reporting.

To gather testimonial evidence regarding how beneficiaries view the contributions that the project has made to its five goals, we met with those benefiting from the project's activities. These included officials from several Government of Georgia agencies, including a chief adviser to the Prime Minister and officials from the Revenue Service, the Georgia National Investment Agency, the Georgian National Tourism Administration, the Civil Registry Agency, Sakpatenti, the Data Exchange Agency, the Adjara Region Minister of Agriculture, and the deputy minister of finance.

We gathered additional observational and testimonial evidence through site visits and interviews from private sector stakeholders and beneficiaries, including.

- Seaport terminal officials at Batumi and Poti regarding project assistance with a trade facilitation system.

- Tourism representatives from hotels, exhibition and conference facilities, tour operators, and others.

- World Bank regional officials in Tbilisi.

- Leasing company representatives benefiting from legal changes facilitated by the project to increase access to finance.

- Agricultural instructors at the project's open-field vegetable knowledge plot in Bolnisi.

- Greenhouse industry representatives in Tbilisi and Tskaltubo.

- Instructors at a farm service center in Adjara that had benefited from project training in growing mandarin oranges.

- Apparel industry representatives in Tbilisi and a vocational school in Kutaisi that received sewing machines and curriculum assistance.

- Participants in a customer service training program sponsored by the project in Batumi.

We tested a judgmental sample of data the contractor used to measure and report progress on its performance indicators for each of the five high-level project goals. We used a modified dollar unit sampling technique that allowed us to test a relatively small number of data collection forms while achieving high audit coverage for each selected performance indicator. The average percentage of total values tested was 86 percent for five selected indicators reported in 2010 and 86 percent for eight selected indicators reported in 2011.

We walked through a typical data-entry screen and noted that the degree to which the computer database fields were standardized was an internal control that reduced risk of inaccurate reporting. We also noted that the contractor's beneficiary forms and computer database track gender for certain types of data (e.g., owners, employment, and training participants), and that the contractor had reported on certain data limitations, in particular with respect to agricultural data.

MANAGEMENT COMMENTS

USAID | CAUCASUS
FROM THE AMERICAN PEOPLE

MEMORANDUM

Date: December 11, 2012

TO: IG/A/PA, Director, Steven Ramonas

FROM: USAID/Caucasus-Georgia, Mission Director, Stephen M. Haykin /s/

SUBJECT: Mission's Comments on Audit of USAID/Georgia's Economic Prosperity Initiative (Report No. 9-114-13-00X-P)

This memorandum transmits the Mission's comments on the subject audit of USAID-funded Economic Prosperity Initiative implemented by Deloitte in Georgia. The Mission will address all thirteen recommendations, and has already taken steps to close them.

Plan for Corrective Actions with Target Completion Dates

1. We recommend that USAID/Georgia approve a method for attributing to economic governance interventions progress toward project goals and modify the contract as necessary to enable the method to be implemented.
   - Mission concurs with the recommendation to approve methods to identify the contribution of individual economic governance interventions (*e.g.*, implementing risk-based audit practices, upgrading trademark registration system, implementing trade facilitation system) toward achieving project goals. Mission is working with the Economic Prosperity Initiative activity (EPI) implementing partner to identify expected economic impacts. This action will be complete by the end of Q2/FY13.

2. We recommend that USAID/Georgia issue in writing guidance on project design incorporating into contracts measures of success tailored to the feasibility of performance data collection and attribution for each project component.
   - Mission concurs that the feasibility of performance data collection and attribution for new activities needs to be assessed prior to incorporating into contracts. Mission's analytical requirements for project design were revised and expanded in 2011 with the release of new agency guidelines. These guidelines include requirements for more rigorous analyses (including cost benefit analysis), development of logical frameworks, and preparation of performance management plans. The project design guidance clearly seeks to attribute results to project

components and differentiates the performance management plan to track progress within the project. Mission is in the process of finalizing a new Mission Order on project design to provide clear guidance to the Mission's Development Objective teams. The Mission Order is in clearance and will be approved in January 2013.

3. We recommend that USAID/Georgia develop a written strategy for strengthening property rights that incorporates the full range of activities described on page 12 of the contract.
   - Mission concurs and will document its strategy and approach to remain engaged with the Government of Georgia (GOG) on property rights issues. However, the viability of implementing a strategy and approach is dependent on buy-in from the Government of Georgia, which prior to the change of governments in October 2012, was largely lacking. This action will be complete by the end of Q2/FY13.

4. We recommend that USAID/Georgia establish a mechanism to bring Government of Georgia agencies together to prioritize interventions under the Economic Prosperity Initiative's economic governance component.
   - Mission concurs that prioritizing interventions with the Government of Georgia is necessary to provide direction to the EPI activity. Mission is engaged in regular discussions with the ministers, first deputy ministers, and or deputy ministers at the Ministries of Agriculture, Economy and Sustainable Development, Finance and Justice; all key interlocutors for the economic governance component. As the 'mechanism' to date has been the Mission's active engagement with GOG counterparts this recommendation is considered adequately addressed.

5. We recommend that USAID/Georgia approve in writing quantitative performance targets for all market sectors in which it measures productivity and employment increases attributable to the project.
   - Mission concurs and will approve in writing quantitative targets for all market sectors in which the EPI activity measures productivity and employment increases. These will continue to be included in the PMP, which is submitted for approval together with annual work plan in September of each year.

6. We recommend that USAID/Georgia modify the contract to replace "USAID-approved semiannual targets" with "USAID-approved targets set at the appropriate frequency for each market sector in which USAID measures productivity and employment increases attributable to the Economic Prosperity Initiative".
   - Mission concurs and will modify the contract accordingly. This action will be complete by the end of Q2/FY13.

7. We recommend that USAID/Georgia modify the contract to clarify whether the contractor may count investment commitments toward the contract's $500 million foreign investment target, and

may count import substitution and increased tourism occurring in Georgia toward the contract's $150 million exports target.

- Mission concurs that it would be appropriate to reflect in the contract whether investment commitments should be counted against the high level result of $500 million in foreign direct investment, and whether import substitution and tourism revenues should be counted against the high level result of $150 million in exports. Mission will modify the contract to include import substitution and tourism revenues against the high level result of $150 million in exports. However, Mission has determined that the achievement of the high level result of $500 million in foreign direct investments is outside the manageable control of the EPI activity and has decided to remove this result from the contract. This result will become a context indicator in the EPI activity's PMP. This action will be complete by the end of Q2/FY13.

8. We recommend that USAID/Georgia modify the contract provision on page 9 to clarify that the contractor is required to track each high-level goal by the targeted market sectors or components that can contribute to it.
    - Mission concurs. This action will be complete by the end of Q2/FY13.

9. We recommend that USAID/Georgia modify the contract provision on page 26 to clarify that the contractor can collect and submit performance indicator data to USAID/Georgia annually, if the mission agrees in writing that data cannot practically be collected and submitted twice during the fiscal year.
    - Mission concurs. This action will be complete by the end of Q2/FY13.

10. We recommend that USAID/Georgia modify the contract to either clarify or remove the requirement on page 10 that the contractor quantify the expected change in each identified World Economic Forum indicator throughout the project and as of project completion.
    - Mission concurs and will modify the contract to clarify that "The contractor will monitor and measure the change in each identified WEF indicator over the life of the project, and as of project completion." Mission recognizes that changes in WEF are outside of the manageable control of the EPI activity, however, Mission wants changes to be measured and included in the activity's PMP as context indicators. This action will be complete by the end of Q2/FY13.

11. We recommend that USAID/Georgia extend by 6 months deadlines for achieving contract benchmarks for revenue increases in the Economic Prosperity Initiative's agricultural and nonagricultural private sector components.
    - Mission concurs and will modify the contract accordingly. This action will be complete by the end of Q2/FY13.

12. We recommend that USAID/Georgia make a written determination as to whether "(primarily 5 hectares and more)" in the first bulleted benchmark on page 16 of the contract is feasible and, if not, delete it from the benchmark.

- Mission concurs and will modify the contract to delete "(primarily 5 hectares and more)". This action will be complete by the end of Q2/FY13.

13. We recommend that USAID/Georgia either modify the contract, if it determines that current contract requirements for calculating project overhead rates are incorrect, or determine to what extent it overpaid the contractor in noncompliance with the contract and recover any overpayment.
    - The Mission concurs. The contract inadvertently included language inconsistent with the contractor's NICRA. The Mission will modify the contract to make it consistent with the approved NICRA.

Sincerely,

Stephen M. Haykin
Mission Director
USAID/Caucasus

Eight Areas Targeted by Contract for Economic Governance Interventions and Associated Action Plans

Eight Areas Targeted by the Contract for Economic Governance Interventions	Associated Action Plans
1. Improved Regulatory Environment and Licensing	Building Code Development. The Urbanization and Construction Department of the Ministry of Economy and Sustainable Development and USAID EPI agreed on this annual action plan covering the period 10/1/11 to 9/30/12. EPI assisted in translating and reviewing the International Building Code and adapting it to Georgia. EPI has completed the first draft of the structural code and submitted it to the Government of Georgia for endorsement. Georgia's Accreditation and Conformity Assessment Systems. The Georgian Accreditation Center and USAID EPI agreed on this annual action plan covering the period 10/1/11 to 9/30/12. EPI collaborated with the American National Standards Institute to help Georgian laboratories and product certification bodies obtain international accreditation and meet internationally recognized food safety standards for testing and certification. EPI completed planned training and anticipated that accreditations for a multitest laboratory and a wine laboratory would be approved by September 2012.
2. Strengthen Property Rights	Intellectual Property Rights. Sakpatenti (the Georgian equivalent of the U.S. Patent and Trademark Office) and the project agreed on this annual action plan covering the period 10/1/11 to 9/30/12. EPI worked with Sakpatenti to streamline registration processes and develop an electronic filing system for IPR applications. Deloitte conducted public outreach and training on e-filing and has seen a 15 percent increase in the number of IPR registrations from April to June 2012.
3. Enhance Investment Sector Economic Governance	Investment and Export Promotion. The Georgian National Investment Agency and USAID EPI agreed on this annual action plan covering the period 10/1/11 to 9/30/12. The action plan overlaps with EPI interventions relating to tax reform, customs, IPR, and the regulatory environment. In addition to developing investment promotion strategies for targeted sectors, EPI completed recommendations to streamline the Accounting and Auditing Law adopted by the Parliament of Georgia and to simplify reporting standards for small and medium-sized enterprises. EPI is also working to strengthen the Georgian National Investment Agency's capacity for targeted investment promotion.

4. Enhance Economic Governance in the Area of International Trade and Customs 5. Strengthen Tax Systems	Tax Systems and Customs Administration and International Trade. This action plan covers two areas targeted by the contract for interventions, since the Georgian Revenue Service is the beneficiary for both areas. The Georgian Revenue Service and USAID EPI agreed on this annual action plan covering the period 10/1/11 to 9/30/12. EPI's interventions in these areas include development of a trade facilitation system and reforms to tax and customs administration.
6. Strengthen Procurement and Privatization Systems	State Procurement System. The State Procurement Agency and USAID EPI agreed on this annual action plan, covering the period 10/1/11 to 9/30/12. EPI developed a supplier guide entitled "Doing Business with the Georgian Government" and conducted trainer-based sessions on Georgia's e-procurement system. After providing training to farmers and businesses, EPI will complete activities under this action plan by the end of 2012. Privatization System. The Privatization Department of the Ministry of Economy and Sustainable Development and USAID EPI agreed on this annual action plan, covering the period 10/1/11 to 9/30/12. Much of the activity envisioned for EPI was handed off to the ministry after it decided to implement the automated state property management system in-house. EPI's role is now limited to providing quality control services.
7. Improve Agricultural Policy Environment	Agricultural Policy. This is the only plan that does not state that a Georgian Government agency has agreed to it. Instead, the plan states that "USAID EPI, in consultation with the Ministry of Agriculture, Regional Ministry of Adjara, and other agricultural stakeholders, has developed" the action plan, covering the period 10/1/11 to 9/30/12. The Ministry of Agriculture has delayed the plan for a year, and EPI is handing off development of the initial agricultural strategy to the Ministry of Agriculture.
8. Establish a Core Team of Local Specialists to Assist in Implementing Reforms	The contract does not require an action plan for this intervention; instead, it requires the contractor to establish and use a core team of local specialists to assist the Government of Georgia with new reform priorities. EPI reported in its July 2012 quarterly report that it continues to increase capacity of its reform specialists through on-the-job training and participation at relevant conferences and workshops. Several Georgian nationals have moved into leadership positions.

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