



*Office of Inspector General
for the Millennium Challenge Corporation*

September 21, 2011

Mr. Patrick Fine
Vice President of Compact Operations
Millennium Challenge Corporation
875 Fifteenth Street, N.W.
Washington, DC 20005

Subject: Limited Scope Review of the Millennium Challenge Corporation (MCC)
Resources Managed by the Millennium Development Authority (MiDA),
Under the Compact Agreement Between the MCC and the Government
of Ghana
(Report No. M-000-11-011-S)

Dear Mr. Fine:

This letter transmits our final report pertaining to our limited scope review of MiDA. 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.

Most of the issues and recommendations in this report were discussed with both MiDA and MCC management immediately after the fieldwork ended. At that time, both MiDA and MCC's management was in general agreement with the issues and proposed recommendations. On December 16, 2010 we provided a letter to MCC's management (included as Appendix IV) describing these issues to facilitate immediate attention. MCC's management responses dated August 2, 2011 and January 12, 2011 are included in their entirety in Appendixes II and III, respectively.

The report contains ten recommendations to address: (1) putting funds to better use, (2) improving the likelihood that the compact will be completed by its end date, and (3) auditing a grant. MCC agreed with all ten recommendations. We consider that management decisions have been reached on all 10 Recommendations and final action taken on Recommendations 1-9. Final action will take place on Recommendation No. 10 when MCC approves the Compact Program Closure Plan.

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

Sincerely,

/s/

Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

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SUMMARY

On August 1, 2006, the Millennium Challenge Corporation (MCC) and the Government of Ghana signed a 5-year compact that totaled approximately \$547 million and entered-into-force on February 16, 2007. The goals of the compact are to reduce poverty through economic growth by enhancing the profitability of agricultural production; improve the delivery of business and technical services that support commercial agriculture expansion; reduce transportation costs affecting agricultural commerce; and strengthen rural institutions that provide services to agricultural projects under the compact. Of the \$547 million compact, \$241 million was allocated to agriculture, \$143.1 million to transportation, \$101.3 million to rural development and the remainder allocated to monitoring and evaluation and program administration. The Ghanaian government designated the Millennium Development Authority (MiDA) as the accountable entity that would have the legal authority to oversee the compact.¹

The objective of this review was to answer the following questions:

- What is the current status of several compact projects, including the upgrading of the National Highway, trunk roads, and the Agricultural Credit Program?
- Are there any weaknesses in the existing internal controls related to the procurement process?

According to the construction contractor, the Lot 2 section of the National Highway Road Project (funded at \$83.6 million) cannot be completed by the end of the compact without additional funding. The contractor, MSF, in its “Acceleration Study Programme and Cost Package of Measures” has requested \$13.9 million in additional funding for “road construction acceleration costs” to complete Lot 2 of the National Highway by the end of the compact period in February 2012.

The Trunk Roads Project (budgeted at \$31.8 million) is also at risk of not being completed by February 2012. At the time of the Office of Inspector General’s (OIG) fieldwork, a portion of the AF-2 trunk road was underwater as a result of floods, and construction could not proceed on this portion of the road.

The Irrigation Project may not be completed on time. At the time of our review only the feasibility designs and studies had been completed. This occurred as a result of unanticipated delays in completing preliminary steps in implementation of the Irrigation Project (putting into place suitable institutional and/or operational arrangements for some of the schemes, etc.).

Additionally, the Agricultural Credit Program has not met expectations owing to, among other factors, poor performance by the Bank of Ghana and Agricultural Credit Program consultant, unrealistic cash flow assumptions used in the borrowers’ business plans, and lack of capacity on the part of some of the participating financial institutions. This allows

¹ Per Act 702 of the Parliament of the Republic of Ghana, The Millennium Development Authority Act, 2006.

MCC and MiDA the opportunity to reevaluate the planned uses of the funds associated with the Agricultural Credit Program and possibly put them to better use.

Funding of \$1.8 million has been held in a non-interest bearing bank account unused for several years. The account was opened at the request of MCC and the funds are to be used to purchase land as part of the resettlement action plan. However, the \$1.8 million should be used for immediate compact expenditures and funds requested on an “as-needed” basis through the Common Payment System for the purchase of land as part of the resettlement action plan.

OIG met and discussed most of these issues and recommendations with both MiDA and MCC management immediately after the fieldwork ended. At that time, both MiDA and MCC management were in general agreement with the issues and proposed recommendations. OIG also provided a letter to MCC’s management (included as Appendix IV) on December 16, 2010, describing these issues to facilitate its immediate attention. MCC’s management responses dated August 2, 2011 and January 12, 2011 are included in their entirety in Appendixes II and III, respectively.

The OIG recommends:

- *The Millennium Development Authority take immediate measures to address the contractor’s, “Acceleration Study Programme and Cost Package of Measures” to ensure timely completion of the Lot 2 section of the National Highway. (See page 7)*
- *The Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of Lot 2. (See page 7)*
- *The Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of the AF-2 trunk road. (See page 7)*
- *The Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects or activities the \$4.3 million budgeted, but not yet disbursed to the Agriculture Credit Program. (See page 8)*
- *The Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects the \$4.5 million of funds currently in the Agriculture Credit Program repayment account. (See page 8)*
- *The Millennium Challenge Corporation and Millennium Development Authority develop plans to (a) collect as much of the \$15.8 million of loans outstanding as possible, and (b) determine how best to use the funds collected. (See page 9)*

- *The Millennium Development Authority transfer the \$1.8 million to a permitted account so it can be used for other compact activities. (See page 9)*
- *The Millennium Challenge Corporation and Millennium Development Authority (a) determine the feasibility of completing the Irrigation Project by compact end, and (b) if it is determined that it is not feasible to complete the Irrigation Project by compact end, develop a contingency plan. (See page 9)*
- *The Millennium Development Authority arrange for audit coverage of the \$2 million Alliance for Green Revolution Agency grant. (See page 10)*
- *The Millennium Development Authority determine what will be done with any funds remaining from the Alliance for Green Revolution Agency grant activity at the end of the grant period. (See page 10)*

Detailed results of this review appear in the following section. The scope and methodology are included in Appendix I. MCC agreed with all ten recommendations. We consider that management decisions have been reached on all 10 Recommendations and final action taken on Recommendations 1-9. Final action will take place on Recommendation No. 10 when MCC approves the Compact Program Closure Plan.

REVIEW RESULTS

Road Projects Are at Risk of Not Being Completed

Both Lot 2 of the National Highway and the Trunk Roads Projects are behind schedule and at risk of not being completed by the compact's expiration in February 2012. According to the construction contractor, the Lot 2 section of the National Highway Road Project (funded at \$83.6 million) cannot be completed by the end of the compact without additional funding. According to MiDA officials, the delays occurred because of resettlement issues, because the consultation, design, and feasibility studies were not done prior to the entry-into-force date², and because of unseasonal rains. The contractor, MSF, in its "Acceleration Study Programme and Cost Package of Measures" has requested \$13.9 million in additional funding for "road construction acceleration costs" to complete Lot 2 of the National Highway by the end of the compact period in February 2012.

The Trunk Roads Project (budgeted at \$31.8 million) is also at risk of not being completed by February 2012. At the time of OIG's fieldwork, a portion of the AF-2 trunk road was underwater owing to floods (as shown in the photograph below), and construction could not proceed on this portion of the road.



Photo of the AF-2 Trunk Road underwater in Ghana. (Photograph by MiDA's procurement agent.)

² The compact was signed on August 1, 2006 and the entry-into-force date was February 16, 2007.

Representatives from the relevant contractors, the project consulting engineers, and MiDA plan to meet to determine when the remaining road project activities can be realistically completed. Revised project timelines are expected in mid-December 2010, and updated cost estimates are expected by mid-January 2011.

Immediately after fieldwork ended, OIG met with both MiDA and MCC officials regarding these issues. At that time, management from both parties was in general agreement with the issues and following recommendations. As a result, OIG makes the following recommendations:

Recommendation 1: We recommend that the Millennium Development Authority take immediate measures to address the contractor's, "Acceleration Study Programme and Cost Package of Measures" to ensure timely completion of the Lot 2 section of the National Highway.

Recommendation 2: We recommend that the Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of Lot 2.

Recommendation 3: We recommend that the Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of the AF-2 trunk road.

The Agricultural Credit Program Has Not Met Expectations

The Agricultural Credit Program (ACP) has not met expectations established by MiDA and MCC at the inception of the program. MiDA expected that a maximum of 20 percent of the loan portfolio would be at risk of nonrepayment. However, as of September 30, 2010, 70.6 percent of the ACP loan portfolio³ was greater than 30 days past due⁴ and 54.5 percent of the Participating Financial Institution (PFI) loan portfolio⁵ was greater than 30 days past due (see Table 1). The poor performance of the ACP is well understood and documented by MCC and MiDA.

The following factors led to the poor performance:

- A lack of capacity on the part of the Bank of Ghana
- Some PFIs borrowing more from the revolving credit fund than was prudent
- A low level of competency of the staff at some PFIs, especially at rural banks

³ The ACP portfolio refers to the portfolio of loans the participating financial institutions took out from the revolving credit fund.

⁴ The 70.6 percent refers to portfolio-at-risk, which is defined as the "Share of value of all loans disbursed from the agricultural loan fund that have one or more installments of principal or interest past due over thirty (30) days, disaggregated by short-term and medium-term loans."

⁵ The PFI portfolio refers to the portfolio of loans the PFIs made to sub-borrowers, such as farmers.

- Overly optimistic business plans with unrealistic agricultural price assumptions
- Inadequate and inconsistent loan documentation, including borrowers not having been given detailed repayment schedules to record payments of principal and interest

Table 1. Loans Past Due

	<u>Actual</u>	<u>Expected Maximum</u>	<u>Difference</u>
Agricultural Credit Program (ACP) Portfolio	70.60%	20%	50.60%
Participating Financial Institution (PFI) Portfolio	54.50%	20%	34.50%

As of September 30, 2010, the balance of loans outstanding to PFIs under the ACP was \$15.8 million. It is difficult to determine how much of the \$15.8 million will ultimately be repaid, but the poor credit performance suggests that credit losses will be large and more than originally anticipated.

In addition to the \$15.8 million loan portfolio, as of September 30, 2010, approximately \$3.7 million was held in the ACP repayment account at the Bank of Ghana. This \$3.7 million was available for lending to new borrowers. Subsequent to our fieldwork, MCC notified us that the \$3.7 million amount increased to \$4.5 million, which should be put to better use.

MCC has disbursed \$19.6 million of the \$26 million budgeted for use in the ACP. The remaining \$6.4 million was still available for disbursement to the ACP. However, subsequent to our fieldwork, MCC notified us that the total amount budgeted but undisbursed was \$4.3 million. As a result of the difficulties associated with the ACP, all or a portion of the \$4.3 million should be put to better use.

As a result of the ACP's difficulties, the MCC and MiDA now have the opportunity to reevaluate the planned uses of the associated funds and possibly put them to better use. Accordingly, OIG makes the following recommendations:

Recommendation 4: We recommend that the Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects or activities the \$4.3 million budgeted, but not yet disbursed to the Agriculture Credit Program.

Recommendation 5: We recommend that the Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects the \$4.5 million of funds currently in the Agriculture Credit Program repayment account.

Recommendation 6: We recommend that the Millennium Challenge Corporation and Millennium Development Authority develop plans to (a) collect as much of the \$15.8 million of loans outstanding as possible, and (b) determine how best to use the funds collected.

**Resettlement Funding of
\$1.8 million Held in a
Non-interest Bearing Account**

Funding of \$1.8 million has been held in a non-interest bearing bank account unused for several years. The account was opened at the request of MCC and the funds are to be used to purchase land as part of the resettlement action plan. However, it is uncertain how much of the \$1.8 million will ultimately be needed to purchase the land. Accordingly, the \$1.8 million should be used for immediate compact expenditures and funds requested on an “as-needed” basis through the Common Payment System for the purchase of land as part of the resettlement action plan.

Recommendation 7: We recommend that the Millennium Development Authority transfer the \$1.8 million to a permitted account so it can be used for other compact activities.

**The Irrigation Project May
Not be Completed on Time**

The Irrigation Project may not be completed on time. At the time of our review only the feasibility designs and studies had been completed. This occurred as a result of unanticipated delays in completing preliminary steps in implementation of the Irrigation Project (putting into place suitable institutional and/or operational arrangements for some of the schemes, etc.). The initial compact plan was to irrigate 5,060 hectares and be implemented over 4 years (beginning in 2008 and ending in 2012). That coverage has now been reduced to about 1,880 hectares at an estimated construction cost of \$13.6 million. Consequently, it may be difficult to complete the project over the remaining compact period. Accordingly, OIG makes the following recommendation:

Recommendation 8: We recommend that the Millennium Challenge Corporation and Millennium Development Authority (a) determine the feasibility of completing the Irrigation Project by compact end, and (b) if it is determined that it is not feasible to complete the Irrigation Project by compact end, develop a contingency plan.

Grant to AGRA Not Audited

Audit coverage has not been arranged for a \$2 million grant provided to the Alliance for Green Revolution Agency (AGRA). The grant agreement states that MiDA will contribute \$2 million to AGRA, which will in turn contribute \$0.5 million. The combined \$2.5 million will serve as a first loss guarantee on agriculture-related loans issued by a private bank.

AGRA is a “Covered Provider” as defined by the Ghanaian compact and therefore is required to be audited. Section 3.8(d)(iii) of the compact states,

The Government shall submit, or cause to be submitted, to MCC...a plan...for the audit of the expenditures of any Covered Providers...which audit plan, in the form and substance as approved by MCC, the Government shall adopt, or cause to be adopted, no later than sixty (60) days prior to the end of the first period to be audited (such plan, the “Audit Plan”).

The grant agreement contains numerous provisions under which the grant is intended to be implemented. The provisions include establishment of steering and oversight committees, guarantee fund and Ghana loan portfolio operations, claims, recoveries, and duties and responsibilities of the partners.

Additionally, according to the grant agreement, any funds remaining at the end of the grant period will be returned to MiDA or its designee. To date, MiDA has not identified a designee. Therefore, any funds remaining at the end of the grant period will be returned to MiDA. OIG makes the following recommendations:

Recommendation 9: We recommend that the Millennium Development Authority arrange for audit coverage of the \$2 million Alliance for Green Revolution Agency grant.

Recommendation 10: We recommend that the Millennium Development Authority determine what will be done with any funds remaining from the Alliance for Green Revolution Agency grant activity at the end of the grant period.

EVALUATION OF MANAGEMENT COMMENTS

On August 2, 2011, MCC provided a formal response to our draft report (included as Appendix II). Subsequently, in an e-mail dated August 31, 2011, MCC clarified its formal response to our draft report. Consequently, we modified Recommendations 4 and 5 in the draft report to those Recommendations shown in this final report.

MCC agreed with all ten recommendations. We consider that management decisions have been reached on all 10 Recommendations and final action taken on Recommendations 1-9. Final action will take place on Recommendation No. 10 when MCC approves the Compact Program Closure Plan.

MCC agreed with **Recommendation No. 1** and has already worked with MiDA to begin settlement of the contractor's claims. On May 13, 2011, MiDA and the Engineer agreed to an interim payment of \$8.084 million and that amount has since been paid to the contractor. The purpose of the interim payment was to partially settle the contractor's delay claim and request for extension of time and to provide for reimbursement of acceleration costs to be incurred by the contractor to reach completion by the agreed date of January, 31 2012. Assuming successful resolution of the balance of the claim and payment of appropriate acceleration costs, the contractor has indicated it can complete construction by January 31, 2012. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 2** and has already taken steps to ensure reasonable contingency plans for the completion of Lot 2 are developed. In connection with the preparation of closure plans and contingency plans, meetings involving MCC, its independent engineer, and MiDA were held with the transportation construction supervisors in May 2011 to discuss, among other things, contingency plans for contracts facing significant completion risk. More recently, at its June 2011 meeting, the Board of Directors of MiDA has made a similar request, reinforcing the need for contingency planning to ensure completion of all works contracts. Discussions have also been initiated with the Government of Ghana regarding the possible need for additional funds from government to complete the works. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 3** and has been engaged in discussions with MiDA regarding contingency plans for the completion of the AF-2 trunk road. As part of the Compact Program Closure Plan currently being drafted by MiDA and reviewed by MCC, MCC has requested that MiDA complete contingency plans for all projects and activities, including addressing the completion risk associated with the AF-2 trunk road. In terms of contingency planning specifically for AF-2, consideration is being given to reduction in the amount of sealing such that the road would end up as a combination of a sealed and gravel road. MCC has determined that decisions as to how to proceed will have to be made in the next few weeks and revisited again in October 2011 in order to ensure contract work is completed by the end of the Compact term. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation Nos. 4 and 5** and, together with MiDA, has already begun the process of re-allocating the remaining undisbursed funds originally budgeted

for the Agriculture Credit Program to other Compact activities. MCC determined that no new Compact funds would be disbursed to MiDA for ACP loans and MCC and MiDA subsequently determined that all lending, including lending funded by recycled receipts, would also cease. As to funds reallocation, MCC stated in an e-mail dated August 31, 2011, that a total of \$8.8 million has been put to better use. The \$8.8 million is composed of \$4.3 million of budgeted but undisbursed ACP funding and \$4.5 million from the ACP repayment account. Additionally, MiDA is currently in the process of reviewing other Compact projects and activities to identify areas where remaining funds are needed. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 6**. MiDA is committed to recouping payments to the extent possible. MiDA and MCC have designed and MiDA has implemented a plan to recoup as much as possible from end-borrowers through the PFIs before the end of the Compact. Additionally, MCC and MiDA continue to explore various options for collections outside of the PFIs. A team was in Accra, Ghana the week of July 25, 2011 reviewing progress and revising the action plan for maximizing collections from borrowers, PFIs, and banks. MiDA has focused on using existing personnel to ensure payments are collected during the life of the Compact. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 7**. After discussions with MCC, MiDA submitted and MCC approved a no objection request to transfer the \$1.8 million to a permitted account to be managed and used in accordance with the terms of the Compact and the Bank Agreement on July 22, 2011. An equal amount of Compact funds not yet disbursed will remain committed in the activity's budget for resettlement payments until expended for outstanding claims by Project Affected Persons or until it becomes evident the amount will not be expended prior to the end of the Compact, in which case the funds will be expended for another purpose approved by MCC. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 8**. MCC has been working with MiDA since October 2010 to determine how to appropriately re-scope the Compact's Irrigation Activity. The scope of the Irrigation Activity has already been reduced. Of the amount originally budgeted for the Irrigation Activity, approximately \$6 million was committed and disbursed for the completion of feasibility studies, designs, and environmental and social assessments during the activity's planning phase and in covering the irrigation activity's share of the cost of the project management consultant. Another \$3 million was set aside for construction supervision with the balance remaining for construction works for three lots in three Intervention Zones, albeit for a lesser number of hectares than originally planned.

In addition MiDA, under MCC's oversight, is monitoring the progress of construction and the environmental and social impact of the irrigation schemes, and planning for the sustainability of the activity. MCC will continue to work with MiDA on a plan for project completion that acknowledges any re-scoping, contingency plans, and final work plan necessary for ensuring completion of the activity within the Compact term. Contingency planning will be included as part of the Compact Program Closure Plan, expected to be approved by August 31, 2011. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 9**. AGRA has been added to current and future MiDA external audits. On May 13, 2011, OIG approved the audit planning document for the period July 1, 2010-December 31, 2010, which includes the covered provider AGRA. Going forward, AGRA is included in the audit contract's Terms of Reference (TOR) for all subsequent periods including the final audit period through the Compact closure period. OIG considers that a management decision has been reached which also constitutes final action.

MCC agreed with **Recommendation No. 10**. MCC will instruct MiDA to decide what will be done with the remaining funds in the AGRA grant at the end of Compact. This must be completed as a requirement of the Compact Program Closure Plan for the Ghana Compact, currently being drafted by MiDA and reviewed by MCC. As previously mentioned, the Compact Program Closure Plan is expected to be approved by August 31, 2011. OIG considers that a management decision has been reached. Final action will take place on Recommendation No. 10 when MCC approves the Compact Program Closure Plan.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted this review of the Millennium Development Authority to determine the current status of several compact projects, including the upgrading of the National Highway, trunk roads, and the Agricultural Credit Program. Also, we sought to develop recommendations that would improve the likelihood that the compact projects will be finished by the compact end date and to identify obvious internal control weaknesses in the procurement process in order to lessen the probability of waste, fraud, and abuse. While this was not an audit, we planned and performed this review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We also conducted this review in accordance with Government Auditing Standards, specifically Chapter 3 and Chapter 7, Sections 7.55 and 7.72 to 7.79. The fieldwork for this review was conducted from October 10 to October 28, 2010, in Ghana.

Methodology

We interviewed Millennium Development Authority management, the independent procurement agent, and managers of the road projects, Agriculture Credit Program (ACP), and procurement office. We conducted a site visit of Lot 2 of the National Highway Road Project, and we reviewed pertinent documentation related to the road projects, ACP, and procurement process.

To answer the review objectives, steps were established to determine the following:

- What is the current status of several compact projects, including the upgrading of the National Highway, trunk roads, and the Agricultural Credit Program?
- Are there any weaknesses in the existing internal controls related to the procurement process?

MANAGEMENT COMMENTS



August 2, 2011

Mr. Alvin Brown
Assistant Inspector General
For the Millennium Challenge Corporation
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The Millennium Challenge Corporation (MCC) appreciates the opportunity to respond to the Office of Inspector General's (OIG) draft report dated July 26, 2011, entitled "Limited Scope Review of the Millennium Challenge Corporation (MCC) Resources Managed by the Millennium Development Authority (MiDA), Under the Compact Agreement Between the MCC and the Government of Ghana" (Report No. M-000-11-00X-S). MCC's specific responses to the 10 recommendations in the draft report are detailed below. The actions outlined in this letter constitute MCC's management decision with respect to each of the recommendations.

1. The OIG recommends that the Millennium Development Authority take immediate measures to address the contractor's, "Acceleration Study Programme and Cost Package of Measures" to ensure timely completion of the Lot 2 section of the National Highway.

MCC agrees with this recommendation and has already worked with MiDA to begin settlement of the Contractor's claims. Resolving the Contractor's "Acceleration Study Programme and Cost Package of Measures" in order to ensure timely completion of the Lot 2 section of the National Highway has been a priority for both MiDA and MCC. On May 13, 2011, MiDA and the Engineer agreed to an interim payment of \$8.084 million and that amount has since been paid to the Contractor. The purpose of the interim payment is to partially settle the Contractor's delay claim and request for extension of time and, in addition, to provide for reimbursement of acceleration costs to be incurred by the Contractor to reach completion by the agreed date of January, 31 2012. A work program demonstrating how that date can be met has been provided to MiDA and the Contractor has taken steps to accelerate the pace of work. A recommendation has been put forward regarding settlement amounts for both the delay claim and the acceleration and the parties have resumed discussions as of July 28, 2011, to finalize the negotiations

and arrive at the final settlement amount, which will be fully justified and accompanied by supporting documentation. By putting the claim behind them and making payments necessary for acceleration, all parties, MiDA, the Engineer, and Contractor, can concentrate on the completion of the construction works. Assuming successful resolution of the balance of the claim and payment of appropriate acceleration costs, the Contractor has indicated it can complete construction by January 31, 2012.

2. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of Lot 2.

MCC agrees with this recommendation and has already taken steps to ensure reasonable contingency plans for the completion of Lot 2 are developed. First, as noted in the response to recommendation 1 above, assuming successful resolution of the Contractor's "Acceleration Study Programme and Cost Package of Measures" that would include the payment of acceleration costs by MiDA under the construction contract, the Contractor has agreed to a completion date of January 31, 2012 for Lot 2 of the N1 Highway. In addition, as part of the Compact Program Closure Plan currently being drafted by MiDA and reviewed by MCC, MCC has requested that MiDA complete contingency plans for all projects and activities, including completion of the construction on N1 Lot 2. The Compact Program Closure Plan is expected to be approved by August 31, 2011. In connection with the preparation of closure plans and contingency plans, meetings involving MCC, its independent engineer, and MiDA were held with the transportation construction supervisors in May to discuss, among other things, contingency plans for contracts facing significant completion risk. More recently, at its June meeting, the Board of Directors of MiDA has made a similar request, reinforcing the need for contingency planning to ensure completion of all works contracts. Discussions have also been initiated with the Government of Ghana regarding the possible need for additional funds from government to complete the works.

3. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority coordinate and develop contingency plans for the completion of the AF-2 trunk road.

MCC agrees with this recommendation and has been engaged in discussions with MiDA on the issue. As part of the Compact Program Closure Plan currently being drafted by MiDA and reviewed by MCC, MCC has requested that MiDA complete contingency plans for all projects and activities, including addressing the completion risk associated with the AF-2 trunk road. It is understood that, at the time of the OIG LSR field work in 2010, very little tangible progress had been made on AF-2. Since then, however, the Contractor, who was awarded both Lots AF-1 and AF-2, has continued to make progress on AF-1, reaching 75% physical completion as of the end of June 2011, at the same time bringing AF-2 up to a completion level of almost 44% (per the supervisor's Monthly Progress Reports for AF-1 and AF-2 dated June 2011). As completion on AF-1 nears, the Contractor will be able to dedicate a greater share of resources to AF-2. In terms of contingency planning specifically for AF-2, consideration is being given to reduction in

the amount of sealing such that the road would end up as a combination of a sealed and gravel road. MCC has determined that decisions as to how to proceed will have to be made in the next few weeks and revisited again in October 2011 in order to ensure contract work is completed by the end of the Compact term.

MCC will jointly respond to recommendations 4 and 5.

4. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects or activities the \$6.4 million budgeted, but not yet disbursed to the Agriculture Credit Program.

5. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority decommit or reallocate to other compact projects the \$3.7 million of funds currently in the Agriculture Credit Program repayment account.

MCC agrees with each of these recommendations and, together with MiDA, has already begun the process of re-allocating the remaining undisbursed funds originally budgeted for the Agriculture Credit Program to other Compact activities. Indeed, at the time of the OIG field work that formed the basis for these recommendations, MCC and MiDA had already conducted an initial joint review of the ACP utilizing MiDA's internal auditor. As a result of its ongoing review, MCC determined that no new Compact funds would be disbursed to MiDA for ACP loans and MCC and MiDA subsequently determined that all lending, including lending funded by recycled receipts, would also cease. As to reallocation, MiDA formally requested US\$4.5 million be re-directed to the Rural Financial Services Activity, using the remaining funds in the ACP repayment account plus a portion of the ACP funding remaining undisbursed under the Compact, and MCC approved that request in June 2011. MiDA is currently in the process of reviewing other Compact projects and activities to identify areas where the remaining funds are needed. In addition, as part of the Compact Program Closure Plan currently being drafted by MiDA and reviewed by MCC, MiDA is determining how the program will ultimately be closed out. As previously mentioned, the Compact Program Closure Plan is expected to be approved by August 31, 2011.

6. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority develop plans to (a) collect as much of the \$15.8 million of loans outstanding as possible, and (b) determine how best to use the funds collected.

MCC agrees with this recommendation. MiDA is committed to recouping payments to the extent possible. MiDA and MCC have designed and MiDA has implemented a plan to recoup as much as possible from end-borrowers through the PFIs before the end of the Compact. Additionally, MCC and MiDA continue to explore various options for collections outside of the PFIs. A team was in Accra the week of July 25th reviewing progress and revising the action plan for maximizing collections from borrowers, PFIs, and banks. MiDA has focused on using existing personnel to ensure payments are collected during the life of the Compact. In addition, as noted above in connection with MCC response and management decision with respect to recommendations four and five,

as part of the Compact Program Closure Plan currently being drafted by MiDA and reviewed by MCC, MiDA is determining how the program will ultimately be closed out. As previously mentioned, the Compact Program Closure Plan is expected to be approved by August 31, 2011.

7. The OIG recommends that the Millennium Development Authority transfer the \$1.8 million [funding for resettlement in a non-interest bearing account] to a permitted account so it can be used for other compact activities.

MCC agrees with this recommendation. After discussions with MCC, MiDA submitted and MCC approved a no objection request to transfer the \$1.8 million to a permitted account to be managed and used in accordance with the terms of the Compact and the Bank Agreement on July 22, 2011. An equal amount of Compact funds not yet disbursed will remain committed in the activity's budget for resettlement payments until expended for outstanding claims by Project Affected Persons or until it becomes evident the amount will not be expended prior to the end of the Compact, in which case the funds will be expended for another purpose approved by MCC.

8. The OIG recommends that the Millennium Challenge Corporation and Millennium Development Authority (a) determine the feasibility of completing the Irrigation Project by compact end, and (b) if it is determined that it is not feasible to complete the Irrigation Project by compact end, develop a contingency plan.

MCC agrees with this recommendation. In fact, MCC has been working with MiDA since October 2010 to determine how to appropriately re-scope the Compact's Irrigation Activity. Indeed, the scope of the Irrigation Activity has already been reduced. Of the amount originally budgeted for the Irrigation Activity, approximately \$6 million was committed and disbursed for the completion of feasibility studies, designs, and environmental and social assessments during the activity's planning phase and in covering the irrigation activity's share of the cost of the project management consultant. Another \$3 million was set aside for construction supervision with the balance remaining for construction works for three lots in the three Intervention Zones, albeit for a lesser number of hectares than originally planned.

Bidding documents were prepared and released for works in all three lots. After additional analysis and a determination that there were not sufficient remaining Compact funds allocated to complete the Irrigation Activity as then contemplated, MCC approved MiDA's cancellation of Lot 2 of the Irrigation Activity, thereby saving on both construction and construction supervision costs in amounts sufficient to adequately fund the other lots. MiDA received bids September 30, 2010, and after the evaluation and approval process, accepted the winning bid for each lot in December 2010 and signed works contracts for Lots 1 and 3 in early 2011, as a result of which the entire budget for the Irrigation Activity has been committed. The executed works contracts are summarized below.

Contract	Lot 1 Northern	Lot 3 Torgorme	Lot 3 KPIWSP
Contractor	Jiangxi Zhongmei Engineering Construction Company Limited	Erdmac Company Ltd	Ceekabs Ltd
Acceptance date	8 Dec 2010	17 Dec 2010	17 Dec 2010
Contract signing date	4 Mar 2011	7 Jan 2011	7 Jan 2011
Completion date	21 Jan 2012	21 Jan 2012	31 July 2011*
Contract price	\$ 3,046,861	\$ 9,192,847	\$ 1,386,237

* As amended

MiDA, under MCC's oversight, is monitoring the progress of construction and the environmental and social impact of the irrigation schemes, and planning for the sustainability of the activity. MCC will continue to work with MiDA on a plan for project completion that acknowledges any re-scoping, contingency plans, and final work plan necessary for ensuring completion of the activity within the Compact term. Contingency planning will be included as part of the Compact Program Closure Plan, expected to be approved by August 31, 2011.

9. The OIG recommends that the Millennium Development Authority arrange for audit coverage of the \$2 million Alliance for Green Revolution Agency grant.

MCC agrees with this recommendation. AGRA has been added to current and future MiDA external audits. On May 13, 2011, OIG approved the audit planning document for the period July 1, 2010-December 31, 2010, which includes the covered provider AGRA. Going forward, AGRA is included in the audit contract's Terms of Reference (TOR) for all subsequent periods including the final audit period through the Compact closure period. In addition to constituting MCC's management decision, the actions outlined above also represent MCC's final action in regard to this recommendation.

10. The OIG recommends that the Millennium Development Authority determine what will be done with any funds remaining from the AGRA grant at the end of the grant period.

MCC agrees with this recommendation. MCC will instruct MiDA to decide what will be done with remaining funds in the AGRA grant at the end of Compact. This must be completed as a requirement of the Compact Program Closure Plan for the Ghana

Compact, currently being drafted by MiDA and reviewed by MCC. As previously mentioned, the Compact Program Closure Plan is expected to be approved by August 31, 2011.

Sincerely,

Patrick Fine /s/
Vice President of the Department of Compact Operations
Millennium Challenge Corporation

CC: Jonathan Bloom, Deputy Vice President of the Department of Compact Operations
Katerina Ntep, Resident Country Director, Ghana
Arlene McDonald, MCC Compliance Officer

MANAGEMENT COMMENTS



January 12, 2011

Mr. Alvin Brown
 Assistant Inspector General
 For the Millennium Challenge Corporation
 1401 H Street NW, Suite 770
 Washington, DC 20005

Dear Mr. Brown:

Thank you for your letter of December 16 outlining concerns noted by the Office of Inspector General following the recent limited scope review of MCC's Compact with the Government of Ghana. I appreciate the effort made by you and your team to bring the three items to my attention and have discussed them with the Ghana Country Team and Resident Mission in Accra. Below are brief responses to each point regarding the current status, and an outline of steps MCC and MiDA are taking to address them.

Issue 1: Delays in the construction of the Lot 2 section of the National Highway Road Project and Trunk Roads Project may mean completion is no longer possible within the Compact period.

MCC and MiDA agree that a number of factors, including unseasonal rains, resettlement and utility relocation issues, have contributed to delayed construction on N1 Lot 2. MiDA has been analyzing the remaining project activities and reviewing with the Lot 2 construction supervisor the "Acceleration Study Program and Cost Package of Measures" submitted by the contractor (MSF). MiDA is currently expecting from the contractor a revised version of that program, as requested just prior to the holidays, and, immediately upon receipt, will complete its analysis and enter into negotiations with the contractor to bring the matter to a mutually satisfactory resolution. MiDA, with the assistance of its construction supervisor and project management support consultant, is considering options for construction areas most heavily impacted by delayed resettlement as well as non-critical design elements that could be scaled down or removed from the contract. Such considerations will alleviate some budget concerns and improve the timeline for completion. MCC is closely coordinating with MiDA regarding the situation and hence will be in a position to provide a prompt response to MiDA's proposal, which is expected in the coming days. A contract variation may make sense to complete the works within specifications and within the term of the Compact, which expires in February 2012.

While the teams are doing everything they can to ensure the Trunk Roads Activity is completed on time, they do recognize the possibility that, considering planned design and construction requirements, additional delays could likely push the completion date past the Compact term. To avoid this eventuality, MiDA is considering a range of measures from possible changes to

pavement standards and additional scaling down of design and scope, within acceptable international standards.

During my trip to Accra last week, I raised our grave concerns about completing these projects at the highest levels of government, and received assurances that the GoG was fully committed to taking the actions necessary, including providing additional funds if necessary, to ensure the N1 Lot 2 and Trunk Roads were completed within the Compact term.

Issue 2: Delay in starting the Irrigation Project and OIG recommendation to de-commit or reallocate funds budgeted for the project.

Unanticipated delays in completing preliminary steps in implementation of the Irrigation Activity (i.e., additional due diligence; attracting and securing “anchor” tenants; putting into place suitable institutional and/or operational arrangements for some of the schemes) have led to implementation delays. Increased projected costs have also impacted on the design of the program. As a result, the Irrigation Activity has recently been scaled down. Originally, three lots were presented for bid. Budget and time considerations have resulted in MiDA eliminating one of these lots, and consideration is being given to further cuts, while considering small scale irrigation activities as an alternative to support poor farmers in the Northern Zone.

Issue 3: Performance of the Agricultural Credit Program and OIG recommendations to a) develop a strategy for and focus on the recovery of outstanding loans, b) de-commit or reallocate all or a portion of the \$3.7 million in the ACP repayment account, and c) put all or a portion of the \$6.4 million still available for disbursement to the ACP to better use.

MCC first learned of the loan repayment problems in the ACP in Q1 FY 2010 and immediately notified MiDA that no additional funds would be made available. No additional funding for ACP lending has been requested or approved since that time.

We agree that any additional lending should be minimal and should come from the reflow of funds previously distributed to MiDA and that no additional MCC resources should be disbursed to MiDA for that purpose. We appreciate that OIG recognizes the importance of utilizing some ACP funding to recover loans that are currently outstanding, and we note that some resources may be appropriately used to support capacity building at the rural banks as well. Upon finalizing a revised ACP implementation plan and corresponding budget, we anticipate reallocating any remaining funds to other Compact activities.

Finally, during my visit to Accra this past week, MCC’s outgoing and incoming Resident Country Directors and I met with MiDA Senior Management to discuss the overall Compact budget and the need to continue frequent risk analyses for all Compact activities. Appropriately, MiDA is taking a holistic approach to reallocation of funding within the entire Compact budget. This review will be reflected in the March 2011 Disbursement Request. I believe this approach incorporates the recommendations in your letter.

Please let me know if you would like additional information on any of the above items. Once again, thank you. I am certain you will find this response to the issues raised in your letter,

reflecting actions by both MiDA and MCC, to be appropriate and timely, and I am confident that these problems will be dealt with in a way that allows for the successful completion of the Ghana Compact in accordance with MCC's principles and guidelines.

Sincerely,

Jonathan Bloom
Deputy Vice President of the Department of Compact Operations
Millennium Challenge Corporation

CC: Patrick Fine, Vice President of the Department of Compact Operations
Dennis Nolan, Deputy Chief Financial Officer
Katerina Ntep, Resident Country Director, Ghana
Arlene MacDonald, MCC Compliance Officer



*Office of Inspector General
for the Millennium Challenge Corporation*

December 16, 2010

Jonathan Bloom
Deputy Vice President of Department of Compact Implementation
Millennium Challenge Corporation
875 15th Street, NW
Washington, D.C. 20005

Dear Mr. Bloom:

The Office of Inspector General recently conducted a limited scope review of the Millennium Challenge Corporation's Compact with the Government of Ghana. The objectives of the review were to (a) determine the current status of several Compact projects, including the upgrading of the National Highway, trunk roads, and the Agricultural Credit Program (ACP), (b) review the procurement process and related internal controls, and (c) determine the validity of a Ghanaian newspaper article asserting that Compact activities were causing environmental damage to Volta Lake. During our review, we found that Lot 2 of the National Highway and Trunk Roads Projects were behind schedule and at risk of not being completed by the Compact's expiration in February 2012. Additionally, we believe funds associated with the ACP and possibly the Irrigation Project can be put to better use. Due to the sensitivity and urgency of these matters, the OIG believes that these issues should be brought to your immediate attention.

The Lot 2 section of the National Highway Road Project (funded at \$63.0 million) may not be completed in time by the end of the Compact. According to MIDA officials, the delay is due primarily to unseasonal rains, resettlement issues, and the fact that consultation, design and feasibility studies weren't done prior to the Entry-Into-Force date. The contractor (MSF) has requested \$13.9 million in additional funding for "road construction acceleration costs" to complete Lot 2 of the National Highway by the end of the Compact period in February 2012. However, due to the above mentioned delays, it is still uncertain whether the contractor can complete the project in February 2012, even if provided the requested \$13.9 million.

The Trunk Roads Project currently budgeted at \$31.8 million is also at risk of not being completed by February 2012. Currently a significant portion of the AF-2 trunk road is underwater due to floods and construction cannot proceed on this portion of the road.

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Representatives from the relevant contractors, the project consulting engineers, and MiDA plan to meet soon to determine when the remaining road project activities can be realistically completed. Revised project timelines are expected in mid-December 2010 and updated cost estimates are expected by mid-January 2011.

Another concern is the Irrigation Project, currently budgeted at \$21.4 million. This project, projected to irrigate 5,060 hectares and be completed over four years (2008-2012), per the Compact, has yet to begin. As a result, the OIG believes it will be difficult to complete the project over the remaining Compact period. We believe MiDA and MCC should re-evaluate the feasibility of completing the Irrigation Project. If it is determined that it isn't feasible to complete the project within the Compact, then the budgeted funds should be de-committed or reallocated to other Compact activities.

Also, the Agricultural Credit Program (ACP) has not performed as well as originally expected. For example, on September 30, 2010, 70.6% of the ACP loan portfolio¹ was greater than 30 days past due². This percentage compares to an expected rate of 20%³ as shown in the Compact.

Additionally, on September 30, 2010, 64.6% of the Participating Financial Institution (PFI) loan portfolio⁴ was greater than 30 days past due. This percentage also compares to an expected rate of 20%. The reasons for the poor performance of the ACP are well understood and documented by MCC and MiDA.

On September 30, 2010 the balance of loans outstanding to PFIs under the ACP was \$15.8 million. It is difficult to determine how much of the \$15.8 million will ultimately be repaid but the poor credit performance so far suggests that credit losses will be large and more than originally anticipated. Accordingly, we believe the best course of action is for MiDA and MCC to develop a strategy for recovering as much of the \$15.8 million of loans outstanding as possible. The primary focus should be on loan recovery efforts rather than making new loans.

In addition to the \$15.8 million loan portfolio, on September 30, 2010 there was approximately \$3.7 million in the ACP repayment account held at the Bank of Ghana. This \$3.7 million is available for lending to new borrowers. The OIG believes all or a portion of the \$3.7 million in the ACP repayment account should be de-committed or reallocated to other Compact projects based on the poor performance to date.

MCC has disbursed \$19.6 million of the \$26 million budgeted for use in the ACP. The difference of \$6.4 million is still available for disbursement to the ACP. As a result of the difficulties associated with the ACP, all or a portion of the \$6.4 million should be put to better

1 The ACP portfolio refers to the portfolio of loans the participating financial institutions took out from the revolving credit fund.

2 The 70.6% refers to portfolio-at-risk which is defined as the "Share of value of all loans disbursed from the agricultural loan fund that have one or more installments of principal or interest past due over thirty (30) days, disaggregated by short-term and medium-term loans."

3 The Ghanaian Compact targeted a portfolio-at-risk of years 2-6 at 20%, although the Compact doesn't differentiate between the ACP and participating financial institution portfolios.

4 The PF portfolio refers to the portfolio of loans the PFIs made to sub-borrowers, such as farmers.

use. The funds might be used to help recover the \$15.8 million portfolio of loans outstanding, be de-committed, or reallocated to other Compact projects.

With less than 15 months remaining before the end of the Compact, the DIG is highlighting the issues above so that MCC and MiDA can take action to ensure that the Compact is successful and that Compact funds are used in the best manner possible.

Sincerely,

Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

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