Office of Inspector General
for the Millennium Challenge Corporation

March 30, 2010

Mr. Michael Casella,
Acting Vice President, Administration and Finance
Millennium Challenge Corporation
875 Fifteenth Street, N.W.
Washington, DC 20005

Subject: Limited Scope Review of the Millennium Challenge Corporation (MCC) Resources Managed by Millennium Challenge Account-Tanzania (MCA-Tanzania), Under the Compact Agreement Between the MCC and the Government of the Republic of Tanzania
(Report No. M-000-10-002-S)

Dear Mr. Casella:

This letter transmits our report pertaining to our limited scope review of MCA - Tanzania. OIG performed this review, in part, to obtain reasonable assurance that; (1) MCA-Tanzania's representations in its fund accountability statements had complied with MCC's "Cost Principles for Government Affiliates Involved in MCC Compact Implementation", its fiscal accountability plan (FAP), the compact, and other applicable laws, regulations, and guidance, and (2) MCA-Tanzania had complied with MCC's "Policies and Procedures for Common Payment System".

Our review identified instances in which MCA-Tanzania's expenditures and internal controls did not fully comply with applicable rules, regulations and guidance. We identified significant internal control deficiencies and questioned costs of $70,977 at MCA-Tanzania. The detailed findings and recommendations are discussed in the Findings section of this report.

I appreciate the cooperation and courtesy extended to my staff during this review. This report is being transmitted to you for your action. Please advise the USAID Assistant Inspector General for the Millennium Challenge Corporation within 30 days of this letter of the action planned or taken to implement the recommendations. Refer questions concerning this report to Richard J. Taylor, Director, Financial Audits division, at (202) 216-6963.

Sincerely,

/s/

Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

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BACKGROUND

On February 17, 2008, the Millennium Challenge Corporation (MCC) and the Government of the United Republic of Tanzania signed a $698.1 million compact. The overall goal of the compact is to stimulate economic growth, increase household incomes, and raise the quality of life through targeted infrastructure investments in transport, energy, and water. The specific objectives of the compact are to increase agricultural activity and to increase business investment and spending by visitors through activities in the transport sector (Transport Sector Project), to increase investment, economic output and household productivity in several regions through activities in the energy sector (Energy Sector Project), and to increase investment in human and physical capital in two large cities through activities in the water sector (Water Sector Project).

OBJECTIVES

The AIG/MCC performed this review to answer the following questions:

> Are MCA-Tanzania's expenditures allowable, allocable, and reasonable per MCC's "Cost Principles for Government Affiliates Involved in MCC Compact Implementation"?
>
> Is MCA-Tanzania complying with MCC's "Policies and Procedures for Common Payment System"?

FINDINGS

<u>Are MCA-Tanzania's expenditures allowable, allocable, and reasonable per MCC's "Cost Principles for Government Affiliates Involved in MCC Compact Implementation"?</u>

Our review identified findings and questioned costs for the following items:

Summary of Findings and Questioned Costs by Category

Category	Questioned Cost	Notes
Revenue Excluded from Fund Accountability Statement	$ -	1
Building Renovations	10,329	2
Purchase of Motor Vehicles	51,706	3
Polo Shirts and Wheel Covers	8,942	4
Excess Cash in Safe and Unreported Cash Balances	-	5
Total Questioned Costs	$ 70,977	

Notes:

1. Revenue Excluded From Fund Accountability Statement:

USAID AIG/MCC Finding:

During our fieldwork, we noted a difference between the revenue reported in the Fund Accountability Statement (FAS) prepared by MCA-Tanzania for the period January 1, 2009 through June 30, 2009, and the revenue reported according to MCC's records. We were informed that the FAS is prepared from the General Ledger, which is generated by the Tanzania government's Epicor system. Payments made with working capital (items not previously budgeted within the EPICOR accounting system) are not recorded in the General Ledger, and are maintained in a separate "off-the-books" manual system. The amounts maintained off the books are not recorded in the FAS. According to the independent auditors, $165,098 related to procurement agent payments, was excluded from the period ending June 30, 2009 Fund Accountability Statement, however, we are unable to determine whether this entails the extent of "off-the-books" record keeping. According to MCA-Tanzania, the reason for not including the working capital funds in the FAS is because the funds are not budgeted in the Detailed Financial Plan (DFP).

The Office of Inspector General for the MCC Guidelines for Financial Audits Contracted by the Millennium Challenge Corporation's Accountable Entities, Chapter 3.1, states that the audit report of the FAS must include revenues, expenditures, and cash balances of all of the MCC funded programs. Maintaining off-the-books records (which were not provided for our review during field work) is a material weakness in the MCA-Tanzania's internal control system, and is not an acceptable practice for good governance and accountability. Until this issue is adequately resolved, the review and issuance of MCA-Tanzania Fund Accountability Statement reports have been suspended.

MCA-Tanzania Management Response:

In its December 28, 2009, response, MCA-Tanzania agreed with our finding that certain revenues and expenditures are not recorded in its accounting system, and included in the Fund Accountability Statement. MCA-Tanzania is currently working with software developers to integrate working capital revenue and related expenditures through its accounting system. In the meantime, while the EPICOR accounting system is being updated, the MCA-Tanzania Finance department and Fiscal Agent have agreed to process the records by processing journal entries in the databases where the expenditures were incurred, thereby fully accounting for all funds received and expended in the Fund Accountability Statement generated from the EPICOR accounting system.

USAID AIG/MCC Evaluation of MCA Tanzania Comments:

MCA-Tanzania's proposed corrective action plan should resolve the finding. We will monitor the progress of the implementation of MCA-Tanzania's action plan.

2. Building Renovations:

USAID AIG/MCC Finding:

We questioned $10,329 (TZS 13,939,340) of building renovation costs in accordance with the Cost Principles. Details regarding the building renovation costs are as follows:

		Renovation Cost	
Building Floors	**MCA-Tanzania Occupancy?**	**Tanzanian Shillings (TZS)[1]**	**U.S. Dollars (USD)[2]**
2, 3 and 4	Yes	TZS 14,020,000	USD 10,389
1, 5 and 6	No	13,939,340	10,329
		TZS 27,959,340	USD 20,718

MCA-Tanzania, using MCC program funds, paid for renovations to the National Development Corporation (NDC) Development House building, only a portion of which they occupy. The total cost of the renovation was TZS 27,959,340. The cost of renovations pertaining to MCA-Tanzania's office space on the 2nd, 3rd and 4th floors was TZS 14,020,000 ($10,389).

Per agreement, MCA office space is paid for by the Government of Tanzania. To offset the TZS 13,939,340 cost of renovations to the floors of the other building occupants, i.e. the 1st, 5th, and 6th floors, the landlord, NDC, agreed to provide a credit of TZS 13,939,340 to the rent that will be paid by the Government of Tanzania. However, the agreement does not give credit to the

[1] The contract amounts were in Tanzanian Shillings (TZS).
[2] Tanzanian shillings converted to U.S. Dollars based on the exchange rate in effect on January 21, 2009.

MCC program for the cost of the renovations on the floors of the NDC Development House that are not occupied by MCA-Tanzania.

The costs of renovation to the portion of the building not occupied by MCA-Tanzania is not allowable per MCC's Cost Principles, specifically Chapter 2.2 Allocability, which states,

> To be allocable, costs must meet one of the following criteria:
>
> a. Be incurred for work related to the Grant, or
>
> b. Benefit both the Grant and other work, distributed to them in reasonable proportion to the benefits received, or
>
> c. Be necessary to the overall operation of the Government Affiliate, although a direct relationship to any particular cost element cannot be shown. In such cases, there must be at least an indirect showing of benefit to the Grant.

The renovation costs associated with floors unoccupied by MCA-Tanzania (a) were not incurred for work related to the compact, (b) did not benefit the compact, and (c) were not necessary to the overall operation of MCA-Tanzania. Accordingly, we questioned the $10,329 (TZS 13,939,340) renovation cost associated with the renovation of the 1st, 5th and 6th floors.

MCA-Tanzania Management Response:

During the exit conference held on December 11, 2009, MCA-Tanzania concurred with this finding. Having concluded all procedural demands the Government of Tanzania has paid of electricity costs for MCA-T offices, costs which are an MCC cost item. The amount paid in turn for the renovation work is TZS 13,939,340. The electricity cost paid by NDC and later NDC bills MCA-T for 70% of the total bill. As such, using Tanzania Govt. funds offsets the amount deducted from the rent budget line and serves as a credit to the MCC program.

USAID AIG/MCC Evaluation of MCA Tanzania Comments:

We received the invoice of TZS 13,939,340 (TZS 19,913,342 X 70 percent) from the National Development Corporation (NDC) to MCA-Tanzania dated January 22, 2010, and the payment voucher from The United Republic of Tanzania to NDC for TZS 13,939,340, also dated January 22, 2010.

Without documentation indicating that: (1) electricity is a consistent expenditure of MCA-Tanzania, and not included as part of the rent or other building expenses supplied per the sharing agreement with The United Republic of Tanzania, (2) verification of the amounts per the electric bills (It is unusual that the amount of the electrical bill [TZS 13,939,340] is the exact amount of other tenant's share of the renovation costs), and (3) copies of accounting records reflecting such transactions, we can not accept MCA-Tanzania's management response as adequate.

3. Purchase of Motor Vehicles:

USAID AIG/MCC Finding:

Our review of the procurement files pertaining to the purchase of 17 motor vehicles (Tender No. MCAT/CIF/0011) disclosed that none of the four prospective bidders fully complied with the requirements of the bid documents and the MCC Program Procurement Guidelines. Of the four prospective bidders, three were disqualified for various prequalification or technical deficiencies.

The winning bidder, DT Dobie Tanzania, submitted its quotation in Japanese yen. According to the Program Procurement Guidelines, Chapter 2.28, dated February 15, 2008; "Bidding documents shall state the currency or currencies in which bidders are to state their prices. All bids are to be determined and paid only in United States dollars, the local currency of the country of the MCA Entity, or a combination of the two as stated in the bidding documents. No other currency is permitted." In addition, Chapter 2.29, Currency of Bid states; "The bidding documents shall caution bidders that the bid price must be expressed in the currency requested. The requested currency may be either United States dollars, the local currency of the country of the MCA Entity, or a combination of the two. Bids may not be requested or expressed in any other currency."

By not following the MCC Program Procurement Guidelines, MCA-Tanzania included a currency swap futures derivative component in its contract with DT Dobie Tanzania, exposing MCC program funds to an unacceptable risk. Consequently, because of exchange rate fluctuation, MCA Tanzania lost $51,706 on this contract due to foreign exchange rate loses. We have questioned the $51,706 foreign exchange rate loss incurred under this contract as an unallowable cost based on MCA Tanzania's noncompliance with the MCC Program Procurement Guidelines.

According to the Procurement Agent, a waiver was granted by the Millennium Challenge Corporation allowing MCA Tanzania to proceed with the contract in Japanese yen. As of the date of this report, we have not been provided with any documentation related to the waiver.

In addition, the procurement files were not adequately documented to provide an independent reviewer with a clear understanding of the basis for disqualifying bidders during the various evaluation phases. In reviewing the files, we noted that one of the bidders, Quality Motors Limited, was eliminated from further consideration during the preliminary examination phase for one instance of non-compliance; the lack of a spare parts list for Lot 1. Quality Motors Limited included spare parts lists for Lots 2 and 3. The spare parts lists were generally comprised of oil filters, and other such minor items. Although DT Dobie Tanzania, the eventual winning bidder, also did not comply with all of the preliminary examination items, their bid was accepted for the technical evaluation phase. The procurement files did not provide sufficient detail for an independent reviewer to ascertain why one bidder's deficiencies were significant enough to be eliminated for further consideration, whilst another bidder's non-compliance was deemed insignificant, and allowed to precede to the next phase.

According to the Procurement Agent, Quality Motors Limited's automobiles did not have the engine horse power required by the specification of the Request for Quotations. Although we were informed that this concern was deemed of crucial importance for the disqualification of Quality Motor's bid, the procurement files did not address this issue.

It should further be noted that Quality Motors Limited's quotation for Lot 1 was significantly lower (approximately $200,000 or 30 percent of the winning bid amount) than the selected bidder, DT Dobie Tanzania. When it became known that only one bidder remained after technical evaluation stage, and that bidder's quotation was not compliant with the RFQ specifications and procurement guidelines, all bids should have been rejected in accordance with the MCC Program Procurement Guidelines, Chapters 2.61 through 2.64. By not following the specifications included in the bidding documents and procurement guidelines, MCA Tanzania missed an opportunity to reevaluate its motor vehicle requirements, and potentially obtain better value for the program.

MCA-Tanzania Management Response:

Records that document the advice sought by MCA-T and provided by MCC on how to handle a price quote for the purchase of motor vehicles using the Japanese Yen instead of the US dollar has not been retrieved. As explained in our earlier explanation our email server crashed some time last year.

USAID AIG/MCC Evaluation of MCA Tanzania Comments:

We maintain our position that the lack of compliance with the MCC Procurement Program Guidelines resulted in a significant loss of program funds.

4. Polo Shirts and Wheel Covers:

USAID AIG/MCC Finding:

During the course of our review, we noted an expenditure of $8,942 for 500 polo shirts and 250 spare tire covers with the MCA-Tanzania logo printed on them.

We have questioned these costs as being unallowable per the Cost Principles, Chapter 4.2 x, Public Relations, which states;

> Public relations means those activities dedicated to maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public as well as maintaining a positive image of the Accountable Entity. Allowable public relations costs include: (a) the costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of the Grant, (b) the costs of conducting general liaison with news media to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters relating to the Grant, and (c) costs specifically required by the Grant. Reasonable costs for ceremonial events are allowable costs only for the Accountable Entity. Costs of any public relations activities not related to the Grant are not allowable.

The polo shirts and wheel covers with the MCA-Tanzania logo does not qualify as an allowable public relations cost as defined by the cost principles. The cost principles require that the activity, in order to be allowable, must either; (1) communicate specific activities and accomplishments of the program, (2) conduct liaison with the news media to keep the public informed about the program, or (3) be specifically required by the compact. Polo shirts and wheel covers with the MCA logo accomplishes none of these criteria.

In addition, the distribution list shows that the majority of the polo shirts and wheel covers were provided to individuals and organizations affiliated with MCA-Tanzania, such as MCA-Tanzania employees, board members, implementing entities involved with the compact, MCC personnel, and personnel of the Government of Tanzania ministries. Expenditures on vanity items provided to individuals associated with the program carries the risk of the appearance of lack of independence and potential conflict of interest.

We questioned the $8,942 cost of 500 polo shirts and 250 wheel covers with the MCA-Tanzania logo because they do not qualify as allowable public relations expenditures.

MCA-Tanzania Management Response:

As explained during the exit conference on December 11, 2009, the interpretation of the Cost Principle was made in consideration of the local environment where the public is normally informed of the program activities by such means as polo Shirts and Wheels Covers which easily catch the public image on the Compact activities. The idea which is also acceptable by MCC. However, since there is no comprehensive list of items which has been categorized as allowable or non-allowable for Public Relations, further consultations will be made with MCC to obtain such list of items.

USAID AIG/MCC Evaluation of MCA Tanzania Comments:

We agree that the Cost Principles do not adequately define, nor render clarity to, what constitutes an allowable or unallowable cost. However, in this instance, the cost principle regarding public relations is clear that in order to qualify as allowable, a public relations expenditure must promote understanding of the Accountable Entity by communicating specific activities and accomplishments of the program. The MCA-Tanzania logos, in and of themselves, attached to polo shirts and wheel covers, do not *communicate specific activities and accomplishments of the program* (nor are they involved with conducting liaison with the media or specifically required by the compact).

As a side note, during our field visit, we observed that MCA-Tanzania's automobiles contained the logo of the automobile dealership, DT Dobie, on the wheel covers, and a driver wore a shirt bearing the DT Dobie logo.

5. Excess Cash in Safe and Unreported Cash Balances:

USAID AIG/MCC Finding:

When MCA-Tanzania employees travel for business, they are provided with travel advances. The advances are fully expensed in the general ledger when provided to the employees.

When the employees return from travel, reconciliations are performed between the travel advances and actual travel expenses. If the actual travel expenses were less than the travel advance provided then the employee returns the excess amount in cash to the MCA-Tanzania Assistant Accountant. The cash is then placed in a safe. At the time of our field visit, there was the local currency equivalent of approximately $5,000 in the safe.

MCA-Tanzania cannot place the returned cash in the permitted accounts maintained at the Bank of Tanzania – a financial institution that does not accept cash deposits. MCA-Tanzania management would like to open a local commercial bank account to deposit the returned funds. However, according to MCA-Tanzania staff, MCC has prohibited MCA-Tanzania from opening a bank account at a commercial bank.

When the cash is returned and placed in the safe there are no adjusting entries in the accounting system to reflect the replenishment of cash. The fiscal agent has no involvement or record of the returned cash. The returned cash is essentially "off the books". This raises three issues:

- The actual travel expenses are overstated by the amount of the returned cash,
- The actual cash balance is understated by the amount of the returned cash, and
- The possibility of undetected misappropriations of funds is increased because the fiscal agent doesn't have custody or record of the returned cash.

In order to mitigate these internal control deficiencies, MCA-Tanzania should;

(1) Open a bank account to maintain cash that exceeds a set "petty-cash" threshold (an amount determined to be acceptable to keep in an office safe).

(2) Properly record cash returned from advances (of any kind) in MCA-Tanzania's accounting system at the time of its receipt.

MCA-Tanzania Management Response:

Based on MCC's regulations, MCA-T has not been able to open a bank account for its petty cash. However, the refunds are normally program admin costs and therefore in the December 2009 FAP update, MCA-T proposed using the returned unspent funds to be used as part of the petty cash instead of keeping the cash intact and at the same time continuing to request for extra petty cash funds from MCC. Given that MCA-T maintains three petty cash funds, namely for DSM admin, Zanzibar office admin and the Office of CEO, the amounts surrendered balances would be fully utilized under the same program administration cost lines.

USAID AIG/MCC Evaluation of MCA Tanzania Comments:

The proposed corrective action plan provided by MCA-Tanzania would not entirely address the internal control deficiencies involving transparency and accountability. Currently, advances of cash are booked in the accounting system as expenditures. Amounts returned as excess to needs is placed into the safe, however, the amount is not properly recorded as a debt to cash, and credit to the expenditure in the accounting system. This practice results in an understatement of cash and overstatement of expenditures in the accounting system and Fund Accountability Statement. In addition, maintaining an increasingly large, unknown amount of cash in the safe increases the risk of malfeasance.

Is MCA-Tanzania complying with MCC's "Policies and Procedures for Common Payment System"?

The results of the review disclosed no basis to take exception with MCA-Tanzania compliance with MCC's "Policies and Procedures for Common Payment System".

We selected expenditures from MCA-Tanzania's general ledger for the period from compact inception through October 31, 2009, using a judgmental sampling methodology. The selected transactions formed the basis for the expenditures review (see discussion above). If the selected expenditures involved payment via the common payment system (CPS), we also tested the transaction for compliance with various criteria presented in MCC's "Policies and Procedures for Common Payment System".

Recommendations

We are making the following recommendations that will be included in the Inspector General's Audit Recommendation Tracking System.

Recommendation 1: We recommend that MCC requests and verifies that MCA-Tanzania corrects the internal control deficiency described in note 1 of the Findings section of this report.

Recommendation 2: We recommend that MCC verify that the questioned costs of \$10,329 (TZS 13,939,340) are; (a) properly credited to the program, or (b) initiate action to recover the unallowable costs.

Recommendation 3: We recommend that the responsible MCC official make a management decision on the \$51,706 in questioned costs due to noncompliance with the MCC Program Procurement Guidelines as described in Note 3 of the Findings section of this report, and recover any amounts determined to be unallowable.

Recommendation 4: We recommend that the responsible MCC official make a management decision on the \$8,942 in questioned unallowable public relations costs as described in Note 4 of the Findings section of this report, and recover any amounts determined to be unallowable.

Recommendation 5: We recommend that MCC revise Chapter 4.2 x, Public Relations, of the Cost Principles, to clarify the definition, and provide specific examples of types of expenditures that constitute allowable and unallowable costs.

Recommendation 6: We recommend that MCC request MCA-Tanzania to submit a corrective action plan designed to adequately correct the internal control deficiencies described in Note 5 in the Findings section of this report.