



OFFICE OF INSPECTOR GENERAL

for the Millennium Challenge Corporation

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION- FUNDED PROGRAMS IN EL SALVADOR

AUDIT REPORT NO. M-000-11-005-P
September 30, 2011

WASHINGTON, DC



***Office of Inspector General
for the Millennium Challenge Corporation***

September 30, 2011

Mr. Daniel W. Yohannes
Chief Executive Officer
Millennium Challenge Corporation
875 Fifteenth Street, N.W.
Washington, DC 20005

Dear Mr. Yohannes:

This letter transmits the Office of Inspector General's final report on the *Audit of the Millennium Challenge Corporation-Funded Programs in El Salvador*. In finalizing the report, we considered your written comments on our draft report and included those comments in their entirety in Appendix II of this report.

The report contains four recommendations to strengthen the Millennium Challenge Corporation's (MCC) process for managing El Salvador's compact program. OIG agrees with MCC's management decisions for recommendations 1, 2, 3, and 4. Final action will occur when MCC provides additional documentation showing that the recommendations have been implemented.

I appreciate the cooperation and courtesy extended to my staff during this audit.

Sincerely,

/s/

Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

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Abbreviations

The following abbreviations appear in this report:

- FOMILENIO Fondo del Milenio
- MCC Millennium Challenge Corporation
- OIG Office of Inspector General

SUMMARY OF RESULTS

On November 29, 2006, the Millennium Challenge Corporation (MCC) signed a \$460.9 million compact with the Government of El Salvador. The overall goal of the compact is to advance economic growth and reduce poverty in the Northern Zone of El Salvador.¹ To achieve this goal, the parties selected three projects: (1) Connectivity (roads), (2) Productive Development (activities to transition farmers and enterprises to high-profit activities, investment support, and financial services), and (3) Human Development (education, water and sanitation, rural electricity, and community infrastructure). Fondo del Milenio (FOMILENIO) is the accountable entity² for the compact. The compact entered into force³ on September 20, 2007, and will end on September 20, 2012. As of March 31, 2011, FOMILENIO had disbursed \$225 million of the compact.

The Connectivity Project was intended to physically integrate the Northern Zone with the rest of the country and within the region, encourage new economic opportunities for rural households, lower transportation costs, and decrease travel times to markets through the completion of the Northern Transnational Highway and the Network of Connecting Roads project activities. The budget for the Connectivity Project was \$233.6 million, with \$140 million for the Northern Transnational Highway and \$93.6 million for the Network of Connecting Roads project activity. However, funding for the Network of Connecting Roads was subsequently reallocated to the Northern Transnational Highway.⁴ Funds from other compact project activities were also reallocated to the Northern Transnational Highway, increasing its funding to \$246.1 million.⁵ As of March 31, 2011, FOMILENIO had disbursed \$118.9 million for the Northern Transnational Highway.

The Production and Business Services Project activity is one of three project activities under the Productive Development Project. At \$57 million, the Production and Business Services Project activity aims to provide, among other things, technical assistance to poor farmers to help them shift to high-value agricultural products. As of March 31, 2011, FOMILENIO had disbursed \$31.4 million for the Production and Business Services Project activity.

The audit objectives were to determine whether (1) the MCC-funded Connectivity Project in El Salvador is achieving its project activity goal of integrating the Northern Zone with national and regional highway systems and the Honduras and Guatemala borders, and (2) the MCC-funded Production and Business Services Project activity in El Salvador is achieving its goal of providing technical assistance and training to farmers to transition them to high-profit activities in the Northern Zone.

¹ Appendix III presents a map of El Salvador's Northern Zone.

² An accountable entity is the legal entity designated by the host government to implement the compact during the compact term.

³ Entry into force is the date that all conditions precedent have been completed by the compact country's government and compact implementation begins.

⁴ In March 2008, the Network of Connecting Roads' original budget was reduced by \$7.1 million to \$86.5 million. The \$7.1 million was reallocated to the Northern Transnational Highway project activity. In March 2009, the remaining \$86.5 million from the Network of Connecting Roads was also reallocated to the Northern Transnational Highway.

⁵ By March 2011, the budget for the Northern Transnational Highway had increased to \$255.3 million because of additional reallocations of project activities.

The Office of Inspector General (OIG) found that the MCC-funded Connectivity Project in El Salvador will not achieve its project activity goals of integrating the Northern Zone with the national and regional highway systems and the Honduras and Guatemala borders because the funding provided by the compact was insufficient to fully implement the Connectivity Project. The original intent of the Connectivity Project was to physically integrate El Salvador's Northern Zone with the rest of the country and within the region to reduce travel cost and time. However, the feasibility study for the Connectivity Project was not completed until after compact signing. The feasibility study found that \$911 million would be needed to complete the project, which exceeded the original Connectivity Project budget by \$677.4 million. Consequently, sufficient funds were not available to construct the Connectivity Project. Subsequently, MCC and the Government of El Salvador agreed not to fund the 240 kilometers of Network of Connecting Roads and reallocated its \$86.5 million in funding to the Northern Transnational Highway. As a result, the Network of Connecting Roads will no longer benefit 176,318 Salvadorians under the compact. Also, according to MCC and FOMILENIO officials, the sections of the Northern Transnational Highway leading to the borders of Honduras and Guatemala will not be constructed because suitable border control measures were not in place for these new border crossings (see page 4).

OIG also found that the Production and Business Services Project activity provided technical assistance and training to farmers in the agricultural value chains.⁶ However, OIG was unable to determine if the training would provide farmers sufficient skills and knowledge to transition farmers to high-profit activities. Also, OIG could not confirm the data reported in the Monitoring and Evaluation Plan results for two indicators and has concerns about the data's reliability. For instance, in March 2011 FOMILENIO reported that 12,465 farmers were trained, exceeding its target of 9,135 farmers trained in year 4 of the compact. However, an OIG reconciliation found that only 10,148 farmers were trained (see page 5).

In addition, an indicator in the Monitoring and Evaluation Plan measures the "Number of beneficiaries of technical assistance and training," which counts individuals' participation in technical assistance and training. However, the Monitoring and Evaluation Plan did not establish the amount of training or technical assistance needed to provide farmers with new skills. Therefore, there is a risk that a farmer would not attend enough training sessions to obtain sufficient skills and knowledge to successfully transition to high-profit activities. OIG believes that the amount of training should be established before a farmer is considered a beneficiary (see page 5).

The audit identified the following concerns detailed in the report:

- A feasibility study for the Connectivity Project was not completed before compact signing. The study would have provided better cost information to base decisions about the budget for the Connectivity Project (page 4).
- A written contingency plan was not developed for Section 7 of the Northern Transnational Highway, which is at risk of not being completed by compact end (page 4).
- Certain indicators in the Monitoring and Evaluation plan required revision or the results were questionable (page 5).

⁶ Agricultural value chains include horticulture and dairy farmers.

To address these concerns, this report recommends that the Millennium Challenge Corporation:

1. Require FOMILENIO to develop a written contingency plan for Section 7 of the Northern Transnational Highway to ensure road completion (page 5).
2. In conjunction with FOMILENIO, revise and document the revision of certain indicators in the Monitoring and Evaluation plan (page 7).
3. In conjunction with FOMILENIO, document the verification of reported data used for the following indicators:
 - Number of farmers trained
 - Number of beneficiaries that have applied improved techniques (page 7)
4. In conjunction with FOMILENIO, finalize and implement the Productive Development Project–specific Monitoring and Evaluation manual (page 7).

Detailed findings appear in the following section. Appendix I contains a discussion of the audit's scope and methodology. Appendix II presents MCC's comments. MCC agreed with Recommendations 1, 2, 3, and 4. Management decisions have been reached on Recommendations 1, 2, 3, and 4, and final action will occur when MCC provides additional documentation showing that the recommendations have been implemented.

AUDIT FINDINGS

Feasibility Study Was Not Completed Before Compact Signing

MCC's compact, signed in November 2006, required the Government of El Salvador to conduct, at its own expense, a feasibility study⁷ to the satisfaction of MCC. An Investment Memorandum signed prior to the compact in August 2006 stated that the feasibility study, including final economic and environmental analyses, was to be completed by September 2007. However, when the feasibility study was completed in February 2008, it identified higher than expected cost estimates to complete the Connectivity Project (\$911 million versus \$233.6 million). This caused MCC and the Government of El Salvador to no longer fund the Network of Connecting Roads; its funding, \$86.5 million, was then reallocated to the Northern Transnational Highway. As a result, 176,318 Salvadorans would not benefit from the Network of Connecting Roads. If MCC had required a completed feasibility study before compact signing, it would have had better cost information on which to base decisions about the budget for the Connectivity Project.

This audit is not recommending that MCC revise its policy to require that a feasibility study be completed before compact signing, because a similar recommendation was made in an audit report on MCC's funding of activities in Tanzania.⁸ In its memorandum to OIG regarding the recommendation, dated May 20, 2011, MCC agreed that prior to compact signing, it would ensure that cost estimates will be in sufficient detail and will identify the studies, analyses, or assessments required to be completed in each country.

Written Contingency Plan Was Not Developed for Highway Section 7

FOMILENIO has not established a written contingency plan for Section 7 of the Northern Transnational Highway. A written contingency plan is necessary given the risk that insufficient time may remain under the compact for the highway to be completed before the compact and MCC funding end. Specifically, construction of Section 7 of the Northern Transnational Highway began in March 2011, and the contract is to be completed in July 2012, 2 months before the compact ends in September 2012. Delays have occurred on the other sections of the Northern Transnational Highway for a number of reasons, including delays in the removal of utility poles, difficulties in resettlement along the right-of-way, design deficiencies of the retaining walls, and excessive amounts of rain. Therefore, it is reasonable to expect that delays could occur on this section as well, and if so, the road may not be completed when the compact ends.

⁷ A feasibility study is a preliminary study undertaken to assess whether a planned project is likely to be practical and successful, and to estimate its cost. It is a tool for planning and managing project investments to avoid unfounded spending of effort, time, and funds.

⁸ *Audit of the Millennium Challenge Corporation's Funding of Activities in Tanzania* (M-000-11-003-P), March 30, 2011.

MCC's guidelines for the program closure of compacts states that no work may be performed after the compact end date, unless it is related to program closure. If any work is to be performed after the compact end date, it must be paid for by alternative sources of funding.

MCC does not have a policy or procedure to require Millennium Challenge Accounts to provide it with a written contingency plan for project activities that are at risk for not being completed by the end of a compact. FOMILENIO management believes that Section 7 of the Northern Transnational Highway will be completed by July 2012, and is using lessons learned from the other sections to prevent delays. However, if Section 7 of the Northern Transnational Highway is not completed before the compact ends, 43,346 Salvadorans will be affected and up to \$14 million of MCC funding will have been contributed to an unfinished product. Therefore, this audit makes the following recommendation:

Recommendation 1. *We recommend that the Millennium Challenge Corporation's Vice President for the Department of Compact Operations require FOMILENIO to develop a written contingency plan for Section 7 of the Northern Transnational Highway to ensure road completion.*

Certain Indicators Were Not Precise or the Results Were Questionable

MCC's *Policy for Monitoring and Evaluation of Compacts and Threshold Programs* requires definitions of indicators to be operationally precise and clear about what is being measured and how results are interpreted. In addition, it states that,

Data should reflect stable and consistent data collection processes and analysis methods over time. Project managers should be confident that progress toward performance targets reflects real changes rather than variations in data collection methods. Reliability can be affected by questionable validity as well as by changes in data collection processes.⁹

However, definitions for three of six indicators reviewed by OIG for the Production and Business Services Project activity were not precise, and reported results for two indicators were questionable. Specifically, the audit team noted the following:

- The definition for the "Number of beneficiaries of technical assistance and training" indicator includes the number of farmers who receive at least one type of assistance from the Production and Business Services Project activity. However, the Monitoring and Evaluation Plan did not establish the amount of training or technical assistance needed to provide farmers with new skills. According to a FOMILENIO official, if farmers attend one training session or receive 1 day of technical assistance, they are considered beneficiaries. However, OIG believes that the amount of training should be established before a farmer is considered a beneficiary, because it is unlikely that 1 day of training could provide the farmer sufficient skills and knowledge to transition to high-value agricultural productions.

⁹ MCC, *Policy for Monitoring and Evaluation of Compacts and Threshold Programs*, May 12, 2009.

- The definition for the “Number of beneficiaries that have applied improved techniques” includes the total number of farmers or rural entrepreneurs who are applying new production or managerial techniques introduced by the project, such as input use, production techniques, irrigation, post-harvest treatment, and farm management techniques. However, the Monitoring and Evaluation Plan does not identify the minimum amount of techniques farmers must improve.
- The definition for the “Investment in productive chains by selected beneficiaries” indicator states that investments represent the amount of MCC funding and counterpart contributions¹⁰ spent on inputs, equipment, and infrastructure, as laid out in business plans for all Productive Development projects.¹¹ However, according to a FOMILENIO official, the amount of contributions that a project beneficiary provides is not determined by business plans. Instead, it is determined by a formula that considers land, labor, inputs, technical assistance, local infrastructure, and equipment for each farmer.
- OIG questioned the reliability of the reported results for the “Number of farmers trained” indicator. FOMILENIO reported to MCC that 12,465 beneficiaries were trained in the agricultural value chains, exceeding its 9,135 farmers trained target in year 4 of the compact. However, OIG found that the number of beneficiaries totaled 10,148 (19 percent difference). Furthermore, OIG found that the data field containing the beneficiaries’ phase of implementation was not always completed.
- OIG questioned the reliability of the reported results for the “Number of beneficiaries that have applied improved techniques” indicator. FOMILENIO reported to MCC that 5,328 of 5,800 beneficiaries applied improved techniques in year 4 of the compact. However, OIG found that 4,084 beneficiaries applied improved techniques (23 percent difference). Furthermore, OIG found that the “adopted practices” fields for 714 beneficiaries were blank.

The definitions for three of four indicators reviewed by OIG for the Connectivity Project also needed revision. Specifically, the audit team noted the following:

- The definition for the “Increase in income of households near the Northern Transnational Highway” and “Land prices along the Northern Transnational Highway” indicators were not revised in the Monitoring and Evaluation Plan after MCC changed its beneficiary definition for road projects. Originally, each indicator measured changes in income and land prices within 2 kilometers of the Northern Transnational Highway. MCC subsequently changed its beneficiary definition to count beneficiaries within 5 kilometers of the highway. However, the plan was not revised to reflect this change.
- The definition for the “Travel time from Guatemala to Honduras through the Northern Zone” indicator does not account for project changes. After MCC and the Government of El Salvador decided to end funding for sections of the Northern Transnational Highway connecting the borders, the indicator definition was not modified accordingly.

¹⁰ Counterpart contributions refer to cash, goods, or services that beneficiaries contribute to Productive Development projects, such as to their farms.

¹¹ The Production and Business Services Project activity is one of three project activities under the Productive Development Project.

With regard to the Production and Business Services Project activity, MCC's Monitoring and Evaluation Plan did not provide enough detail for the indicators. Rather than revising this plan, MCC and FOMILENIO decided to create a specific Monitoring and Evaluation manual, which would provide more detail about the Productive Development Project indicators. However, the manual had not been completed at the time of our fieldwork.

With regard to the Connectivity Project, revisions were not made to the Monitoring and Evaluation Plan for two reasons. First, an MCC economist was not available at the time to assist with revising the targets for the increase in income and land prices indicators. Second, MCC overlooked the revision of the definition of the travel time indicator during the most recent Monitoring and Evaluation Plan revision.

As a result, MCC and FOMILENIO management may not have the information for the aforementioned indicators to measure the results of the project. Therefore, this audit makes the following recommendations:

Recommendation 2. We recommend that the Millennium Challenge Corporation's Vice President for the Department of Policy and Evaluation, in conjunction with FOMILENIO, revise and document the revision of the following indicators:

- *Number of beneficiaries of technical assistance and training*
- *Number of beneficiaries that have applied improved techniques*
- *Investment in productive chains by selected beneficiaries*
- *Increase in income of households near the Northern Transnational Highway*
- *Land prices along the Northern Transnational Highway*
- *Travel time from Guatemala to Honduras through the Northern Zone*

Recommendation 3. We recommend that the Millennium Challenge Corporation's Vice President for the Department of Policy and Evaluation, in conjunction with FOMILENIO, document the verification of reported data used for the following indicators:

- *Number of farmers trained*
- *Number of beneficiaries that have applied improved techniques*

Recommendation 4. We recommend that the Millennium Challenge Corporation's Vice President for the Department of Policy and Evaluation, in conjunction with FOMILENIO, finalize and implement the Productive Development Project-specific Monitoring and Evaluation manual.

EVALUATION OF MANAGEMENT COMMENTS

MCC's written comments on the draft report are included in their entirety in Appendix II of this report. In its comments, MCC agreed with the four recommendations.

MCC agreed with Recommendation 1, to develop a written contingency plan for Section 7 of the Northern Transnational Highway to ensure road completion. In accordance with MCC's Program Closure Guidelines, Fondo del Milenio (FOMILENIO) is currently finalizing its Program Closure Plan, which will identify completion risks for Section 7 of the Northern Transnational Highway and any other projects, activities, and subactivities deemed to be significant. MCC will ensure that the final version of FOMILENIO's Program Closure Plan will be approved no later than December 31, 2011. OIG agrees with MCC's management decision. However, final action will not take place until MCC provides OIG with the Program Closure Plan.

MCC agreed with Recommendation 2, in conjunction with FOMILENIO, to revise and document the revisions of three indicators within the Production and Business Services Project activity and three indicators within the Connectivity Project. MCC agreed to work with FOMILENIO to revise and/or clarify the definitions of the indicators in the Monitoring and Evaluation Plan, taking into account OIG's comments and observations. MCC considers that acceptance of the revised Monitoring and Evaluation Plan will constitute final management decision on this recommendation and will take final action by March 2012. OIG agrees with MCC's management decision. However, final action will not take place until MCC provides OIG with the Monitoring and Evaluation Plan.

MCC agreed with Recommendation 3, in conjunction with FOMILENIO, to document the verification of reported data used for the following two indicators: (a) number of farmers trained and (b) number of beneficiaries that have applied improved techniques. MCC stated in its response that FOMILENIO had provided OIG with incorrect information to support the two indicators, but that MCC had provided OIG with the correct information on July 27, 2011. MCC asserted that this new information had been verified and considered this its final management decision. It also considered that it had already taken final action on the recommendation. OIG agrees with MCC's management decision to verify the reported data. However, MCC did not provide documentation for how it had verified the data. Consequently, OIG believes that final action has not yet occurred on Recommendation 3.

MCC agreed with Recommendation 4, in conjunction with FOMILENIO, to finalize and implement the Productive Development Project-specific Monitoring and Evaluation manual. MCC agreed with the recommendation and, in conjunction with FOMILENIO, will finalize the manual by the end of March 2012. MCC considers this its final management decision on the recommendation. OIG agrees with MCC's management decision. However, final action will not take place until MCC provides OIG with the Productive Development Project-specific Monitoring and Evaluation manual.

MCC provided additional comments to this report in Tab A of its management comments, which OIG also evaluated.

MCC stated that OIG's audit objective to determine whether the MCC-funded Connectivity Project in El Salvador is achieving its project activity goal of integrating the Northern Zone with national and regional highway systems and the Honduras and Guatemala border is narrower than the actual objective of the Connectivity Project as defined by the compact. The objective of the Connectivity Project is to reduce travel cost and time within the Northern Zone, in the rest of country, and within the region. OIG communicated its audit objective for the Connectivity Project to MCC at the beginning of the audit and emphasized that its focus would be on the project activity goals and not the compact objective for the Connectivity Project, because the compact objective would not be measurable until all road projects are complete.

MCC disagreed with OIG's conclusion that the Connectivity Project will not achieve its project activity goals of integrating the Northern Zone with the national and regional highway systems and the Honduras and Guatemala borders because the funding provided by the compact was insufficient to fully implement the Connectivity Project. OIG's conclusion was based on the planned integration of the Northern Zone, which included the Northern Transnational Highway and the Network of Connecting Roads.

MCC disagreed with OIG's use of the original design option in drawing its conclusions about the integration of the Connectivity Project with the Northern Transnational Highway. MCC further stated that the initial border crossings for the Northern Transnational Highway were eliminated for technical reasons, and FOMILENIO decided to change the design to connect to existing borders. However, OIG's conclusions focused on the MCC-funded activities at the time the compact was signed. These included the initial border crossings and MCC's agreement to fund the Network of Connecting Roads, which were both subsequently eliminated from the compact.

MCC disagreed with OIG that sufficient funds were not available to construct the Connectivity Project. MCC acknowledges that MCC funds were insufficient for all roads initially envisioned, but the Government of El Salvador has allocated sufficient funds to complete the roads. OIG drew its conclusions on the achievements made using MCC funding.

MCC indicated that the draft report suggests that the project will not meet its targets for beneficiaries due to the fact that the feasibility study for the Northern Transnational Highway was not completed prior to the compact signing. MCC further pointed out that the Government of El Salvador has arranged financing to complete the Network of Connecting Roads. However, at the time the compact was signed, MCC agreed to fund certain projects, such as the Network of Connecting Roads, but MCC's funding for this project activity was subsequently eliminated and reallocated to the Northern Transnational Highway. OIG recognizes the importance of government contributions toward the completion of the compact projects as being a part of MCC's country ownership model. However, the elimination of MCC funding from the Connectivity Project affects MCC's attribution to the overall project, including the number of beneficiaries reached.

SCOPE AND METHODOLOGY

Scope

OIG conducted this performance audit of MCC-funded programs in El Salvador in accordance with *Generally Accepted Government Auditing Standards*, July 2007 Revision (GAO-07-731G). 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 in accordance with our audit objectives. We believe that the evidence obtained provides that reasonable basis.

We audited the \$255.3 million Connectivity Project because it represented more than 50 percent of the compact budget. We also audited the \$57 million Production and Business Services Project activity because it represented 80 percent of the Productive Development Project budget. We conducted our fieldwork from February 10 to June 13, 2011, at MCC headquarters in Washington, DC, with a site visit to FOMILENIO in San Salvador, El Salvador, and cities in the Northern Zone of El Salvador, from March 28 to April 15, 2011.

We examined the internal control environment by identifying and assessing the relevant controls. This included a review of supporting documentation over project oversight for the Connectivity Project and Production and Business Services Project activity.

We relied on computer-processed data from FOMILENIO and the implementing entity to access whether performance targets in the Monitoring and Evaluation Plan were met for the Connectivity Project and Production and Business Services Project activity. However, the data were not verified. We also used a translation website to convert documents provided to us in Spanish to English.

Methodology

To answer the audit objectives, we established audit steps to determine whether MCC and FOMILENIO were achieving project activity goals in the Northern Zone by integrating national and regional highway systems, to include countries bordering El Salvador, and by providing technical assistance and training to farmers to transition to high-profit activities. Specifically, we performed the following activities:

- Interviewed MCC, FOMILENIO, and Government of El Salvador officials implementing or overseeing the Connectivity Project to gain an understanding of project implementation, project oversight, changes to the project, monitoring, and sustainability of the project.
- Interviewed contractors constructing the Northern Transnational Highway and supervisory firms to gain an understanding of the quality and supervision of the roads and the sustainability of the project.
- Reviewed and analyzed supporting documentation for the Connectivity Project related to project implementation, project oversight, changes to the project, and monitoring.
- Judgmentally selected three of six sections of the Northern Transnational Highway to conduct site visits of the roads.

- Judgmentally selected one performance indicator from the Connectivity Project and reconciled it against the Monitoring and Evaluation Plan results.
- Interviewed MCC and FOMILENIO officials, and contractors implementing or overseeing the Production and Business Services Project activity, to gain an understanding of project implementation, project oversight, monitoring, and sustainability of the projects.
- Reviewed and analyzed supporting documentation for the Production and Business Services Project activity related to project implementation, project oversight, and monitoring.
- Judgmentally selected 15 farmers from three regions within the Northern Zone with the largest number of farmers in the Production and Business Services Project activity to visit.
- Obtained beneficiary data from FOMILENIO for the Production and Business Services Project activity and reconciled them against the Monitoring and Evaluation Plan results for two indicators.

MANAGEMENT COMMENTS



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Date: September 20, 2011

To: Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

From: Patrick Fine /s/
Vice President, Department of Compact Operations
Millennium Challenge Corporation

Sheila Herrling /s/
Vice President, Department of Policy and Evaluation
Millennium Challenge Corporation

Subject: MCC Response to Report No. M-000-11-00X-P, Audit of the Millennium Challenge Corporation-Funded Programs in El Salvador

Dear Mr. Brown:

The Millennium Challenge Corporation appreciates the opportunity to respond to the Office of Inspector General's draft audit report on El Salvador. MCC's responses to the report's four recommendations are given below. Attached at Tab A are additional comments, clarifications and corrections to the summary of results and audit findings.

***Recommendation 1.** We recommend that the Millennium Challenge Corporation's Vice President of the Department of Compact Operations require FOMILENIO to develop a written contingency plan for Section 7 of the Northern Transnational Highway to ensure road completion.*

MCC Response: MCC agrees with this recommendation. Prior to the audit, MCC has already instituted specific administrative policies and procedures that ensure proper plans are developed and actions taken to mitigate risks related to timely project completion. Specifically, MCC conducts quarterly portfolio reviews in which country teams review all known risks and identify potential mitigation strategies related to compact implementation. If risks persist into the final stages of compact implementation, MCC's Program Closure Guidelines require that contingency plans be prepared to avoid the kinds of potential problems cited in the draft report. The Program

Closure Guidelines require that Program Closure Plans include the following:

- a. A brief description of the closure strategy for the Project. If applicable, the Program Closure Plan for the Project should include detail at the Activity or sub-activity level.
- b. Identification of completion risks and sustainability risks for the Project/Activity, including how the Accountable Entity plans to address these risks, and contingency plans for how to respond if these risks materialize.

In accordance with MCC's Program Closure Guidelines, FOMILENIO is currently finalizing its Program Closure Plan. MCC will ensure that the final approved version – to be completed no later than December 31, 2011 - includes these required components, not only for Section 7 of the Northern Transnational Highway (NTH), but also for any other projects, activities, or sub-activities for which completion risk is deemed to be significant. Acceptance of FOMILENIO's Program Closure Plan will constitute MCC's final management decision on this recommendation.

Recommendation 2. *We recommend that the Millennium Challenge Corporation's Vice President of the Department of Policy and Evaluation, in conjunction with FOMILENIO, revise and document the revision of the following indicators:*

- *Number of beneficiaries of technical assistance and training*
- *Number of beneficiaries that have applied improved techniques*
- *Investment in productive chains by selected beneficiaries*
- *Increase in income of households near the Northern Transnational Highway*
- *Land prices along the Northern Transnational Highway*
- *Travel time from Guatemala to Honduras through the Northern Zone*

MCC Response: MCC agrees to work with FOMILENIO to revise and/or clarify the definitions in the M&E Plan, taking into account the OIG's comments and observations. MCC considers acceptance of the revised M&E Plan will constitute final management decision on this recommendation and will take final action by March 2012.

Recommendation 3. *We recommend that the Millennium Challenge Corporation's Vice President of the Department of Policy and Evaluation, in conjunction with FOMILENIO, document the verification of reported data used for the following indicators:*

- *Number of farmers trained*
- *Number of beneficiaries that have applied improved techniques*

MCC Response: MCC believes this recommendation has already been addressed. FOMILENIO originally provided the OIG with incorrect information. Following this, MCC provided corrected information to the OIG on July 27, 2011, including verified correct reporting data including the names and information for 12,544 farmers trained (0.6% percent difference from the previously reported figure of 12,465) and 5,319 farmers that have applied improved techniques (0.2% difference from the previously reported figure of 5,328). MCC considers this its final management decision, and that final action has already been taken to address this

recommendation.

***Recommendation 4.** We recommend that the Millennium Challenge Corporation's Vice President of the Department of Policy and Evaluation, in conjunction with FOMILENIO, finalize and implement the Productive Development Project-specific Monitoring and Evaluation manual.*

MCC Response: MCC agrees with the recommendation and, in conjunction with FOMILENIO, will finalize the monitoring and evaluation manual for the Productive Development Project by the end of March 2012. MCC considers this its final management decision on this recommendation.

Attachment

Tab A: MCC Management Comments on OIG Audit Report No. M-000-11-00X-P

Tab A: MCC Management Comments on OIG Audit Report No. M-000-11-00X-P

MCC would like to make the following clarifications and corrections to certain factual errors and/or inconsistencies in the draft report.

Objectives of the Connectivity Project

The draft report indicates that one of the objectives of the audit was to “determine whether the MCC-funded Connectivity Project in El Salvador is achieving its project activity goal of integrating the Northern Zone with national and regional highway systems and the Honduras and Guatemala borders”. This goal is not the same as the objective defined in the El Salvador Compact. Specifically, Section 1.1(c) of the Compact defines the objective of the Connectivity Project as follows: “Reduce travel cost and time within the Northern Zone, with the rest of country, and within the region”. Accordingly, the framing of the question in the draft report is narrower than the actual objective of the Connectivity Project as defined in the Compact.

Achievements of the Connectivity Project

In its Summary of Results, the OIG concludes that the Connectivity Project “will not achieve its project activity goals of integrating the Northern Zone with the national and regional highway systems and the Honduras and Guatemala borders because the funding provided by the compact was insufficient to fully implement the Connectivity Project.” The conclusion is incorrect. The Northern Transnational Highway (NTH) is already connected to the Anguiatu border crossing with Guatemala in the Northwest via a 6 mile segment of road north of Metapán. Similarly, upon completion of Segment 7 in July 2012, the NTH will also be connected to the border crossing into Honduras at Amatillo. Additionally, the NTH when completed, will intersect with the following major national highways and road networks: CA-12, CA-4, CA-3, RN-8, SAV-25, SAM-30, SAM-7, CA-7, MOR-1, and UNI-4. This is clear evidence of both national and regional integration.

One of the original design options considered for the NTH entailed the extension of road segments further to the south on the westernmost end of the NTH, and further to the north on the easternmost segment. The original option was not chosen because engineers from FOMILENIO and MCC assessed that this design would have required the construction of bridges over rivers flowing along border crossings, but without any existing or planned roads to connect to on the other side of these rivers in the neighboring countries. The OIG’s focus on the original design option led to the erroneous conclusion that final decision by FOMILENIO (to connect to existing border crossings in the nearby vicinity of both ends of the NTH) reduced integration with Guatemala and Honduras. It did not. Rather, using existing border crossings was a common sense decision that saved money and led to better use of MCC funds.

The draft report also erroneously concludes that “sufficient funds were not available to construct the Connectivity Project”. While it is true that there are insufficient MCC funds for all roads initially envisioned, it is incorrect to imply that the planned connecting roads will not be built. As of September 6, 2011, MCC has verified that the Government of El Salvador has allocated sufficient funds to complete the Connectivity Project. In addition to MCC funds allocated to

construct the NTH (completion projected for July 2012), the Government of El Salvador has confirmed financing totaling more than \$134 million will be used to construct the Network of Connecting Roads, and cover possible contingencies. We believe this is a positive example of U.S. funds leveraging funding from the partner country to meet a national priority and address a major constraint to economic growth.

The draft report suggests that the project will not meet its targets for beneficiaries due to the fact that the feasibility study for the NTH was not completed prior to Compact signing. It is important to point out that the Government of El Salvador's success in arranging financing for the Network of Connecting Roads will make it likely that the Connectivity Project as a whole will exceed its targets for beneficiaries. Further, the audit report overlooks the success of the Compact in ensuring that the Government of El Salvador provide a significant contribution to further Compact objectives. MCC's model encourages host country ownership, which is clearly demonstrated in this case by the Government of El Salvador's provision of counterpart funding.

Thank you for the opportunity to comment on the draft audit report. If you have questions and or need additional information, please contact Pat McDonald, MCC's Compliance Officer at 202-521-7260.

Map of El Salvador's Northern Zone



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