Office of Inspector General

November 26, 2013

Mr. Daniel W. Yohannes
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

Dear Mr. Yohannes:

The enclosed statement summarizes the Office of Inspector General's (OIG's) conclusions on the most serious management and performance challenges facing the Millennium Challenge Corporation (MCC). Our decisions on which challenges to report were based primarily on audits and analyses performed on MCC's operations. More challenges may exist in areas that we have not yet reviewed, and other significant findings may result from future work.

The Reports Consolidation Act of 2000 (Public Law 106-531) requires that agency performance and accountability reports include a statement prepared by each agency's inspector general summarizing the most serious management and performance challenges facing the agency and reporting the agency's progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2013 agency financial report.

We have discussed the management and performance challenges summarized in this statement with responsible MCC officials. If you have any questions or wish to discuss the statement further, please contact me or Tim Cox, Acting Deputy Inspector General, at 202-712-1150.

Sincerely,

/s/

Michael Carroll
Acting Inspector General

Enclosure: a/s

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STATEMENT BY THE OFFICE OF INSPECTOR GENERAL ON THE MILLENNIUM CHALLENGE CORPORATION'S MOST SERIOUS MANAGEMENT AND PERFORMANCE CHALLENGES

Fiscal Year 2013

MCC faces its most serious management challenges for achieving its goals in three areas: managing for results, financial management, and information technology management.

MANAGING FOR RESULTS

MCC provides foreign aid to countries that meet its policy performance indicators of ruling justly, investing in people, and encouraging economic freedom. To date, 25 countries have met these requirements and been awarded more than $9 billion through compact agreements used to reduce poverty and increase economic growth through programs in agriculture, roads, education, health, and tourism. During fiscal year (FY) 2013, MCC had 16 active compacts in its portfolio: Burkina Faso, Cape Verde, Georgia, Indonesia, Jordan, Lesotho, Malawi, Moldova, Mongolia, Morocco, Mozambique, Namibia, Philippines, Senegal, Tanzania, and Zambia, which together were awarded more than $6 billion for projects. MCC faces challenges in ensuring that these compacts achieve planned results. These challenges occur in the context of compact development, compact implementation, and project sustainability.

Compact Development

It takes MCC and a partner country about 2 years to complete the compact development process. During that time, they conduct analyses; define, develop, and appraise a project; negotiate and sign a compact; and prepare for the compact's entry into force. Upon entry into force, the fixed 5-year implementation period starts.

A recent review and audit both noted the need for improvements in compact development. In its review of MCC's compact modifications, OIG reported that MCC significantly modified project activities in 9 of the 23 compacts in place at that time.[1] OIG specifically reported incomplete planning in 6 of the compacts, which were significantly modified because MCC underestimated construction quantities and unit costs during planning. As a result, costs increased during compact implementation, and the compacts had to be modified to reduce the project scope.[2] Meanwhile, OIG's audit of MCC's funding of activities in Mongolia determined that MCC had to revise goals for the number of new property rights registrants downward by 29 percent after it discovered that the data it relied on during planning was not accurate.[3]

[1] OIG defined significant modifications as a cumulative change in project costs of at least $10 million, or a 25 percent change in either the estimated economic rate of return or estimated number of beneficiaries.
[2] "Review of the Millennium Challenge Corporation's Compact Modifications," Report No. M-000-12-006-S, July 20, 2012.
[3] "Audit of the Millennium Challenge Corporation's Funding of Activities in Mongolia," Report No. M-000-12-001-P, March 22, 2012.

Compact Implementation

MCC and the partner country complete compact implementation through a Millennium Challenge Account (MCA) over the 5-year compact term. The MCA is staffed by a team of management, procurement, finance, monitoring and evaluation, and legal professionals, as well as specialists for the specific sectors in the compact, such as infrastructure and agriculture. The MCA procures contractors' services to carry out the compact's projects.

Three recent audits and reviews have noted the need for improvement in compact implementation in the areas of completing timely feasibility studies and designs, managing contractor performance, and resettling people affected by projects.

- OIG reported that the project activities in Mozambique might not achieve their revised goals because contractors were late in providing studies, designs, and cost estimates needed to procure construction contractors. In addition, some construction contractors were not meeting their deadlines and were not properly using advance payments for mobilization.[4]

- OIG reported that MCC significantly modified 30 percent of its compacts because of implementation challenges, and those compacts did not or will not achieve planned results as initially envisioned as a result. In several cases, these implementation challenges arose from poor project management or oversight.[5]

- Many projects that MCC funds involve resettlement (i.e., moving people or acquiring their property). MCC requires MCAs to implement resettlement activities and provide appropriate compensation to people who lose land, assets, or access to resources due to an MCC-funded project. In this audit, OIG found problems with resettlement activities in an MCC-funded road construction project in Ghana. OIG identified concerns with MCC's assessment of livelihood restoration, timely compensation to people affected by the project, and shortcomings with documentation on resettlement payments. In El Salvador, the second country OIG visited, people affected by resettlement were generally satisfied with the process and their compensation.[6]

Sustainability

To make sure project benefits can be sustained over time, MCC requires that sustainability considerations be accounted for within compacts. Sustainability can take a number of forms, such as requiring a partner country to increase its contributions to a road maintenance fund so

[4] "Audit of the Millennium Challenge Corporation's Programs in Mozambique," Report No. M-000-13-003-P, January 31, 2013.
[5] "Review of the Millennium Challenge Corporation's Compact Modifications," Report No. M-000-12-006-S, July 20, 2012.
[6] "Audit of the Millennium Challenge Corporation's Resettlement Activities," Report No. M-000-13-002-P, December 6, 2012."

when a completed MCC-funded road is turned over to the country, adequate funding is available for its care. OIG audits and reviews consider the sustainability of MCC-funded projects and examine whether adequate provisions are in place. Two recent reports show that MCC's efforts to ensure sustainability could be improved.

- The sustainability of an MCC-funded fruit tree productivity project in Morocco was at risk because olive trees may receive less maintenance than outlined in the project's design. Maintenance activities were to be performed over a 2-year contract period to help the trees become viable. However, development of the technical planting details took longer than anticipated, which then delayed planting and reduced the amount of time contractors had for maintenance. In addition, the audit questioned farmers' ability to maintain the trees following the 2-year period in which maintenance was to be provided.[7]

- Funds made available by the Senegalese Government were inadequate to provide annual maintenance for an MCC-funded roads project. Similarly, the long-term sustainability of MCC-funded irrigation works was also at risk due to inadequate maintenance services and funding. OIG reported that MCC is taking action to ensure that adequate funding is available to maintain the investments in roads and irrigation.[8]

FINANCIAL MANAGEMENT

Financial management is critical to developing reliable financial information and to ensuring that operations are effective and efficient, including the use of an entity's resources. Significant MCC activities, liabilities, and expenses occur in compact programs implemented by various MCAs across the globe.

While MCC received an unqualified opinion on its FY 2012 financial statements, the audit report reported on one material weakness and three significant deficiencies in internal control. Two issues in particular indicate ongoing challenges to MCC's ability to prepare complete, reliable financial statements.

- MCC's financial management system follows the guidance prescribed by the Federal Accounting Standards Board, whereas the independent MCAs established by recipient countries do not. MCC addresses this challenge by adjusting its grant liabilities at the MCC level, in order to bring the cash basis reporting by MCAs to MCC's accrual basis. Last year, MCC revised its accrual methodology, and it currently uses disbursement history, unused spending authority, and invoices received but not paid to estimate accruals. However, MCC continues to have challenges with accumulating adequate relevant historical data to accurately estimate accruals. Further, MCC's new accrual validation process has not been fully

[7] "Audit of the Millennium Challenge Corporation-Funded Fruit Tree Productivity Project in Morocco," Report No. M-000-12-005-P, June 15, 2012.
[8] "Audit of the Millennium Challenge Corporation-Funded Program in Senegal," Report No. M-000-13-001-S, March 18, 2013.

implemented. The auditors will continue to examine accrual estimation methodology during the current financial statement audit.

- MCC's accounting department continues to rely on some manual financial reporting processes. This continues to be a control deficiency because manual processes are more vulnerable to human error.

INFORMATION TECHNOLOGY MANAGEMENT

Since FY 2008, OIG has reported information technology (IT) management challenges that affect MCC. For FY 2013, OIG continues to consider MCC's Privacy and IT Governance Programs to be serious management challenges. In addition, OIG considers IT security to be a new challenge going into FY 2014.

Privacy Program

During FY 2012, OIG followed up on MCC's implementation of selected recommendations in a July 2010 audit report on MCC's Privacy Program.[9] The follow-up audit concluded that five recommendations had not been implemented fully and identified a number of new weaknesses. Therefore, OIG made 24 recommendations to strengthen the program.[10]

By the end of FY 2013, MCC completed final action on 20 of the 24 recommendations. Three of the four outstanding recommendations address training, which is an important component of a privacy program. Therefore, OIG continues to consider the shortcomings within MCC's Privacy Program as a management challenge. MCC plans to take final action on the training-related recommendations by November 2013.

IT Governance

In January 2011, OIG reported that weaknesses in MCC's IT governance process led MCC to spend more than $6.9 million for a system that only partially met its needs.[11] Six months later, in June 2011, an OIG contracted audit reported that similar weaknesses may (1) increase IT project costs, (2) lengthen deployment, and (3) deliver solutions that do not satisfy business needs.[12]

OIG made 32 recommendations in two reports to help MCC achieve an appropriate level of IT governance and control. In response, MCC developed a 17-month plan to improve IT

[9] "Audit of the Millennium Challenge Corporation's Implementation of Key Components of a Privacy Program for its Information Technology Systems," Report No. M-000-10-003-P, July 9, 2010.
[10] "Follow-up Audit of the Millennium Challenge Corporation's Implementation of Key Components of a Privacy Program for its Information Technology Systems," Report No. M-000-12-002-P, March 30, 2012.
[11] "Audit of the Millennium Challenge Corporation's Implementation of Selected Key Project Controls for the MCC Integrated Data Analysis System," Report No. M-000-11-002-P, January 31, 2011.
[12] "Risk Assessment of the Millennium Challenge Corporation's Information Technology Governance Over Its Information Technology Investments," Report No. M-000-11-001-O, June 1, 2011.

management, with the final phase to be completed by December 2012. However, MCC requested an extension until February 2014 in completing final action on two significant recommendations that address the management of information used for making decisions.

IT Security

In an FY 2013 report, an OIG contracted audit found that while MCC generally had policies for its IT security program, implementation was not effective enough to preserve the integrity of MCC's information systems.[13] The lack of implementation potentially exposes MCC to unauthorized access, use, disclosure, disruption, modification, or destruction. Consequently, the audit identified numerous areas in MCC's IT security program that can be improved and made 14 recommendations.

OIG considers IT security to be a new challenge because of the number of IT security weaknesses this year, taken together with the nine recommendations from past years that have not been implemented.

[13] "Audit of the Millennium Challenge Corporation's Fiscal Year 2013 Compliance With the Federal Information Security Management Act of 2002," Report No. M-000-13-005-P, September 20**,** 2013.