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United States General Accounting Office  
Washington, DC 20548

Office of the General Counsel

B-283261

September 14, 1999

The Honorable Benjamin A. Gilman  
Chairman, Committee on International Relations  
House of Representatives

The Honorable Doug Bereuter  
Chairman, Subcommittee on Asia and the Pacific  
Committee on International Relations  
House of Representatives

Subject: Foreign Assistance: Issues Concerning the Polish-American Enterprise Fund

In 1989, Congress enacted the Support for East European Democracy (SEED) Act to provide assistance for political and economic development in Eastern Europe.<sup>1</sup> Instead of providing more traditional types of foreign assistance, the Act, among other things, authorized enterprise funds to promote private sector development in Poland and Hungary through grants, loans, equity investments, and other measures.<sup>2</sup> This letter addresses issues raised by your staff regarding structural changes undergone by the Polish-American Enterprise Fund (Polish Fund) and its management company to enable them to operate more like private venture capital companies.<sup>3</sup> Specifically, we determined (1) whether these structural changes were permitted by law, (2) whether the purchase of the Polish Fund's management company by its employees at book value<sup>4</sup> was permitted by law and whether it favored the employees, (3) whether monies earned by Polish Fund management company employees contravened a \$150,000 salary cap, and (4) how proceeds from the sale of the Polish Fund's assets will be distributed.

<sup>1</sup>P.L. 101-179, 103 Stat. 1299, codified at 22 U.S.C. §§ 5401-5495.

<sup>2</sup>22 U.S.C. § 5421.

<sup>3</sup>In a separate report, Foreign Assistance: Enterprise Funds' Contributions to Private Sector Development Vary (GAO/NSIAD-99-221, Sept. 14, 1999), we address a number of broad issues regarding 10 U.S. enterprise funds, including the Polish Fund, in Central Europe, and the newly independent states of the former Soviet Union.

<sup>4</sup>Book value is the residual value of an entity's assets after deducting its liabilities.

For the reasons discussed in this letter, we concluded that structural changes to the Polish Fund and its management company were consistent with applicable legislation. We also concluded that the purchase of the Polish Fund's management company by its employees at book value was consistent with existing law and that, under the circumstances, the terms of the purchase were reasonable. Furthermore, we concluded that Polish Fund management company employees can earn more than \$150,000 in annual salary as long as additional amounts are derived from sources other than U.S. funds. Finally, regarding distribution of Polish Fund proceeds, the administration plans to return \$120 million to the U.S. Treasury and to provide the balance to a foundation for additional private-sector development in Poland.

CHANGES IN STRUCTURE TO THE POLISH FUND AND ITS MANAGEMENT COMPANY WERE CONSISTENT WITH THE SEED ACT

A. Background

Under the SEED Act, the Polish Fund was formed in 1990 as a private, nonprofit entity. The Fund is governed by a board of directors composed of both U.S. and host country citizens. The U.S. Agency for International Development (USAID) has provided grants to and oversees the Fund, and the Department of State is responsible for overall coordination of U.S. assistance under the SEED Act, including the enterprise fund program. USAID has authorized \$264 million in grants to the Polish Fund.

As early as 1991, USAID, State, and Fund officials began discussing altering the Polish Fund's structure. These changes involved spinning off the management of the Fund into a separate management company that would manage both the Fund's investments and those of an affiliated private fund. A vital part of the plan was to have Polish Fund employees leave their positions and become employees of the management company.

According to USAID, these changes were made to set up a structure that more closely paralleled a private-sector investment company that manages multiple investment funds. Polish Fund and USAID officials stated that this kind of structure would better attract private investors who would otherwise be reluctant to provide capital to an entity like the Polish Fund, which could have been perceived as being affiliated with the U.S. government. The changes also were intended to provide former Polish Fund employees with additional compensation incentives. Finally, according to USAID, the changes would lower the Polish Fund's management costs because management fees would be spread over two funds.

After the Polish Fund board of directors approved these changes to the Fund's structure, Enterprise Investors, L.P., was formed in 1992 to manage investments of both the Polish Fund and a new private investment fund named the Polish Private Equity Fund. The Polish Fund and the European Bank for Reconstruction and Development owned 60 percent and 40 percent, respectively, of Enterprise Investors. The Polish Private Equity Fund was capitalized at approximately \$150 million—

\$50 million from the Polish Fund, \$50 million from the European Bank for Reconstruction and Development, and the rest from other investors.

On September 25, 1996, USAID, with State's concurrence, approved a further elaboration of the process begun in 1992 by allowing employees of Enterprise Investors to purchase the company from the Polish Fund and the European Bank for Reconstruction and Development. It also approved formation of a second private fund, the Polish Enterprise Fund, L.P., capitalized at an additional \$150 million. According to State, these changes were intended to (1) emphasize U.S. policy to expand trade and investment ties with Poland; (2) bring more money under Enterprise Investors' management, which would further reduce the fee charged to the Polish Fund;<sup>5</sup> (3) attract additional capital; and (4) increase compensation possibilities for Enterprise Investors' employees and thereby reduce the risk of loss of staff.

The employees of Enterprise Investors purchased their company, which had been renamed Enterprise Investors Corporation, on April 30, 1997. This entity currently manages the Polish Fund, the Polish Private Equity Fund, and the Polish Enterprise Fund.<sup>6</sup> According to the Polish Fund, the total management fees for 1998 were \$7.5 million, with \$1.5 million paid by the Polish Fund and the remainder paid by the two private funds.<sup>7</sup>

## B. Legal Discussion

The Polish Fund's structural changes were permitted by the SEED Act. The act indicates that the Polish Fund is a private, nongovernmental entity that received funds to develop the Polish private sector. The act authorized the Polish Fund to engage in transactions that would attract U.S. private venture capital; establish financial instruments that would enable individuals to invest in the private sector in Poland; and distribute to private investors returns on investments that include private venture capital. These authorities were intended to maximize the effectiveness of Polish Fund activities and multiply the impact of U.S. grants.<sup>8</sup> USAID attorneys

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<sup>5</sup>When compared with its capital, operating expenses of the Polish Fund are the lowest of the 10 enterprise funds discussed in the report mentioned in footnote 3.

<sup>6</sup>The Polish Fund has indicated that an additional private fund might be formed, which would also be managed by Enterprise Investors Corporation.

<sup>7</sup>In September 1997, the Hungarian Fund implemented structural changes similar to those of the Polish Fund. At that time, MAVA Investment Management Kft. was formed to manage both the Hungarian Fund and a private fund sponsored by the Hungarian Fund, Hungarian Equity Partners, which was capitalized at \$50 million to invest in the private sector in Hungary. MAVA is owned by former Hungarian Fund employees. At this point, the Hungarian Fund is associated with only this one private fund. USAID has tentatively approved similar changes for the Russian Fund and Bulgarian-American Enterprise Fund, and the Department of Defense has approved them for the Defense Enterprise Fund, but none have been fully implemented. Although it is likely that other enterprise funds will make similar changes in the future, this will depend on how well the private markets are operating in the area covered by each.

<sup>8</sup>22 U.S.C. §§ 5421(i) and (j).

concluded that the private character of the Polish Fund, as well as these authorities, allowed it to make the described changes in structure.

As a private entity, the Polish Fund could establish a management company staffed by its former employees, who would also manage affiliated private investment funds. The SEED Act clearly intended that the Fund enter into financial arrangements, including attracting private capital, that would enhance private-sector development in Poland. Consistent with this intention, in 1994 USAID amended its grant agreement with the Polish Fund to allow it to establish, invest in, or finance subsidiaries and affiliates, which have substantially the same directors, managers, and employees, provided it receives USAID's prior written approval. According to USAID, the Polish Fund received the required approval regarding the purchase of Enterprise Investors by its employees<sup>9</sup>

#### EMPLOYEES' PURCHASE OF ENTERPRISE INVESTORS WAS CONSISTENT WITH APPLICABLE LEGISLATION

##### A. Background

Before USAID approved the sale of Enterprise Investors to its employees, USAID, State, and Polish Fund officials had a number of discussions about the details of the purchase. State was concerned about the appearance of a conflict of interest because the two individuals who were to serve as directors of the employee-owned management company would also continue to serve as Polish Fund directors. Thus, State wanted to ensure that the directors would not be involved in valuing Enterprise Investors for sale to its employees. To deal with this problem, the two directors agreed to recuse themselves from any votes of the Polish Fund board of directors concerning Enterprise Investors, and State and USAID agreed that the Polish Fund should obtain an independent valuation of Enterprise Investors that would be used to negotiate a fair and equitable price.

Initially, USAID and State considered a number of pricing elements for the independent valuator to consider, including the book value of Enterprise Investors, the market value of all its assets, prices in comparable transactions involving professional fund managers, and its net present value. Ultimately, however, the Polish Fund board decided, and State and USAID agreed, that the purchase price should be based solely on book value. The Fund asked the independent valuator to determine the book value of the company.

USAID also considered publicly bidding the sale of Enterprise Investors but eventually abandoned this idea. According to USAID and State officials, this approach risked losing Enterprise Investors' staff, which was making the company successful. Furthermore, though USAID officials were aware that other venture capital firms were operating in Poland, no such groups had indicated any interest in purchasing Enterprise Investors.

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<sup>9</sup>According to USAID, Congress was notified of these changes.

Subsequently, an independent auditor concluded that, as of April 30, 1997, the book value of Enterprise Investors was approximately \$485,000.<sup>10</sup> The book value assets included furniture, computers, and telephones in leased space. Enterprise Investors' employees purchased their company on April 30, 1997. The terms of the sale called for Enterprise Investors' employees to pay the \$485,000 to the Polish Fund and the European Bank for Reconstruction and Development, the former owners of Enterprise Investors, in four equal yearly installments with no interest. The first payment was to be made on April 30, 1998, 1 year after the sale. According to the Polish Fund, the payments have been made for 1998 and 1999.

## B. Legal Discussion and Valuation Issue

USAID, State, and the Polish Fund board of directors were acting within their authority in arranging to sell Enterprise Investors at book value and not publicly competing the sale. Neither the SEED Act nor any other law required any particular method of valuing Enterprise Investors. Moreover, the sale of Enterprise Investors to its employees was an entirely private transaction that was not subject to federal procurement laws and regulations.

Although the terms of the sale were advantageous to Enterprise Investors' employees, under the circumstances, they were reasonable. The facts indicate that Enterprise Investors' employees purchased an established, successful entity at the book value price of \$485,000. Furthermore, as a consequence of the purchase, these employees became managers of a second private fund, the Polish Enterprise Fund, from which they could earn additional salary and profits on investments.<sup>11</sup> Venture capital experts that we interviewed said that sales of venture capital management companies are rare and that there is no fixed method of valuation when they do occur; however, most agreed that, at least as a general matter, valuation of such entities with a portfolio of successful investments should include some amount based on potential future income in addition to book value. Finally, the other terms of the sale—no public competition, payments over 4 years at no interest, and the first payment due a year after the sale—appear favorable to Enterprise Investors' employees.

Notwithstanding these factors, USAID's and State's approving the sale under these circumstances was reasonable. According to USAID and State officials, the primary reason for limiting the valuation to book value was the need to preserve continuity of Enterprise Investors' staff, which was critical to the success of the Polish Fund and to the raising of further capital for the second private fund, the Polish Enterprise Fund. If the purchase price exceeded book value, all or part of Enterprise Investors' staff

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<sup>10</sup>The independent valuation was performed as part of an audit of Enterprise Investors' consolidated financial statements as of April 30, 1997.

<sup>11</sup>The formation of the Polish Enterprise Fund was linked to the purchase of Enterprise Investors by its employees. According to State, without privatization, the Polish Fund could not assure private investors that Enterprise Investors was stable; that is, that it could pay competitive compensation to retain key investment staff.

could have been lost to a competing entity. USAID and State officials cited the lack of continuity of management in the Czech-Slovak Enterprise Fund as causing major disruptions of its operations and did not want to risk that happening to the Polish Fund. USAID and State officials also stated that any goodwill<sup>12</sup> value that accrued to Enterprise Investors was due to the skill and experience of its employees rather than its name or the services it provided. Thus, it was not appropriate to charge Enterprise Investors' employees for the value of their own experience.

The State and USAID position was supported by several venture capital experts who agreed that book value was an appropriate method of valuation when necessary to ensure the continuity of management company staff. They also emphasized that the principal value—the goodwill—in any venture capital management company lay in the expertise of its personnel. If valued employees left a management company, private investors would have no interest in continuing their relationship with it.

COMPENSATION RECEIVED BY ENTERPRISE  
INVESTORS' EMPLOYEES DOES NOT  
CONTRAVENE SALARY CAP

A. Background

Although the SEED Act itself does not place a specific dollar limit on compensation,<sup>13</sup> the Polish Fund grant agreement precludes salaries of its employees, and employees of organizations in which the Fund owns a majority interest, from exceeding \$150,000 on monies payable from grant funds.<sup>14</sup> USAID and Fund officials agree that this limitation extends to salaries paid to Enterprise Investors' employees from management fees attributable to the Polish Fund, even though the Fund has no ownership interest in Enterprise Investors. USAID monitors the salary cap by reviewing the Polish Fund's semiannual report, which contains the Fund's statement that the Fund is complying with the salary cap.<sup>15</sup>

When Enterprise Investors was formed in 1992, Polish Fund employees terminated their employment with the Fund and became employees of Enterprise Investors. At that point, the former Fund employees began receiving salary through management fees the Polish Fund and the Polish Private Equity Fund paid Enterprise Investors for management services. This new arrangement afforded these employees two sources of additional compensation: first, they could earn additional salary through management fees paid by the Equity Fund; and second, they could share in profits on

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<sup>12</sup>Goodwill value represents the excess of the purchase price of an entity over the fair value of all identifiable net assets at the time of acquisition.

<sup>13</sup>22 U.S.C. § 5421(1).

<sup>14</sup>The same provision is included in the grant agreements of the other enterprise funds.

<sup>15</sup>USAID does not directly audit the Polish Fund's books and records to determine compliance with the salary cap.

Equity Fund investments—commonly referred to as carried interest.<sup>16</sup> Similar compensation benefits were again provided to Enterprise Investors' employees when the Polish Enterprise Fund was formed in April 1997.

USAID and the Polish Fund have indicated that no employee of Enterprise Investors currently earns more than \$150,000 from Polish Fund contributions to salary. They also indicated, however, that a number do earn substantially more from management fees attributable to the Polish Private Equity Fund and the Polish Enterprise Fund.<sup>17</sup> Although carried interest payments derived from investments of these two private funds will probably be made to Enterprise Investors' employees in the future, the Fund indicated that none have been made to date. Neither USAID, the Polish Fund, nor Enterprise Investors could provide us with any estimates about how much carried interest might eventually be paid.

## B. Legal Discussion

The additional compensation payments resulting from the changes in structure to the Polish Fund and Enterprise Investors do not contravene the \$150,000 salary cap set forth in the Fund's grant agreement with USAID. The grant agreement clearly indicates that compensation or profit-sharing that exceeds \$150,000 per year may be paid from earnings or sources other than U.S. grant funds. Since the salary payments to employees of Enterprise Investors that exceed \$150,000 are derived from private sources, they are not subject to the agreed salary cap for Enterprise Investors' employees. The same would be true for any profits on investments that may be paid in the future.

## DISTRIBUTION OF POLISH FUND PROCEEDS

### A. Background

The SEED Act did not provide for termination of the Polish Fund (or the Hungarian Fund) or describe how its assets were to be distributed upon liquidation. The only reference to this issue in the legislative history is a Congressional Budget Office estimate included in the accompanying House Report.<sup>18</sup> The report states that the estimate of costs of providing grants to the two enterprise funds assumed "full disbursement . . . and no repayments, dividends, or recoveries to the federal

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<sup>16</sup>To avoid conflict of interest problems about Enterprise Investors steering investments away from the Polish Fund, from which carried interest could not be earned, the limited partnership agreement of the Polish Private Equity Fund stated that investment opportunities had to be presented to both entities simultaneously. The amounts invested by each entity were to be determined in proportion to monies available for investment from each fund.

<sup>17</sup>The Polish Fund and Enterprise Investors stated that their contracts with private investors precluded them from providing us with specific information about private salaries. The Hungarian Fund informed us that one MAVA employee was paid more than \$150,000 in 1998, but that it did not contribute more than \$150,000.

<sup>18</sup>H. Rep. 101-278, at 17, 19-20 (Pt. 2 1989).

government from the Funds' activities." When these enterprise funds were first established, many U.S. officials did not expect them to recoup their original grants.

In part because of the success of Polish Fund investments, as early as 1992, administration, congressional, and Polish Fund officials concluded that a plan was necessary to terminate the Fund. Accordingly, after consulting with congressional appropriators, in 1994 USAID amended the Polish Fund grant agreement, and the Polish Fund amended its certificate of incorporation, to provide for termination of the Fund and liquidation and distribution of its assets. The amended certificate of incorporation states that the President of the United States is to determine how liquidated Polish Fund assets will be distributed. Distributions are to be made to a nonprofit entity or entities for assistance in Poland, the U.S. government, or a combination of both. The amended certificate also included a proviso stating that the intention of the amendment was to have "the proceeds from the sale of . . . [Polish Fund] assets be used in Poland, unless there are reasons to do otherwise."

In 1996, the Polish Fund board began discussions with the administration about disposition of the proceeds from the sale of Polish Fund assets. Subsequently, the administration developed a distribution plan that called for Fund proceeds to be divided between the U.S. Treasury and the endowment of a foundation whose purpose would be the further development of the Polish private sector, a goal consistent with that of the Polish Fund under the SEED Act.<sup>19</sup> Under the plan, \$155.3 million was to be returned to the U.S. Treasury and a maximum of \$130 million was to be provided to the foundation. Whereas the Polish Fund focused exclusively on the business sector, the foundation was intended to focus on the broader private sector, including nongovernmental organizations. The proposed foundation was to be a Delaware corporation with operations in Poland.

## B. Current Plan

The administration's current plan,<sup>20</sup> which, to some extent, was based on the 1996 proposal, was submitted to Congress on May 11, 1999, consistent with a notification requirement in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for fiscal year 1999.<sup>21</sup> Under the plan, \$120 million of the

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<sup>19</sup>In formulating this plan, the administration considered but rejected a proposal to return all Polish Fund proceeds to the U.S. Treasury because it would have been politically unpopular in Poland, with the Polish American community, and with Poland's supporters in Congress. The administration also considered a proposal to provide all the proceeds to a Polish entity, but decided that turning close to \$270 million over to a new and untested foundation would have been unwise and would not allow for the first substantial return to U.S. taxpayers on an assistance program. The administration also concluded that such a plan would not be well received by members of the Congress who wanted a substantial portion of the proceeds returned to the United States.

<sup>20</sup>State and USAID considered several variations of the current plan. Thus, the administration dropped a proposal (1) dividing reflows between the United States, a Polish foundation, and several trust funds supporting activities in Central Europe and the Baltic states; (2) returning to the United States an amount based on the original \$240 million U.S. capitalization of the Polish Fund; and (3) terminating the Fund.

estimated \$270 million in returns on Polish Fund investments is to go to the U.S. Treasury in amounts of \$40 million each in fiscal years 1999, 2000, and 2001. The \$120 million represents one-half the amount of the initial \$240 million in grant funds that USAID was authorized to provide to the Polish Fund. The Polish Fund will provide the balance, an estimated \$150 million, to a U.S. entity named the Polish-American Freedom Foundation, as a grant in the form of an endowment. The Foundation will be a nonprofit Delaware corporation, and its principal business will be conducted through a wholly owned and controlled subsidiary organized under Polish law.

After the administration submitted its plan to Congress, the Polish Fund drafted a grant agreement setting forth the relationship between the Polish Fund and the Foundation and describing the scope of the Foundation's activities. Concurrently, USAID drafted amendments to its grant agreement with the Polish Fund to provide for the grant relationship between the Polish Fund and the Foundation. Drafts of these documents have been reviewed and approved by USAID, State, other relevant U.S. agencies and the Polish Fund.

The grant agreement between the Polish Fund and the Polish Foundation provides that the Foundation's endowment, estimated to be \$150 million, will be used to support private sector development in Poland<sup>22</sup> in the areas of economic reform, leadership development, civil society, local government and business development, and legal reform, consistent with section 201(a) of the SEED Act. The grant agreement also authorizes the Foundation to support assistance programs in other countries in Central and Eastern Europe and the Western newly independent states in their transition to democracy and free markets, but only after legislative authority is obtained. Administration officials said they would seek legislation to authorize Foundation activities outside of Poland because the SEED Act only authorizes Polish Fund activities for private sector development in Poland. Both the grant agreement and the amendments to the USAID-Polish Fund grant agreement provide that for its first 5 years the Foundation must restrict its activities to the five areas described in the grant agreement.<sup>23</sup>

The Foundation will be managed by a board of directors composed of six U.S. and five Polish citizens, some of whom will be Polish Fund board members, according to State. The initial board will be appointed by the Polish Fund, and the board members will select a chairman. Board members will serve staggered 3-year terms, and subsequent board members will be elected by the Foundation. The U.S. Ambassador to Poland will be a permanent, nonvoting liaison to the Foundation board.

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<sup>21</sup>P.L. 105-277, 112 Stat. 2681-200.

<sup>22</sup>As a general matter, the Foundation cannot spend the endowment's principal for its activities. Foundation activities must be financed by earnings generated by the endowment or funds obtained from outside sources. Endowment principal can only be used under extraordinary circumstances and must be restored as soon as practicable.

<sup>23</sup>An amendment to the Polish Fund-USAID grant agreement indicates that the Polish Fund will continue to exist as long as the Foundation is operating.

The U.S. members of the Foundation's board of directors will not be compensated for their services but will be reimbursed for reasonable expenses. The Polish members, however, will be compensated. Foundation employees will be subject to a \$150,000 salary cap much like that covering Polish Fund employees and employees of Enterprise Investors. Compensation exceeding \$150,000, however, can be paid from sources other than the Foundation endowment and endowment proceeds. According to State and USAID officials, the additional salary could come from contributions to the Foundation from private entities. These officials also stated, however, that there are no plans for the Foundation to undergo the kind of structural changes made to the Polish Fund, with the attendant enhanced compensation possibilities.

The Foundation's grant agreement with the Polish Fund provides the Polish Fund, the USAID Inspector General, and the Comptroller General of the United States with a right to audit and resolve all questions regarding endowment expenditures. This audit right includes access to Foundation records necessary to complete an audit. The grant agreement also includes conflict of interest provisions imposing disclosure and recusal requirements on Foundation directors and officers when considering transactions with entities in which they hold a financial interest. These provisions also preclude Foundation directors, officers, and employees from using confidential or privileged information for financial gain or other advantage.

Finally, both the grant agreement and the amended grant agreement between USAID and the Polish Fund authorize the Polish Fund to terminate, or USAID<sup>24</sup> to cause the Fund to terminate, the grant agreement for (1) the Foundation's failure to comply with the grant agreement, (2) foreign policy reasons, (3) insolvency, (4) unauthorized changes in structure, and (5) improper Polish taxation of U.S. foreign assistance. Should termination occur, Foundation funds are to be returned to USAID.<sup>25</sup> According to State, this right of termination will both protect the U.S. interest in the Foundation and allow the United States to direct the use of any returns.

#### SCOPE AND METHODOLOGY

To address the questions raised, we reviewed the SEED Act and its legislative history as well as other relevant legislation, regulations, and congressional correspondence. We also discussed the issues raised with State, USAID, and Polish Fund officials and attorneys, and reviewed documentation provided by each. For further information concerning the valuation of the sale of Enterprise Investors to its employees, we interviewed a number of graduate business school professors and private venture capitalists.

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<sup>24</sup>USAID must first consult with the Polish Fund's board of directors before exercising this right.

<sup>25</sup>A USAID attorney indicated that the return of the funds to USAID instead of directly to the U.S. Treasury was primarily for convenience and that USAID would have to return the money to the U.S. Treasury.

AGENCY COMMENTS  
AND OUR EVALUATION

State, USAID, and Polish Fund officials provided written comments on a draft of this report (see enclosures I, II, and III, respectively). They also provided technical comments that we have incorporated, as appropriate. State and USAID characterized the report as thorough and balanced.

In the Polish Fund's written comments to this report, the Fund disagreed with our conclusion that the terms of the sale of Enterprise Investors to its employees were advantageous to the employees. The Fund concluded that valuing the sale at book value was appropriate and, thus, the terms of the sale were fair and reasonable. We agree that the sale of Enterprise Investors to its employees at book value was a reasonable way of preserving continuity of the Enterprise Investors' staff and avoiding disruption in management. Nevertheless, arranging a sales price without including some potential for future income, and allowing purchase payments over 4 years at no interest with the first payment due a year after the sale, was advantageous to Enterprise Investors' employees.

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Unless you publicly announce its contents earlier, we plan no further distribution of this letter until 30 days after its issue date. At that time, we will send copies to the Honorable Madeleine K. Albright, the Secretary of State; the Honorable J. Brady Anderson, the Administrator of USAID; and other interested congressional committees. We will also make copies available to others upon request.

If you or your staff have any questions concerning this report, please contact me on (202) 512-5400 or Richard Seldin on (202) 512-4094. Other GAO contacts and staff acknowledgments are listed in enclosure IV.



Robert P. Murphy  
General Counsel

COMMENTS FROM THE DEPARTMENT OF STATE

United States Department of State

Chief Financial Officer

Washington, D.C. 20520-7427

AUG 25 1999

Dear Mr. Hinton:

We appreciate the opportunity to review your draft report, "FOREIGN ASSISTANCE: Issues Concerning the Polish Enterprise Fund," GAO/OGC-99-61R, GAO Job Code 711353.

The Office of the Coordinator of Assistance for Eastern Europe has reviewed the above-referenced draft report. We consider this report regarding the structural changes undergone by the Polish-American Enterprise Fund (PAEF), which was referred to as the "Polish Fund" in the report, to be thorough and balanced. We note that the structural changes enabled the PAEF to raise more than \$262 million in non-U.S. Government (USG) capital, and to reduce the cost to U.S. taxpayers to manage its USG grant. The structural changes enabled the PAEF to retain their investment team, whose efforts are expected to return an estimated \$270 million in reflows, which will be split between a payment to the U.S. Treasury and the planned establishment of the Polish-American Freedom Foundation.

If you have any questions concerning this response, please contact Mr. Donald Sheehan at (202) 647-1183.

Sincerely,

A handwritten signature in cursive script that reads "Bert Edwards".

Bert T. Edwards

Cc:

GAO/OGC – Mr. Seldin  
State/EUR/EEA – Mr. Sheehan

Mr. Henry L. Hinton, Jr.,  
Assistant Comptroller General,  
National Security and International Affairs,  
U.S. General Accounting Office.

COMMENTS FROM THE U.S. AGENCY FOR  
INTERNATIONAL DEVELOPMENT



U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

August 19, 1999

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

Dear Mr. Hinton:

I am pleased to provide the U.S. Agency for International Development's (USAID's) formal response on the GAO draft report entitled "FOREIGN ASSISTANCE: Issues Concerning the Polish Enterprise Fund" [August 1999].

Your report on the issues raised regarding the structural changes undergone by the Polish-American Enterprise Fund (Polish Fund) and its management company is thorough and balanced. The structural changes enabled the Polish Fund to mobilize \$262 million in non-U.S. Government capital, (more than their USAID grant), and to reduce the cost to U.S. taxpayers to manage the grant. The changes enabled the Polish Fund to retain their investment team, one that will likely return about \$270 million to be split between the U.S. Treasury and a philanthropic foundation in Poland.

USAID appreciates the efforts of the GAO to address the issues covered in this report. Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

A handwritten signature in black ink, appearing to read "Terrence J. Brown".

Terrence J. Brown  
Assistant Administrator  
Bureau for Management

1300 PENNSYLVANIA AVENUE, N.W.  
WASHINGTON, D.C. 20523

COMMENTS FROM THE POLISH-AMERICAN  
ENTERPRISE FUND

Polish-American Enterprise Fund

Robert G. Farns  
President & Chief Executive Officer

August 26, 1999

Richard Seldin, Esq.  
Senior Attorney  
Office of General Counsel  
National Security and International Affairs Division  
U.S. General Accounting Office  
441 G Street, N.W.  
Room 7662  
Washington, D.C. 20548

Dear Mr. Seldin:

The Polish-American Enterprise Fund requests that the following comments be included in the forthcoming General Accounting Office report on "Issues Concerning the Polish-American Enterprise Fund":

The goal of establishing a private management company and raising private funds was to help in meeting the overall PAEF (and USG) objectives of (1) leveraging USG money; (2) replacing USG money with private sector funds; and (3) reducing PAEF operating costs.

The results are that (1) USG money has been leveraged. PAEF invested and loaned \$655 million through September 30, 1998 after receiving only \$240 million of investment funds from the USG; (2) PAEF has replaced USG funds with private funds, and thus can return \$120 million to the USG and provide approximately \$150 million to a USG-approved foundation to assist Poland; and (3) because PAEF's overhead costs have been shared with the private funds, PAEF's operating costs are less than 0.7% of its assets, resulting in savings to the USG of an estimated \$25-30 million.

FUND ADVISORS, ENTERPRISE INVESTORS

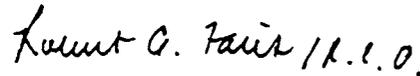
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Richard Seldin, Esq.  
August 26, 1999  
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With respect to pages seven and eight of the report, the PAEF agrees with the position of the State Department, USAID, and the venture capital community, that book value is the appropriate method for valuing an entity such as Enterprise Investors. Therefore, the terms of the sale of Enterprise Investors to its employees were fair and reasonable, and not advantageous to them, as the GAO suggests on page seven. The apparent inconsistency between page seven (where venture capitalists conclude that book value was "not an appropriate measure") and page eight (where venture capitalists conclude that the valuation was appropriate) is the difference between a theoretical view of the venture capital world by non-practitioners, and the real world.

Sincerely,



Robert G. Faris  
President and Chief Executive Officer

cc: Robert Murphy, Esq.  
General Counsel

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