

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

TESTIMONY OF ROGER C. VIADERO
INSPECTOR GENERAL
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U.S. DEPARTMENT OF AGRICULTURE

Before the

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON AGRICULTURE

on the

RUSSIAN FOOD AID ASSISTANCE AGREEMENTS

October 6, 1999



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MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I appreciate the opportunity to be here today to testify about our work on food aid assistance to Russia. I will discuss briefly our work related to the 1992-1993 food aid assistance program to the Newly Independent State (NIS) of the former Soviet Union and then describe our current efforts on the 1999 Russian food aid assistance program. With me today is James R. Ebbitt, Assistant Inspector General for Audit.

Recently the media has been reporting possible money laundering through U.S. banks of funds provided by the U.S. Government to the Russian Federation. In the last several weeks, there have even been unconfirmed reports that funds derived from USDA-donated commodities have been diverted and ended up in these money laundering schemes. Some of the articles have alleged that there may have been illegal diversion of or unapproved uses of these U.S. agricultural commodities provided under the food aid assistance agreements.

While we have not been able to confirm the kinds of widespread abuse some of these articles allege for either the earlier 1992-1993 program or the current program, we are very concerned about these allegations. Because of the adverse impact they may have on the U.S.

Department of Agriculture (USDA) program, we have been monitoring the situation and we

have kept the Secretary and the Congress informed as to the information that we have gathered.

To set the stage for a discussion of our work on the current program, I would like to briefly discuss our earlier work.

OIG's Earlier Efforts

Since 1994, my office has been involved in evaluating various aspects of the Department's \$1.9 billion in food aid assistance to the Newly Independent States (NIS) of the former Soviet Union. We have issued six reports describing the results of our reviews. Our prior reports on the earlier food aid agreements identified that cooperating sponsors (either foreign governments or private voluntary organizations) did not comply with their agreements; they (1) did not file required logistical and financial reports, (2) did not effectively control accountability for the commodities they received, and (3) improperly used monetized proceeds. (The sales process of converting commodities to cash is called "monetization.") In addition, we found that the Department needed to strengthen its management controls over the food assistance program primarily through stronger monitoring. In response to our recommendations, changes made on the early 1990's programs served as a point to build from in 1999.

1999 Russian Food Aid Agreements

In November 1998 the Governments of the United States of America and the Russian Federation announced negotiations on providing American food assistance to the Russian Federation. As a result of these negotiations, the two Governments entered into two food aid assistance agreements in December 1998 under the authority of Public Law (P.L.) 480, title I, and section 416(b). Donations of 1.5 million metric tons (MT) of wheat were provided to the Russian Government under section 416(b), and an additional 1.5 million metric tons of various commodities were financed under P.L. 480, title I, under concessional terms. Subsequently, agreements were signed with private voluntary organizations (PVO) operating in Russia to donate approximately 100,000 MT of various commodities. Amendments to the P.L. 480, title I, and section 416(b) agreements were signed in February, March, and May 1999. These amendments reallocated some commodities and clarified agreement costs on transportation.

According to FAS, the program goals of these two massive food aid assistance agreements were (1) to provide contributions to the Russian pension fund and (2) to provide food directly to the most needy groups. The estimated total cost for all the agreements is in excess of \$1.0 billion; the estimated total cost of the commodities is \$746 million. (These figures are as of September 21, 1999.) 2.6 million MT of the commodities were authorized to be monetized with estimated proceeds totaling approximately \$403 million.

OIG's Involvement in Monitoring the
Implementation of the 1999 Russian Food Aid Agreements

Because of the issues raised during our reviews of the Russian food aid assistance in 1992-1993 and because of the magnitude of food aid assistance (in excess of \$1.0 billion) to the Russian Federation, we decided to take a proactive approach in monitoring the implementation of these new agreements. Beginning in December 1998, my staff initiated meetings with FAS Export Credit officials to obtain specific details about implementation of the agreements, particularly FAS' efforts to implement procedures to minimize potential misuse and improper losses of commodities (in our reports on the 1992-1993 agreements, for example, we recommended that FAS strengthen controls over inventory accountability). Beginning in January 1999, members of my staff have regularly attended the weekly (currently biweekly) meetings of the USDA Washington, D.C., working group, which includes Foreign Agricultural Service (FAS) and Farm Service Agency (FSA) staff.

We wanted to make sure that the concerns we noted in our previous reviews would be addressed in this program. FAS needed to make sure that there were strong accounting controls over the flow of monetized proceeds, and it needed to be concerned about the financial viability and integrity of the Russian financial institutions that these funds would be flowing through. Reports of the recent collapse of a number of Russian financial institutions and questionable transfer of program funds out of Russia heightened these concerns.

OIG's Comments on FAS' Monitoring Plan

In our meetings with the FAS General Sales Manager and his Export Credit staff, we agreed to provide our comments on FAS' monitoring plan, dated January 19, 1999. In our February 25, 1999, memorandum to FAS, we commended its efforts in developing the monitoring plan (FAS had no such a plan for its 1992-1993 food aid assistance), and we raised our concerns to FAS to strengthen its monitoring process. Mr. Chairman, with your concurrence, we would like to submit for the record a copy of our February 25, 1999, memorandum to the FAS General Sales Manager.

In our February 25 memorandum, we recommended that FAS (1) immediately increase the size of its monitoring staff detailed to Russia, (2) quickly sign specific agreements with or get commitments from other government and private entities who said they would commit staff to assist in the monitoring, and (3) work with the Commodity Credit Corporation (or other funding sources) and the assisting agencies to develop specific budgets for the monitoring efforts. We also recommended that FAS ensure that qualified staff were selected and trained if contracted local personnel were used in the monitoring efforts. Since approved workplans (submitted by the Russian Government showing the distribution of the commodities) are critical in tracking and monitoring all shipments of commodities, we recommended that FAS develop a system to ensure that no purchase authorizations or shipping tenders were issued without approved workplans and that the most up-to-date workplans were then circulated and coordinated with all FAS monitoring staff.

We also made a number of recommendations to strengthen the monitoring process itself. For example, we recommended establishing threshold criteria for referring any significant discrepancies for immediate consideration to the Moscow Bilateral Working Group. (The Moscow Bilateral Working Group is composed of representatives from U.S. Government agencies at the Moscow U.S. Embassy and from Russian Federation Government agencies.) FAS needed to establish timely reporting requirements and ensure that all related tracking reports were properly reconciled to the original shipment reports. FAS needed to specify a minimum level of spotchecks or onsite visits to be made as shipments arrived and were transported in Russia and a selection methodology for selecting sites for such monitoring visits.

In the sensitive area of accounting for the proceeds from the monetized commodities, we recommended that FAS (a) immediately determine from the Russian Government where (or with whom) the "Special Account" would be established in which monetized proceeds would be deposited and (b) verify the financial viability and integrity of the institution, if a private Russian banking institution was used. Concerning deposits to the Pension Fund, we suggested that the monitoring plan specify that for each shipment, the Moscow FAS monitoring staff be responsible to track the deposits made to the Special Account (and eventually to the Russia Pension Fund) and to reconcile these deposits against the estimated rouble value approved by the USDA Minister Counselor for Agricultural Affairs. FAS also needed some assurance from the Russian Federation as to the disposition of monetized proceeds to the Pension Fund.

Further Actions by FAS To Clarify and Strengthen
Its Monitoring Plan

Over the months since January of this year, we obtained additional information from FAS officials and from the USDA Washington, D.C., working group as to how FAS was strengthening its monitoring efforts and its team in Russia. In addition to the original three onsite staff (including the Minister Counselor for Agricultural Affairs), FAS decided to detail five additional USDA employees to Russia. FAS announced that it was contracting with a private consulting firm to provide training to its monitoring team and to provide administrative support to its Moscow monitoring team. FAS officials stated that it was working with the accounting officials of the Commodity Credit Corporation to resolve the budget and interagency funding issues related to funding the monitoring efforts. And FAS officials also announced that it was increasing the number of onsite monitoring visits, possibly to as much as 15-20 percent of the shipments.

On May 3, 1999, FAS formally responded to our February 25 memorandum, officially confirming many of the actions that I have just discussed. With your permission Mr. Chairman, we would like to submit FAS' response for the record. In response to our concern about strengthening its monitoring team, FAS stated that it had detailed five USDA employees to its monitoring team in Russia (in addition to its three staff that were previously onsite in Russia) and agreed to continually evaluate the size of its monitoring team in order to ensure adequate accountability. FAS reported that the Russian Interior Ministry had formed a

special force that could provide extensive additional monitoring effort. FAS had worked with the U.S. Ambassador to the Russian Federation to establish a "country team" approach to its monitoring effort, ensuring that all American officers connected with the U.S. Embassy would conduct monitoring visits, if possible. FAS had also exchanged memorandums with the U.S. Agency for International Development regarding its support of the monitoring effort. In addition, FAS had established an operating budget of \$2 million for fiscal year 1999 to fund the current monitoring plan. FAS agreed to develop criteria in selecting contract personnel to be used in the monitoring and had developed guidelines for performing onsite inspections to ensure consistency in monitoring activities among all personnel.

FAS also assured us that the Minister Counselor for Agricultural Affairs would ensure that all revised and approved workplans were distributed to the appropriate parties; furthermore, FAS had begun to put some of this information on its Internet Home Page so that it would be available to all interested parties. FAS stated that no freight tenders or invitations to bid would be issued without approved workplans that had been reviewed by either the General Sales Manager or the Deputy Administrator for Export Credits. In clarifying the amount of monitoring, FAS stated that it planned to monitor as many ship arrivals and discharges as possible, and it planned to monitor substantially more than 10 percent of shipments to Russia. Its monitoring team had developed a standard report to be used on all monitoring visits by all personnel.

In addition, FAS stated that it would require its monitors to review original records as part of onsite visits and would be coordinating the onsite visits to match the delivery of the commodities to their destinations or recipients.

As for the financial accounting concerns we raised, FAS stated that it, the Moscow Bilateral Working Group and the Treasury Attache at the U.S. Embassy would continue to work on the necessary financial reports. FAS assured us that the Minister Counselor for Agricultural Affairs would be responsible for reconciling deposits into the Special Account against the estimated rouble proceeds for each shipment. According to FAS' response, the Special Account will reside only with the Russian Treasury and the Central Bank in Moscow; that is, the Special Account will not be established in a private Russian banking institution. FAS also assured my office that the Minister Counselor for Agricultural Affairs would verify the final disposition of any funds remaining in the Special Account when the program ends.

In addition, FAS agreed with our reporting concerns; all significant discrepancies will be immediately transmitted to the monitoring team headquarters for analysis and resolution, and reports will be required to be submitted in a timely manner.

As shown in its written response, FAS addressed as many of our concerns and issues that we had raised on its initial monitoring plan. Now I would like to discuss our trip to Moscow in May 1999 to observe the implementation of the food aid agreements.

OIG's Participation in the U.S. Government Interagency Team Trip

Earlier this year, FAS invited OIG to participate with a U.S. Government Interagency Team trip to Russia. The trip occurred from May 3 to May 14. Because one of the primary objectives for this trip was to monitor and evaluate the implementation of the food aid agreements between the two Governments and because we had already raised concerns about the implementation of the 1992-1993 food aid agreements, we believed our presence on the team could be beneficial.

I would like to emphasize that our participation on this Interagency Team was as an observer. The trip was of a short duration and did not plan or allow for completion of audit fieldwork. The itinerary, established by FAS, included a variety of meetings with representatives from private and Government (American, Russian, and European Union) entities and site visits to Russian grain terminals and other processing plants and to a senior citizens' facility where we were able to observe many of the controls and procedures that the Russian Federation had established. Furthermore, we did not have an opportunity to review or track the processing of the monetized proceeds to the Russian Government Pension Fund, interview FAS' onsite monitors, or review FAS' tracking records other than those provided in the information packet provided to the Interagency Team members. Nevertheless, my representative on this Interagency Team trip was able to corroborate much of the information that FAS had been providing us on its monitoring efforts including the utilization of the U.S. Embassy staff in its efforts and the coordination of its efforts with entities in the Russian Federation.

We documented our observations on this trip in a memorandum to FAS dated August 13, 1999. With your permission Mr. Chairman, I would like to submit our trip memorandum for the record. In summary, we reported on a number of positive efforts that FAS had made to ensure that the goals of the food aid assistance agreements -- to provide funds to the Russian Pension Fund and to provide food to the most needy recipients -- were being carried out. We observed what appeared to be a high level of commitment to the agreements at all levels and among all parties, from Russian Government officials to FAS monitors. Based on our limited opportunity to inspect the controls and documents at the grain warehouses and mills and at a social welfare institution, we concluded that the controls appeared to be providing some reasonable assurance that the commodities were being used for the intended purposes and were getting to the intended recipients. Additionally, we found that the staff of the Moscow U.S. Embassy were coordinating their efforts to provide the necessary monitoring of the program. Finally, we observed that a good working relationship had been established between FAS and the European Union (EU) staff in Moscow.

Mr. Chairman, we caution, however, that our comments are based on interviews and very limited record reviews and physical observations. While we believe that FAS has made a significant effort to establish controls, from our short visit there we cannot provide assurance that the controls are fully in place and working.

Our trip memorandum did provide some recommendations to FAS on strengthening its food aid program monitoring efforts. We suggested that the Moscow Bilateral Working Group

document more completely the information it uses to make decisions (such as changes in the distribution plans) and the followup work it performs based on these decisions; it was unclear, for example, whether the Group had performed adequate followup to ensure that the Russian Ministry of Agriculture had processed all of the financial guarantees. In the event that any of the regional governments and corporations did not pay for the commodities received, these financial guarantees would have allowed recovery of the sales proceeds by authorizing the Russian Finance Ministry to offset these accounts payable against funds due to the regions from the Russian Government. In addition, this Working Group needed to better define, coordinate, and document assistance in monitoring the food aid effort received from other Russian ministries and the European Union Moscow representatives to ensure that its monitoring efforts were being carried out efficiently and effectively. FAS itself needed to ensure that changes to the food aid distribution plans were controlled, that its tracking reports contained clear, complete, and accurate information, and that local Russian media representatives were aware that food distribution information was available on the Internet. Finally, in order to ensure better utilization of its monitoring resources, FAS needed to determine the specific level (and approach) of shipment monitoring that would be acceptable.

To summarize Mr. Chairman, we concluded from our limited observations on this Interagency Team trip and our limited review of FAS' documents, that FAS had made a significant leap forward in implementing adequate controls and monitoring procedures to ensure that the food aid programs are being properly carried out. As we pointed out previously, our reports on the earlier 1992-1993 food aid agreements noted a general lack of adequate accountability

controls and at best a very nascent monitoring process. Under the current food aid agreements, FAS has acted quickly to supplement its monitoring efforts and has willingly modified its monitoring plan to resolve the concerns raised by my office and other parties, including other members of this Congress. FAS needs to sharpen the focus of its monitoring efforts and determine whether its resources are being used most efficiently, but as we have observed, all involved parties appear committed to ensuring that the program goals are properly carried.

USDA Food Aid Assistance Proceeds and Transfer of Funds Abroad

Earlier in our testimony, we discussed ongoing media allegations about possible illegal "laundering" through American banks of proceeds from the USDA food aid assistance program. FAS needs to be ever vigilant to prevent this from happening, but with one exception which I will discuss, we **have no evidence nor do we have any direct knowledge** of any money laundering involving USDA food aid program funds. However, we would also emphasize that, **due to the breakdowns of internal control procedures (and in some cases, the absence of adequate control procedures)** under the 1992-1993 food aid assistance program that we had previously reported on, we cannot say with absolute assurance that such money laundering involving proceeds from earlier monetized USDA-donated commodities did not occur or is not occurring. Regarding the current program, because of the problems in the Russian banking system and because the FAS current level monitoring effort cannot provide

absolute assurance such money laundering schemes are not occurring, we also cannot provide this assurance.

The exception I referred to involves a private voluntary organization (PVO) called the Fund for Democracy and Development (FDD). Recently, FAS provided to my office a stack of copies of cablegrams and letters showing a questionable transfer of proceeds derived from USDA-donated commodities from a banking institution in Russia to a foreign banking institution. We are conducting a criminal investigation of this matter. FDD is headquartered in Washington, D.C., and had received \$19.6 million in USDA commodities under four FAS commodity donation agreements in fiscal years 1993 and 1994 to carry out both humanitarian and developmental programs in Russia. One of the agreements authorized monetization of the commodities (which had a Commodity Credit Corporation-acquisition cost of \$13.8 million) with the proceeds to be used by FDD for approved developmental projects in Russia. The net sales proceeds from the monetized commodities totaled approximately \$3.7 million.

FAS became aware of this questionable transfer in late 1998, but did not notify us until recently. FDD and other parties made attempts to recover the funds. In a letter dated April 6, 1999, FDD notified FAS that it had recovered 50 percent of the questionable transfer and that the recovered funds were deposited in a FDD U.S. bank account. Currently, we have been unable to confirm the recovery of these funds and do not have any information as to the whereabouts of the other half of the transferred amount. We are continuing to monitor FAS' efforts to track and recover these funds.

Suggestions for Future Consideration

Mr. Chairman, through the completion of the current Russian food aid agreements, we will continue to participate in the FAS' Washington, D.C., working group, to provide timely feedback to FAS officials on sensitive issues and concerns, and to provide other assistance, if requested. A large portion of the USDA commodities were purchased and shipped as of September of this year. FAS will need to be vigilant in monitoring the final shipments of the USDA commodities, particularly in guaranteeing that the commodities are received by the intended recipients and in guaranteeing that all the monetary proceeds from the sale of these commodities under the 1999 food aid agreements are eventually deposited in the Russian Pension Fund. The next few months will be just as critical since the majority of the sales proceeds from the monetized commodities will eventually be transferred to the Special Account and, then, to the Russian Pension Fund. As of September 3, 1999, only approximately \$30.3 million of the estimated total proceeds of \$403 million had been forwarded to the Russian Pension Fund. (The estimated total proceeds of \$403 million were calculated as of April 13, 1999.)

Because of the recent rash of media articles alleging illegal transfer of funds or money laundering from Russia involving both Russian and American banking institutions, FAS needs to be particularly wary of proceeds from the sale of commodities flowing through the Russian banking system. FAS needs to provide even greater assurance to both you and the Department that the financial control procedures that it has established are in place and are

working effectively to detect any fraud, waste, or abuse. FAS' Moscow working group will need to work closely with the Government of the Russian Federation to ensure that funds are not diverted or seized as the funds flow through its banking system and to ensure the financial institutions handling the funds are reputable. FAS' monitors will need to closely scrutinize and track the flow of the funds by reconciling the biweekly financial reports against the agreed-to sale prices and the amount of commodities shipped. FAS will need to monitor the sales proceeds, and, if necessary, follow up with the Russian Ministry of Agriculture and its brokers to ensure timely receipt. In the event that receipts are not forthcoming or not timely, FAS will need to work closely with the Russian Federation Government, particularly the Ministry of Finance, to invoke the financial guarantees that were agreed to by all participants. Lastly, FAS will need to continue monitoring the shipments by performing onsite inspections and reconciling the tracking reports.

Mr. Chairman, thank you for the opportunity to present the issues that we identified under the prior Russian food aid agreements and our observations and views on the current food aid agreements. Our goal has always been to ensure the successful accomplishment and the financial integrity of these agreements. This concludes my prepared statement Mr. Chairman. I will be happy to answer any questions you may have.