Office of Inspector General

October 14, 2015

Ms. Dana J. Hyde
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

Dear Ms. Hyde:

The enclosed statement summarizes the Office of Inspector General's conclusions on the most serious management and performance challenges for the Millennium Challenge Corporation (MCC) in fiscal year 2015. We based decisions on which challenges to report primarily on audits and analyses of 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 each federal agency include in its performance and accountability report a statement by its inspector general summarizing the most serious management and performance challenges facing the agency and assessing its progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2015 agency financial report.

We have discussed the management and performance challenges summarized in this statement with the responsible MCC officials. If you have any questions or wish to discuss the statement further, I would be happy to meet with you.

Sincerely,

/s/

Catherine Trujillo
Acting Deputy Inspector General

Enclosure: a/s

Office of Inspector General
U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20523
http://oig.usaid.gov

Statement by the Office of Inspector General on the Millennium Challenge Corporation's Most Serious Management and Performance Challenges Fiscal Year 2015

The Millennium Challenge Corporation (MCC) provides foreign aid to countries that meet its policy indicators of ruling justly, investing in people, and encouraging economic freedom. The compacts are designed to reduce poverty and increase economic growth through projects in sectors such as agriculture, education, transportation, and water and sanitation. At the end of the fiscal year, MCC had nine current compacts worth $3 billion: Cabo Verde II, El Salvador II, Georgia II, Ghana II, Indonesia, Jordan, Malawi, Philippines, and Zambia. MCC continues to face its most serious management challenges in the following areas:

- Developing Compacts
- Implementing Compacts
- Sustaining Compact Benefits
- Managing Finances Efficiently

Developing Compacts

MCC and its partner countries take approximately 2 years to develop compacts. They do preparatory analysis, project definition, project development and appraisal, compact negotiation and signing, and preparation for entry into force. Once a compact enters into force, the fixed, 5-year implementation period starts. The compact development process is collaborative, involving partner-country stakeholders and MCC.

A recent Office of Inspector (OIG) review identified the need for improvement in compact development, specifically during the due diligence review of proposed projects when identifying alternative proposals should be done.

- In July 2015,[1] OIG reported that MCC did not consider alternatives in designing the Centralized Irrigation System Rehabilitation Activity in the Moldova compact. The due diligence review at the time accepted the country's proposal to rehabilitate existing Soviet-era systems. However, during compact implementation, construction could not proceed because insufficient funding was available to build the systems in the manner planned. This required MCC to conduct a study at that point to identify alternatives, resulting in delays to the implementation of the irrigation system rehabilitation.

Implementing Compacts

MCC and its partner countries, through Millennium Challenge Accounts (MCAs), complete the compact implementation process over the compact term. Each MCA is staffed by a team of professionals in management, procurement, finance, monitoring and evaluation, and law and by specialists in sectors covered by the compact, such as infrastructure and agriculture. The MCA procures contractors to implement the compact projects and oversees them with the assistance of contracted specialists.
Two recent reviews, one of MCA procurement,[2] the other of a small-scale fisheries project,[3] illustrate, respectively, challenges encountered during compact implementation.

[1] *Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova*, Report No. M-000-15-005-S, July 28, 2015. Fieldwork on this review was completed on September 20, 2013.
[2] *Review of the Millennium Challenge Corporation's Procurement Process for Selected Country Programs*, Report No. M-000-15-006-S, August 12, 2015. Fieldwork on this review was completed on September 4, 2014.

- Auditors found three areas for improvement in the procurement process: MCC did not have written requirements for MCA market outreach to help attract a sufficient number of quality bidders. MCA terms of reference were not always accurate and clear, resulting in failed procurements. Contractor past performance information was not always used by the MCAs when selecting contractors.

- Because MCC and the MCA did not have an effective plan for overseeing a nationwide mobile fish vendor project, it did not achieve its project goals. The $3.3 million project for mobile vendors was to train 2,000 vendors and provide them with motorbikes equipped with coolers. Instead, it trained 1,234 mobile vendors, achieving 62 percent of the training goal, and gave motorbikes to 699 of them, achieving 35 percent of the equipment goal.

Sustaining Compact Benefits

To ensure that project benefits can be sustained over time, MCC requires that sustainability be part of compact design and development. Sustainability can take a number of forms, like requiring a partner country to increase its contributions to a road maintenance fund so that when the MCC-funded road is completed, the partner country has adequate funding for upkeep. Recent OIG audits[1,3] showed that sustainability measures could be improved.

- OIG reported that the sustainability of certain project activities was at risk. Under the first Morocco compact, 15 of 30 completed fishery infrastructure projects were not operational (fully functioning) at compact end, including boat landing sites, ports, and wholesale fish markets. Delivery of planned sustainability benefits would not occur unless the projects become operational.

- The sustainability of irrigation systems was at risk because the water user associations charged with managing and maintaining them had not received all planned training or experience on operating them.

Managing Finances Efficiently

Strong financial management is critical to effective and efficient operations. MCC must not only manage its finances well but also see that MCAs do so.

- MCC received an unqualified audit opinion on its fiscal year (FY) 2014 financial statements and demonstrated further progress in improving its financial management practices. The audit report cited one material weakness and one significant deficiency in internal control. The latter, described below, represents an ongoing challenge to MCC's ability to prepare complete, reliable financial statements.

- MCC's financial management system follows the guidance prescribed by the Federal Accounting Standards Advisory Board, whereas the independent MCAs established by recipient countries do not. MCC addresses this challenge by adjusting its grant liabilities at headquarters to bring the cash-basis reporting by MCAs in line with MCC's accrual basis. In FY 2012, MCC revised its methodology for estimating grant accruals by examining disbursement history, unused spending authority, and invoices received but not paid. In FY 2014, MCC further revised its process so that it includes contract retentions as part of its grant accrual estimates. Further, in FY 2014 it was noted that accumulating sufficient MCA disbursement data to reasonably validate grant accrual estimates was a challenge and

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[3] *Review of the Millennium Challenge Corporation-Funded Small-Scale Fisheries Project in Morocco*, Report No. M-000-15-004-S, March 30, 2015. Fieldwork on this review was completed on October 12, 2013.

time-consuming. As we perform the current financial statement audit, we continue to examine MCC’s method for validating accrual estimates.