



OFFICE OF INSPECTOR GENERAL

REVIEW OF THE MILLENNIUM CHALLENGE CORPORATION'S TRANSITION TO HIGH-VALUE AGRICULTURE PROJECT IN MOLDOVA

REVIEW REPORT NO. M-000-15-005-S
JULY 28, 2015

WASHINGTON, D.C.



Office of Inspector General

July 28, 2015

Mr. Kamran Khan
Vice President, Department of Compact Operations
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

Dear Mr. Khan:

This letter transmits our final report on the *Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova*. In finalizing the review report, we considered your comments on the draft and included them in their entirety, excluding attachments, in Appendix II.

The review report contains three recommendations to assist the Millennium Challenge Corporation (MCC) in improving the quality of due diligence during compact development, the viability of water user associations, and the guidance on use and approval of administrative funds by resident country officials. After reviewing information provided in response to the draft report, we acknowledge MCC's management decisions on all three recommendations. Please provide evidence of final action on the open recommendations to my office.

Thank you and your staff for the cooperation and assistance extended to us during this effort.

Sincerely,

/s/

Mark S. Norman
Acting Deputy Assistant Inspector General for MCC
Office of Audit

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REVIEW RESULTS

The Millennium Challenge Corporation (MCC) signed a 5-year, \$262 million compact with the Government of Moldova in January 2010, consisting of the Transition to High-Value Agriculture Project (\$102 million) and the Road Rehabilitation Project (\$133 million).¹ The compact aimed to reinvigorate the agricultural sector and grow incomes through increased agricultural productivity, improved irrigation, and expanded access to markets and services through improved roads. This review focused on the Transition to High-Value Agriculture Project because of the historic importance of the agricultural sector to the Moldovan economy.

The Transition to High-Value Agriculture Project comprises four activities:

- **Centralized Irrigation System Rehabilitation Activity (CISRA)** to rehabilitate up to 11 irrigation systems covering 15,500 hectares (\$73.6 million).
- **Irrigation Sector Reform Activity** to provide technical assistance and capacity building to (1) support the legal transfer of management and operations of systems MCC has rehabilitated from the government to water user associations (WUAs), (2) improve water resource management, and (3) strengthen the legal and institutional framework needed for private or donor investment in the irrigation sector (\$9.6 million).
- **Access to Agricultural Finance Activity** to provide loans and technical assistance to support investments in agriculture by farmers and rural entrepreneurs (\$14.2 million).
- **Growing High-Value Agriculture Sales Activity** to provide support and training to help farmers and agribusinesses better access high-value agriculture markets and support the shift to high-value agriculture by producers and processors (\$4.5 million).

The Millennium Challenge Account-Moldova (MCA-M) formed as the partner-country entity to implement the compact. As of September 2013, MCA-M had committed nearly \$132 million for the Moldova compact.

The objective of this review was to determine whether the MCC-funded project in Moldova was on track to increase incomes through the Transition to High-Value Agriculture Project. OIG found it was not because implementation of the biggest activity—CISRA—was behind schedule.

OIG found the following problems:

- MCC did not consider alternatives in designing irrigation rehabilitation (page 3). MCC had to identify alternatives during project implementation because those doing due diligence during compact design accepted Moldova's country proposal to rehabilitate the existing systems. That decision put the activity significantly behind schedule, jeopardizing its goals.

¹Of the compact's total \$262 million, \$24 million is for compact administration and \$3 million for monitoring and evaluation.

- The viability of WUAs was uncertain (page 4). MCA-M contracted with a consultant to provide capacity-building activities so that WUAs would be able to take over management responsibilities from the government during the compact. The capacity building largely depended on hands-on practice that was in doubt since the irrigation systems' completion was behind schedule.

In another matter, MCC resident country officials in Moldova used funds for atypical purposes (page 6). The officials used \$202,000 in administrative funds to hire a communications consultant who worked under seven contracts providing training on leadership, communications, and partnerships. This use of funds is unusual; administrative funds are used to pay for expenses such as housing, travel, and storage, rather than compact implementation.

To address these concerns, OIG recommends that MCC's Vice President, Department of Compact Operations:

1. Issue formal quality assurance guidance for due diligence during compact development (page 4).
2. Direct Millennium Challenge Account-Moldova to document and implement a plan for improving the viability of water user associations (page 5).
3. Issue guidance on the appropriate use and approval of administrative funds by MCC resident country officials (page 6).

Detailed findings appear in the following section, followed by the other matter. Our evaluation of management comments is included on page 7. Appendix I describes the review's scope and methodology. MCC's written comments are included in their entirety in Appendix II.

REVIEW FINDINGS

MCC Did Not Consider Alternatives in Designing Irrigation Rehabilitation

MCC’s *Guidance for Compact Eligible Countries*, published in 2007, defines due diligence as the detailed review of each component of the proposed project for “technical, economic and environmental feasibility as well as implementation issues and sustainability.” Further, the guidance provides for the “consideration of alternatives in terms of choice of project, technology, design, construction, [and] location.”

However, MCC did not consider alternatives in designing CISRA. According to MCC officials, those who conducted due diligence accepted the government’s proposal to rehabilitate the existing Soviet-era systems. The flaw in the due diligence did not prevent the activity from going ahead because MCC lacks a formal mechanism for ensuring the quality of due diligence.

MCA-M expected construction to start in the fall of 2012 on all 11 CISRA irrigation systems. However, construction could not proceed because insufficient funding was available to build them in the manner planned. Therefore, as of September 2013, CISRA was significantly behind schedule.

To address this issue, MCC did a study to identify alternatives. The results showed that the irrigation system goals could mostly be met within budget by building new irrigation systems rather than rehabilitating the existing systems. So MCC and MCA-M changed the design entirely and began replacing, rather than rehabilitating, the irrigation systems (as shown in the photo below).



Workers use heat fusion to join replacement pipe sections. (Photo by OIG, September 2013)

The rehabilitation of these irrigation systems was to be the keystone of the project and was designed to address a serious constraint facing Moldovan producers—the lack of reliable water. CISRA’s share of the Transition to High-Value Agriculture Project’s total funding amounted to about 72 percent (about \$74 million). Consequently, neither agricultural productivity nor incomes

will increase as expected unless MCA-M completes the project's irrigation systems by the compact end date and the farmers have reliable access to water.

While MCC should be credited with salvaging its planned irrigation efforts, the implementation delays have resulted in significant risk to the successful completion of the project. If MCA-M does not complete the irrigation systems before the compact ends, CISRA will not achieve its goals of rehabilitating irrigation systems covering approximately 15,500 hectares and increasing project beneficiaries' annual income.

The problem related to due diligence is troubling because, before developing the Moldovan compact and in response to previous OIG audit reports, MCC agreed that it would improve project preparedness before compact implementation. The OIG reports cited poor planning as a cause of implementation challenges in MCC compacts with Tanzania and El Salvador.

In the *Audit of the Millennium Challenge Corporation's Funding of Activities in Tanzania* (Report No. M-000-11-003-P, dated March 30, 2011), OIG reported that MCC did not conduct adequate due diligence before signing the compact and lacked critical information on several projects. For instance, the compact included a \$53 million project to build a hydropower plant, but MCC was unaware of extensive environmental risks at the proposed site. OIG recommended that MCC amend its compact development policy to identify the requisite studies to be completed before compact signing. While MCC initially disagreed with the OIG's recommendation, in a follow-up memorandum dated May 20, 2011, it agreed that before signing a compact, it would identify the studies, analyses, or assessments required to be completed by each country and would ensure that cost estimates were sufficiently detailed.

In the *Audit of the Millennium Challenge Corporation-Funded Programs in El Salvador* (Report No. M-000-11-005-P, dated September 30, 2011), OIG reported that before compact signing in 2006 the Salvadoran Government did not complete a study of the feasibility of constructing a network of connecting roads. The study, completed more than a year later, contained higher-than-expected cost estimates: \$911 million, rather than \$233.6 million. MCC and the Government of El Salvador decided not to pursue the connecting roads and reallocated the funds. OIG did not make a recommendation because of another recommendation made that year related to due diligence.

Had a mechanism for assuring the quality of due diligence been in place when the Moldova compact was designed, it could have identified the lack of alternatives. That might have led to a cost-effective design, allowing the irrigation system rehabilitation to proceed on schedule and increasing the likelihood of boosting farmers' reliable access to water.

To improve due diligence for future compacts, we make the following recommendation.

Recommendation 1. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, issue formal quality assurance guidance for due diligence during compact development.*

Viability of Water User Associations Was Uncertain

One of the compact's objectives was the "establishment of fully-functional WUAs with the capacity to effectively manage and maintain the rehabilitated [irrigation] systems." Transferring

the management of the irrigation systems, long the responsibility of the Government of Moldova, to the WUAs was expected to yield many benefits. For instance, dedicated funding would be available for the systems' continual maintenance because WUAs can establish and collect water tariffs. However, by compact end, the WUAs may not receive all the training and operating experience they need to manage the irrigation systems.

MCA-M hired a consultant in October 2010 to provide technical assistance and training. Besides preparing annual plans, budgets, and environmental and social management plans, the training includes operating and maintaining the irrigation systems. However, many of the irrigation systems were behind schedule, reducing the time available for the WUA members to gain experience operating them. The consultant said at the time of OIG's country visit that all the WUAs would need additional assistance after the compact ends, and that four WUAs in particular may not have the necessary expertise to be viable.

If the WUAs do not receive sufficient training and experience to manage and maintain the irrigation systems effectively, those systems will be at risk. In addition, management of the irrigation systems could revert to the Moldovan Government, precluding the planned benefits of WUA-managed irrigation systems.

To help address the sustainability of the WUAs, we make the following recommendation.

Recommendation 2. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, direct the Millennium Challenge Account-Moldova to document and implement a plan for improving the viability of water user associations.*

OTHER MATTER

MCC Used Administrative Funds for Atypical Purposes

MCC resident country officials have at their disposal administrative funds that they typically use for expenses such as housing, travel, and storage.

However, MCC resident country officials in Moldova used administrative funds for atypical purposes. Officials expended \$202,000 in administrative funds to make seven awards, four of them on a sole-source basis, to a communications consultant. The consultant was to provide training to MCA-M and MCC resident country officials on leadership, communications, and “partnerships to lead to transformational change.”

MCC resident country officials in Moldova were able to use administrative funds to hire the consultant because MCC does not have guidance on the appropriate use of these funds or on headquarters approval of their use. Instead, MCC relies on the discretion of the resident country officials for proper fund use.

Without controls over the appropriate use of the administrative funds by resident country officials, misuse or fraud could occur. To address these concerns, we make the following recommendation.

Recommendation 3. *We recommend that the Millennium Challenge Corporation’s Vice President, Department of Compact Operations, issue guidance on the appropriate use and approval of administrative funds by resident country officials.*

EVALUATION OF MANAGEMENT COMMENTS

MCC agreed with the three recommendations in the draft report and described actions planned or already taken to address them. MCC's comments are included in their entirety in Appendix II. Our evaluation of them follows.

Recommendation 1. MCC agreed with the recommendation and noted actions it had already taken to improve compact development:

- Required compact development teams to submit their due diligence findings and proposed project designs to internal peer reviews by relevant technical experts.
- Created two technical divisions in the Department of Compact Operations responsible for quality and consistency in the development and implementation of compact projects.

OIG acknowledges MCC's management decision to take these actions but cannot acknowledge final action until MCC provides evidence that it has completed them.

Recommendation 2. MCC agreed with the recommendation and noted actions it had already taken to improve the viability of the water user associations. MCC said it had developed a list of priorities for sustainability with water user associations at the top. Explaining that one objective was to attract post-compact donor funding for strengthening WUAs, MCC said USAID agreed in June 2015 to provide them with technical support for 5 years so that they could operate and maintain the new irrigation systems effectively.

OIG acknowledges MCC's management decision but cannot acknowledge final action until MCC provides evidence that it has completed noted actions.

Recommendation 3. MCC agreed and decided to issue a memorandum to all MCC resident country directors and deputy resident country directors reminding them of the controls and procedures in place to ensure the appropriate use of administrative and operational funds.

OIG acknowledges MCC's management decision. Final action will occur when MCC issues the memorandum.

SCOPE AND METHODOLOGY

Scope

We conducted this review in accordance with the generally accepted government auditing standards in Chapter 3 of *Government Auditing Standards* and with documentation, evidence, and finding development standards in Sections 6.56 through 6.82. Those standards require that we obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our review objective. We believe that the evidence obtained provides that reasonable basis.

MCC signed a compact with the Government of Moldova for \$262 million. It entered into force in September 2010. This review focused on the compact's \$102 million Transition to High-Value Agriculture Project.

We conducted our fieldwork from August to December 2013 at MCC headquarters in Washington, D.C., and visited MCA-M in Chisinau, Moldova, from September 2 to September 20, 2013. In Moldova, we visited two irrigation systems under construction in Criuleni and Lopatna and met with officials of two WUAs.

To answer the review objective, we met with MCC officials to gain an understanding of compact activities. We observed activities and interviewed MCA-M staff, contractors, and program beneficiaries. We analyzed documents and reports to identify concerns. We examined the internal control environment by identifying, assessing, and testing the relevant controls. In particular, we reviewed MCA-M's processes for awarding major procurements by comparing actions taken with the *Program Procurement Guidelines*.

Methodology

The review team met with MCC staff in Moldova and in Washington, D.C. In addition, we met with MCA-M staff and beneficiaries in Moldova.

To answer the review objective, we established review steps to determine whether MCC and MCA-M were achieving the project activity goals. We did the following:

- Interviewed MCC and MCA-M officials to gain an understanding of the project activities.
- Interviewed contractors, Moldovan Government officials, other donors, and project beneficiaries to gain their perspectives on the risks facing the project.
- Reviewed documents supporting the project activities, including the compact, due diligence documents, the monitoring and evaluation plan, contracts, and progress reports.

The review team judgmentally selected 2 irrigation systems out of 11 because at the time of the review, they were the only two irrigation systems being constructed. At each site, the team confirmed that construction was in progress and met with the contractor and supervisory engineer to discuss the progress. Because the review team used judgmental sampling as described above, the results cannot be projected to all the systems.

MANAGEMENT COMMENTS



Date: July 10, 2015

To: Mark S. Norman
Acting Deputy Assistant Inspector General for MCC Office of Audit

From: Kamran Khan /s/
Vice President, Department of Compact Operations
Millennium Challenge Corporation

Subject: MCC Response to Report No. M-000-15-00X-S, Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova

The Millennium Challenge Corporation (MCC) appreciates the opportunity to respond to the Office of Inspector General's (OIG) draft audit report on the Transition to High-Value Agriculture Project funded under MCC's compact with Moldova. MCC's responses to the report's recommendations are given below. MCC notes that that the report's recommendations have largely already been addressed given that this report comes almost two years after the launch of the audit (August 2013) and just two months prior to the compact end date.

***Recommendation 1.** We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, issue formal quality assurance guidance for due diligence during compact development.*

MCC Response: MCC agrees with this recommendation and has already addressed this, as follows. MCC conducted an internal operational audit in 2013 to review the design process for the irrigation systems; the findings of this review were shared with the OIG during the course of this audit. In 2014, MCC undertook a thorough review of its entire compact development process; this review resulted in process changes including several additional presentations to and approvals by its internal Investment Management Committee and Chief Executive Officer. In addition, MCC has formalized the expectation that compact development teams submit their due diligence findings and proposed project designs to internal peer reviews by relevant technical experts (and in some cases, to external experts for peer review) to assess and corroborate the

quality of proposed projects before final investment decisions are made. Further, MCC made changes in the organizational structure of the Department of Compact Operations to strengthen technical oversight and focus; the department now includes two technical divisions, each of which have sector-specific practice groups that are led by technical experts who are responsible for maintaining standards and ensuring quality and consistency of the development and implementation of compact projects.

Recommendation 2. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, direct the Millennium Challenge Account-Moldova to document and implement a plan for improving the viability of the water user associations.*

MCC Response: MCC agrees with this recommendation and has already addressed this, as follows. Since early in compact implementation, MCC has been cognizant of the need for significant support to guarantee water user association (WUA) sustainability post-compact; MCC has been especially focused on increasing this support since the delays in the completion of the irrigation systems were apparent. MCC, with MCA-Moldova, conducted sustainability workshops in Moldova in June and July of 2013, prior to the start of this performance audit, in order to identify biggest risks to sustainability of compact investments. MCC and MCA-Moldova developed a sustainability plan that placed the risk to the WUAs at top of the list of priorities. The main objective for ensuring WUA sustainability was to attract post-compact donor funding for WUA institutional strengthening. As of June 2015, USAID has agreed to incorporate sufficient funds into their budget for the next five years (starting mid-fiscal year 2016) to provide robust technical support to the WUAs to help them mature and have capacities to effectively operate and maintain the new irrigation systems.

Recommendation 3. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, issue guidance on the appropriate use and approval of administrative funds by resident country officials.*

MCC Response: MCC agrees with this recommendation. MCC's budget for administrative funding includes a small amount of funding that is managed by MCC resident country missions; any procurements utilizing this funding are conducted either by the relevant US embassies under the International Cooperative Administrative Support Services (ICASS) or by MCC through its contract and grants management division. This RCM-managed funding supports compact implementation in many important ways and is used in accordance with US government regulations and with appropriate approvals from MCC management. Oversight of these funds is primarily provided by MCC through the budget and procurement process.

MCC budget formulation and execution processes have sufficient controls to mitigate the risk noted in the audit report. The controls are designed at various stages. The first stage is during the budget formulation process, when MCC management approves the allotments for each country (please see Attachment A). The second stage is during budget execution, when the funds are committed/obligated through the ICASS or MCC procurement process; at this stage the budget owner either (i) goes through the ICASS/General Services Officer within the embassy and relies on the State Department approval process or (ii) follows the procurement guidelines and process

dictated by MCC's contract and grants management division. For procurements processed in-country within the US embassies (scenario (i) in preceding sentence), MCC does not control or manage the procurement process. In the case referenced in this audit report, the sourcing decisions were made by embassy procurement personnel after the completion of an open competition; MCC has previously shared documentation substantiating this series of actions with the OIG.

To reinforce MCC's guidelines, MCC's Vice President of Compact Operations will issue a memorandum to all MCC resident country directors and deputy resident country directors reminding them of the controls and procedures in place to ensure appropriate use of administrative and operational funds managed by resident country missions.

Thank you again for the opportunity to share our comments on the draft report.

Attachment:

Attachment A: Budget Approval Process Documentation

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