

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

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

Before the

UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
SUBCOMMITTEE ON PRODUCTION AND PRICE COMPETITIVENESS

on the

DEPARTMENT'S FOOD AID ASSISTANCE PROGRAMS

July 18, 2000



**ROGER C. VIADERO
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U.S. DEPARTMENT OF AGRICULTURE
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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 the Department's food aid assistance programs. I will give an overview of our prior work; briefly summarize our involvement with the 1999 Russian Food Aid Agreements, our review of private voluntary organizations (PVO's) that administer some of the Department's food aid assistance programs, and our investigative efforts; and finally, highlight the Department's actions to correct the concerns we have raised. With me today is James R. Ebbitt, Assistant Inspector General for Audit.

OIG's Efforts

Since 1994, my office has been involved in evaluating various aspects of the Department's food assistance programs. We have evaluated and monitored the almost \$3 billion in food aid assistance in the Newly Independent States (NIS) of the former Soviet Union. We have also reported on the sufficiency of the Department's controls over PVO's use of Food for Progress (FFP) program grant funds. For fiscal year's (FY) 1996 and 1997, the Department had 61 FFP grant agreements with 27 PVO's that provided over 336,000 metric tons (MT) of commodities and almost \$18 million in administrative funding. We have issued six reports describing the results of our reviews.

We have also investigated several elaborate schemes to defraud the Department's export programs. Our reports on food aid assistance identified that cooperating sponsors (foreign governments and PVO's) did not always 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) in some instances, 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. The Department has implemented positive changes in response to our recommendations.

1999 Russian Food Aid Assistance Agreements

In December 1998, the Governments of the United States and Russia entered two food aid agreements that provided over 3 million MT of wheat and various other commodities to the Russian Government. According to the Department's Foreign Agricultural Service (FAS), the program goals of these two massive food aid assistance agreements were to provide contributions to the Russian Pension Fund and to distribute food directly to the most needy groups. The estimated total cost for all the agreements was in excess of \$1 billion. The commodities were estimated to have a cost of \$746 million, and their monetized proceeds were estimated to total \$403 million.

Beginning in December 1998, we monitored FAS' efforts to implement procedures to minimize potential misuse and losses of commodities. In February 1999, we

recommended that, among other things, FAS increase the size and effectiveness of its monitoring staff in Moscow; verify the financial integrity of any private Russian institutions that would handle monetized proceeds; and assign the Moscow FAS monitoring staff responsibility to track the deposits going to the Russian Pension Fund.

In May 1999, OIG participated with FAS on a U.S. Government Interagency Team trip to Russia to observe the implementation of the food aid agreements. I want to emphasize that our participation on this Interagency Team was as an observer. We were able to corroborate much of the information that FAS had been providing to us on its monitoring efforts. We documented our observations on this trip in a memorandum to FAS. We believe that FAS made a significant effort to establish controls and strengthen monitoring efforts. However, because our earlier request for additional funding to perform onsite reviews of these controls was declined, we could not provide you with more assurance that these controls were effective. But we have continued to work with FAS to monitor and to assist it in its oversight responsibilities.

Investigations

The criminal investigations we have conducted have uncovered elaborate schemes and identified substantial monetary fraud. For example, in 1995 we reported our investigation of a North Carolina vegetable oil supply company that resulted in the conviction of the company vice president, the plant manager, and a former USDA grain inspector on charges that they conspired to under fill contracts to deliver vegetable oil to

the Commodity Credit Corporation (CCC). CCC purchased the packaged oil from the supplier for export and free distribution to developing countries under the Food for Peace Program. Our investigation disclosed that the supplier bought 4.2 million fewer pounds of oil than he billed CCC for under his contract, and diverted another 1 million pounds of oil that was earmarked for the CCC contract. The supplier sold this oil to two domestic oil companies in New Jersey and New York. As a result of the scheme, CCC was defrauded of over \$2 million in vegetable oil.

The company vice president used over \$130,000 of the illegally obtained CCC funds to pay kickbacks to his plant manager for under filling the contracts. The plant manager in turn paid the USDA inspector over \$2,000 to falsify official USDA weight reports.

In addition to the convictions, our investigation resulted in an order of restitution in the amount of \$1,020,000 and other monetary penalties of over \$6.4 million. This case represents one of the largest successful prosecutions involving CCC contract fraud.

In 1996 we reported that our investigation found that an exporter had submitted false statements to FAS to receive payments for shipping nonfat dry milk under the Dairy Export Incentive Program (DEIP). The purpose of the DEIP was to promote the sale of U.S. dairy products abroad through payments to U.S. dairy exporters for sales of dairy products to specified foreign countries. Our investigation found that the exporter diverted nonfat dry milk that should have been shipped to the United Arab Emirates (UAE) to Singapore and eventually shipped the material to the Philippines, an area not

eligible for DEIP payments. This resulted in a loss of over \$1 million in DEIP funds.

Our investigation also determined that the UAE buyer of the nonfat dry milk listed on the paperwork submitted by the exporter to FAS had been created by the exporter as a device to fraudulently obtain the DEIP payments. The subject of this investigation pled guilty to making false statements and was sentenced to 6 months imprisonment and 3 years' supervised release. He was also ordered to pay over \$1 million in restitution.

The Department's Actions to Address the Concerns We Raised

I would like to highlight the Department's actions to correct the internal control and accountability areas we have questioned. Our concerns fall in two categories:

(1) Cooperating sponsors did not always comply with food aid agreements; and (2) the Department needed to strengthen its management controls over the food aid assistance programs.

➤ Cooperating Sponsors Did Not Comply with Agreements

Cooperating sponsors include both foreign recipient governments and PVO's. In a direct feeding operation, PVO's may directly distribute food stocks to beneficiaries including widows, orphans, and sick children in shelters and orphanages in a recipient country. PVO's can also monetize (sell) the USDA donated commodities as a component of a wide range of projects. Both the monetization and the related projects must have prior approval of the Department. For example, a PVO may use

proceeds from monetized commodities to provide loans to farmers in a recipient country to increase agricultural production.

We found that cooperating sponsors did not always comply with their agreements by not (1) filing required reports, (2) following monetization requirements, and (3) effectively controlling commodities they received.

1. Cooperating Sponsors Did Not File Required Reports.

In 1994, we reported that because two cooperating sponsors did not file required reports, USDA did not have reasonable assurance that donated commodities, valued at over \$99 million including transportation costs, were being properly used to accomplish program objectives. In 1996, we again reported on this issue because we found that the Department was not aware of the problems created by a PVO that was negligent in managing the distribution and monetization of 12,750 metric tons of commodities valued at over \$19.6 million. In response to our recommendations, the Department included monitoring requirements in the agreements and emphasized reporting requirements to cooperating sponsors. Finally, the Department has not entered into any new program with the PVO; however, they did not agree to debar the PVO.

2. Cooperating Sponsors Did Not Follow Monetization Requirements.

In 1994, we reported this issue after evaluating agreements with two foreign governments and six PVO's. We found this situation had occurred because the cooperating sponsors abdicated their control over monetization to third parties

who were not subject to the agreement, violated the terms of the agreements, or incorrectly believed that the monetized proceeds were used in accordance with the agreement. As a result, over \$900,000 in proceeds for two agreements with a foreign government was not realized because commodities were sold for less than established prices and due to apparent collusion between the buyers and sellers. In addition, 95 percent (over 307,000 metric tons) of the commodities monetized in another country were not sold at competitive prices established through private channels as required by the agreement. Also, two PVO's established unauthorized loan revolving funds from monetized proceeds. One of these PVO's had committed \$809,000 in monetized funds to projects not covered by the agreement and had not complied with the foreign government's law regarding the importation and monetization of humanitarian aid.

In response to our recommendations, the Department corrected the specific deficiencies. The Department also increased the number of meetings with the cooperating sponsors to enhance their knowledge of processes necessary to carry out successful monetization programs.

In 1999, we reported that four of the five PVO's reviewed generally complied with grant agreement terms for FY's 1996 and 1997. However, the other PVO had a history of serious grant agreement violations dating back to FY 1993. We believe that this PVO materially violated provisions of its agreements and should be debarred. In fact, the foreign governments' assessed import taxes against this PVO on \$3.7 million of commodities donated as part of its FY 1996 and 1997

agreements. The two governments declared the PVO's activities in their countries were commercial businesses and taxed the monetization proceeds derived from the sale of these commodities. As a result, nearly all of the \$3.7 million of commodities and freight costs provided by the Department under the two agreements will be used to pay import and sales taxes and these funds will not be available for the intended purposes. In response to recommendations, the Department ceased its efforts to retroactively amend the agreements and conducted reviews on the PVO's open grant agreements. At this time, we do not believe that the Department has effectively dealt with this PVO. We continue to work with the Department on this issue.

In 1999, we also reported on the PVO's noncompliance with a FY 1993 agreement involving about 8,000 MT of commodities valued at \$14 million. A 1999 follow-up review conducted by FAS in response to our work raised even more serious questions regarding the PVO's use of monetized proceeds from the sale of the commodities. The FAS review determined that the PVO (1) monetized over 2,000 MT of commodities that should have been directly distributed to the needy, (2) monetized 8,000 MT of commodities through retail outlets affiliated with the PVO, and (3) used monetized proceeds for unauthorized and ineligible purposes. The unauthorized and ineligible purposes included (1) making loans that did not qualify as humanitarian assistance, (2) making grants to affiliated organizations and for purchases of ineligible items such as a golden belt, and

(3) payment of expenses related to other agreements including commercial taxes.

As a result, little of the commodities were distributed directly to the recipients.

3. Cooperating Sponsors Did Not Effectively Control the Accountability for the Commodities They Received.

In 1994, we reported that a cooperating sponsor's controls over commodity accountability did not prevent the unauthorized diversion of almost 2,000 metric tons of donated butter, which were valued at over \$2.8 million. In addition, we found that a PVO allowed donated commodities to be transshipped and bartered in direct violation of the agreement. This PVO bartered over \$470,000 in commodities for services for which it had already received payment. This PVO also transshipped \$680,000 in commodities to another country. In response to our recommendations, the Department reviewed and monitored cooperating sponsor operations to ensure that there were adequate controls to safeguard commodities against diversions, transshipment, and unauthorized bartering. The Department also agreed to hold cooperating sponsors liable for these losses and in future agreements for excessive losses caused by inadequate controls or misuse of commodities.

Effective controls over the monetized proceeds derived from commodities are also essential. In 1999, we found that the Department did not require budgets for monetization proceeds that PVO's used to pay for projects and did not monitor the use of those proceeds. Department officials have expressed concerns about

funding and staffing for these requirements and have also stated that the controls in these areas are sufficient. However, as an alternative, they recently informed us that compliance staff would begin to monitor and validate the use of monetized proceeds. We are waiting for documentation of their final corrective action plan.

4. Joint Commission Operations in Kyrgyzstan and Russia Were Inefficient and These Operations Did Not Comply With Their Agreements.

In 1997, we reported that although the work of the U.S. Joint Commissions in Kyrgyzstan and Russia provided benefits to the recipients of its loans, funding needs were not prioritized using agricultural assessments, and legal matters were not thoroughly researched before the establishment of the joint commissions. As a result of the inefficiencies of the joint commissions, monetized funds and interest totaling about \$11.8 million were not available for use in agricultural and humanitarian projects.

The Department needed to improve its oversight and controls to ensure that the terms of agreements were fulfilled. We found that the Government of Kyrgyzstan bartered over half of the donated commodities to Uzbekistan for a natural gas debt. As a result, the Kyrgyzstan Joint Commission was denied the use of over \$2.5 million and agribusiness and rural development goals were not met. Further, the Russian Federation did not follow the terms of its 416(b) commodity agreement. As a result, collusion among the buyers and restricted sales to government or former government entities in Russia caused commodities to be sold for over \$38 million less than anticipated during the monetization process. In

response to our recommendations, the Department sought recovery of the funds and terminated both Joint Commissions. The Department also took the position to not enter into, or support any future Joint Commissions without a legislative mandate and specific guidelines for implementation.

5. PVO's Received Funding for Foreign Taxes They Did Not Pay.

In 1999, we reported that three of the five PVO's reviewed had received over \$264,000 in grant funds for foreign social security and payroll taxes that they did not pay to their host governments. In response to our recommendations, the Department conducted follow-up inquiries and reviews of these activities and made determinations on the questioned costs. Departmental officials recently told us that these issues have been resolved and the appropriate amounts have been collected. They will soon forward documentation of these actions to my office.

➤ **Controls Over Food Aid Assistance Needed to be Improved**

In 1994, we reported that the Department had not instituted effective management controls over the food aid assistance program. We believed that without such controls, the Department would be unable to fully identify program accomplishments or recognize when commodities were lost, stolen, or being diverted to unauthorized uses. A couple of the specific weakness we reported included that (1) Federal regulations and internal operating procedures on program operations needed to be published and (2) independent auditors and more supervisory field visits could be

used to better manage the program. The Department took actions to initiate these program improvements.

In 1999, we reported that the Department had improved its monitoring of PVO activities by implementing a two-tiered system to control advances of grant funds, requiring a standardized budget for administrative funds, and developing software to analyze quarterly PVO budget reports. However, other controls needed to be strengthened to ensure that funds and commodities are efficiently used to achieve Food for Progress goals and objectives. As an example, the Department did not conduct timely reviews of the semiannual logistics and monetization reports submitted by PVO's. These reports were held until the grant closeout reviews were performed. As of September 1998, the Department was still in the process of closing out 130 of 185 agreements for FY's 1992 through 1996. In response to our recommendation, the Department developed a plan and timeframe to complete closeout reviews of the backlogged agreements. They also developed procedures to ensure future agreements receive timely closeout reviews. In addition, the Department had not validated information PVO's reported in the semiannual reports or required the PVO's to submit copies of their annual audit reports for review. In response to these concerns, the Department developed a process for validating information reported by PVO that it is now implementing. And, the requirement to have annual audit report submitted is now in place.

Suggestions for the Future

Mr. Chairman, the Department funds initiatives in countries where other donor countries have departed, but where market reforms are beginning. In the past, donations were heavily concentrated in the NIS; the Department is now shifting to other areas of the world with the greater use of monetization of commodities. In complement with this global expansion, the Department is also seeking more of a balance between the direct distribution of commodities and proposals with market development potential. As such, FAS will need to be vigilant in monitoring the shipments of the commodities to ensure the intended recipients receive them and that the monetary proceeds from the sale of the commodities are used for the intended purposes.

Mr. Chairman, thank you for the opportunity to present the issues that we have identified regarding the Department's food aid assistance programs. Our goal has always been to ensure the successful accomplishment and the financial integrity of the programs. This concludes my prepared statement Mr. Chairman, I will be happy to answer any questions you may have.