OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/UKRAINE'S AGROINVEST PROJECT

AUDIT REPORT NO. 9-121-13-002-P
MARCH 31, 2013

WASHINGTON, D.C.

Office of Inspector General

March 31, 2013

MEMORANDUM

TO: USAID/Ukraine Mission Director, Jed Barton

FROM: Acting IG/A/PA Director, Nathan Lokos /s/

SUBJECT: Audit of USAID/Ukraine's AgroInvest Project (Report No. 9-121-13-002-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.

This report contains ten recommendations to help strengthen the implementation of USAID/Ukraine's AgroInvest Project. Management decisions have been made on all ten recommendations, and final action has been taken on Recommendation 7. The mission should coordinate with USAID's Audit Performance and Compliance Division (M/CFA/APC) concerning final action on the remaining recommendations. Please note that we do not agree with the mission's management decisions on Recommendations 3, 4, 6, 8, and 9.

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

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CONTENTS

Abbreviations

The following abbreviations appear in this report:

ADS	Automated Directives System
AMDI	Agrarian Markets Development Institute
CIDA	Canadian International Development Agency
COR	contracting officer’s representative
IPR	Implementation and Procurement Reform
PMP	performance management plan
OIG	Office of Inspector General
SMP	small and medium-sized producer

SUMMARY OF RESULTS

Vast, fertile plains cover approximately 70 percent of Ukraine. The Eastern European nation's favorable climate and rich soil give it immense agricultural potential. As a leading exporter of grains and sunflower oil, Ukraine is poised to become an emerging player in global food production and security.

Despite Ukraine's successes, inefficiency plagues the agricultural sector. Although it accounts for more than 10 percent of the gross domestic product and nearly 16 percent of the workforce, the agricultural sector only operates at about a third of its production capacity.

Ukraine's lengthy land reform process has transformed the ownership structure of agricultural lands. During this process, the government dismantled its former collective farms and transferred many of the newly privatized land plots to the ownership of approximately 7 million rural residents. However, a long-standing moratorium on the sale of these plots stalled the development of a land market. Instead, Ukraine's agriculture sector operates in a leasing market in which private landowners enter into medium- to long-term agreements with farmers or agricultural enterprises in exchange for low rent. Since farmers and agricultural enterprises work land they do not own, they have little incentive to invest in productivity-boosting improvements. The absence of a land market and inconsistent legislation, priorities, and regulations have impeded the productivity of Ukraine's agriculture sector.

Small and medium-sized producers (SMPs) generate a significant portion of Ukraine's agricultural output, but their productivity is poor compared with larger, more dominant agricultural enterprises. Ukrainian financial institutions often limit credit to these producers because agriculture is inherently risky. When credit is extended, the financial institutions charge high interest rates, typically ranging from 20 to 45 percent. This limits the ability of SMPs to modernize and expand their operations. Furthermore, cooperation among SMPs remains low, and weak market infrastructure, including a lack of post-harvest handling, consolidation, and market facilities, reduces their overall competitiveness.

To address these issues and help Ukraine realize its agricultural potential, USAID/Ukraine awarded Chemonics International Inc. a 5-year, $20.61 million cost-plus-fixed-fee term level of effort contract.[1] According to the contract, this project "will accelerate broad-based economic recovery in Ukraine through the establishment of a more inclusive and competitive agricultural industry. USAID/Ukraine designed the project to create: (1) less volatile and more market-oriented agricultural policies that result in increased investments; (2) sustainable access to financial services for SMPs; and (3) a more efficient market infrastructure for SMPs."[2]

In August 2012 USAID/Ukraine modified the contract to decrease the total estimated cost of the project by $1.85 million to $18.76 million. This modification also reduced the project's scope of work by removing the requirement to oversee a subcontract with the Agrarian Markets Development Institute (AMDI), a Ukrainian nongovernmental organization working, in part, to

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[1] According to Federal Acquisition Regulation Subpart 16.306, "A cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract . . . The term form describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period."

[2] This report refers to these as Components One, Two, and Three. There are three tasks under Component One, one under Component Two, and two under Component Three.

reform agrarian policy and develop agricultural markets. Project implementation is expected to run from January 2011 to January 2016.

USAID's Office of Inspector General's (OIG's) Performance Audits Division conducted this audit as part of its fiscal year 2012 audit plan. The objective was to determine whether USAID/Ukraine's AgroInvest project was achieving its main goal of accelerating broad-based economic recovery through activities that support a stable, market-oriented policy environment; stimulate access to finance; and facilitate market infrastructure for SMPs.

AgroInvest had several notable successes in its nearly 2 years of implementation.

- AgroInvest suggested revisions to Ukraine's draft law on a land market, and staff members said some of the revisions appear verbatim in the current version. Additionally, AgroInvest succeeded in removing some provisions from the draft law.

- AgroInvest assisted with finalizing the law on agricultural cooperation that improved the legal, tax, financial, credit, and economic conditions for agricultural cooperatives. Approved by Parliament on October 16, 2012, the law establishes not-for-profit status for agricultural cooperatives and removes the system of double taxation of agricultural cooperatives and their members that sell produce through the cooperative.

- Representatives from partner credit unions and groups in the value chain[3] were trained to assess a potential agricultural borrower's creditworthiness. AgroInvest also helped develop tools to analyze a potential borrower's financial position and reduce the risk of default.

- AgroInvest sponsored training, field days, study tours, and workshops facilitated by partner credit unions to encourage crop diversification among their agricultural members.

Ukrainians learn about garlic production during a training event sponsored by AgroInvest and a credit union. (Photo by OIG, September 25, 2012)

[3] A value chain includes all activities required to produce a product or service and deliver it to the final customer. Value chains include activities such as production, marketing, and distribution.

- AgroInvest developed a new type of loan for the purchase and installation of equipment necessary to establish modern greenhouses. Credit union officials said their members were interested, and several have already issued loans for new equipment.

- Several cooperatives, marketing groups, and producer groups were trained in business planning. Beneficiaries said the training helped them project revenue better and make more informed decisions. After the training, some groups applied for AgroInvest grants. Although AgroInvest had not awarded any grants to these groups as of September 30, 2012, many are in the approval process.

AgroInvest is helping developers of several regional and wholesale markets navigate the land allocation, business planning, market design, and feasibility study processes. At least two of these markets are running temporary stalls where local farmers can sell their produce, like the one in the photo below, while permanent structures are under construction.

Producers in Kherson Oblast sell their goods from this temporary stall in a wholesale market that is receiving assistance from AgroInvest. (Photo by OIG, September 27, 2012)

Despite these achievements, AgroInvest is not achieving its main goal. Delays impeded the project's implementation, which is estimated to be at least 1 year behind schedule.

Lack of stable leadership at Chemonics and USAID/Ukraine contributed to the delays. Three chiefs of party and three contracting officer's representatives (CORs) have led AgroInvest since it began 2 years ago. The changes in chiefs of party have been particularly disruptive because each new leader needed time to become familiar with the project's activities and develop his direction for it.

Chemonics hired well-qualified professionals to lead each of the project's three components. However, many had little experience working on USAID-funded projects, and that created a learning curve that slowed down the awarding of subawards and, consequently, the implementation of project activities (page 6). It also prompted the Chemonics home office to play a more active role in managing AgroInvest, which contributed to the project's slow implementation.

Although AgroInvest's staff prepared timely work plans outlining the activities that were to be undertaken each year, USAID/Ukraine required them to perform additional, unscheduled tasks that caused more delays. For example, at the mission's request, the policy team prepared an additional framework assessment, which diverted time and resources from the defined priorities under Component One (page 9).

USAID/Ukraine's insistence on promoting two concepts,[4] meant to facilitate the transition to a land market once the Ukrainian Government ends its moratorium on the sale of agricultural land, also contributed to the project's delays (page 10). Although one of the concepts, that of field associations, is still being developed, USAID/Ukraine urged AgroInvest to begin the work necessary to set the stage for its eventual implementation. This prevented AgroInvest from awarding grants for critical activities under Component One until the two concepts could be incorporated into the grantees' scopes of work.

In addition, the audit found that:

- AgroInvest delayed the start of its land rights public education and outreach campaign (page 12). The project lost time and opportunities to educate rural landowners on their land rights.

- AgroInvest did not fully leverage its relationships with financial institutions (page 13).

- AgroInvest's reported results did not meet USAID's data quality standards (page 16).

To address these issues and to strengthen the effectiveness of USAID/Ukraine's AgroInvest project, we recommend that USAID/Ukraine:

1. Work with Chemonics International Inc. to implement a plan to streamline the subaward process for the AgroInvest project (page 8).

2. Work with Chemonics International Inc. to provide and document training for AgroInvest staff on relevant USAID regulations for awarding subawards, such as conducting environmental review and assessment checklists (page 8).

3. Reassess AgroInvest's policy priorities and implement a plan to achieve these priorities during the remainder of the contract (page 10).

[4] The two are the owner finance concept and the field association concept. According to AgroInvest, the first one "revolves around a landowner lessee 'financing' the purchase of his/her land by a tenant farmer." The field association concept "envisions the creation of an association of landowners for each land mass farmed as a single unit and allowing the association to negotiate as a single party with lessors of the field."

4. Solicit the assistance of independent experts to review in writing the field association concept for economic, political, and social impacts, and to develop and document alternative models for consideration (page 12).

5. Refrain from allocating more resources to the field association concept until a full, independent legal review can be conducted. If this review deems that the concept is not in line with the Ukrainian Constitution, we recommend that USAID/Ukraine discontinue its work on it and document that determination (page 12).

6. Conduct an independent analysis of the field association concept to determine whether it is in line with the strategic priorities of the U.S. Government for the independent states of the former Soviet Union. As part of this analysis, USAID/Ukraine should vet the concept with appropriate U.S. Government officials at the Embassy and document the results (page 12).

7. Work with Chemonics International Inc. to immediately implement a public education and outreach campaign that focuses on basic land rights and can be expanded if and when the legislation on a land market is finalized (page 13).

8. Perform and document an analysis that considers the use of a microfinance instrument or grants to fully leverage partners under AgroInvest's Access to Finance component (page 16).

9. Work with Chemonics International Inc. to reassess AgroInvest's future relationship with commercial banks, dedicate more resources to activities with credit unions, and document the results (page 16).

10. Work with Chemonics International Inc. to implement a plan to verify that the results reported by AgroInvest comply with the data quality standards outlined in Automated Directives System (ADS) 203.3.11.1 (page 18).

Detailed findings follow. The audit's scope and methodology are described in Appendix I. Our evaluation of management comments is on page 19. The full text of management comments is in Appendix II.

AUDIT FINDINGS

Subaward Processes Contributed to Project Delays

AgroInvest has a $5,746,455[5] budget for local subawards, including subgrants and subcontracts, to achieve its goals. The contract stipulates that the project "is expected to have a higher burn rate in its first years when the major subgrants will be awarded and feasibility studies will be commissioned. The contractor will therefore appropriately plan for a higher burn rate during the first years of the project and decrease this rate during the final years."

The contract specifies that AgroInvest will award grants under Components One and Three. For Component One, to support a stable, market-oriented policy environment, USAID/Ukraine required AgroInvest to:

> Ensure that Ukrainian organizations will have the leading role in the implementation of this task. The political scene in Ukraine is characterized by entrenched relationships, shifting government leaders and a complex array of laws and regulations. Ukrainian organizations are better able to navigate this environment.

Additionally, the project plans to help strengthen 20 industry associations with grants worth up to $40,000 per organization.

For Component Three, to facilitate market infrastructure for SMPs, the contract states, "Support to cooperatives/producer organizations is a promising strategy to build the necessary market infrastructure to increase productivity." Chemonics is to select 20 producer organizations for assistance and provide them with small grants worth up to $25,000 to support their projects.

Table 1 shows that as of September 29, 2012, the project had not awarded and disbursed funds as quickly as the contract required. It summarizes the amount that AgroInvest approved and disbursed for subawards compared with its total budget for subawards.

Table 1. Summary of Subawards Approved and Disbursed ($) (Unaudited)

	Approved	Disbursed
Subgrants	658,761	42,042
Subcontracts	570,273	271,903
Total	1,229,034	313,945
Budget	5,746,455	5,746,455
Percent of Total Budget	21	5

[5] AgroInvest originally had a budget of $7.5 million for local subawards. In the fifth contract modification, USAID/Ukraine reduced this amount by $1,753,545.

The project did not sign its first grant agreement until June 11, 2012, 9 months into the second year. Although the grant approval processes for the components were the same, the approval timing and condition of the grants were unique to each component task. To date, AgroInvest has only conducted one or two rounds of competition for the following tasks:

- Strengthen Industry Associations (Component One, Task B) had a round begin on April 10, 2012. However, the six grantees under this task were not approved until July/August 2012, averaging 115 days from competition to grant approval by USAID/Ukraine.

- Provide Public Education for Land Rights (Component One, Task C) had a round begin on November 16, 2011. The first round of applications had to be reassessed because two of the four presentations did not support the proposals. AgroInvest then initiated another round to select a third potential grantee. The grant evaluation committee approved the grantees on March 15, 2012, yet the mission did not approve the grants until June 29, 2012—226 days after the competition began.

- Producer Organization Development (Component Three, Task A) had a first round begin January 25, 2012, and a second round begin April 30, 2012. The grant evaluation committee approved the first round on March 7, 2012, and the second round on June 27, 2012. However, as of September 29, 2012, the mission had not approved any grantees.

In addition, the contract originally required AgroInvest to work with AMDI. The project signed an implementation agreement with AMDI on April 4, 2011, but did not provide the mission with a grant proposal package until October 13, 2011.

According to AgroInvest staff and the COR, the project limited the number of grants awarded because the applications they received were weak, unsustainable, and did not grasp the project's goals. In addition, grantees needed extensive training on USAID grant proposal requirements to submit compliant applications. This work caused a significant delay.

For Component One, the constant shifting of AgroInvest's and the mission's priorities also delayed the project's grant approvals. For example, USAID/Ukraine officials required a grantee to conduct focus groups on the two concepts. This was not included in the grantee's original scope of work, and it took 144 days to negotiate and incorporate the focus groups into the signed agreement. The inclusion of these concepts should not have caused this significant delay to a major activity focused on educating the public about land rights.

For Component Three, the project did not receive many proposals from producer organizations from priority regions, despite having conducted planning-related training in these regions. Officials from many of the organizations said they were not prepared or did not have the capacity for the rigorous grant approval process.

Moreover, many of the delays in Component Three stemmed from the fact that AgroInvest's Ukrainian staff had little experience working on USAID projects. This is evident in delays caused by having to spend 7 months redoing environmental review and assessment checklists that were not conducted properly. As of September 29, 2012, no grants had been issued for this component.

A mission official said AgroInvest's inefficient internal grant processes contributed to the unacceptably long delay in preparing the original AMDI grant proposal. After it was submitted in October 2011, the mission decided to award a direct contract to AMDI to comply with USAID

Forward.[6] While USAID/Ukraine pulled together the direct award for AMDI, the project placed AMDI under a subcontract to continue its activities.

The poor management of the subaward processes and subsequent delays have led to a lack of results. AgroInvest underperformed on many indicators in its performance management plan (PMP).

In addition, the poor management has the potential to cause hardship for the beneficiaries and be detrimental to USAID/Ukraine's reputation. For example, AgroInvest notified one fruit and vegetable producer in July 2012 of its successful grant application. The producer began purchasing strawberry seedlings to be kept in a cold storage unit that would be purchased with the grant funds. However, by late September, AgroInvest had still not awarded the grant. According to representatives of the producer, if the cold storage unit was not in place by the end of October, they risked losing the harvest cycle and their investment in the seedlings.

A fruit and vegetable producer hoped to install a cold storage unit here that would be purchased with AgroInvest grant assistance. (Photo by OIG, September 25, 2012)

In another potential grantee's case, a cooperative was building a dairy plant with assistance from a major international organization and regional and local governments. The cooperative applied for an AgroInvest grant in late February 2012 to help purchase a boiler, the final piece of equipment needed before the plant could become operational. However, as of September 30, 2012, AgroInvest had yet to award the grant, and the dairy plant still was not in operation.

To address the issues identified in the subaward process, we make the following recommendations.

> ***Recommendation 1.*** *We recommend that USAID/Ukraine work with Chemonics International Inc. to implement a plan to streamline the subaward process for the AgroInvest project.*
>
> ***Recommendation 2.*** *We recommend that USAID/Ukraine work with Chemonics International Inc. to provide and document training for AgroInvest staff on relevant*

[6] USAID Forward is an agency initiative that requires missions to build local capacity by providing more awards directly to local organizations.

USAID regulations for the awarding of subawards, such as conducting environmental review and assessment checklists.

Shifting Priorities Hampered Market-Oriented Reforms

The AgroInvest contract for Component One, Task A, Accelerate Market-Oriented Reforms, states, "AgroInvest will improve public private dialogue, and provide assistance to Ukraine to design and implement sustainable market oriented and [World Trade Organization]-compliant agricultural reforms." The project will address areas such as "land reform, taxes, agricultural finance, cooperative legislation, tariff and non-tariff barriers, subsidies and the fine tuning of wholesale market legislation." In addition, "USAID will closely monitor agricultural policy reform activities, and if progress is not evident, the project will elect to shift its emphasis and resources to other components and tasks."

Moreover, AgroInvest's strategic policy priority needs assessment, issued in September 2011, identified five priority areas: (1) trade policies, (2) taxes and subsidies, (3) financial market and credit policies, (4) land market development, and (5) market infrastructure investment. This strategy lists criteria for undertaking policy dialogue and a proposed policy framework that sets short- to long-term goals for the project. Criteria include:

- Does the policy question have a reasonable likelihood of implementation?
- Does it address AgroInvest's comparative advantage?
- Is it appropriate for AgroInvest to address?

The market-oriented reforms task has not had much success due to AgroInvest's continued focus on the draft law on a land market, ad hoc requests, and the Ukrainian Government's lack of interest in stated priority areas.

Activities for the first 2 years of the project primarily focused on the draft legislation on a land market. This was because the Ukrainian Government was moving quickly and the project needed to be vigilant of the constant changes to the draft. The activities related to this legislation were vital and accounted for in the contract and strategy; however, Ukraine recently announced that the moratorium on selling land from former collectives will not end until January 1, 2016.

Although the contract does recognize the need for flexibility, AgroInvest has lost focus on the priorities identified in its strategy. The staff prepared timely work plans outlining the key activities to be undertaken each year, yet implementation of the activities has been delayed by ad hoc requests. Examples include:

- At the mission's request, the policy component team prepared an additional framework assessment, which diverted time and resources away from the defined priorities under the component.

- A major stakeholder asked for assistance in establishing a social assistance framework similar to the U.S. Government's food stamp program.

- At the mission's request, AgroInvest began incorporating the concepts into the project. In particular, one concept (discussed in further detail below) was not fully developed, but disrupted many areas of the project. Promoting this concept has taken up limited staff and financial resources that AgroInvest could have utilized in other areas of policy reform.

These ad hoc requests may not meet the criteria established in the strategic policy priority needs assessment, such as whether the policy question has a reasonable likelihood of implementation or whether it is appropriate for AgroInvest to address.

Ultimately, the Ukrainian Government is responsible for implementing policy reform. However, it has not shown any interest in moving on the priorities that AgroInvest identified, such as U.S. farm bill-type support, taxation, and subsidies. Without the government's support, AgroInvest has little control over the passage of new legislation.

It is evident from the lack of AgroInvest's progress on its PMP indicators that the frequent shifting of priorities has slowed the project. Addressing requests beyond established priorities has used resources that could have produced greater results in other areas of the project.

Therefore, we make the following recommendation.

> ***Recommendation 3.*** *We recommend that USAID/Ukraine reassess AgroInvest's policy priorities and implement a plan to achieve these priorities during the remainder of the contract.*

Field Association Concept Poses Serious Risks

Chapter 11 of the Foreign Assistance Act of 1961, as amended, outlines the U.S. Government's priorities for its support for economic and democratic development in the independent states of the former Soviet Union. Among these priorities is the creation and development of private enterprise and free market systems based on the principle of private ownership of property.

In *Democracy and Governance: A Conceptual Framework*, USAID states that the U.S. Government "works to encourage democracy in developing nations throughout the world on the basis of the ideals of liberty, personal and civic freedom, and government of, for, and by the people."

Article 41 of the Ukrainian Constitution states that "everyone shall have the right to own, use, or dispose of his property." It further states, "No one shall be unlawfully deprived of the right for property. The right for private property shall be inviolable."

In anticipation that the Ukrainian Government would lift its long-standing moratorium on the sale of agricultural land in January 2012, a short-term technical assistance contractor hired by Chemonics developed the field association concept. The contractor did so after recognizing that even though farmers would be able to buy land once the land market opens, many would keep leasing land.

Although a field association has been compared to a condominium or homeowners association, it is more accurately described as an organization of landowners whose land forms a natural contiguous field. Lessees would be required to deal directly with the association instead of the individual landowners in all matters. Since participation in this type of association is mandatory, an individual landowner who wants to work his or her own land would need to approach the association for permission, and associations should only allow them to do so if it raised the total value of leases for the owners. Therefore, associations could deny landowners the right to use their land.

A USAID/Ukraine official readily accepted the association concept as the best—and only—viable model to address this issue and encouraged AgroInvest to promote the concept despite a lack of independent analysis, legal review, or consultation with other USAID/Ukraine offices, such as the Office of Democracy and Governance. According to this official, no additional economic, political, or social evaluations of this concept or development of alternative models occurred because few experts were available to do such work. A legal review has not been conducted since the concept is still in development.

While the concept paper does not identify any negative consequences that might arise from implementation, some mission officials and AgroInvest employees said the concept is incongruous with the Ukrainian Constitution. Prior to implementing it, USAID/Ukraine would likely need to encourage a change in the Ukrainian Constitution. One AgroInvest employee added that the concept threatens the land rights of Ukrainian citizens.

AgroInvest held a series of focus groups with landowners and farmers to determine their interest in the concept. Reactions were mixed; some participants reportedly acknowledged the potential benefits of an association, and others raised several concerns, like the sustainability of the associations.

However, the results of some of the focus groups did not accurately reflect landowners' feelings about the concept because moderators did not tell participants that joining the associations would be mandatory. The grantee leading those groups said it opted not to present that aspect because they feared that protests or political complications might result from the implementation of the concept. Additionally, they left it out because AgroInvest only required a study of the public's attitude toward the concept, and moderators felt this could be done without emphasizing the need for mandatory participation.

USAID/Ukraine faces several serious risks with the association concept. If the mission successfully implements it, this might encourage the violation of the land rights of Ukrainian citizens as established in their Constitution. Furthermore, AgroInvest could contradict the goal of its own communications program, which was designed in response to a contract requirement to help citizens understand their land rights and provide legal assistance so rural landowners can effectively defend them.

By not soliciting independent experts to study the concept, USAID/Ukraine and AgroInvest remain unaware of its potential weaknesses or problems that might arise from its implementation. Without a legal review, they risk promoting a concept that is inconsistent with Ukraine's current legal framework. Also, by not encouraging the development of alternative concepts, USAID/Ukraine and AgroInvest have not considered the possibility of other viable models that might be more appropriate for Ukraine.

Most importantly, the principles included in the association concept might not align with the U.S. Government's stated strategic priorities for the region.

To address the problems identified with the association concept, we make the following recommendations.

Recommendation 4. *We recommend that USAID/Ukraine solicit the assistance of independent experts to review in writing the field association concept for economic, political, and social impacts, and to develop and document alternative models for consideration.*

Recommendation 5. *We recommend that USAID/Ukraine refrain from allocating more resources to the field association concept until a full, independent legal review can be conducted. If this review deems that the concept is not in line with the Ukrainian Constitution, we recommend that USAID/Ukraine discontinue its work on it and document that determination.*

Recommendation 6. *We recommend that USAID/Ukraine conduct an independent analysis of the field association concept to determine whether it is in line with the strategic priorities of the U.S. Government for the independent states of the former Soviet Union. As part of this analysis, USAID/Ukraine should vet the concept with appropriate U.S. Government officials at the Embassy and document the results.*

AgroInvest Delayed Its Land Rights Public Education and Outreach Campaign

The AgroInvest contract for Component One, Task C, Provide Public Education for Land Rights, states that it "shall develop a communications program that helps citizens understand their land rights and shall support them with legal assistance in defined geographic areas so that rural landowners in these target communities can effectively take actions to defend these rights." An expected result of this task is that people would have a better understanding of their land rights.

According to an AgroInvest progress report, USAID/Ukraine approved the project's land rights public education and outreach campaign strategy on August 8, 2011. The strategy identified its primary and secondary target audiences, and outlined the campaign's objectives. Those objectives are to:

- Increase private plot holders' awareness of current land rights and how to adequately plan for the land market so informed decisions about land sales and purchases can be made.
- Increase farmers' awareness of how to protect farm holdings in the event of a land market.
- Educate target groups on the new legislation (once adopted) and its implications for their land rights, risks, and opportunities.
- Provide information to all target groups on locally available and trustworthy legal assistance.

The strategy calls for a baseline survey that measures land rights literacy in the target audiences. According to the project's work plan, AgroInvest was to conduct the survey during November and December 2011, publish the results in January 2012, and use them to develop the campaign. Also in January 2012, AgroInvest was to begin establishing a resource center and hotline that would directly answer questions from landowners and farmers on current land policy and markets issues, inventory existing land education materials and develop new ones, and host a Web portal with information on legislation, frequently asked questions, reference materials, and more. The information campaign, including television and radio spots, would begin the following month.

AgroInvest postponed the campaign for a variety of reasons. Mission officials did not approve the questions in the original baseline survey because they did not believe they would provide a fair, accurate representation of the level of awareness of land rights. Furthermore, the mission decided to expand the survey's scope to address aspects of all three components and approved the new questionnaires in October 2012.

USAID/Ukraine and AgroInvest delayed establishing the resource center and hotline. AgroInvest's grant selection committee chose an organization to oversee the resource center in January 2012, but the mission did not approve the grant until June 2012. Negotiations for awarding the grant took several months because in addition to negotiating about a basic land rights message, USAID/Ukraine officials insisted on inserting the concepts into the agreement.

Furthermore, as of October 15, 2012, AgroInvest had not yet awarded the subcontract for the information campaign that will include television/radio programming, the hotline, and work with press clubs. Mission officials and AgroInvest employees decided to wait until the Ukrainian Government approved the wording of the draft law on the land market before moving ahead with the campaign.

AgroInvest is moving into the third year of implementation and has lost valuable time and opportunities to educate vulnerable landowners, particularly the approximately 6 million private plot holders selected as the campaign's primary target audience. According to the strategy, this group is the most likely to give up their land (generally ranging from one to seven hectares), lose their livelihoods, or sell their land for less than its value.

Without an approved baseline survey instrument, AgroInvest could not conduct the survey as scheduled at the beginning of the project. Therefore, the project has no baseline from which it can measure current levels of awareness of land rights or the effect of the outreach campaign. Also, the resource center's activities are still in their initial stages when they should be well under way, and the time lost could have been spent providing important information to landowners.

AgroInvest's legal services providers confirm that rural landowners are still largely uninformed about their land rights. Many have difficulty executing and enforcing their lease agreements. As a result, they do not know how to protect their land rights and are vulnerable. Therefore, we make the following recommendation.

> ***Recommendation 7.*** *We recommend that USAID/Ukraine work with Chemonics International Inc. to immediately implement a public education and outreach campaign that focuses on basic land rights and can be expanded if and when the legislation on the land market is finalized.*

AgroInvest Did Not Fully Leverage Its Relationships With Financial Institutions

The AgroInvest contract for Component Two, Stimulate Access to Finance, states, "Given the absence of financial institutions committed to expanding agricultural lending, interventions in this component need to be facilitated around a number of promising opportunities" that will benefit SMPs. The project is to collaborate with other donors and projects to "optimize impact of technical assistance." It provides an example of such collaborations:

> The Canadian International Development Agency [CIDA] has funded a quasi-leasing company dedicated to serve micro and small producers that offers improvements in technology, such as greenhouse and drip irrigation equipment. The company is expanding quickly, and could be a potential project partner.

Furthermore, USAID's project design guidance states that sustainability should be built in from the start and that the project should "leverage or mobilize 'solution-holders' and partners strategically."

Agency guidance such as ADS 219, *Microenterprise Development,* and USAID Forward's Implementation and Procurement Reform (IPR) explain ways that missions can increase development assistance. ADS 219 primarily focuses on "extending and strengthening microentrepreneurs' and other poor people's access to appropriate financial services." IPR Objective 2 includes strengthening "private sector capacity to improve aid effectiveness and sustainability." IPR further quotes the International NGO Training and Research Centre definition of capacity development as "external intervention to improve an organization's performance, resources, and sustainability."

As stated in AgroInvest's *Regulatory and Institutional Barriers for Increasing Access to Finance for Small and Medium-Scale Producers*, issued in June 2011, Ukrainian financial institutions suffer from "limited liquidity and do not show levels of return on assets or return on equity normally exhibited by banks able to substantially expand lending activity." This lack of liquidity also restricts medium- to long-term lending because interest rates are linked to short-term capital.[7] Without access to external, lower cost capital, financial institutions—especially credit unions—cannot extend credit for longer periods of time. Currently, interest charged for short-term loans ranges from 22.5 to 80 percent, which prices out SMPs that are not willing to obtain high-interest credit, even taking into consideration increased productivity. Loans for modern agricultural technologies (like equipment) that would improve production efficiency[8] generally are medium- to long-term.

AgroInvest provides technical assistance, but not grants or other assistance mechanisms, to financial institutions. Though this is a vital activity, the assistance under Component Two is incomplete because capital investment is not available. Mission officials expressed concern about providing grants under Component Two because they believed it would create a market distortion and they feared that credit unions may not have sufficient internal controls in place. Though these are legitimate concerns, the project is providing training to its partner credit unions to address identified internal control weaknesses.

Credit union associations agreed to take part in the project because they had discussed with AgroInvest access to capital as a potentially viable option. Also, the contract specifically cites a potential partnership with a company funded by CIDA. However, the project was not designed to

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[7] The sources of capital for Ukrainian financial institutions include customers' deposit accounts. These accounts carry high interest rates. Therefore, to earn a profit, the financial institutions must assess higher interest rates on credit products.

[8] According to AgroInvest, several organizations estimate that the average age of farm equipment in Ukraine is more than 14 years.

fully leverage these relationships because it did not include a capital assistance mechanism.

The majority of the banks that AgroInvest contacted were not interested in utilizing the project's technical assistance.[9] Only three signed memorandums of understanding. Officials at some banks said they would train their employees or prefer to receive technical assistance from another donor. An official at one bank said it has no plans to hire credit officers to focus on agriculture products and rejected AgroInvest's invitations to training.

Also, Ukrainian banks have stringent lending requirements that make receiving credit products difficult for many SMPs. For example, three banks denied applications from potential borrowers even though they were recommended by a group that works with AgroInvest.

The banks do not appear to be interested in or capable of expanding their market share in agriculture. As stated in AgroInvest's regulatory and institutional barriers assessment, "It is extremely difficult, if not impossible, to induce a bank to target a market such as Ukrainian SMPs for additional credit . . . until such time as SMPs become a significant source of deposits and retail income."

Furthermore, the project's strategy and action plan states, "Although banks and other financial institutions are interested in the possibility of providing credit to SMPs and addressing the unmet demand for credit, they will have limited ability to do so in the short-run period."

In contrast, credit unions are concentrated in rural areas, and their customers are primarily SMPs. Additionally, credit unions appear more willing and able to help their customers meet lending requirements, like documenting cash flows.

AgroInvest helped train credit union employees like these to assess creditworthiness to help give loans to members. (Photo by OIG, September 19, 2012)

[9] Some banks have expressed interest in the owner finance concept. However, the Ukrainian Government announced that the moratorium on agricultural land would not be lifted until January 2016. Therefore, AgroInvest may need to reassess the likelihood of this concept's success since agricultural land cannot be sold throughout the duration of the project.

Activities with the credit unions have yielded the following positive results:

- Credit union employees were trained on assessing creditworthiness, new lending products, and new technologies for the agricultural sector.

- Credit unions offered courses to their members about the new lending products and technologies.

- Some credit unions have issued loans to their members to purchase greenhouse technologies.

Access to affordable capital for the credit unions and the CIDA-funded company could potentially expand capacity building locally as intended by USAID Forward and fully leverage other donor projects.

To address the problems identified in the project's relationships with financial institutions, we make the following recommendations.

> ***Recommendation 8.*** *We recommend that USAID/Ukraine perform and document an analysis that considers the use of a microfinance instrument or grants to fully leverage partners under AgroInvest's Access to Finance component.*
>
> ***Recommendation 9.*** *We recommend that USAID/Ukraine work with Chemonics International Inc. to reassess AgroInvest's future relationship with commercial banks, dedicate more resources to activities with credit unions, and document the results.*

AgroInvest's Reported Results Did Not Meet Data Quality Standards

ADS 200.6 defines performance management as "the systematic process of monitoring the achievements of program operations; collecting and analyzing performance information to track progress toward planned results; using performance information and evaluations to influence decision-making and resource allocation." ADS 203.3.11 recognizes the need to balance the cost and quality of data to confirm that reported data are of "sufficiently high quality to support the appropriate level" of making decisions.

According to ADS 203.3.11.1, key data quality standards for performance management and credible reporting include:

- Validity: Data should clearly and adequately represent the intended result.

- Reliability: Data should reflect stable, consistent data collection processes and analysis methods over time.

- Timeliness: Data should be timely enough to influence management decision making at the appropriate levels.

AgroInvest measures the results of its activities through 30 performance indicators. However, for many of these indicators, the reported results did not meet prescribed data quality standards and cannot be attributed to USAID's efforts.

Validity. Under its Access to Finance component, AgroInvest measures *Number of new borrowers and loans.* AgroInvest's partner banks and credit unions limit access to information about their financial transactions because it is proprietary. So the project based results for this indicator on partners' summaries of credit transactions that provided no detail. This data cannot be linked to unique individuals, making it difficult to determine an accurate number of new borrowers and loans due to AgroInvest's assistance.

AgroInvest also used this data to calculate *Number of agriculture-related firms benefitting directly from USG [U.S. Government] supported interventions*, which tracks the number of SMPs receiving training to improve their organizational effectiveness and ability to access credit. In calculating the results for this indicator, AgroInvest included the number of people attending training sessions on new loan products and 50 percent of the result for *Number of new borrowers and loans*. Since the results are based on an estimate that cannot be verified and lacks a direct link to AgroInvest's assistance, it is difficult to claim that these beneficiaries have benefitted directly from a U.S. Government-supported intervention.

Reliability*.* According to AgroInvest's PMP, the project measures *Number of rural landowners reached* by tracking those reached through mass media, office consultations, or targeted written materials.

However, in its results for this indicator, AgroInvest reported on two tasks using two distinct methodologies. Early in the project's implementation, AgroInvest had a task that involved educating journalists on land reform initiatives, with an emphasis on those that affected rural areas. Since the program could not determine the number of rural landowners reached through its media training events, AgroInvest estimated the results of this activity based on the number of people the journalists' outlets reached, the percentage of Ukrainians who live in rural areas, and the percentage of the rural population that was believed to have access to the media.

In contrast, AgroInvest had another task offering legal services for landowners. For this task, it began to report the number of rural landowners who received those services directly. That number could, unlike the above estimated results, be reported with a high degree of accuracy.

It is difficult to compare the estimated results from the media training with the direct results of how many people received legal assistance and arrive at an accurate, reliable number of rural landowners reached through the project's interventions.

Timeliness. Under the project's third component, AgroInvest measures *Value of investment (in kind or otherwise) facilitated through producer group projects*. AgroInvest plans to support these groups through grants that cover no more than 25 percent of the costs of a project the group designed. It then reports the remaining 75 percent of the project's cost as the result of this indicator.

AgroInvest reported generating $419,631 in investments through grant projects. However, as of September 30, 2012, AgroInvest had not awarded any grants to producer groups. Until these grants are awarded, AgroInvest should not include them among the project's accomplishments.

USAID/Ukraine relies on discussions with AgroInvest staff to validate these results. Although mission officials annually review the results for reasonableness, they do not review them for accuracy. USAID/Ukraine relies on AgroInvest's reported results to make informed decisions about the project's progress. Because of extensive implementation delays, AgroInvest only recently began to report significant results from its activities. But the results were not measured accurately, lacked direct links to the activities, and were reported too early to reflect the true accomplishments of the project's interventions.

Because of the problems listed above, USAID/Ukraine risks making programming decisions for the AgroInvest project based on weak data. To confirm that AgroInvest's reported results accurately represent the progress of its activities, we make the following recommendation.

> ***Recommendation 10.*** *We recommend that USAID/Ukraine work with Chemonics International Inc. to implement a plan to verify that the results reported by AgroInvest comply with the data quality standards outlined in Automated Directives System 203.3.11.1.*

EVALUATION OF MANAGEMENT COMMENTS

USAID/Ukraine has made management decisions on all ten recommendations and has taken final action on Recommendation 7. However, as discussed below, we disagree with the mission's management decisions on Recommendations 3, 4, 6, 8, and 9.

Recommendation 1. The mission agreed with the recommendation to streamline the subaward process. To address the issues identified, Chemonics hired a new grants manager with previous experience managing USAID grants. Also, USAID/Ukraine and the Chemonics home office will review the current grant process to find ways to streamline the process. The target date for completing the revision of the grants process was March 1, 2013. The mission has made a management decision for this recommendation.

Recommendation 2. The mission agreed with the recommendation to work with Chemonics to provide and document training for Agroinvest staff on relevant USAID regulations. To address the recommendation, Chemonics is in the process of hiring an environmental expert who will assist the AgroInvest project on a part-time basis to develop high-quality environmental impact assessments and environmental mitigation and monitoring plans. USAID/Ukraine expected that this expert would begin no later than March 1, 2013. The target date for responding to the recommendation was March 15, 2013. The mission has made a management decision for this recommendation.

Recommendation 3. The mission disagreed with the recommendation to reassess Agroinvest's priorities and implement a plan to achieve those priorities during the remainder of the project. In fact, mission officials said they do not see any need to reassess them.

According to the AgroInvest contract, Chemonics was to "produce a market-oriented, WTO-compliant policy strategy and help the [Ukrainian Government], the Parliament of Ukraine, and other state agencies, as well private organizations, implement this strategy." In response to this requirement, Chemonics released its September 2011 strategic priority needs assessment, which outlines five key policy areas to be undertaken during the course of the project. As discussed in the finding, the AgroInvest project lost focus on several areas because instead of working toward the priority areas identified in its assessment, officials decided to pursue policy issues as they arose.

The contract further stipulates that the project would update its policy reform strategy regularly. However, this has not happened.

Our recommendation asks that USAID/Ukraine work with the AgroInvest project to update its policy priorities and implement a plan to achieve them. We believe that by defining its priorities for the remainder of the contract, AgroInvest will be able to meet its component goal of creating less volatile and more market-oriented agricultural policies that result in increased investment.

The mission has made a management decision that it will not reassess the priority policy areas for the Agroinvest project and implement a plan to achieve those priorities during the remainder of the contract. We disagree with this decision.

Recommendation 4. In its response, USAID/Ukraine did not clearly express its position on the recommendation that it solicit the assistance of independent experts to review the field association concept. Nevertheless, according to the mission, the recommendation has been fully addressed because the concept has been presented to and favorably received by USAID Washington, the European Bank for Reconstruction and Development, the World Bank, and Ukrainian experts.

However, we do not believe that the fact that these organizations and people favorably received the presentation constitutes agreement on their part, especially with the concept of mandatory participation in such associations.

Also in its response USAID/Ukraine asserts that several models of owners associations were and are under consideration, among them one that calls for mandatory participation. However, USAID/Ukraine officials and the concept's author stressed the necessity of mandatory participation. The author's concept paper describes the model:

> A Field Association would be a mandatory organization of lessors in a field. Much like a condominium or neighborhood association for residential property owners (or a Marketing Order in agriculture), those owning land in a field would be required to belong to the Field Association unless they were also the lessee(s). Another way of conceiving of a Field Association is that lessees would be required to deal directly with the Field Association, rather than individual landowners.

Although the mission's response states that USAID/Ukraine has considered—"and will continue to consider"—all options relating to land tenure, at the end of our fieldwork a key USAID/Ukraine official explained that because of a lack of qualified experts, no one had been brought on to review the concept.

In its response, USAID/Ukraine acknowledges the controversial nature of land reform. For this reason, we believe it is important to thoroughly review and document the potential economic, political, and social impacts of the field association model or any other viable model that USAID/Ukraine considers. The mission's management decision is effectively to take no action on this recommendation. We disagree that this recommendation has been fully addressed and disagree with this management decision.

Recommendation 5. The mission agreed with the recommendation that it refrain from allocating more resources to the field association concept until a full, independent legal review can be conducted, and, if this review deems that the concept is not in line with the Ukrainian Constitution, that the mission discontinue its work on it. To address the recommendation, Chemonics included plans for a comprehensive legal review in its approved fiscal year 2013 work plan. The target date for the completion of the review is April 30, 2013. The mission has made a management decision on this recommendation.

Recommendation 6. In its response, USAID/Ukraine did not clearly express its position on the recommendation that it conduct an independent analysis on the field association concept to determine whether it is in line with the strategic priorities of the U.S. Government for the independent states of the former Soviet Union, and that, as part of this analysis, it vet the concept with appropriate U.S. Government officials at the Embassy. The mission's response indicated that it considered the recommendation "addressed."

However, we consider that this response signals its disagreement. According to the mission's response, Embassy officials have been briefed on the association concept, and no issues surfaced about the concept running counter to U.S. Government priorities for the area.

In its response, USAID/Ukraine acknowledges the controversial nature of land reform in Ukraine. The Ukrainian Constitution stresses that the right of private property shall be inviolable. U.S. Government guidance for development assistance in the region echoes the importance of the principle of private ownership of property. USAID/Ukraine officials and Chemonics staff admit that the Ukrainian Constitution would likely need to be amended to implement the field association concept. A key AgroInvest staff member also expressed concern that implementing it would violate the land rights of Ukrainian citizens.

Although USAID/Ukraine stressed that it briefed Embassy officials on the concept, this does not constitute agreement on their part, especially concerning the issue of mandatory participation in field associations. The project's main contact within the economic section of the Embassy prior to October 2012 knew very little about the concept. Furthermore, although USAID/Ukraine's Office of Democracy and Governance also works with policy issues, representatives from that office had no knowledge of the field association concept or its potential impact.

USAID/Ukraine has effectively made the management decision that it will take no action on this recommendation, we disagree with that decision.

Recommendation 7. In its response, USAID/Ukraine did not clearly express its position on the recommendation that it immediately implement a public education and outreach campaign that focuses on basic land rights and can be expanded if and when the legislation on the land market is finalized. However, we consider that the mission's response to the recommendation signals its agreement. The AgroInvest project issued a subcontract on December 14, 2012, that launched the campaign. A management decision has been made on this recommendation, and final action has been taken.

Recommendation 8. The mission disagreed with this recommendation to perform and document an analysis of using a microfinance instrument or grants to fully leverage partners. In its response, USAID/Ukraine said it considered spending limited resources on technical assistance to be more efficient than subsidizing credit unions' interest rates through grants. The mission also said the experience of other regional missions has shown that providing grants did not lead to sustainable results or decreased interest rates.

The credit unions and credit union associations interviewed during the audit expressed their appreciation for the technical assistance received from the AgroInvest project. However, access to affordable capital remains a challenge that results in low levels of lending to SMPs. A microfinance instrument or grants to credit unions are two potential ways to stimulate access to financial services for these producers.

The mission has made a management decision to take no action on this recommendation. We disagree with this decision.

Recommendation 9. The mission agreed with the recommendation to (1) reassess Agroinvest's future relationship with commercial banks and (2) dedicate more resources to activities with credit unions. However, although its response indicated that it considered this recommendation addressed because Agroinvest was limiting its technical assistance to three partner banks and was remaining open to partnering with other banks in the future, the response did not indicate whether the mission intended to perform the recommended reassessment. While a management decision has been made on this recommendation, we do not agree with that decision.

Recommendation 10. The mission agreed with the recommendation to implement a plan to verify that the results reported by Agroinvest comply with data quality standards. In December 2012 Chemonics assigned its monitoring and evaluations expert to work with USAID/Ukraine and AgroInvest field staff to develop a plan that will ensure that the project's reported PMP data comply with ADS requirements. The target date for the development of the plan was March 1, 2013, and the target date for its full implementation is June 30, 2013. A management decision has been made on this recommendation.

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 objectives. We believe that the evidence obtained provides that reasonable basis.

The objective of the audit was to determine whether USAID/Ukraine's AgroInvest project is achieving its main goals of accelerating broad-based economic recovery through activities that support a stable, market-oriented policy environment; stimulate access to finance; and facilitate market infrastructure for SMPs. On January 25, 2011, USAID/Ukraine awarded a 5-year, $20.61 million, cost plus fixed-fee term level of effort contract to Chemonics to implement AgroInvest. On August 10, 2012, USAID/Ukraine modified the contract to revise the scope and decrease the total estimated cost of the project by $1.85 million to $18.76 million. As of September 30, cumulative obligations and disbursements under AgroInvest totaled $13.43 million and $4.57 million, respectively. Because this was a performance audit looking at project implementation rather than specific financial transactions, the audit team did not audit a specific portion of the $4.57 million in disbursements.

OIG conducted audit fieldwork in Ukraine from September 12 to October 19, 2012. We conducted our fieldwork at USAID/Ukraine and Chemonics' offices in Kyiv and at partner and beneficiary sites in and around the cities of Kyiv, Dnipropetrovsk, Zaporizhzhya, Simferopol, Kherson, Chernivsti, and Rivne. Our fieldwork covered the period from January 25, 2011, to September 30, 2012.

In planning and performing the audit, we assessed management activities and controls established by USAID/Ukraine and Chemonics. In doing so, we reviewed annual work plans, the PMP, progress reports, data quality assessments, and monitoring reports. We reviewed USAID/Ukraine's fiscal year 2011 and 2012 annual self-assessments of management controls for its economic growth office. In addition, we assessed the implementing partner's activities to address any problems related to trafficking in persons and gender inclusion.

Methodology

To answer the audit objective, we obtained an understanding of what USAID/Ukraine intended to accomplish through AgroInvest. We interviewed the COR and technical team responsible for overseeing the project. We interviewed USAID/Ukraine's contracting officer, director of the Office of Democracy and Governance, countering trafficking in persons specialist, gender specialist, and mission environmental officer. We interviewed Chemonics' personnel responsible for the project's activities and met with officials from the Ministry of Agrarian Policy and Food.

We assessed USAID/Ukraine's management of the project by reviewing applicable policies and strategic plans, annual work plans, quarterly and annual progress reports, and other documents produced by USAID/Ukraine and Chemonics. We performed site visits of project beneficiaries to observe and discuss the progress and impact of the activities. We judgmentally selected sites based on geography and activity levels representing the various components of the project. We compared the expected results with the reported results. We determined the accuracy of the reported results by comparing them with the supporting documentation maintained in Chemonics' Kyiv office.

MANAGEMENT COMMENTS

January 16, 2013

MEMORANDUM

TO: Steven Ramonas, IG/A/PA Director

FROM: E. Jed Barton, Mission Director, USAID/Ukraine /s/

SUBJECT: Audit of USAID/Ukraine's AgroInvest Project (Report No. 9-121-13-00X-P)

This Memorandum transmits the Mission's response to the OIG's draft report on the audit of USAID/Ukraine's AgroInvest Project implemented by Chemonics International, Inc.

The stated objective of this audit, as outlined in the OIG's audit notification letter and the audit draft report, was to determine whether USAID/Ukraine's AgroInvest project is achieving its main goal of accelerating broad based economic recovery through activities that support a stable, market-oriented policy environment; stimulate access to finance; and facilitate market infrastructure for small and medium producers.

Following are the Mission's comments on the findings of the audit and on the draft report's recommendations.

Audit Findings and Recommendations:

Finding #1. Subaward Processes Contributed to Project Delays

Mission's feedback: While the Mission agrees with this finding in general, the accompanying audit report narrative does not seem to present full analysis of factors that contributed to delays in subaward processes. Many of the report statements simply state that delays took place or seem to focus primarily on the administrative part of the grant process.

At the same time, it is important to take into account the technical and capacity building work that AgroInvest is doing to assist its grantees to become more sustainable as organizations. This work starts from the day of first review of grant applications. The key purpose of providing grant support by AgroInvest project regardless of types of grantees is to build capacity of local organizations to better perform their roles as policy advocates, service providers, etc. The majority of initial applications received in response to grant solicitations were extremely weak. They mainly called for addressing very basic needs of applicants (staff salaries, office rent, equipment, etc) and did not request support to pursue substantive goals, strategies or organizational sustainability. To remedy those weaknesses, the AgroInvest team worked intensively with each of the short-listed applicants to help them better determine goals and strategies to be supported in order to strengthen applicants as organizations and achieve sector impact as a result of a grant activity. It is important to note that most of the applicants are well known sector associations and other types of NGOs experienced in working in the agriculture sector. At the AgroInvest design stage USAID planned to strengthen such organizations through grants and expected to disburse a large portion of those grants during the first two years of award. However, the degree of applicants' internal weaknesses could not be envisioned at the design stage. The Mission considers weak grant proposals as the most significant, though not the only, factor that contributed to delays in subaward process. The audit report does not provide its own analysis of the technical part of grants process and only quotes AgroInvest staff and COR who raised the issue of weak proposals as an important obstacle that contributed to delays.

Another significant factor that contributed to delays was lack of USAID grant management experience of locally hired staff. To clarify, this statement primarily applies to local grants management team of AgroInvest, and to a lesser extent to component leaders who, in fact, manage the technical work mainly and not necessarily need to be intimately familiar with USAID grants regulations.

The audit report overestimates the influence of USAID's technical direction on grant award delays in general. For example, the Summary of Results section states that USAID's request to incorporate the two land reform concepts into the grantees' scopes of work resulted in delaying grants for critical activities. In fact, USAID requested that only one grantee adds those activities to its SOW. As the activity under that subgrant had a major focus on land reform, USAID considered it important to add a few activities to explore proposed approaches to resolving critical land issues, such as lack of financing and the vulnerable position of almost 7 million private land owners.

The audit makes the following recommendations with regard to this finding:

1. ***We recommend that USAID/Ukraine work with Chemonics International, Inc. to implement a plan to streamline the subaward process for the AgroInvest project.***

The Mission agrees with this recommendation. The issue of limited USAID grants experience by AgroInvest local staff has been recently addressed by hiring a new grants manager to replace one of the grants staff who resigned for family reasons in November. The new grants manager has solid hands-on experience of USAID grants management under other USAID projects. In addition, the Mission, together with Chemonics home office and AgroInvest field team, will review the current grant process to identify opportunities to streamline the process. The target completion date for revising the grants process is March 1, 2013.

2. ***We recommend that USAID/Ukraine work with Chemonics International to provide and document training to AgroInvest staff on relevant USAID regulations for the awarding of subawards, such as conducting environmental review and assessment checklists.***

The Mission agrees with this recommendation. We recognize that AgroInvest does not have staff with experience or background in conducting environmental impact assessments, which contributed to delays in obtaining the Mission's clearances for subgrants to producer organizations. Chemonics is in the process of selecting an environmental expert who will be engaged on a part time basis to assist AgroInvest team with developing high quality assessments and EMMPs for upcoming subawards. The expert is expected to start working not later than March 1 2013 and will be additionally trained by the Mission MEO in specific USAID environmental compliance requirements. The target completion date for responding to this recommendation is March 15, 2013.

Finding #2. Shifting Priorities Hampered Market-Oriented Reforms

Mission's feedback: The Mission disagrees with this finding.

Success in a technical assistance project's policy work hugely depends on cooperating country government's changing policy agenda. At the beginning of its implementation AgroInvest identified policy areas to get engaged in depending on the government's priorities and their potential impact on the sector. Those areas were presented in the Strategic Policy Priority Needs document issued in September 2011. Later, in close coordination with the GOU's existing policy priorities and taking into account the significance of their potential economic impact, AgroInvest has concentrated its efforts on two major policy areas: land reform and agricultural cooperatives development. While deciding to narrow AgroInvest's focus to these two priorities we utilized the selection criteria established by Strategic Policy Priority Needs document and quoted by the audit report. We would like to stress that the Mission has been consistently focused on these two policy priorities and did not direct AgroInvest to shift to any other policy areas.

The importance of agricultural land and land policy to Ukraine's economic development and USG priorities cannot be overestimated. There has not been an operative agricultural land market in Ukraine for nearly a century. Agricultural land accounts for over 70 percent of the area of Ukraine and is arguably the primary natural resource of Ukraine, much like oil is for Saudi Arabia. Private individuals own three quarters of this land. The landholdings are small, averaging 4.2 hectares, and, with few exceptions, not economically viable on a standalone basis. There are 6.8 million land owners, most of whom are elderly and impoverished. Nearly all of this land is leased to agricultural enterprises. Regardless of how well the land sale market operates, cultivators will lease the large majority of the land for the foreseeable future, perhaps forever.

The preeminent factor which will influence the development of Ukraine's agricultural sector is the efficiency and equity of the agricultural land lease and sale markets. Moreover, efficient and equitable land sale and lease markets would enhance the welfares of current landowners and, importantly, make land attractive as long term investments for millions of Ukrainians, both urban and rural. For these reasons, USAID/Ukraine has made this the central focus of AgroInvest's work.

Another critical policy area that AgroInvest focused on since inception is agricultural cooperation as an important mechanism to increase productivity, sales, and income by small and medium agricultural producers.

Other identified policy priorities, while significant, stood lower on the government's policy agenda and therefore had less likelihood to be moved forward over the past year. For this reason, AgroInvest did not spend much effort on those less promising areas. The audit report narrative fully supports this approach.

Significant progress has been achieved in both of these priority policy areas. As a result of AgroInvest's consistent focus on the two policy areas, a draft land market law was improved and legislation regulating agricultural cooperation was adopted. Both of these successes are recognized in the Summary of Results section of the audit report. These are reforms that will have an impact on millions of Ukrainians and stimulate agricultural sector development.
While recognizing the importance of land reform for development of agriculture sector in Ukraine in the Summary of Results section, the audit report further seems to describe AgroInvest's focus on land as one of the major factors that contributed to limited successes in other policy areas. This conclusion is not supported by facts.

Activities and concepts described by the audit report as ad hoc requests either provided important information on the status of land governance system in Ukraine both to the project and the GOU or were aimed to address major issues facing Ukrainian land owners and farmers. Namely, the Land Government Assessment Framework (LGAF), owner financing concept, and land owners associations concept are in line with promoting a transparent and efficient land reform as the established policy priority. Virtually all policy recommendations put forth by AgroInvest/USAID were reviewed by a wide spectrum of Ukrainian experts and incorporated into LGAF and, because of this, more widely communicated to stakeholders. The work on LGAF by AgroInvest was not, as characterized in the IG Audit Report, a diversion and dilution of effort from established priorities, but rather, an opportunity to advance work on the project's central priority area more effectively. Also, the audit report is not clear on what activities were delayed or results not achieved as a result of implementing these tasks.

Finally, a major stakeholder's request for assistance in establishing a social assistance framework was limited to bringing a US expert for a few days to present the US Government's Food Stamp Program and discuss its applicability for Ukraine with major stakeholders and GOU. It is not clear how this limited activity contributed to project delays with implementing other tasks, as stated in the audit report.

The audit makes the following recommendation with regard to this finding:

3. **We recommend that USAID/Ukraine reassess AgroInvest's policy priorities and implement a plan to achieve these priorities during the remainder of the contract.**

We disagree with this recommendation. As explained in the Mission's comments above, in order to succeed in policy work, AgroInvest is focusing on areas that have significant likelihood to be reformed and have major potential impact on the sector. Land reform and policies for cooperatives development will remain those priority areas at least during the next year. Despite the fact that the agricultural land sales moratorium has been extended through January of 2016, the GOU is now moving forward with drafting new legislation that will govern the future land market and will have impact on 7 million land owners. The GOU is also continuing to improve legislation for agricultural cooperatives, looking at further streamlining of tax procedures for them. AgroInvest will stay actively engaged in these two policy areas.

In addition, the GOU has recently requested AgroInvest's assistance in developing an effective strategy for development of wholesale agricultural markets across Ukraine. As wholesale market legislation has been defined as one of AgroInvest's policy priorities, we plan to provide requested assistance to the government over the coming year. The GOU's interest in implementing reforms in other policy areas identified by AgroInvest as priority remains to be seen and AgroInvest will consider its engagement in them should opportunities arise. Therefore, we do not see the need in spending time and limited resources on reassessing AgroInvest's policy priorities now.

Finding #3. USAID/Ukraine and AgroInvest Face Several Serious Risks With Field Association Concept

Mission's feedback: The IG audit report asserts that "USAID/Ukraine has not sought the opinion of other independent experts on the Association concept." As the IG Auditors are aware, there have been close and continuing consultations with the World Bank in Ukraine on both Owners Associations and Owner Financing. In addition, and at the request of World Bank, a presentation on the approaches was made at World Bank Headquarters in Washington, DC. The World Bank and the EBRD are supportive. The approaches have also been vetted by a panel of Ukrainian land experts as part of the LGAF process. Most importantly, the approach has the strong support of the Minister of Agriculture and several prominent members of the Ukrainian Parliament.

The IG report further asserts that field associations were all mandatory. In fact, several models of associations have been under consideration, among them a model with mandatory participation.

Landowners almost universally agree that they have little or no negotiating power with farmers and receive very low lease rates (averaging $17 per acre per year) and that their condition could be improved by organizing. In focus groups and other contacts with landowners, we have found considerable support, but also and not unexpectedly, concerns. A sizable minority of landowners cherish the unrealistic hope the Government will dictate favorable lease rates and institute other protections for their land or even purchase the land for high prices, rather than the landowners having to take action themselves. And, of course, all reasonable landowners are concerned about the terms of any association and there is the need to reassure and convincingly demonstrate that an association would support, rather than contravene free market principles and would, in no way, represent a return to the Socialist past. In these regards, there is controversy, but, again, considerable support among landowners, in the Government, and with the World Bank. We conclude from this the need to continue exploring the approach, including soliciting comments from stakeholders and conceptual work on implementation approaches, rather than a signal to abandon this important initiative.

The audit makes the following recommendations with regard to this finding:

4. **We recommend that USAID/Ukraine solicit the assistance of independent experts in writing to review the field association concept for economic, political and social impacts and to develop and document alternative models for consideration.**

We consider this recommendation addressed. The field association concept has been reviewed favorably by experts at USAID Washington, the EBRD, World Bank and Ukrainian expert participants in the LGAF discussions. USAID/Ukraine has repeatedly asked the implementer to provide alternative models, but they, nor the World Bank or any other donors have offered any viable alternative. USAID has considered, and will continue to consider, all options related to rationalizing land tenure that achieve the following two goals in accordance with our larger formal objective of broad-based economic development: 1) assist Ukraine in reaching its enormous production potential; and 2) develop market mechanisms to ensure that landowners receive a fair market payment for the efficient utilization of their resources. The two goals are mutually inclusive.

Owners Associations has the potential of:

- Greatly improving the efficiency of the agricultural land lease market. Of particular importance, in this regard, is reducing extremely high transactions costs borne by both lessors and lessees.

- Markedly higher payments for leases, from their current, near-token levels (averaging $17 per acre annually). Importantly, lease rates would correlate with the economic value of the land.

- Facilitating measures to protect soil fertility and to ensure maintenance and upgrade of fixed investments, such as drainage ditches.

- Enhancing agricultural land values to levels consistent with the land's inherent economic value.

- Making agricultural land a viable long-term investment for millions of Ukrainian citizens.

- Facilitating a gradual, market-based, transformation from the current highly concentrated pattern of agricultural enterprises to one more conducive to modern, competitive agriculture.

Simply put, without Owners Associations to offset the extreme market power of lessees, millions of Ukrainians will continue to be denied the large majority of the value of their landholdings and the agricultural sector will continue to be characterized by high rates of soil degradation and low investment and productivity. This egregious market failure in the leasing market has created a de facto Latifundia of lessees. To convey a sense of the extent to which this is true, the ten largest agricultural enterprises in Ukraine control an area larger than New Jersey (or 129 times the size of the District of Columbia). Owners Associations can establish the conditions to reverse these problems. The World Bank, the Minister of Agriculture, the panel of Ukrainian experts who worked on LGAF, and others concur with this assessment.

5. **We recommend that USAID/Ukraine refrain from allocating more resources to the field association concept until a full, independent legal review can be conducted. If this review deems that the concept is not in line with the Ukrainian Constitution, we recommend that USAID/Ukraine discontinue its work on it and document that determination**

We agree with this recommendation. A comprehensive legal review of the field associations concept is included in AgroInvest's FY2013 approved work plan. The expected deadline for completing this analysis is April 2013.

6. **We recommend that USAID/Ukraine conduct an independent analysis on the field association concept to determine whether it is in line with the strategic priorities of the US Government for the independent states of**

the former Soviet Union. As part of this analysis, USAID/Ukraine should vet the concept with appropriate US Government officials at the embassy and document the results.

We consider this recommendation addressed. USAID Ukraine has briefed Embassy officials on the field association concept several times. There has never been any question about the concept running counter to “strategic priorities of the US Government for the independent states of the former Soviet Union”.

Finding #4. AgroInvest Delayed Its Land Rights Public Education Campaign

Mission’s feedback: Over the past two years the GOU has been amending existing and draft legislation that regulates land governance so intensively that if launched earlier, the land rights education campaign would have had to have been refocused continuously. For example, the GOU adopted legislation on new system of immovable property registration and established a new State Registration Service in early 2011. Since then this legislation was amended several times. In addition, for the past two years there has been a lack of certainty about the date for lifting the agricultural land sales moratorium and there was no approved law in place to set rules for the to-be-established land market. Only recently did the GOU extended the moratorium to January 2016 and made a decision to draft completely new legislation to regulate the land market instead of the current draft Law on Land Market. Given this volatile legislative environment, the Mission made a decision to delay the land rights education campaign as its messages would have had been changed innumerably, rendering it incapable of achieving its ultimate goal to educate almost 7 million of land owners about their property rights. Now that there is more clarity in the legal situation with regard to land, AgroInvest is moving forward with the land rights education campaign. In addition, the baseline survey is in the field and its results are expected by February 2013.

The audit makes the following recommendation with regard to this finding:

7. **We recommend that USAID/Ukraine work with Chemonics International, Inc. to immediately implement a public education and outreach campaign that focuses on basic land rights and can be expanded if and when the legislation on land market in finalized.**

The land rights education campaign has been launched. A respective subcontract has been signed on December 14, 2012.

Finding #5. AgroInvest Did Not Fully Leverage Its Relationships with Financial Institutions

Mission’s feedback: Agricultural lending is considered to be risky worldwide and especially in Ukraine. Lack of solid collateral, outdated technologies used by producers, poor contract enforcement, and an unstable regulatory environment are the key risks that limit agricultural lending to small and medium producers in this country. In addition, the Ukrainian financial sector is recovering from the economic crisis very slowly and interest rates are extremely high across all sectors of economy. In agriculture, they are even higher than average as a result of the abovementioned risks. AgroInvest is working with its partners (both financial institutions and agricultural producers) to help them develop instruments and approaches that would reduce some of the critical risks. In particular, the project is concentrating on increasing understanding of financial institutions about specifics of agricultural technologies, as well as educating farmers about modern advanced technologies. This combined effort helps financial service providers to more accurately assess risks and stimulates producers to apply for loans to finance procurement and installation of modern technologies and equipment, in turn adding confidence to financial institutions on the likelihood of credit repays. As a result, lending grows and interest rates go down due to more realistic assessment of risks of particular credits.

During the AgroInvest design stage the Mission put major focus on the provision of technical assistance, and training to stimulate increased access to finance and planned to leverage capital for micro financing from other partners such as ACM (named CIDA funded company in the audit report) and EBRD. Initially ACM did not express interest in receiving technical assistance from AgroInvest as it had partnered with another CIDA funded project. As that project is soon coming to its end, ACM has notified AgroInvest about potential interest in partnership in the near future.

AgroInvest also signed an MOU with EBRD to work with their newly launched Micro Loan Program for agricultural producers. As soon as EBRD completes due diligence studies for its Ukrainian partner banks, we expect to be able to leverage substantial credit resources from this program by linking AgroInvest producer partners with EBRD partner banks.

The audit makes the following recommendations with regard to this finding:

8. **We recommend that USAID/Ukraine perform and document an analysis that considers the use of a microfinance instrument or grants to fully leverage partners under AgroInvest's Access to Finance component.**

We disagree with this recommendation. We consider it more efficient to spend limited resources on technical assistance as it has larger impact than subsidizing credit unions' interest rates through grants. In addition, experience of other regional missions has shown that provision of similar grants did not lead to sustainable results nor it did not help to considerably decrease high interest rates. For these reasons we do not consider moving forward in that direction.

9. **We recommend that USAID/Ukraine work with Chemonics International, Inc. to reassess Agroinvest's future relationship with commercial banks, dedicate more resources to activities with credit unions, and document the results.**

We agree with this recommendation. AgroInvest has already limited its technical assistance to three partner banks that have expressed strong interest in receiving this assistance. At the same time, the project will remain open for partnering with other banks should they request assistance in the future. This is reflected in the approved project's work plan for FY2013. Therefore, we consider this recommendation addressed.

Finding #6. AgroInvest's Reported Results Did Not Meet Data Quality Standards

We will implement a plan to ensure that reported PMP data meet ADS standards.

10. **We recommend that USAID/Ukraine work with Chemonics International, Inc. to implement a plan to verify that the results reported by AgroInvest**

comply with the data quality standards outlined in Automated Directives System 203.3.11.1.

We agree with this recommendation. At no cost for USAID, in December 2012 Chemonics has assigned its M&IE home office expert to work with AgroInvest field staff and USAID/Ukraine to develop a plan to ensure that AgroInvest's reported PMP data comply with ADS requirements. The plan is expected to be developed and approved by March 1, 2013 and fully implemented by June 30, 2013.

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