



OFFICE OF INSPECTOR GENERAL

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION THRESHOLD PROGRAM ADMINISTERED BY USAID/PARAGUAY

AUDIT REPORT NO. 1-526-09-010-P
SEPTEMBER 2, 2009

SAN SALVADOR, EL SALVADOR



Office of Inspector General

September 2, 2009

MEMORANDUM

TO: USAID/Paraguay Mission Director, Rose Rakas

FROM: Regional Inspector General/San Salvador, Catherine Trujillo /s/

SUBJECT: Audit of the Millennium Challenge Corporation Threshold Program Administered by USAID/Paraguay (Report No. 1-526-09-010-P)

This memorandum transmits our final report on the subject audit. We have carefully considered your comments on the draft report in finalizing the audit report and have included your response in appendix II of the report.

The report contains eight recommendations intended to improve the effectiveness and implementation of the Millennium Challenge Corporation's threshold program administered by USAID/Paraguay. Final action has been taken on recommendation no. 2, while a management decision has been reached on the remaining recommendations (nos. 1, and 3-8). Determination of final action will be made by the Audit Performance and Compliance Division upon completion of the planned corrective actions.

I want to express my appreciation for the cooperation and courtesy extended to my staff during the audit.

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SUMMARY OF RESULTS

To help Paraguay meet a criterion for control of corruption, which would make Paraguay competitive for expanded funding from the Millennium Challenge Corporation (MCC), the MCC approved a two-year threshold program in February 2006 to help Paraguay fight corruption. The program has been extended to May 30, 2009. Totalling \$34.6 million, the program was to focus on reducing impunity for corrupt practices in the public sector and informal economic activity. As of February 2009, \$34.6 million has been obligated and \$28.7 million has been spent. Aside from the Government of Paraguay (GOP), the main implementing partners were Casals & Associates (\$21.7 million contract), Chemonics International, Inc. (\$10.2 million contract), and the Department of Treasury (\$1.9 million agreement) (pages 3-4).

The Regional Inspector General/San Salvador performed this audit to determine whether the Millennium Challenge Corporation threshold program administered by USAID/Paraguay achieved planned results and to assess the program's impact (page 4).

Based on the most current information available from the World Bank, the program did not achieve its overall goal of enabling Paraguay to exceed the median score on the World Bank's "control of corruption" indicator for low income countries and thus become eligible for assistance through a compact with the MCC. However, the program was successful in reducing informal economic activity and was partially successful in reducing impunity. Due to the progress achieved, MCC has agreed to a second threshold program, estimated to be over \$30 million, to build upon the progress made in the initial program (page 6).

More specifically, the program achieved planned results related to (1) average time required to process complaints, (2) reduction of value-added tax evasion rate, (3) value of seized merchandise for alleged infringement of customs regulations, (4) corruption cases properly submitted to the Public Ministry, (5) number of days to start a business, and (6) number of maquila¹ enterprises established. The program partially achieved planned results related to the number of cases investigated using the forensics laboratory, number of government institutions implementing new standards for internal control, and number of government institutions exchanging public registry data. The program was not successful in increasing the number of government institutions subject to oversight by the Congress (page 6).

To increase the likelihood of reaching MCC compact eligibility, USAID/Paraguay needs to (1) coordinate with implementing partners and the GOP to establish an action plan to complete certain activities (page 8), (2) focus custom and border enforcement activities more closely on Ciudad del Este, which is thought to be the center of smuggling activity in Paraguay (page 10), (3) include indicators under the new program showing more impact toward the MCC score cards (page 11), (4) work with the parties involved so that boats procured for the GOP are functional and being utilized (page 13), and (5) schedule a security system evaluation for the identification and passport system (page 14).

¹ A maquila is a manufacturing or assembly plant that imports components free of customs duties and then exports the finished products.

This report recommends that USAID/Paraguay:

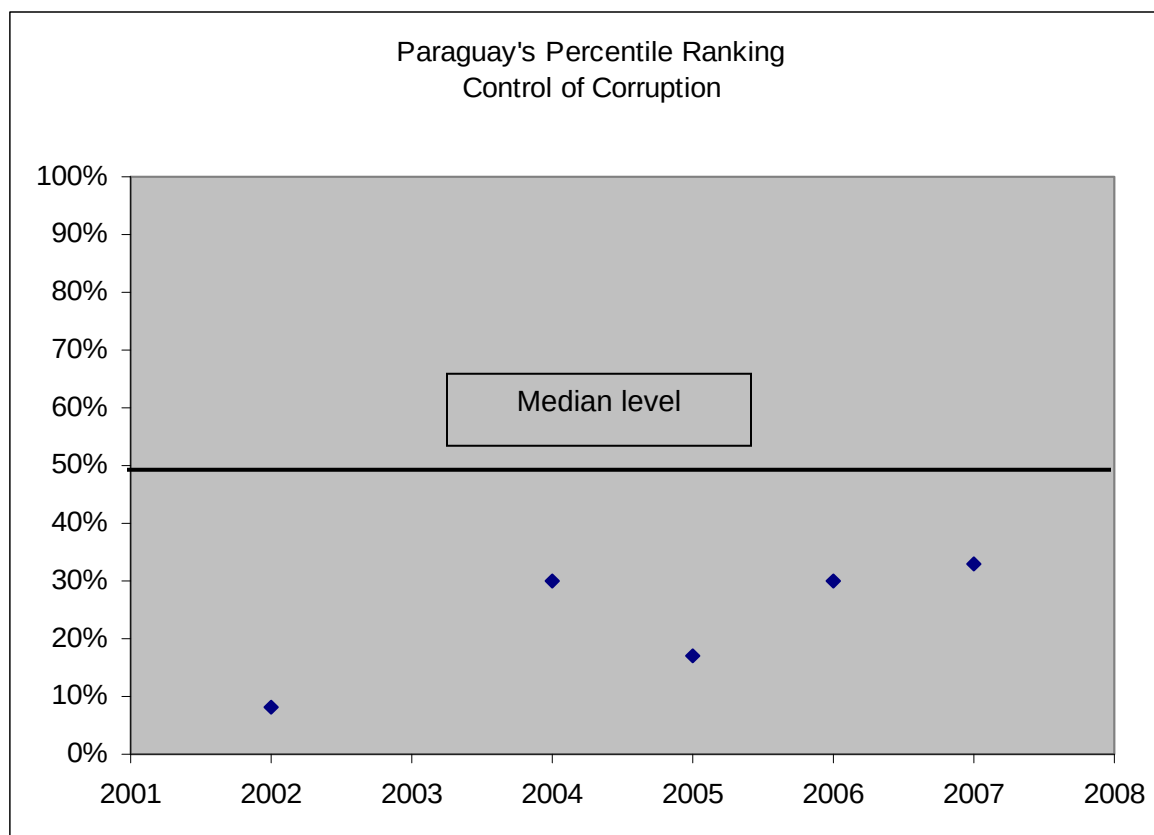
- In coordination with the implementing partner and the GOP, establish an action plan with benchmarks and timeframes to assess the capabilities of staff in the forensics laboratory and provide necessary training, complete the implementation of strengthened internal controls in five ministries, and implement an online interface for public registry information (page 10).
- Include a clause in the agreement for the second threshold program that would allow it to recover any expenditures that are wasted as a result of failure of the Government of Paraguay to fulfill its obligations under the agreement (page 10).
- Focus border and customs control activities during the follow-on program on Ciudad del Este (page 11).
- In coordination with its implementing partners, establish procedures to track statistics on outcomes related to complaints of judicial misconduct, customs law enforcement actions, and tax and customs evasion cases (page 12).
- In coordination with DETAVE, verify that all maintenance issues and/or manufacturing defects have been resolved to put the 10 idle boats costing \$357,320 in operation (page 14).
- Ensure that DETAVE develops and implements an action plan for maintaining and using the boats (page 14).
- Formalize a procedure to conduct periodic end-use checks for commodities purchased under the program (page 14).
- In coordination with its partners, budget for and schedule an independent security assessment of the identification and passport system as soon as possible (page 15).

USAID/Paraguay agreed to implement the recommendations and has developed specific plans to address them. Final action has been taken on recommendation no. 2, while a management decision has been reached on the remaining eight recommendations (nos. 1, and 3-8). Our evaluation of management comments is provided in the Evaluation of Management Comments section of this report (page 16), and USAID/Paraguay's comments in their entirety are included in appendix II.

BACKGROUND

Paraguay meets all of the eligibility requirements to receive assistance through a compact with the Millennium Challenge Corporation (MCC) except for the criterion for control of corruption. To meet the criterion, Paraguay must score above the median for low-income countries on the World Bank's control of corruption indicator. Figure 1 shows Paraguay's scores on the control of corruption indicator since 2002.

Graph 1: Paraguay's Percentile Ranking on the World Bank's Control of Corruption Indicator, 2002-2007 (Latest Information Available)²



To help the Government of Paraguay (GOP) fight corruption, USAID and the GOP signed the Millennium Challenge Account threshold program strategic objective grant agreement (SOAG) for Paraguay in May 2006. This program, totaling \$34.6 million, was originally expected to end November 30, 2008, but has since been extended to May 30,

² The standard errors for 2002, 2004, 2005, 2006, and 2007 were plus or minus 1.4, 4.8, 2.6, 4.5, and 4.6 percent, respectively. There is roughly a 70 percent chance that Paraguay's percentile ranking for the level of corruption lies within plus or minus the stated standard errors. For example, with a standard error of 4.6 for 2007, there is a 70 percent probability that Paraguay's percentile ranking for the level of corruption was between 28.4 and 37.6 percent (33 percent plus or minus 4.6 percent).

2009. As of February 2009, \$34.6 million had been obligated and \$28.7 million had been spent. Another extension until August 2009 is anticipated in order to complete the implementation of a national identification card and passport system. The program includes 10 components. Components 1 through 5 focus on reducing impunity by implementing effective sanctions for corrupt practices. Components 6 through 10 focus on reducing informal economic activity by improving tax and customs enforcement and improving the investment climate. Although this is an MCC program with MCC funding, USAID/Paraguay has been given responsibility for administering and monitoring the implementation of the program.

USAID/Paraguay's Threshold program works with 28 GOP institutions ranging from the Public Ministry (prosecutor's office) to the Ministry of Finance. Other main implementing partners include the following:

- Casals & Associates – Casals was awarded a \$21.7 million contract from the period May 2006 to April 2009. Casals was responsible for implementing Components 1-5 related to reducing impunity.
- Chemonics International, Inc. – Chemonics was awarded a \$10.2 million contract from the period May 2006 to February 2009. Chemonics was responsible for implementing Components 6, 7, 9, and 10 related to reducing informal economic activity and the acquisition of goods for component 8.
- U.S. Department of Treasury – The Office of Technical Assistance was awarded a \$1.9 million agreement for the period September 2006 to March 2009. A technical advisor provided technical assistance on Component 8, which focused on strengthening GOP investigation units for corruption, customs fraud, and tax fraud and evasion.

The MCC has consented to a second threshold program that will build on progress achieved during the initial program by targeting improved performance on the World Bank's control of corruption and rule of law indicators. The \$30.3 million program, not yet signed, will focus on anti-corruption efforts in law enforcement, customs, and the healthcare and judicial sectors.

AUDIT OBJECTIVE

As part of its FY 2009 audit plan, the Regional Inspector General/San Salvador performed an audit of USAID/Paraguay's Millennium Challenge Corporation Threshold Anti-Corruption Activities to answer the following question:

- Did the Millennium Challenge Corporation threshold program administered by USAID/Paraguay achieve planned results and what has been the impact?

The audit scope and methodology are presented in appendix I.



Source: U.S. Central Intelligence Agency

AUDIT FINDINGS

Based on the most current information available from the World Bank, the program did not achieve its overall goal of enabling Paraguay to exceed the median score on the World Bank's "control of corruption" indicator for low income countries and thus become eligible for assistance through a compact with the MCC. However, the program was successful in reducing informal economic activity and was partially successful in reducing impunity. Due to the progress achieved, MCC has agreed to a second threshold program to build on the progress made during the initial program.

More specifically, the program helped reduce informal economic activity by reducing value-added tax (VAT) evasion, seizing merchandise that was allegedly smuggled into Paraguay, reducing the number of days required to start a business, increasing the number of corruption cases presented to the Public Ministry for prosecution, and helping to establish new *maquila* enterprises.³ The program helped reduce impunity by reducing the time required to process complaints against judges, and more limited progress has been toward strengthening internal controls in five GOP ministries. In addition, with program support, a USAID contractor is in the process of implementing an automated system for issuing national identity cards and passports, which should reduce opportunities for producing fraudulent documents and make it easier for government institutions investigating crimes to exchange information online. Some other program accomplishments are discussed in Table 1, which compares planned results with actual accomplishments as of November 2008, the original planned completion date for the program.

Table 1: Main Indicators for the Two-Year Threshold Program

Component Goal	Indicator	November 2008 Target	November 2008 Result
1. Increase the investigative capability of the Public Ministry	Number of cases investigated by newly trained personnel using the forensics laboratory	10	0
2. Increase the capability of the judiciary disciplinary system	Average time required to process complaints related to disciplinary cases	4 months	4 months
3. Strengthen internal control systems	Number of government institutions implementing new standards for internal control	5	5 in process of meeting target
4. Strengthen oversight of the public registry to safeguard the integrity of public records	Number of government institutions exchanging public registry data online	3	3 in process of meeting target
5. Increase transparency and effectiveness of public finance legislative oversight	Number of government institutions subject to budget execution oversight by the Congress	5	0

³ *Maquilas* are manufacturing or assembly plants that import components free of customs duties and then export the finished products while only paying duties on the value-added (value of the finished product less the cost of the imported components).

Component Goal	Indicator	November 2008 Target	November 2008 Result
6. Increase operational efficiency and transparency of government tax authority	Reduce VAT evasion rate	51%	51%
7. Strengthen border and customs controls	Value of seized merchandise on goods for alleged infringement of customs regulations	\$6.5 million	\$6.7 million
8. Increase the Ministry of Finance's internal investigation capabilities	Corruption cases properly submitted to the Public Ministry	13	143
9. Design and implement one-stop shops and call centers to facilitate the legal establishment of new businesses	Average number of days spent to start a business	36	25
10. Promote investment in maquilas	Number of <i>maquila</i> enterprises established	15	31

As shown in the table above, USAID/Paraguay, along with its implementing partners and the GOP, achieved some important results and impacts as follows:

- The program was able to dramatically reduce the number of days to start a business from 74 days to 25 days. The program also assisted the GOP to establish a one-stop shop for registering a business, which reduced the number of procedures from 17 to 7. In addition to reducing the administrative burden on entrepreneurs, this reduces opportunities for bribery and petty corruption. According to a report by the World Bank, Paraguay improved from a "starting a business" rank of 135 in 2007 to a rank of 66 in 2008. Making it easier to start a business helps improve Paraguay's investment climate.
- The program assisted 31 entrepreneurs to formally set up *maquila* enterprises in Paraguay. These enterprises created formal jobs tied to export markets and helped encourage additional investment in the country.



This *maquila* in Ciudad del Este exported blankets and comforters to Brazil. Photo taken by a RIG/San Salvador auditor on March 13, 2009.

- The program assisted in reducing the percentage of businesses evading the

collection and payment of the value added tax, and thus, helps formalize the economy and brings about more equitable sharing of the tax burden.

- USAID/Paraguay and its partners demonstrated success in strengthening border and customs controls by helping the GOP increase seizures of goods for alleged infringement of customs regulations. (However, the impact of this component can be increased by focusing more closely on Ciudad del Este, thought to be the center of smuggling activity in Paraguay, during the planned follow-on threshold program; see page 10).



Wine seized near the Asuncion border with Argentina from an importer that was allegedly attempting to evade custom duties. Photo taken by a RIG/San Salvador auditor on March 17, 2009.

The program has not been successful in increasing the number of cases investigated by a new forensics laboratory, although USAID/Paraguay and its partner have equipped the laboratory, nor has it achieved success in increasing legislative oversight over executive branch institutions. In addition, as USAID/Paraguay moves toward initiating a new two-year threshold program, there are opportunities to strengthen program impacts and better measure progress under the follow-on program. These issues are discussed in the following sections.

Four Program Components Achieved Only Limited Results

Summary: The program did not achieve certain planned results, primarily due to lack of focus, priority, or political will on the part of certain GOP counterparts. These planned results were related to the forensics laboratory, implementing stronger internal controls in government institutions, exchanging identification and other public registry information online, and strengthening oversight by the Congress over government institutions. All of these planned results were meant to reduce impunity regarding corruption. As of February 2009, \$12.2 million has been spent on these four components. The implementation problems experienced under the program made the program less effective in helping Paraguay strengthen its performance on the World Bank's control of corruption indicator and thus become eligible for MCC compact assistance.

The program did not achieve four planned results as discussed below:

- Under Component 1 (increasing the investigative capability of the Public Ministry) the forensics laboratory was not yet functioning. USAID/Paraguay and its partner had

coordinated their planned assistance to the forensics laboratory through discussions with an attorney general in the previous presidential administration that left office in September 2005. However, we were told that when he left and was replaced by a second attorney general, also during the previous administration, the focus of getting the laboratory operational suffered because of other priorities. To date, USAID's partner has installed laboratory equipment and trained laboratory personnel. However, the implementing partner related that some laboratory staff may not have the basic skills required to benefit from the new equipment and training, and may not be able to effectively investigate cases using forensic techniques. An October 2008 assessment of the laboratory recommended that the technical competence of each member of the forensic lab staff be evaluated, and that specific training on forensic applications be given. As a result of these challenges, no cases have yet been investigated as of March 2009 using the forensics laboratory.



Forensics laboratory equipment provided by the program and recently installed in the laboratory in Asuncion, but not yet used. Photo taken by a RIG/San Salvador auditor on March 18, 2009.

- Component 3 (strengthening internal control systems in GOP ministries) was delayed because the previous administration did not issue a required Presidential decree that would mandate the process to be followed by GOP ministries to evaluate their business processes and, ultimately implement stronger internal controls. USAID/Paraguay issued a temporary stop work order in September 2007, but then partially lifted it in November 2007 when the GOP promised to issue the decree. However, we were told that the decree that was issued was too vague to be of use. Finally, after a change in administration in August 2008, a satisfactory decree was issued. Currently five ministries are following the process to evaluate and strengthen their internal controls but none of them have completed the process.
- Under Component 4 (strengthening oversight of the public registry to safeguard the integrity of public records), a major activity involves procurement and installation of an automated national identity card and passport system. Implementation was delayed by misconduct on the part of GOP officials during the procurement.⁴ After

⁴ Details are available in the OIG's "Audit of the Procurement Process for a National Identification Card and Passport System Financed by the Millennium Challenge Corporation and Monitored by USAID/Paraguay" (audit report number 1-526-08-005-P, June 27, 2008).

the misconduct was discovered, the previous administration declined to accept the decisions made by USAID/Paraguay's contractor and little was accomplished until a new administration took office. The new administration is still organizing itself and has not yet reached consensus on the need to establish an online interface for public registry data (e.g., national identification card information and motor vehicle registration information), a main goal for this component, but they have agreed to the procurement and installation of an automated national identity card and passport system.

- USAID/Paraguay issued a stop work order for component 5 (increasing legislative oversight) in February 2007 due to the lack of political will of Congress to implement the activity. As of February 2009, the implementing partner had spent a total of \$340,764 on this activity, primarily for technical assistance and training to the Congress. USAID/Paraguay reallocated the remaining budget of about \$1.2 million to other activities.

The problems experienced on these program components impeded the program's effectiveness in reducing impunity and helping improve Paraguay's score on the World Bank's control of corruption indicator. Moreover, where the GOP did not meet its commitments to carry out activities that the GOP itself had requested – as with the legislative oversight activities under Component 5 – MCC resources were spent with little effect. USAID/Paraguay needs to ensure that planned benefits under the current program are achieved to the extent possible, and it needs to better protect itself under the follow-on program against the possibility that changes in political will or priorities might lead to unproductive expenditures of MCC resources.

Recommendation No. 1: We recommend that USAID/Paraguay, in coordination with the implementing partner and the Government of Paraguay, establish an action plan with benchmarks and timeframes to assess the capabilities of staff in the forensics laboratory and provide necessary training, complete the implementation of strengthened internal controls in five ministries, and implement an online interface for public registry information.

Recommendation No. 2: We recommend that USAID/Paraguay include a clause in the agreement for the second threshold program that would allow it to recover any expenditures that are wasted as a result of failure of the Government of Paraguay to fulfill its obligations under the agreement.

Customs and Border Enforcement Activities Need to Focus More Heavily on Ciudad del Este

Summary: It is widely acknowledged that Ciudad del Este is the center for smuggling activities in Paraguay. However, the threshold program focused instead on customs enforcement activities in Asuncion, where the headquarters of the customs department are located, because USAID/Paraguay and its partner did not think that they had sufficient resources to confront the more powerful interests centered in Ciudad del Este. While this perspective is, at the least, defensible, we think it is likely that the decision not to focus on Ciudad del Este limited the program's potential to achieve the kind of transformational results that would have helped Paraguay meet the control of corruption criterion and thus qualify for MCC compact assistance.

Ciudad del Este, located on the Paraná River which adjoins both Brazil and Argentina, is thought to be the most important center for smuggling activities in Paraguay. For example, the Economist Intelligence Unit 2008 Country Profile for Paraguay states that Ciudad del Este is Paraguay's smuggling center for smuggled goods on the border with Brazil and Argentina. It seems unlikely that the GOP could very dramatically improve customs enforcement without focusing at some point on Ciudad del Este.

However, program activities to strengthen border and customs control focused on headquarters operations in Asuncion, and only \$598,974 (9 percent) of the \$6.7 million in illicit merchandise seized under the program was seized in Ciudad del Este. The decision to focus, at least at first, on Asuncion is understandable, given that efforts to reform government institutions are often begun at the headquarters level and later expanded to regional and local levels. It should also be noted that Asuncion borders Argentina, so there are real customs enforcement concerns in Asuncion. Moreover, program officials stated that insufficient resources were available to take on the powerful interests that operate in Ciudad del Este.

Still, based on discussions with officials of a GOP anti-contraband unit and a U.S. Department of Treasury official, it is our opinion that the decision not to focus on Ciudad del Este limited the program's potential to achieve the kind of dramatic, highly visible results that would change corruption perceptions enough to increase Paraguay's score on the control of corruption above the median for low-income countries and thus enable Paraguay to become eligible for MCC compact assistance.

USAID/Paraguay envisions a more robust effort that will focus more heavily on Ciudad del Este during the upcoming threshold 2 program. However, these plans have not been finalized.

Recommendation No. 3: We recommend that USAID/Paraguay focus border and customs control activities during the follow-on program on Ciudad del Este.

Some Additional Program Impacts Need to Be Tracked

Summary: At the highest level, the threshold program has a very clear indicator of success: MCC compact eligibility. Most of the program components also had satisfactory measures of program impact, but in a few cases, tracking additional statistics on outcomes would help USAID/Paraguay measure the impact of activities carried out under individual program components.

The overall goal of the threshold program is to reduce impunity and informal economic activity, leading to MCC compact eligibility. The goal of achieving MCC compact eligibility provides a very clear indicator of program success at the highest level. Most of the program components also had satisfactory measures of program impact, but in three cases we think it would be valuable for USAID/Paraguay to track additional statistics to monitor the program's impact:

- The goal of Component 2 was to increase the capability of the judiciary disciplinary system and the associated performance indicator is the average time required to

process complaints related to disciplinary cases. This indicator measured the speed of the disciplinary process, which is valuable information, but USAID/Paraguay was not tracking the outcomes of cases (i.e., the numbers of cases where no wrongdoing was found, the number that led to disciplinary action, and so on).

- The goal of Component 7 was to strengthen border and customs controls and the associated performance indicator is the value of merchandise that is seized for alleged infringement of customs regulations. Again, this is valuable information, but presumably USAID/Paraguay and its partners are also concerned about the final disposition of seized merchandise and any associated criminal or civil cases (i.e., duties and fines paid, criminal penalties assessed, amounts of merchandise released back to importers, etc.). A U.S. Department of Treasury official stated that, without these and similar statistics, it is difficult to judge how increased seizures of merchandise relate to improved compliance with customs laws and regulations.
- The goal of Component 8 was to increase the Ministry of Finance's internal investigation capabilities and the associated performance indicator tracks the number of tax and customs evasion cases properly submitted to the Public Ministry. As in the previous examples, this is valuable information but the outcome of the cases (e.g., cases where an indictment is filed, cases dismissed, cases with convictions, etc.) is probably of even greater interest, even though the program does not finance any activities that would influence the disposition of cases within the Public Ministry or the court system.

Note that for all of these cases, we are not advocating that formal indicators or performance targets be established for outcomes. Instead, we are simply advocating that USAID/Paraguay compile statistics on the outcomes.

USAID/Paraguay and its implementing partners used program indicators that measured outcomes that could be significantly influenced by program activities and for which performance targets could be set. This is a sound approach, but, given the overall program goal of helping Paraguay become eligible for MCC compact assistance, tracking statistics on the intermediate outcomes outlined above will likely help.

Recommendation No. 4: We recommend that USAID/Paraguay, in coordination with its implementing partners establish procedures to track statistics on outcomes related to complaints of judicial misconduct, customs law enforcement actions, and tax and customs evasions cases.

Patrol Boats Purchased Under the Program Are Not Being Used

Summary: Twelve boats, costing \$414,704, were procured under the program to help the GOP strengthen border control and customs enforcement. However, four of these boats were in the shop, two were not properly working, and four were not being used. GOP officials stated that one of the boats had leaks in the fuel tank and structural problems, and they were concerned that other boats had similar problems. We were told that the boats were idle because DETAVE did not have personnel to operate them and because DETAVE did not have a plan for maintaining the boats. As a result, as of March 2009, 10 boats costing \$357,320 were not being used. This impairs the GOP's ability to enforce border and customs regulations.

Under Component 7, 12 boats costing \$414,704 were procured under the program to help the GOP strengthen border control and customs enforcement. These boats were given to a special unit of the GOP called DETAVE, an anti-contraband unit with border patrol and customs enforcement responsibilities. Although Paraguay is a landlocked country, Paraguay has river borders with Argentina and Brazil. DETAVE did not have its own boats previously and the boats were to provide DETAVE with its own surveillance capability along these river borders. Six boats were delivered to DETAVE in April 2008, and the remaining six boats were delivered in December 2008. The boats were purchased from a local manufacturer.



Four of the 12 boats purchased under the program in Asuncion. The program purchased four large boats (depicted here) and eight smaller boats. Photo taken by a RIG/San Salvador auditor on March 17, 2009.

As of March 2009, 10 of the 12 boats were either in the shop for maintenance, not properly working, or not being used. (Four of these boats were in the shop, two were not properly working, and four were not being used.) GOP officials stated that one of the boats had leaks in the fuel tank as well as structural problems, and they were concerned that five other boats not yet used had similar problems.⁵ During our visit we confirmed

⁵ GOP officials were of the opinion that many of these issues were due to manufacturing defects, while the manufacturer maintains that the problems occurred because the boats were kept idle for long periods of time and were not properly maintained.

that fuel was leaking from one of the motors. Some of these issues were not discovered immediately because the six boats received in December 2008 were immediately returned to the manufacturer because DETAVE did not have dock space for the boats.



Fuel leaking from a motor on a boat in Asuncion. Photo taken by a RIG/San Salvador auditor on March 26, 2009.

There were several reasons why the boats were idle. First, we were told that DETAVE had high personnel turnover and personnel shortages. Second, DETAVE does not have a maintenance plan for the boats. Third, had the mission followed USAID policy, Section 324.5.6 of the Automated Directives System which states that USAID shall carry out, or arrange to have carried out, end-use checks on commodities, the issue of the idle boats could have been detected in a timelier manner. While this section mentions that it is not necessary that every commodity be checked, given that the boats are high-value items and 12 boats were purchased, it would have been advisable for USAID/Paraguay to have conducted end-use checks on at least some of the boats.

As a consequence, 10 boats purchased under the program at a cost of \$357,320 remain idle, impeding the GOP's ability to enforce border and customs regulations.

Recommendation No. 5: We recommend that USAID/Paraguay, in coordination with DETAVE, verify that all maintenance issues and/or manufacturing defects have been resolved to put the 10 idle boats costing \$357,320 in operation.

Recommendation No. 6: We recommend that USAID/Paraguay ensure that DETAVE develops and implements an action plan for maintaining and using the boats.

Recommendation No. 7: We recommend that USAID/Paraguay formalize a procedure to conduct periodic end-use checks for commodities purchased under the program.

A Security Assessment of the Identification and Passport System Is Needed

Summary: Best practices dictate that security assessments should be performed of information systems to determine the adequacy of security controls. The threshold program is financing an automated identification and passport system with a target date for completion of August 2009. However, no security assessment of the system has been done and there are no plans or funds budgeted to conduct an assessment of this system because program personnel have focused on the immediate task of developing the system rather than on conducting or planning for security assessments of the system. It is important to perform a security assessment as soon as possible to limit the consequences of any security vulnerabilities.

Best practices require that critical information systems be assessed to ensure that adequate security controls are in place. For example, the National Institute of Standards and Technology's (NIST) publication Special Publication 800-53, entitled "Recommended Security Controls," revised in December 2007, indicates that government organizations should conduct an assessment of the security controls over information systems at least annually to determine the extent to which the controls are implemented correctly, operating as intended, and producing the desired outcome with respect to information security.⁶ USAID/Paraguay's information technology specialist acknowledges that such assessments are needed.

This system being developed under Component 4 at an estimated cost of \$5.4 million is intended to strengthen the registration and identification of persons and to maintain a more reliable system of personal identification and passport system. The company developing the system has a target completion date of August 2009. Currently, no security assessment of the system has been done and there are no plans or funds budgeted to conduct a security assessment of this important system.

No such plans have been developed because to date the focus has been on completing development of the system.

Given the critical nature of the personal identification information to be stored in the system and the need to protect the system against manipulation and issuance of fraudulent identification documents, it is important to conduct a security assessment of the system as soon as possible. Identifying any security control weaknesses early on will help limit the consequences of any vulnerabilities.

Recommendation No. 8: We recommend that USAID/Paraguay, in coordination with its partners, budget for and schedule an independent security assessment of the identification and passport system as soon as possible.

⁶ This publication is not binding on the GOP but is cited as an example of best practices.

EVALUATION OF MANAGEMENT COMMENTS

In response to our draft report, USAID/Paraguay agreed to each of the eight audit recommendations. Furthermore, the mission has or intends to develop specific plans to implement each recommendation. On the basis of an evaluation of the mission's response to the draft report, this audit determined that final action has been taken on recommendation no. 2, while a management decision has been reached on the remaining recommendations (nos. 1, and 3-8). Determination of final action will be made by the Audit Performance and Compliance Division upon completion of the planned corrective actions.

Mission comments in their entirety are presented in appendix II.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/San Salvador conducted this performance audit in accordance with generally accepted Government auditing standards to determine if the Millennium Challenge Corporation (MCC) threshold program administered by USAID/Paraguay achieved planned results and to assess the program's impact. 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 based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Audit fieldwork was conducted at USAID/Paraguay from March 9 through March 27, 2009. The audit primarily covered the period from May 31, 2006, through November 30, 2008.

In planning and performing the audit, we assessed the effectiveness of management controls related to the MCC threshold program. Specifically, we obtained an understanding and evaluated (1) the strategic objective grant agreement (SOAG) and subsequent implementation letters, (2) USAID/Paraguay's Federal Managers' Financial Integrity Act of 1982 assessment, (3) oversight and monitoring performed by USAID/Paraguay officials, (4) performance measures, and (5) reports on actual program results. We also conducted interviews with key USAID/Paraguay personnel, the main implementing partners, Government of Paraguay (GOP) officials, and beneficiaries. We conducted the audit at USAID/Paraguay, located in Asuncion, Paraguay, visited implementing partners and beneficiaries located in Asuncion, and conducted site visits in Asuncion and Ciudad del Este.

Methodology

To answer the audit objective, we reviewed the SOAG and subsequent implementation letters for planned results. We also reviewed quarterly reports for actual results reported for the ten components of the program.

We validated performance results reported by USAID/Paraguay by comparing reported results to source documentation, physical observations during our field visits and interviews, and other available sources of information.

We reviewed applicable laws and regulations, agreements, and USAID policies and procedures pertaining to the threshold program and USAID including the following: USAID/Paraguay's Federal Managers' Financial Integrity Act of 1982 assessment; the National Institute of Standards and Technology's publication on Recommended Security Controls for Federal Information Systems; the SOAG and subsequent implementation letters implementing partners' contracts; and Automated Directives System Chapter 324 titled "Post Procurement."

We interviewed USAID/Paraguay officials, a U.S. Department of Treasury official, a U.S. Department of Justice official, the main implementing partners, GOP officials, and businessmen to determine progress toward achieving intended results. We conducted

site visits to the main warehouse in Asuncion for seized goods for alleged infringement of customs regulations. We also conducted site visits to see 6 of 12 boats purchased under the program and cross checked serial numbers from an inventory list against those on the boats. We performed similar steps for 3 of the 20 vehicles purchased under the program. Finally, we visited 4 of 31 *maquila* enterprises assisted under the program.

MANAGEMENT COMMENTS

June 29, 2009

TO: Timothy Cox, Regional Inspector General/San Salvador

FROM: Robert Kahn, Acting USAID/Paraguay Mission Director

SUBJECT: Comments on the Draft Report of the Audit of the Millennium Challenge Corporation Threshold Program Administered by USAID/Paraguay (Report No. 1-526-09-00X-P)

Dear Mr. Cox:

Thank you for the opportunity to respond to audit Report No. 1-526-09-00X-P entitled "Audit of the Millennium Challenge Corporation Threshold Program". We have reviewed the audit carefully, and would like to make the following comments:

Recommendation No. 1: We recommend that USAID/Paraguay, in coordination with the implementing partner and the Government of Paraguay, establish an action plan with benchmarks and timeframes to assess the capabilities of staff in the forensics laboratory and provide necessary training, complete the implementation of strengthened internal controls in five ministries, and implement an online interface for public registry information.

We concur with the recommendation.

Regarding the forensics laboratory, USAID/Paraguay in conjunction with the Government of Paraguay (GOP) has included in Threshold Program (TCP) phase II an extensive implementation, training, support and sustainability plan, which will be implemented once TCP II activities are initiated. The timeframe for completion is October 30, 2011.

There is a subcomponent in TCP II aimed at promoting and extending the gradual use of the Standardized Model for Internal Control (SMIC). With Threshold Program assistance, the GOP Controller's Office will develop and put into place a plan for the gradual implementation of SMIC. This plan will be developed jointly with the participating institutions and in coordination with the General Audit Office of the Executive Branch of the GOP. This TCP II subcomponent will engage institutions that have not yet incorporated the SMIC, as well as provide support to the five ministries that took part in TCP I in order to sustain full SMIC implementation in those institutions. The timeframe for completion is October 30, 2011.

For the online interface among the Public Registries to be fully implemented, each of the 4 Registries, as well as the Public Ministry and the Ministry of Interior within the GOP need to come to an agreement on: 1) Which institutions will be the beneficiaries of the system and, 2) Which public office will have the responsibility to administer that system.

This lack of agreement within the GOP was the primary reason for this activity not being completed during TCP I, and continues to exist in the current administration.

However, USAID/Paraguay supports in concept the recommendation, "...that USAID/Paraguay, in coordination with the implementing partner and the GOP, establish an action plan with benchmarks and time frames..." to implement the online interface.

TCP I activities for this subcomponent terminated in November 2008. Therefore, there is not an implementing partner with whom USAID/Paraguay and the GOP could coordinate.

Notwithstanding this reality, USAID/Paraguay will encourage the appropriate public offices and Ministries to reach consensus on the items mentioned above. USAID/Paraguay will follow-on and assist the GOP in the articulation of an action plan for the implementation of this online interface. The timeframe for completion is October 30, 2011.

Recommendation No. 2: We recommend that USAID/Paraguay include a clause in the agreement for the second threshold program that would allow it to recover any expenditures that are wasted as a result of failure of the Government of Paraguay to fulfill its obligations under the agreement.

We concur with the recommendation.

An extensive and self-explanatory provision on recovering wasted expenditures is included in Annex 2 – Section E.2 Refunds of the SOAG signed between the GOP and the USG on April 13, 2009. A PDF version of the signed agreement is attached to this memorandum.

Recommendation No. 3: We recommend that USAID/Paraguay focus border and customs control activities during the follow-on program on Ciudad del Este.

We concur with the recommendation.

Even though Customs seizures in the Ciudad del Este area (Alto Parana Department) represented approximately 25% of total seizures nationwide during TCP I, in TCP II a stronger border control program will be implemented in this area. A regional base for DETAVE will be established in Ciudad del Este and will become the most important regional customs base in the country. Customs also will focus on other control mechanisms, such as *a posteriori* controls on imports, audits of foreign trade operators, etc. The timeframe for completion is October 30, 2011.

Recommendation No. 4: We recommend that USAID/Paraguay, in coordination with its implementing partners establish procedures to track statistics on outcomes related to complaints of judicial misconduct, customs law enforcement actions, and tax and customs evasions cases.

We concur with the recommendation.

Procedures to track the statistical outcomes of judicial misconduct are included in TCP II as part of an extensive follow up to strengthen activities in this area. There will

be continuous monitoring of the implementation and outcomes of these new controls and disciplinary systems within the Judiciary. The timeframe for completion is October 30, 2011.

During the implementation of TCP II, the Program will support the development and implementation of a system for tracking seizures related to customs and tax fraud. This system will enable Customs and USAID/Paraguay to track statistics on outcomes, identify potential bottlenecks and take steps that will allow Customs to increase its effectiveness of enforcement actions. The timeframe for completion is October 30, 2011.

Recommendation No. 5: We recommend that USAID/Paraguay, in coordination with DETAVE, verify that all maintenance issues and/or manufacturing defects have been resolved to put the 10 idle boats costing \$357,320 in operation.

We concur with the recommendation.

For the past several months, USAID has been working closely with Customs officials to resolve the problems encountered with the boats. To date, five of the boats that were idle are currently working. These five boats had minor mechanical problems and required no-cost repairs. The other five boats require repairs that will incur costs which will be assumed by Customs. We expect all boats to be functional by September 30, 2009.

Recommendation No. 6: We recommend that USAID/Paraguay ensure that DETAVE develops and implements an action plan for maintaining and using the boats.

We concur with the recommendation.

USAID/Paraguay is currently working with Customs to develop an action plan for the maintenance and use of the boats. As a result of these discussions, Customs has already contracted Yamaha's local dealer (the source of most of the outboard engines) to provide the recommended maintenance, some of which has already been performed. USAID expects to have the maintenance and use plan in place by September 30, 2009.

Recommendation No. 7: We recommend that USAID/Paraguay formalize a procedure to conduct periodic end-use checks for commodities purchased under the program.

We concur with the recommendation.

USAID/Paraguay will formalize existing procedures to conduct end-use checks on commodities purchased under the program. These procedures will include quarterly site visits conducted by the designated USAID activity manager. Any deficiency or problem detected in the use of the commodities will be reflected in the site visit report. These deficiencies will be brought to the attention of the implementing partners and the appropriate GOP office or Ministry for corrective action. We expect these procedures to be formalized by the beginning of TP II activities, and will start to be utilized at the end of the first quarter of program implementation.

Recommendation No. 8: We recommend that USAID/Paraguay, in coordination with its partners, budget for and schedule an independent security assessment of the identification and passport system as soon as possible.

We concur with the recommendation.

An IT security assessment on the current ID software and networking systems was carried out under the Threshold Program in 2008. The report of this assessment was presented to the ID Department's Chief Officer and his technical staff. The report was also taken as an input to outline the hardware and software security elements of the new IT systems to be implemented by the Threshold Program. The assessment was performed independently by a different company than the one in charge of implementing the new identification and passport system.

The deployment of the new system is scheduled for August 2009. After that, the subcontractor will provide a one-year warranty. During this period any hardware malfunction or software bugs will be addressed as part of the warranty. In addition, the subcontractor will provide an initial eight weeks of onsite support and subsequently eight additional weeks of online support as part of the terms of the warranty. Once the system is fully operational and certified by the ID Department, USAID will follow up on the status of the system, and will encourage the GOP to conduct a new independent security assessment within a year of the deployment of the system. If funds were to become available, USAID would seek to financially support this independent security assessment.

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