



OFFICE OF INSPECTOR GENERAL
for the Millennium Challenge Corporation

**AUDIT OF THE MILLENNIUM
CHALLENGE CORPORATION'S
MANAGEMENT OF THE
THRESHOLD PROGRAM**

AUDIT REPORT NO. M-000-09-003-P
April 29, 2009

WASHINGTON, DC



*Office of Inspector General
for the Millennium Challenge Corporation*

April 29, 2009

Mr. Rodney Bent
Acting Chief Executive Officer
Millennium Challenge Corporation
875 Fifteenth Street, N.W.
Washington, DC 20005

Dear Mr. Bent:

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

The report contains nine audit recommendations for corrective action. We consider final action taken on recommendation 4 and management decisions on recommendations 1, 2, and 5 through 9 have been reached. A management decision is pending for recommendation 3.

Please provide my office written notice within 30 days of any additional information related to the actions planned or taken to implement recommendation 3.

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

Sincerely,

Alvin Brown /s/
Assistant Inspector General
Millennium Challenge Corporation

Millennium Challenge Corporation
1401 H Street N.W.
Suite 770
Washington, DC 20005
www.usaid.gov/oig

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SUMMARY OF RESULTS

The Millennium Challenge Corporation's (MCC) Threshold Program was established with the Millennium Challenge Act of 2003 to assist countries that are close to qualifying for eligibility for compact assistance and have demonstrated a significant commitment to improving their performance on eligibility criteria.¹ MCC assists countries by funding their Threshold Country Plans, which are designed to improve country performance in targeted policy areas that prevent the country from becoming compact eligible (see table 1, page 10). As of fiscal year (FY) 2008, MCC provided about \$440 million in funding to 19 countries for the Threshold Program. At that time, 17 of the 19 countries were participating in the program, and 2 had completed their Threshold Programs (see appendix III, page 30).

The objectives of this audit were to determine whether the Threshold Program assisted countries in becoming compact eligible by improving a targeted policy area (Control of Corruption²), and whether the Threshold Program achieved its planned results and what has been the impact of the program (see page 5). We selected the Threshold Program in Albania to further conclude on the objectives.

Our audit did not reveal a clear indication that the MCC Threshold Program was assisting countries in becoming compact eligible. The audit found that MCC did design its Threshold Program to assist countries by ensuring that programmatic interventions focused on the targeted policy indicators where countries fall below the qualifying median point in comparison with their peers. However, the use of the corruption policy indicator to measure the success of MCC's Threshold Program is problematic for several reasons, including attribution of MCC's efforts and other factors such as ongoing government reforms and other donor activity.

The Threshold Program as currently designed and implemented contained several deficiencies noted during the audit. MCC's guidance provided general criteria for selecting countries to participate in the Threshold Program, but the criteria may not be stringent enough to ensure that the selected countries can reach compact eligibility within 3 years (see page 9). Also, MCC did not develop guidance on the use of the Indicator Analysis, which would reinforce the importance of linking identified weaknesses to the targeted policy indicators (see page 12). Finally, unlike the Compact Development process, the Threshold Program does not require a consultative process with a wide range of stakeholders to identify and prioritize specific projects, even though such a process could achieve a greater sense of country ownership and help sustain the changes (see page 13).

MCC acknowledges that countries can become compact eligible without completing their Threshold Program because of the nature of the selection process; even so, MCC

¹ Compact eligibility is determined by country performance on 17 policy indicators, with country performance on these indicators published annually in MCC's Scorebook. MCC obtains the data for the indicators from independent third parties that conduct data gathering and analysis of country data to arrive at their conclusion on country performance. MCC evaluates country eligibility annually on the basis of these policy indicators and, to qualify for compact assistance, a country must pass 9 of the 17 indicators, plus the Control of Corruption indicator.

² Control of Corruption represents 53 percent of the funded programs. See appendix IV, page 31.

continues with a country's Threshold Program because of the extensive effort and money the country invests in developing its program. Countries have also become compact eligible and received compacts without participating in the Threshold Program. Based on the following analysis, country eligibility for compact assistance cannot be attributed to Threshold Program results:

- Eight of the 12 countries that will complete the Threshold Programs as of the end of FY 2009 became compact eligible before completing their Threshold Programs. Three of the eight countries became compact eligible as early as about 1 month before or 1 month after their Threshold Program started (see appendix VI, page 33).
- Three of the 12 countries did not become compact eligible. Two of the three countries did not become compact eligible after completing their Threshold Programs but instead MCC approved another Threshold Agreement (Stage II). Both of these countries were approved for Stage II agreements between 3 and 5 months before their first Threshold Programs ended. Also, one of the three countries' Threshold Program is still on-going and will end in September 2009.
- One of the 12 countries received compact assistance about 11 months before its Threshold Program ended.

In Albania, the program did not achieve the MCC stated goal of improving the targeted policy indicator (Control of Corruption) so that Albania could become compact eligible. The corruption indicator for Albania was at the 23rd percentile at the start of the Threshold Program and declined to the 22nd percentile when it was being considered for a Stage II Threshold Program. Nonetheless, according to the information reported by MCC, the program did reduce corruption and bribery in tax administration, public procurement, and business registration by 23 percent, 25 percent, and 19 percent, respectively. Furthermore, only 6 out of 38 indicators (16 percent) did not meet their targets.

Even so, the audit team identified a number of issues that are specific to the Albania Threshold Program. Performance indicators that were initially developed by Albania, USAID, and MCC in January 2006 were not always measurable, relevant, or attributable to the project intervention. An assessment of performance indicators developed in January 2006 resulted in almost half the indicators being removed from the Albanian Threshold Program projects in April 2008 (page 15). Also, the Albanian Threshold Program included developing an information technology (IT) system to help reduce corruption in tax administration, public procurement, and business registration (electronic government or e-government), but the system lacked internal controls (page 17). Finally, data quality assessments were not performed on Threshold Program data to ensure that accurate data were being reported and indicators were being met. The lack of a data quality assessment may affect the accuracy of the data that MCC used to report the results of the Albanian Threshold Program and that the Office of Inspector General used to analyze the program results (see page 20).

This report contains nine recommendations to MCC's vice president, Department of Policy and International Relations: (1) evaluate the effectiveness of the Threshold Program in regards to assisting countries in becoming compact eligible; (2) develop guidance on performance monitoring with a particular focus on the policy indicators,

which describes the limitations, where they exist, of measuring MCC's impact in MCC's decisional documents on these limitations; (3) develop more definitive guidance for selecting countries for the Threshold Program; (4) develop policy guidance on the Indicator Analysis; (5) develop guidance on a consultative process and its use in developing Threshold Country plans; (6) develop additional monitoring and evaluation requirements for the Threshold Program; (7) require that an IT audit be performed when appropriate to help ensure functionality and sustainability of the IT system; (8) develop a plan to ensure that deficiencies identified in an audit will be corrected; and (9) develop guidance requiring data quality assessments be performed at an appropriate time during the Threshold Program (see pages 7, 9, 11, 12, 13, 17, 20, and 21).

Appendix II contains the management comments in their entirety. In its comments, MCC concurred with eight of the nine recommendations. MCC did not agree with the recommendation that MCC should develop more definitive guidance for selecting countries for the Threshold Program. However, the OIG believes this recommendation is still valid because the criteria for selecting countries for Threshold Program assistance should be as specific and as transparent as the criteria for selecting countries for compacts.

BACKGROUND

The Millennium Challenge Corporation's (MCC) Threshold Program was designed to assist countries that are close to qualifying on the eligibility criteria for Millennium Challenge Account (MCA) compact assistance and have demonstrated a significant commitment to improving their performance on the criteria. The U.S. Agency for International Development (USAID), working with MCC, is the primary agency overseeing Threshold Program implementation. Other U.S. agencies may provide assistance with the Threshold Program. MCC may spend up to 10 percent of its annual appropriation on the program.

Compact assistance gives countries access to a 5-year grant to pursue national priorities that will reduce poverty and increase economic growth. MCA compact eligibility is determined by a country's performance as measured by 17 policy indicators in three categories: (1) Ruling Justly, which includes the Control of Corruption indicator; (2) Investing in People; and (3) Economic Freedom. MCC annually publishes countries' performance in its Scorebook, which illustrates each country's relative performance ranking compared to its peers as measured by per capita income.

A country must receive a passing score on its Control of Corruption indicator to be eligible for compact assistance, so MCC has made significant investments in anticorruption projects. As of September 30, 2008, MCC had invested about \$440 million in Threshold Program grants in 19 countries; for 15 of these countries, about \$231 million, or 53 percent of the funds, was provided to help them reduce corruption. (See appendix IV, page 31, for Threshold Program funds by policy indicator.)

MCC obtains the indicators from independent third-party institutions that rely on objective, publicly available data and an analytically rigorous methodology. In particular, the World Bank Institute (WBI) produces the Control of Corruption indicator and others as part of its Worldwide Governance Indicators research project. WBI develops the indicators by measuring perceptions of governance; according to WBI, perceptions matter because citizens base their actions on their perceptions, impressions, and views. The Control of Corruption indicator is an aggregate of 25 sources of information, and measures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption. One example of a source is the Business Environment and Enterprise Performance Survey produced by the World Bank and European Bank for Reconstruction and Development, which gathered information from firms on "irregular" and "unofficial" payments.

MCC has guidelines in place for the Threshold Program that discusses the purpose and principles of the program, as well as establishes the process for participating in the program. For instance, each country is required to develop a Threshold Country Plan, which proposes specific projects to address the targeted policy indicator. According to MCC, the Indicator Analysis is shared with the threshold country government to facilitate the government's understanding of performance as measured by the indicators and is intended to help guide the government toward areas where indicator performance can be improved for use in the Threshold Country Plan. Also, the Indicator Analysis is intended to stimulate dialog between MCC and the government, and establish targets of

opportunity for a Threshold Program. MCC sends a team member to each threshold country as part of the Indicator Analysis process.

In particular, the Indicator Analysis identifies the specific targeted policy indicators that the country has failed and then details and categorizes the specific underlying source information used by WBI to arrive at the policy indicators. The source information provides the results of surveys and analyses, for instance on the extent and nature of corruption within a country. The Indicator Analysis does not recommend or prioritize the results. That responsibility is left to the country when it develops its Threshold Country Plan.

For this audit, the Office of Inspector General selected the Albania Threshold Program to review. When Albania was selected as a threshold country in fiscal year (FY) 2004, it was at the 46th percentile³ for Control of Corruption and performed poorly in the Economic Freedom category in comparison with its lower income country peers. However, because Albania has now become a lower middle income country, its Control of Corruption indicator was rated at the 23rd percentile in 2006, when it submitted its Threshold Country Plan. Albania's Threshold Country Plan (\$13.85 million) was designed to reduce corruption in three areas: tax administration, public procurement, and business registration. The Threshold Country Plan included e-government systems in all three areas to reduce corruption by increasing transaction transparency and reducing personal interaction between citizens and government employees where bribery often occurred.

AUDIT OBJECTIVES

The Office of the Assistant Inspector General for the MCC conducted this audit as part of its FY 2008 audit plan. The objectives of this audit were to answer the following questions:

- Has the Millennium Challenge Corporation's Threshold Program assisted any countries with improving their indicators and becoming compact eligible?
- Did the Millennium Challenge Corporation's approved country Threshold Program achieve its planned results, including improving the targeted policy indicators, and what has been the impact?

³ A country must score at least in the 50th percentile in order to become compact eligible.

AUDIT FINDINGS

Has the Millennium Challenge Corporation's Threshold Program assisted any countries with improving their indicators and becoming compact eligible?

Our audit did not reveal a clear indication that the Millennium Challenge Corporation's (MCC) Threshold Program was assisting countries in becoming compact eligible. Based on the following analysis, country eligibility for compact assistance cannot be attributed to Threshold Program results:

- Eight of the 12 countries that will complete the Threshold Programs as of the end of fiscal year (FY) 2009 became compact eligible before completing their Threshold Programs. Three of the eight countries became compact eligible as early as about 1 month before or 1 month after their Threshold Program started (see appendix VI).
- Three of the 12 countries did not become compact eligible. Two of the three countries did not become compact eligible after completing their Threshold Programs but instead MCC approved another Threshold Agreement (Stage II). Both of these countries were approved for Stage II agreements between 3 and 5 months before their first Threshold Programs ended. Also, one of the three countries' Threshold Program is still on-going and will end in September 2009.
- One of the 12 countries received compact assistance about 11 months before its Threshold Program ended.

Nevertheless, MCC has designed its Threshold Program to help countries by ensuring that programmatic interventions focus on the targeted policy indicators where countries fall below the qualifying median point in comparison with their peers. MCC has Threshold Program guidance and a defined process in place for (1) identifying country performance using 17 objective policy indicators; (2) selecting countries for participation in the Threshold Program that fall short on the indicators, but that MCC anticipates can become compact eligible after successfully completing the Threshold Program; (3) diagnosing areas of weakness in indicator performance through an Indicator Analysis and providing the analysis to the country for use in developing a plan to address the targeted policy indicators; (4) requiring the country to submit a Threshold Country Plan, which proposes projects to address the targeted policy indicator; and (5) reviewing and approving the plan.

However, we noted a number of deficiencies in the design and implementation of the Threshold Program where improvements can be made as detailed in the following sections. MCC needs to:

- improve guidance for measuring program results;
- clarify selection criteria;
- develop guidance for the Indicator Analysis; and,
- require a consultative process for the Threshold Country Plans.

We also identified deficiencies related to the Albania Threshold Program that may apply to other Threshold Programs. MCC needs to:

- improve performance indicators,
- develop IT system internal controls, and
- perform timely data quality assessments.

With respect to the objective, changes in the countries' scores on the Control of Corruption policy indicator cannot feasibly be attributed to MCC efforts because of a number of factors, including the nature and design of the indicator and other external factors. Many factors outside of MCC's Threshold Program, such as government reforms, other donor activity, and changes in political parties, take place concurrently with the program and impact perceptions. Finally, the sources for the Control of Corruption indicator do not specifically capture MCC's activities in country as part of the World Bank Institute's (WBI) methodology. Nevertheless, MCC stated in one internal decisional memorandum that the Stage I Threshold Program would change Albania's Control of Corruption score. In the decisional memorandum for Stage II, MCC stated that the changes to the scores were attributed to the Stage I Threshold Program. Although specific programs are designed to improve the targeted policy indicator, MCC has little or no assurance that changes in the Albanian Control of Corruption indicator score are a direct result of its efforts, and MCC should be cautious in stating its achievements.

Regarding the design of the Albanian Threshold Country Plan, MCC reviewed and approved the plan and determined that the proposed projects (tax administration, public procurement, and business registration) addressed the targeted Control of Corruption policy indicator. Along with MCC's approval, an Organization for Security and Co-operation in Europe report on *Best Practices in Combating Corruption*⁴ independently cited these areas and identified specific activities where corruption could be curbed. The implementation of the Threshold Country Program did achieve reductions in corruption as measured by the specific project indicators (versus the targeted policy indicator). In particular, the projects' indicators showed reductions in bribery related to taxation, public procurement, and business registration.

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, evaluate the effectiveness of the Threshold Program in regards to assisting countries in becoming compact eligible.

⁴ Organization for Security and Co-operation in Europe, Office of the Co-ordinator for Economic and Environmental Activities, Vienna, Austria, undated.

Additional MCC Threshold Program Guidance Needed on Measuring Program Results

Summary: MCC attributed changes in countries' Control of Corruption indicator scores to its anticorruption interventions, but the changes were not clearly attributable to MCC's efforts. USAID's Automated Directives System (ADS) 203.3.4.2, *Characteristics of Good Performance Indicators*, states that performance indicators should measure changes that are clearly and reasonably attributable to USAID (or U.S. Government, as appropriate) efforts. At the time of this audit, MCC had certain guidance in place, but did not have guidance describing attribution limitations. MCC has little or no assurance that changes in the Control of Corruption indicator score can be fully attributed to its efforts, and it should be cautious in stating its achievements.

MCC attributed changes in countries' Control of Corruption indicator scores to its anticorruption interventions, but the changes were not clearly attributable to MCC's efforts. Numerous documents, including Threshold Country Plans, the USAID Strategic Objective Grant Agreement, and the implementing partner agreement, identified the goal of achieving a specific numerical improvement in the targeted policy indicators as a measure of success. Also MCC used anticipated changes in Albania's Control of Corruption scores to support the rationale for funding the threshold programs in its decisional memoranda and reporting program results. Specifically, MCC used a Control of Corruption Index above the median as a measure of success for the Threshold Program in Albania for both Stage I and Stage II although for Stage II, MCC tempered this goal with caveats and assumptions on the estimated impact. For instance, for the Stage I Threshold Program, the *Success Indicators* for the procurement project states that the outcome target of the project was a Control of Corruption score above the median in 24 months. A median score is required in order to be compact eligible. Also, the business registration project had the identical target of achieving a Control of Corruption score above the median in 24 months. In addition, MCC stated in a decisional memorandum that "Albania has continued significant improvements on the World Bank Institute (WBI) *Control of Corruption* index since beginning implementation of its Threshold Program."

In a discussion on the indicator and its use in measuring the impact of MCC's Threshold intervention, a WBI official stated that the governance indicators are not designed to measure the effect of a specific program. The WBI official stated that the best way to measure a project is by using indicators specifically designed to capture the results of that project and that the governance indicator surveys used to develop the Control of Corruption indicator do not capture MCC's specific efforts. An MCC official agreed with the WBI's assessment, stating that measuring impact of an intervention on the targeted policy indicator would be difficult because of the many ongoing changes within a country. An MCC official also stated that difficulties with attribution are well-known when it comes to changes in the Control of Corruption indicator.

MCC has guidelines in place for compact development that state the intervention must directly affect a targeted indicator, but guidelines for the Threshold Program in the *Outline for a Threshold Country Plan* did not clearly describe limitations in attribution.

Also, MCC did not have a monitoring and evaluation (M&E) specialist in place when developing the Albanian Stage I Threshold Country Plan, although this position subsequently has been filled. Similarly, USAID guidance (ADS 203.3.4.2, *Characteristics of Good Performance Indicators*) provides that indicators should measure changes that are clearly and reasonably attributable to the program, and that attribution exists when the outputs have a logical and causal effect on the results being measured by a given performance indicator.

The goal of the Threshold Program is to improve the targeted policy indicators, and a natural extension of this goal is to attribute changes to a country's score to the Threshold Country Plan. However, the nature of the indicators, and in particular the Control of Corruption indicator, makes attribution to the Threshold Country Plan difficult. Doing so may be perceived as overstating the results of the intervention, and the principle of conservatism for reporting purposes would suggest that a better performance measure is to use indicators specifically designed for and clearly attributable to the intervention.

MCC stated that the attribution difficulty is well-known. However, given that MCC decision-making and program funding documents stated that planned interventions will improve the Control of Corruption indicator, MCC should clearly disclose the limitations on measuring the impact of the program with regard to the targeted policy indicator, and should be cautious in stating its achievements.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, develop guidance on performance monitoring with a particular focus on the policy indicators, which describes the limitations, where they exist, of measuring the Millennium Challenge Corporation's impact in the Millennium Challenge Corporation's decisional documents on these limitations.

Definitive Selection Criteria Needed for the Threshold Program

Summary: MCC did not have definitive selection criteria for Threshold Program participation. MCC used criteria that included selecting countries that (1) were "close" to compact eligibility, (2) demonstrated a "significant commitment" to the compact eligibility criteria, and (3) were not substantially below the median score for compact eligibility. MCC guidance provided that a country's score should not be below the 25th percentile, but did not make this floor a requirement. Compared with the selection criteria for compact assistance, the selection criteria for threshold assistance were less specific and more subjective. The Millennium Challenge Act of 2003 does not prescribe in the same detailed manner for the Threshold Program as the criteria does for MCC compact assistance. By having less definitive selection criteria, MCC may be selecting countries with hurdles that are too great or too numerous to overcome in the less than 3-year lifespan of the program, especially given widespread and intractable issues such as corruption. Also, less stringent criteria may create a larger pool of recipients and smaller grants, potentially diluting the impact of the threshold interventions.

To be eligible for an MCC compact, countries are required to exceed the median score for a specific number of indicators. A country is typically eligible when it passes three of six Ruling Justly indicators plus Control of Corruption, three of five Investing in People indicators, and three of six Economic Freedom indicators (see table 1 for a list of the indicators). As a result, the compact assistance eligibility is more transparent because stakeholders more clearly understand how a country is being assessed when compared with threshold criteria that were less specific and more subjective. MCC, as an organization, promotes transparency, and additional transparency in the Threshold Program selection process would be in keeping with this important value.

Table 1. MCC Compact Eligibility Policy Indicators

	Indicator	Category	Source
1	Civil Liberties	Ruling Justly	Freedom House
2	Political Rights	Ruling Justly	Freedom House
3	Voice and Accountability	Ruling Justly	World Bank Institute
4	Government Effectiveness	Ruling Justly	World Bank Institute
5	Rule of Law	Ruling Justly	World Bank Institute
6	Control of Corruption	Ruling Justly	World Bank Institute
7	Immunization Rates	Investing in People	World Health Organization
8	Public Expenditure on Health	Investing in People	World Health Organization
9	Girls' Primary Education Completion Rate	Investing in People	United Nations Educational, Scientific, and Cultural Organization (UNESCO)
10	Public Expenditure on Primary Education	Investing in People	UNESCO and national sources
11	Natural Resource Management	Investing in People	Center for International Earth Science Information Network/Yale
12	Business Start Up	Economic Freedom	International Finance Corporation
13	Inflation	Economic Freedom	International Monetary Fund
14	Trade Policy	Economic Freedom	Heritage Foundation
15	Regulatory Quality	Economic Freedom	World Bank Institute
16	Fiscal Policy	Economic Freedom	National Sources
17	Land Rights and Access	Economic Freedom	International Finance Corporation

The Millennium Challenge Act (MCA) of 2003, Section 616, does not prescribe in the same detailed manner for the Threshold Program as the criteria does for MCC compact assistance in Section 607. Section 607, for instance, states that compact assistance shall be determined “to the maximum extent possible, upon objective and quantifiable indicators of a country’s demonstrated commitment to the criteria in subsection (b)” of Section 607. Subsection (b) sets forth the specific criteria for compact award, and it aligns with the policy indicators used by MCC. For Threshold Program criteria, Section 616 of the MCA provides only that MCC may help a country become compact eligible even if the country fails to meet the Section 607(b) criteria, so long as it demonstrates “a significant commitment” in meeting the compact criteria.

The MCC selection process identifies countries for participation in the Stage I and Stage II Threshold Programs. For Stage I assistance, MCC selects countries that are “close” to compact eligibility, but “close” was not defined in regard to the number of failed indicators or how far from the median score a country could fall and still be eligible for threshold assistance.⁵ Countries selected for the Threshold Program were typically one or two indicators away from compact eligibility. MCC also cited other subjective criteria,

⁵ Early MCC guidance defined “close” as two or fewer indicators.

such as “significant commitment,” to identify countries for Threshold Program assistance, but again these criteria were not defined.

MCC Threshold Program guidance defined eligible countries as those that were “not substantially below” the median for any indicator and cited a floor of 25th percentile. However, after becoming eligible in FY 2004 with a median score of 46 percent in Control of Corruption, Albania’s median score changed significantly when the country was reclassified as a lower middle income country from a lower income country. Albania’s Control of Corruption score fell to 23 percent for 2006, 16 percent for 2007, and 22 percent for 2008.

MCC provided Albania with a Stage I Threshold Program in 2006 and a Stage II in 2008. MCC explained that Albania had spent many resources on developing its Threshold Country Plan after being deemed eligible in 2004, so it was not feasible to then withhold the grant after Albania’s Control of Corruption score decreased through no fault of its own, but because it was reclassified. MCC recognized that reform efforts may be more arduous at the 22nd percentile. Ultimately, Albania was unable to achieve the many reforms and changes in perception necessary to move the country to the median score in 2 years’ time.

Moldova and Tanzania, for example, which MCC cited as successful in their control of corruption, started with higher scores than Albania at the 46th percentile and 31st percentile, respectively, so the hurdles were not as steep and they were able to exceed the median within the Threshold period.

MCC approved the Albania Stage II program, citing steady progress based on Albania’s “absolute score”; that is, without comparing the country’s performance against its peers. Stage II eligibility criteria includes four elements: (1) the country is nearing completion of implementation of its initial Threshold Program and is a candidate for the year of new Threshold Program funding it would receive, but does not meet the eligibility criteria for compact assistance; (2) performance on the selection criteria and the overall policy environment are generally favorable; (3) performance on its Threshold Program, including progress toward program objectives and performance benchmarks, has been satisfactory; and (4) a Stage II program is likely to have a significant impact on the country’s reform efforts. The Threshold Program has not clearly defined the Stage II criteria, for instance, in regard to “satisfactory performance” and “significant impact.” It is important to note that while improvements in Albania’s Control of Corruption absolute score were laudable, compact funding would not be available unless Albania exceeded the median in comparison with its peers.

By having less defined selection criteria, MCC may be selecting countries with too many hurdles or hurdles that are too great to overcome in the less than 3-year lifespan of the program, especially given widespread and intractable issues such as corruption. This perhaps could explain the creation of the Stage II Threshold Program. Also, less stringent criteria may create a larger pool of recipients and smaller grants, potentially diluting the impact of the threshold interventions.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation’s vice president, Department of Policy and International Relations, develop more definitive guidance for selecting countries for the Threshold Program.

MCC Threshold Program Guidance Needed on the Indicator Analysis

Summary: MCC did not have a specific policy or procedures in place for the Indicator Analysis. The Indicator Analysis is an MCC tool that helps countries identify projects related to the targeted policy indicator that a particular Threshold Program should be designed to address. The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*⁶ states that control activities are an integral part of an entity's planning, implementing, reviewing, and achieving results, and that control activities include policies and procedures. Threshold Program guidance was not in place because producing the Indicator Analysis was a standardized practice and there was no perceived need for documenting this practice. A specific policy and procedures on the Indicator Analysis will reinforce the importance of the analysis in linking identified weaknesses to the targeted policy indicators and will set expectations for its use by the country and MCC.

MCC did not have in place specific policy and procedures, such as for developing the Indicator Analysis, for use as a tool to identify projects and document the results, and for MCC's use of the Indicator Analysis as part of its review of the country's proposal. The Indicator Analysis is a more recent tool developed by MCC to assist eligible threshold countries that had sought additional guidance from MCC on developing programs to address the targeted policy indicators. The results of the Indicator Analysis were incorporated into Albania's Stage II Threshold Country Plan, which referenced for each project the Indicator Analysis results to support the selection of the specific projects.

GAO's *Standards for Internal Control in the Federal Government* state that control activities are an integral part of an entity's planning, implementing, reviewing, and achieving results, and that control activities include policies and procedures. Policies and procedures need to be in place as a control activity to help ensure that the process for developing the Indicator Analysis and its use by a threshold country and MCC are well documented. These policies and procedures should link the use of the Indicator Analysis to the Threshold Country Plan and help ensure that the Threshold Country Plan includes areas identified as weaknesses.

Threshold Program guidance was not in place because producing the Indicator Analysis was a standardized practice and there was no perceived need for documenting this practice. A specific policy and procedures on the Indicator Analysis will reinforce the importance of the analysis in linking identified weaknesses to the targeted policy indicators and set expectations for its use by the country and MCC.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, develop policy guidance on the Threshold Program Indicator

⁶ GAO/AIMD-00-21.3.1, November 1999.

Analysis, including the process for developing the Indicator Analysis, its use by the country as a tool in identifying projects and documenting the results, and Millennium Challenge Corporation's use of the Indicator Analysis as part of its review on a country's proposal.

Consultative Process May Benefit Threshold Country Plans

Summary: A broad consultative process to develop the Albania Threshold Country Plan was not undertaken. MCC has stated that development literature and the experience of practitioners confirm that public participation results in programs that better reflect national priorities and have a higher likelihood of success. Unlike compact assistance, the process for identifying projects for a country's Threshold Country Plan did not require that a consultative process be undertaken to identify and prioritize projects. A high level of engagement with civil society to help identify and prioritize through an early formative consultative process—for instance, for anticorruption efforts—would help achieve a greater sense of country ownership and likely help sustain the anticorruption efforts.

A broad consultative process to develop the Albania Threshold Country Plan was not undertaken. A consultation is two-way communication about proposal development and implementation that occurs between the developers and stakeholders. In Albania, the government priorities generally drove the Threshold Country Plan to address the targeted policy indicators. Although once the planned reform projects had been identified, the government engaged civil society organizations to obtain input on carrying out the identified reforms. Civil society monitoring occurred throughout the project. Members of Albanian civil society and the Government of Albania believe that an early consultative process would be beneficial by providing input into where anticorruption efforts should be placed, prioritizing projects for the greatest impact, and strengthening societal ownership of the efforts and outcomes.

According to MCC's *Guidelines for Conducting a Consultative Process* for compact implementation, development literature and the experience of practitioners confirm that public participation results in programs that better reflect national priorities and have a higher likelihood of success. Further, the inclusion of a consultative process not only improves the design of a program, but also is a method of reinforcing MCC's commitment to the founding principle of development that is accountable to the people.

However, Threshold Program guidance did not require a broad consultative process to identify and prioritize potential projects and to arrive at the Threshold Country Plan, unlike the process for compact assistance.

A high level of engagement with civil society to help identify and prioritize projects through an early formative consultative process—for instance, for anticorruption efforts—would help achieve a greater sense of country ownership and likely help sustain the anticorruption efforts.

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International

Relations, develop policy guidance on a consultative process and its use in developing Threshold Country Plans.

Did the Millennium Challenge Corporation's approved country Threshold Program achieve its planned results, including improving the targeted policy indicator, and what has been the impact?

Although the MCC Threshold Program for Albania did not raise the country's Control of Corruption indicator enough for Albania to become compact eligible, it did achieve intended results by reducing corruption in tax administration, public procurement, and business registration. For example, the percentage of firms stating that bribery was frequent in tax collection was reduced from 42 percent to 19 percent. The percentage of firms saying that bribery was frequent in order to obtain government contracts was reduced from 42 percent to 17 percent. Finally, the percentage of businesses that paid a bribe to register was reduced from 19 percent to zero percent. However, the lack of a data quality assessment may affect the accuracy of the data that MCC used to report the results of the Albanian Threshold Program and that the Office of Inspector General used to analyze the program results.

When Albania submitted its Threshold Country Plan in 2006, its Control of Corruption indicator was ranked at the 23rd percentile. Albania's Threshold Country Plan stated that the success indicators would result in the Control of Corruption indicator being raised above the median, thereby making it compact eligible. However, when Albania received its Stage II Threshold Program in 2008, the Control of Corruption indicator was at the 22nd percentile. Therefore, Albania's Threshold Program did not result in the Control of Corruption indicator exceeding the median, which was the gateway to receiving compact assistance.

MCC's Control of Corruption efforts cannot feasibly be attributed to changes in the country's score on the Control of Corruption indicator because of a number of factors, including the nature and design of the indicator. In a discussion of the indicator and its use in measuring the impact of MCC's Threshold intervention, a World Bank Institute (WBI) official stated that the governance indicators are not designed to measure the effect of a specific program. The official stated that the best way to measure a project is by using indicators specifically designed to capture the results of that project. The surveys used to develop the Control of Corruption Index do not capture MCC's specific efforts.

The project indicators initially developed by Albania, USAID, and MCC were not always measurable, relevant, or attributable to the project intervention. Of the original 75 indicators developed in January 2006, 37 (49 percent) were removed in April 2008. USAID's implementing partner for the Threshold Program in Albania reported on the remaining 38 indicators in its September 2008 final report. Of those 38 indicators, only 6 (16 percent) did not meet their targets, with variances between 16 percent and 55 percent. The indicators that did not meet their targets included training procurement and public officials, procurements completed electronically and openly competed, level of knowledge of National Registration Center's staff, and registering businesses within 1 day.

Albania's Threshold Program included developing an IT system to help reduce corruption in tax administration, public procurement, and business registration (e-government). An independent audit requested by Albania and conducted by an independent audit firm well into project implementation revealed numerous problems with the e-government IT system. The audit firm found deficiencies in the information security approach of e-government services, as well as deficiencies in IT general controls related to physical security of information systems, logical access controls, testing and acceptance management, and computer operations. Further, no system was in place to monitor the recommendations made by the audit firm on the IT audit to ensure that corrective actions were completed.

Finally, MCC should have required that USAID conduct data quality assessments to ensure that performance data were valid, precise, reliable, and timely. Data quality assessments, which would ensure that accurate data were being reported and indicators were being met, were not performed. According to USAID, data quality assessments are required every 3 years. However, the Threshold Programs typically are less than 3 years in length, so the assessments need to be conducted more frequently to ensure data accuracy.

Performance Indicators Could Have Been Improved

Summary: Performance indicators that were initially developed by Albania, USAID, and MCC in January 2006 were not always measurable, relevant, or attributable to the project intervention. These indicators comprised 51 percent of the original 75 performance indicators. Performance indicators should be objective, practical, useful, direct, timely, adequate, and attributable to program efforts. At the time of the audit, MCC did not have monitoring and evaluation (M&E) guidance for Threshold Programs, which would have provided guidelines on how to develop good-quality indicators. Also, an M&E specialist was not on board at MCC when Albania became a threshold country to ensure indicators measured the results of the program. As a result, indicator data were being captured that did not measure the results of the program.

Performance indicators that were initially developed were not always measurable, relevant, or attributable to the project intervention. These indicators comprised 51 percent of the original performance indicators that were developed as early as the Threshold Country Plan proposal.

Albania, MCC, USAID, and the implementing partner developed the indicators and targets through an iterative process beginning with the Threshold Country Plan proposal and ending with the Strategic Objective Grant Agreement (SOAG) and Performance Management Plan (PMP). Once the indicators and targets are approved, they are incorporated into the SOAG, which is signed by the country and USAID. The implementing partner also develops the PMP, which includes the SOAG indicators and targets, and reports to USAID on the progress of the indicators and whether the targets are being met.

USAID ADS 203.3.4, *Selecting Performance Indicators for PMPs*, states that an indicator is a quantitative or qualitative factor or variable that provides a simple and reliable means to measure achievement or help assess performance. Indicators are used to observe progress and to measure actual results compared to expected results. This guidance states that seven criteria should be used when selecting performance indicators:

- **Objective.** Performance indicators should be unambiguous about what is being measured.
- **Practical.** Performance indicators should be selected for which data can be obtained at reasonable cost and in a reasonable time.
- **Useful for management.** Performance indicators should be useful for the relevant level of decision-making.
- **Direct.** Performance indicators should closely track the results they are intended to measure.
- **Attributable to USAID or U.S. Government efforts.** Performance indicators should measure changes that are clearly and reasonably attributable to USAID (or U.S. Government, as appropriate) efforts. Attribution exists when the outputs of USAID-financed activities have a logical and causal effect on the result(s) being measured by a given performance indicator.
- **Timely.** Performance indicators should be available when they are needed to make decisions.
- **Adequate.** There should be as many indicators as are necessary and cost-effective for results management and reporting purposes.

The implementing partner became concerned about the indicators and assessed their quality in its performance monitoring midterm review, dated April 18, 2008. Of the original 75 indicators developed in January 2006, the implementing partner recommended that 39 (52 percent) be removed and provided justification for the removals. The implementing partner based the results of its review on the seven criteria from ADS 203 (as discussed above) and also added two criteria: Indicators should not be milestones, and indicators should be relevant and fall inside the scope of the project. Because MCC had not developed policies and procedures on selecting project indicators, the USAID ADS 203 criteria were used to determine the quality of Albania's performance indicators. The following are examples of indicators that did not meet the ADS 203 criteria:

- Four indicators that were not attributable to USAID's efforts were buoyancy of (1) tax revenue, (2) value-added tax, (3) corporate income tax, and (4) personal income tax as a percentage of the gross domestic product (GDP). These indicators were not attributable to USAID or Threshold Program efforts because tax revenue and GDP are based on and influenced by factors beyond the project's control.
- One indicator measured the percentage of firms reporting gifts expected in meetings with tax inspectors. This indicator is not objective or measurable because it is based on expectations and not on objective criteria such as whether tax inspectors actually asked for gifts. The implementing partner stated that firms would be asked to speculate on whether they felt a gift was expected without providing proof.

- One indicator measured the percentage of businesses that consider corruption a big obstacle to operation and growth. This indicator does not meet the direct criteria because Albania's Threshold Program concentrated on combating corruption in business registration, and did not cover whether corruption occurred in the operation and growth of businesses. Therefore, this indicator does not track the results it is intended to measure because the results are not within the scope of the project.
- Three indicators were actually milestones, which describe one-time events rather than change over time. The three indicators (e-procurement commenced; training of trainers done; and registration files processed by the National Registration Center with tax, labor, and social security offices) are one-time events that will not occur again after they are completed.

MCC and USAID agreed to remove 37 of the 39 indicators that the implementing partner suggested. The two indicators not removed measured tax revenues collected by the Large Taxpayer Office and the average number of tax payments paid per firm per year. Therefore, the implementing partner reported on 38 of the original 75 indicators (51 percent) when it issued its final report on Albania's Threshold Program.

MCC's *Guidelines for Monitoring and Evaluation Plans* present guidelines for M&E plans in compact countries; however, M&E guidance on how to develop good quality indicators had not been developed for Threshold Program countries. Also, MCC did not assign a Threshold Program M&E specialist when Albania's Threshold Country Plan was established. As a result, the indicator data that were captured did not properly measure the program's results.

Recommendation No. 6: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, develop Monitoring and Evaluation guidelines for the Threshold Program that sets forth requirements for developing good-quality indicators.

MCC Lacked a Policy Requiring an Information Technology Audit be Performed and Ensuring that Audit Recommendations be Implemented

Summary: Albania's Threshold Program included developing an IT system to help reduce corruption in tax administration, public procurement, and business registration (e-government), but MCC lacked a policy requiring an information technology audit be performed and the system lacked needed internal controls. GAO internal control standards describe the standards related to IT system controls, including general and application controls. Numerous problems were found during an audit of the IT system requested by Albania, with no evidence that the problems were corrected. The IT problems occurred because of a lack of planning, frequent requirements changes, and no planned IT audit to determine if the system was operating properly.

As a result, MCC was not assured that the IT system could handle e-government functions, was sustainable, and could meet Threshold Program goals of reducing corruption.

An audit requested by Albania and conducted by an independent audit firm, about 21 months into project implementation, revealed numerous problems with the IT system for the e-government projects. No system was in place to monitor the audit firm's recommendations to ensure that corrective actions were completed. Neither the Government of Albania nor USAID could provide supporting documentation that the problems were resolved.

The Threshold Program in Albania began a modernization of the related government agencies, which included the development of an integrated e-government IT system. This system would increase the transparency of elements of public administration, narrow the discretion of certain civil servants, and reduce corruption. Businesses were able to post tenders online without being forced to pay for tender documents and participate in rigged bids. In addition, businesses were registered online and their applications were processed within 24 hours for less than US \$1. Also, taxpayers were able to download forms and pay taxes online, avoiding contact with tax inspectors who would extort bribes. Therefore, the IT system played an important role in reducing corruption.

An Albanian official expressed his concerns to the USAID cognizant technical officer (CTO) on the sustainability of the IT system. In January 2008, the CTO initiated action to contract out for an audit to be performed on the IT system to ascertain whether the system met high performance, reliability, and security standards; and whether the system was in compliance with international best practices.

The independent audit firm found deficiencies and reported them in its June 2008 audit. The audit firm considered the overall level of system management, control, and operative performance of the IT functions within the Public Procurement Agency (PPA), Public Procurement Advocate, National Registration Center, and the General Directorate of Taxation (GDT) insufficient. The audit firm found deficiencies in the information security approach of e-government services, as well as in IT general controls related to physical security of information systems, logical access controls, testing and acceptance management, and computer operations. Examples of the deficiencies the audit firm found include the following:

- Physical security and environmental controls were insufficient to provide assurance that security-related events will not severely impact e-government services and potentially lead to data loss or interruption of services. During the audit team's visit, it was noted that the GDT's server room did not have an adequate cooling system, which could lead to failure of the IT equipment.
- Logical access controls to network and application resources had deficiencies that may lead to unauthorized access to applications and network services.
- Computer operations had control weaknesses in performing backups.
- E-government resources had weak information security controls, such as lack of secure passwords, which may allow an internal user to have inappropriate or unauthorized access to information systems.

- Flaws of security configuration on several Web portals were identified, as well as weak administrator passwords.
- The PPA's database server crashed during performance testing, resulting in complete loss of connectivity to the server and interruption to the production and test Web sites.

No system was in place to ensure that the IT system flaws the audit firm identified were corrected. An Albanian official of the PPA stated the IT problems identified by the audit firm report remained because PPA did not have time to resolve them, but that PPA was working to correct the problems. The implementing partner stated that it had handled most of the system flaws for which it was responsible, but it did not provide any evidence that all the flaws had been corrected. Not correcting the IT system flaws the audit identified could affect the sustainability of the project.

GAO's *Standards for Internal Controls in the Federal Government*⁷ state that internal control activities help ensure that actions are taken to address risks. Control activities need to be established to monitor performance measures and indicators. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved. Further, GAO's *Internal Control Management and Evaluation Tool*⁸ describes the standards related to information system controls: general controls and application controls. General controls include the structure, policies, and procedures that apply to an agency's overall computer operations. Application controls cover the structure, policies, and procedures designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing.

An Albanian official stated that IT problems were due to a lack of planning. Albanian officials held weekly meetings on the technical issues, but requirements changed frequently. Although as required by ADS 548, the USAID CTO requested a review of hardware, software, and services procurement for the Millennium Challenge Albania Threshold Agreement Project, this review did not address the functionality and sustainability of the IT system. Finally, an audit was not performed early in the operational phase to determine whether the IT system was functioning properly. An IT audit would identify any system deficiencies that can be promptly resolved. Appropriate oversight of the IT system would ensure that its goals are being met.

As a result, MCC was not assured that the IT system could handle e-government functions, was sustainable, and could meet Threshold Program goals of reducing corruption. The IT system plays an important role in the areas of taxation, public procurement, and business registration, as well as reducing corruption. Because of the deficiencies the audit firm found, the IT system is not secure, and therefore the potential for unauthorized access exists. For example, unauthorized users could manipulate the bidding process in their favor by underbidding the lowest offer. Unauthorized access to the IT system could undermine the very reason the system was created in the first place: to reduce corruption by increasing transaction transparency.

⁷ *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999).

⁸ *Internal Control Management and Evaluation Tool* (GAO-01-1008G, August 2001).

Recommendation No. 7: We recommend that when a Threshold Program involves an information technology system that is key to the success of the program, the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, require an information technology audit be performed when appropriate to ensure functionality and sustainability of the information technology system.

Recommendation No. 8: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, develop a policy and procedures to ensure that audit recommendations, including those made in information technology audits, will be corrected in a timely manner.

Data Quality Assessments Should Have Been Performed

Summary: The Millennium Challenge Corporation (MCC) did require the U.S. Agency for International Development (USAID) to conduct data quality assessments to ensure that performance data were valid, precise, reliable, timely, and have integrity. Because Threshold Programs are typically less than 3 years in length, and MCC uses USAID program information to report on Threshold Program country performance, MCC did not require USAID to perform data quality assessments more frequently than required by Automated Directives System (ADS) 203.3.5. USAID, the primary implementing partner for the Threshold Program, was required under ADS Chapter 203.3.5 of the ADS to conduct a data quality assessment at some time within 3 years. The USAID Missions may choose to conduct data quality assessments more frequently, if needed, before submitting data that will be used for Government Performance and Results Act (GPRA) reporting purposes or for reporting externally on Agency performance. Also, the USAID CTO was not aware that a data quality assessment should be conducted; he believed that MCC was more involved with assessing data quality. The USAID/Office of Inspector General found a similar issue during its audit of the Threshold Program. As a result, MCC was not assured that accurate data were being reported⁹.

USAID's ADS 203 requires that USAID conduct a data quality assessment at some time within 3 years of the project, or more frequently if needed, before submitting data that will be used for GPRA reporting purposes or for reporting externally on Agency performance. Because MCC uses USAID program information to report on Threshold Program country performance, and Threshold Programs typically are less than 3 years in length, MCC did require USAID to perform data quality assessment more frequently. Also, the USAID CTO was not aware that a data quality assessment should be conducted; he believed that MCC was more involved with assessing data quality. Therefore, USAID did not verify the implementing partner's results reported on the indicators.

⁹ A similar issue was reported in an audit report by USAID/OIG, which recommended that USAID/Office of Development Partners develop guidance that requires data quality assessments meeting ADS standards to be conducted at an appropriate point during Threshold Program implementation. (Audit Report No. P-000-09-007-P, dated April 27, 2009)

At the time of the audit, MCC did not have any policies or procedures related to conducting data quality assessments for the Threshold Program. Further, USAID's implementing partner in Albania performed only limited data verification of program results and stated that data verification could have been better. For example, the implementing partner hired a firm to conduct surveys on bribery and business registration in order to obtain the results for the indicator measuring the percentage of businesses that paid a bribe to register. However, the implementing partner did not verify that the survey results were accurate.

According to ADS 203, data quality assessments should be performed at least every 3 years. The data should be valid, precise, reliable, timely, and have integrity. When assessing data from implementing partners and secondary data sources, ADS 203 recommends comparing central office records to the records kept at field sites, and visiting a broad range of sites to assess whether reports accurately reflect what occurs in the field. Data quality assessment findings should be documented in a memorandum to the file. Communication with the implementing partners should be maintained to spot check that quality assurance mechanisms are being used. Because data quality assessments on the Threshold Program were not conducted according to USAID guidance, MCC was not assured that accurate data were being reported and indicators were being met.

Recommendation No. 9: We recommend that the Millennium Challenge Corporation's vice president, Department of Policy and International Relations, develop guidance requiring data quality assessments be performed at an appropriate time during a country's Threshold Program.

EVALUATION OF MANAGEMENT COMMENTS

The MCC provided written comments to our draft report that are included in their entirety in Appendix II. In its response, MCC agreed with eight of the nine recommendations in the draft report.

In response to Recommendation No. 1, MCC agreed with the recommendation and stated that a review of the Threshold Program is appropriate and would be beneficial to MCC and other stakeholders. MCC has initiated a review of the Threshold Program and will submit its analysis to the Board in June 2009.

In response to Recommendation No. 2, MCC agreed with the recommendation and stated that when there are limitations in measuring the impact of programmatic interventions on policy indicators, MCC will consistently and explicitly inform decision-makers of these limitations in its decisional memoranda. MCC currently makes explicit in decisional documents the limitations of measuring the impact of programmatic interventions on policy indicators. MCC believes that this fully informs its decision-makers on this issue, and MCC will develop guidance to ensure that this practice continues to be consistently applied.

For Recommendation No. 3, MCC did not agree with this recommendation. MCC's position is that the authorizing legislation provides a significant degree of flexibility to the Board regarding the selection of Threshold eligible countries by not requiring definitive standards and benchmarks. Although these specific measurements are not required, MCC agrees that certain elements should be consistently considered during an eligibility review. The Board's selections of threshold countries have resulted in a range of partner countries, some of which are further away from qualifying for compact eligibility than others. According to MCC officials, MCC currently recommends that the Board consider the following five factors when reviewing Threshold Program eligibility: the number of policy areas that need to be addressed, the type of policy reforms necessary, the degree of improvement needed, the government's commitment to and positive trends on reform, and whether MCC's assistance will improve the country's policy performance. These factors were introduced in fiscal year 2008 and are currently being used. Developing more definitive guidance or criteria would reduce the flexibility provided to the Board in the Millennium Challenge Act, and MCC does not believe that reducing this flexibility is either necessary or advisable.

The OIG believes Recommendation No. 3 is still a valid recommendation because as we stated in our finding, MCC cited subjective criteria to identify countries for Threshold Program assistance. Section 616 of the MCA states MCC may help a country become compact eligible as long as the country demonstrates "a significant commitment" in meeting the compact criteria. However, "a significant commitment" is subjective criterion that is not specifically defined. In addition, for Stage I assistance, MCC selected countries that are "close" to compact eligible. However, "close" was not defined regarding the number of failed indicators or how far from the median score a country could fall and still be Threshold Program eligible. By developing more definitive

guidance for selecting countries for the Threshold Program, MCC would be more in line with compact selection criteria, which are more transparent because stakeholders clearly understand how a country is being assessed based on specific criteria. However, we recognize the Board should have flexibility in selecting countries for Threshold Program assistance. Our concern is that selecting too many countries for Threshold Program assistance creates a larger pool of recipients and smaller grants.

For Recommendation No. 4, MCC agreed with this recommendation and has taken final action. MCC developed and provided a copy of guidance on the Threshold Program Indicator Analysis.

In response to Recommendation No. 5, MCC agreed with this recommendation, and will develop more detailed guidance on the consultative process for Threshold eligible countries. MCC agrees that a consultative process is important to include in the development of a Threshold Country Plan and currently asks countries to undertake such a process. In MCC's *Threshold Country Plan Guidance* for fiscal years 2008 and 2009, every Threshold Country Plan is required to include a description of the consultative process undertaken when developing the proposal and a list of the funding levels of other donors working in similar areas. This requirement is reiterated in a separate guidance document, an *Outline for a Threshold Country Plan*. MCC has also published a document entitled *Guidance on the Consultative Process*. While this document is targeted to compact-eligible countries, much of the guidance is equally applicable to Threshold Program development.

For Recommendation No. 6, MCC agreed with this recommendation, and is in the process of developing additional guidance on indicators and data quality. The additional guidance will be developed by August 31, 2009. MCC currently has two monitoring and evaluation guidance documents: an *Outline for a Threshold Country* and the *Guidance on the Preparation of the Results Reporting Tables for the Millennium Challenge Corporation Threshold Country Programs*. The former is to assist Threshold Program-eligible countries in the development of performance indicators as part of the Threshold Country Plan. The latter is additional guidance for program administrators and threshold countries on developing indicators and supplementary information for quarterly reports to MCC. MCC recognizes the internal guidelines already established by USAID, its primary implementer for most Threshold Programs, and expects that USAID will supplement MCC's guidance with its own during implementation.

For Recommendation No. 7, MCC agreed with this recommendation and will work with the primary U.S. Government agencies administering Threshold Programs to include more definitive guidance and procedures on requiring appropriate evaluations of its programmatic activities.

In response to Recommendation No. 8, MCC agreed with this recommendation and will produce guidance on how to respond to programmatic audit findings by August 31, 2009.

For Recommendation No. 9, MCC agreed with this recommendation and will develop more definitive guidance for data quality reviews by August 31, 2009.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted this performance audit of the Millennium Challenge Corporation's (MCC) Threshold Program in accordance with generally accepted Government auditing standards. 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit reviewed Threshold Program documents from 2005 to January 2009. The audit further reviewed the Threshold Program in Albania, which entered the program on April 3, 2006. Albania's Threshold Program totaled \$13.85 million.

We conducted the audit at MCC headquarters in Washington, DC, and in Tirana, Albania, during a site visit in November 2008. We met with the USAID cognizant technical officer (CTO), the implementing partner tasked with implementing the Threshold Program in Albania, and responsible Albanian Government officials. We also met with nongovernmental organizations (NGOs) in Washington, D.C., and Tirana, Albania.

Of the 17 indicators, we focused on the Control of Corruption indicator because MCC spends approximately 53 percent of the Threshold Program budget on that indicator. We selected Albania for a site visit for two reasons: (1) a country must pass the Control of Corruption indicator in order to be eligible for compact assistance and (2) Albania's Threshold Program focused primarily on the Control of Corruption indicator. To reach conclusions regarding the Threshold Program in Albania, we relied on interviews with MCC staff, the USAID CTO, stakeholders, Albanian Government officials, and the implementing partner. We used these interviews to help assess the success of the Threshold Program in Albania. We also used quarterly progress reports and performance management plans from 2006 through 2008 to determine whether indicators and targets were being met. We also coordinated our work with the Office of Inspector General (OIG) for USAID. The USAID OIG issued a draft report, titled *Audit of USAID's Implementation of the Millennium Challenge Corporation's Threshold Program*, on March 19, 2009.

We examined the internal control environment by identifying and assessing the relevant controls. We tested for various controls, including supporting documentation, verification of procedures, and guidance. No prior reports had been issued on the Threshold Program in Albania.

Methodology

To answer the audit objectives, we established audit steps to determine the following:

- Whether MCC's Threshold Program, including its evolution, guidance, funding, country selection process, and results, assisted countries in improving their targeted policy indicators;
- Whether MCC's assistance to a select country in developing its Threshold Program improved the targeted policy indicator;
- Whether MCC provided oversight of the implementation of the program, and what results were achieved by the intervention; and
- Whether the data reported by MCC, USAID, and its implementing partners to the U.S. Congress and the public reflect the progress on the ground.

To conduct these audit steps, we interviewed MCC, USAID, the implementing partner, NGOs, and others to gain an understanding of the overall objectives of the program as well as its achievements and challenges. We then selected a Threshold Program country for detailed testing and verified that the intended results were achieved, which involved reviewing relevant documentation, interviewing officials, and conducting site visits. As part of the testing and review, we interviewed local beneficiaries and end users to determine whether the Threshold Program resulted in improvements and whether the improvements were sustainable. We conducted a detailed examination of supporting documents to verify that intended results were being achieved, to determine whether performance indicator targets were met, and to determine the impact of achieving or not achieving the planned results.

Data quality assessments had not been conducted for the Threshold Program. Although we used existing data for our analysis, we did not perform our own data quality assessments.

MANAGEMENT COMMENTS



Date: April 7, 2009

To: Alvin Brown, Assistant Inspector General, Millennium Challenge Corporation

From: Michael Casella, Deputy Vice President, Department of Administration and Finance, Millennium Challenge Corporation /s/

Regarding: Response to the Draft Report on the Audit of the Millennium Challenge Corporation's Management of the Threshold Program

This memo serves as MCC's management response to the *Draft Report on the Audit of the Millennium Challenge Corporation's Management of the Threshold Program*. MCC appreciates the opportunity to comment on this audit of our Threshold Program.

MCC is dedicated to providing assistance to countries committed to creating a sound policy environment for economic growth and poverty reduction. The Threshold Program was created to help countries -- deemed by MCC's Board of Directors (Board) to be on the "threshold" of receiving compact eligibility -- meet MCC's indicator criteria by providing programmatic support for targeted reforms in areas highlighted by MCC's 17 eligibility indicators. It is important to note, however, that under MCC's authorizing legislation, in addition to considering policy performance, the Board must also consider two other factors when making a determination about a country's compact eligibility: MCC's funding levels, and the opportunity to reduce poverty and generate economic growth in the country. These factors are not addressed in the Threshold Program and, therefore, successful Threshold Program interventions may not always lead to compact eligibility. We therefore concur with the OIG that it would be useful to consider more generally whether the broad objective of helping countries to become eligible, as stated in the legislation, can be achieved exclusively through a programmatic intervention.

Additionally, MCC's eligibility indicators are designed to provide a broad overview of a country's policy performance in three policy areas relative to other countries in its income peer group. Policy performance as measured by these indicators will also reflect a country's efforts outside the Threshold Program, including reforms which may be supported by other donors. MCC recognizes that the cause of changes in scores on many indicators cannot be isolated to a single factor and therefore cannot be attributed solely to MCC's programmatic interventions. This is why MCC takes care to identify

subsources that feed into the indicators that can be, and are, tracked to provide important measurements of progress under our program. Due to lags in the data, in many cases the impact that programmatic interventions have on the policy areas measured by the indicators will be reflected in indicator scores only after several years.

Importantly, the audit concludes that while there are limitations to linking the programmatic interventions to movement on the high-level eligibility indicators, such as the World Bank's Control of Corruption indicator, the programmatic interventions did result in the desired outcomes, *viz.*, improved performance in the targeted policy areas. In Albania, the one country program that the OIG examined in depth, the OIG found that "the implementation of the Threshold Country Program did achieve reductions in corruption." We also note that when Albania was originally selected for Threshold eligibility, it was a Low Income Country (LIC). Albania graduated to the Lower Middle Income Country (LMIC) category in FY2005 because its per capita income increased. When Albania graduated, its relative rank among the other countries in its income group was lower than it was as an LIC because competition is more stringent in the LMIC group. However, as the OIG notes, absolute performance has improved; and Albania's rank in the more competitive LMIC category has improved since it graduated.

MCC believes that with a full portfolio of 21 programs, several which have recently concluded, and new leadership on the Board, it is an opportune time to conduct a review of the Threshold Program. Due to the varying breadth of activities, countries and implementers MCC agrees that more definitive guidance on the program, its intentions, and measures of success would be beneficial. Our responses listed below describe how we intend to address the findings and recommendations in the audit report.

Recommendation No. 1: The audit recommends that MCC "evaluate the effectiveness of the Threshold Program in regards to assisting countries in becoming compact eligible."

MCC concurs with this recommendation and agrees that a review of the Threshold Program is appropriate and would be beneficial to MCC and other stakeholders. MCC has initiated a review of the Threshold Program and will submit its analysis to the Board in June 2009.

Recommendation No. 2: The audit recommends that MCC "develop policy guidance on performance monitoring with a particular focus on the policy indicators, which describes the limitations, where they exist, of measuring the Millennium Challenge Corporation's impact and establishes standard language for use in the Millennium Challenge Corporation's decisional documents on these limitations."

MCC concurs with the recommendation and agrees that when there are limitations in measuring the impact of programmatic interventions on policy indicators it will consistently and explicitly inform decision-makers of these limitations in its decisional memoranda. MCC currently makes explicit in decisional documents the limitations of measuring the impact of programmatic interventions on policy indicators. We believe that this fully informs our decision-makers on this issue, and we will develop guidance to ensure that this practice continues to be consistently applied.

Recommendation No. 3: The audit recommends that MCC "develop more definitive guidance for selecting countries for the Threshold Program."

MCC does not concur with this recommendation. MCC's authorizing legislation provides a significant degree of flexibility to the Board regarding the selection of Threshold eligible countries by not requiring definitive standards and benchmarks. Although these specific measurements are not required, MCC agrees that certain elements should be consistently considered during an eligibility review. The Board's selections of threshold countries have resulted in a range of partner countries, some of which are further away from qualifying for compact eligibility than others.

MCC currently recommends that the Board consider the following five factors when reviewing Threshold Program eligibility: the number of policy areas that need to be addressed, the type of policy reforms necessary, the degree of improvement needed, the government's commitment to and positive trends on reform, and whether MCC's assistance will improve the country's policy performance. These factors were introduced in fiscal year 2008 and are currently being used. Developing more definitive guidance or criteria would reduce the flexibility provided to the Board in the Millennium Challenge Act, and MCC does not believe that reducing this flexibility is either necessary or advisable.

Recommendation No. 4: The audit recommends that MCC “develop policy guidance on the Threshold Program Indicator Analysis, including the process for developing the Indicator Analysis, its use by the country as a tool in identifying projects and documenting the results, and the Millennium Challenge Corporation's use of the Indicator Analysis as part of its review on a country's proposal.”

MCC concurs with this recommendation and has developed guidance on the Threshold Program Indicator Analysis. We have attached a copy for your reference.

Recommendation No. 5: The audit recommends that MCC “develop policy guidance on a consultative process and its use in developing Threshold Country Plans.”

MCC concurs with this recommendation, and will develop more detailed guidance on the consultative process for Threshold eligible countries.

MCC agrees that a consultative process is important to include in the development of a Threshold Country Plan and we currently ask countries to undertake such a process. In MCC's *Threshold Country Plan Guidance* for fiscal years 2008 and 2009, we required every Threshold Country Plan to include a description of the consultative process undertaken when developing the proposal and a list of the funding levels of other donors working in similar areas. This requirement is reiterated in a separate guidance document, an *Outline for a Threshold Country Plan*. MCC has also published a document entitled *Guidance on the Consultative Process*. While this document is targeted to compact-eligible countries, much of the guidance is equally applicable to Threshold Program development.

Recommendation No. 6: The audit recommends that MCC “develop Monitoring and Evaluation guidelines for the Threshold Program that sets forth requirements for developing good quality indicators.”

MCC concurs with this recommendation, and is in the process of developing additional guidance on indicators and data quality. The additional guidance will be developed by August 31, 2009.

MCC currently has two monitoring and evaluation guidance documents: an *Outline for a Threshold Country* and the *Guidance on the Preparation of the Results Reporting Tables for the Millennium Challenge Corporation Threshold Country Programs*. The former is to assist Threshold Program-eligible countries in the development of performance indicators as part of the Threshold Country Plan. The latter is additional guidance for program administrators and threshold countries on developing indicators and supplementary information for quarterly reports to MCC.

MCC recognizes the internal guidelines already established by USAID, our primary implementer for most Threshold Programs, and expects that USAID will supplement MCC's guidance with its own during implementation.

Recommendation No. 7: The audit recommends that “when a Threshold Program involves an information technology system that is key to the success of the program, the Millennium Challenge Corporation’s vice president, Department of Policy and International Relations, require an information technology audit be performed when appropriate to ensure functionality and sustainability of the information technology system.”

MCC concurs with this recommendation and will work with the primary U.S. Government agencies administering Threshold Programs to include more definitive guidance and procedures on requiring appropriate evaluations of our programmatic activities.

Recommendation No. 8: The audit recommends that MCC “develop a policy and procedures to ensure that audit recommendations, including those made in information technology audits, will be corrected in a timely manner.”

MCC concurs with this recommendation and will produce guidance on how to respond to programmatic audit findings by August 31, 2009.

Recommendation No. 9: The audit recommends MCC “develop guidance requiring data quality assessments be performed at an appropriate time during a country’s Threshold Program.”

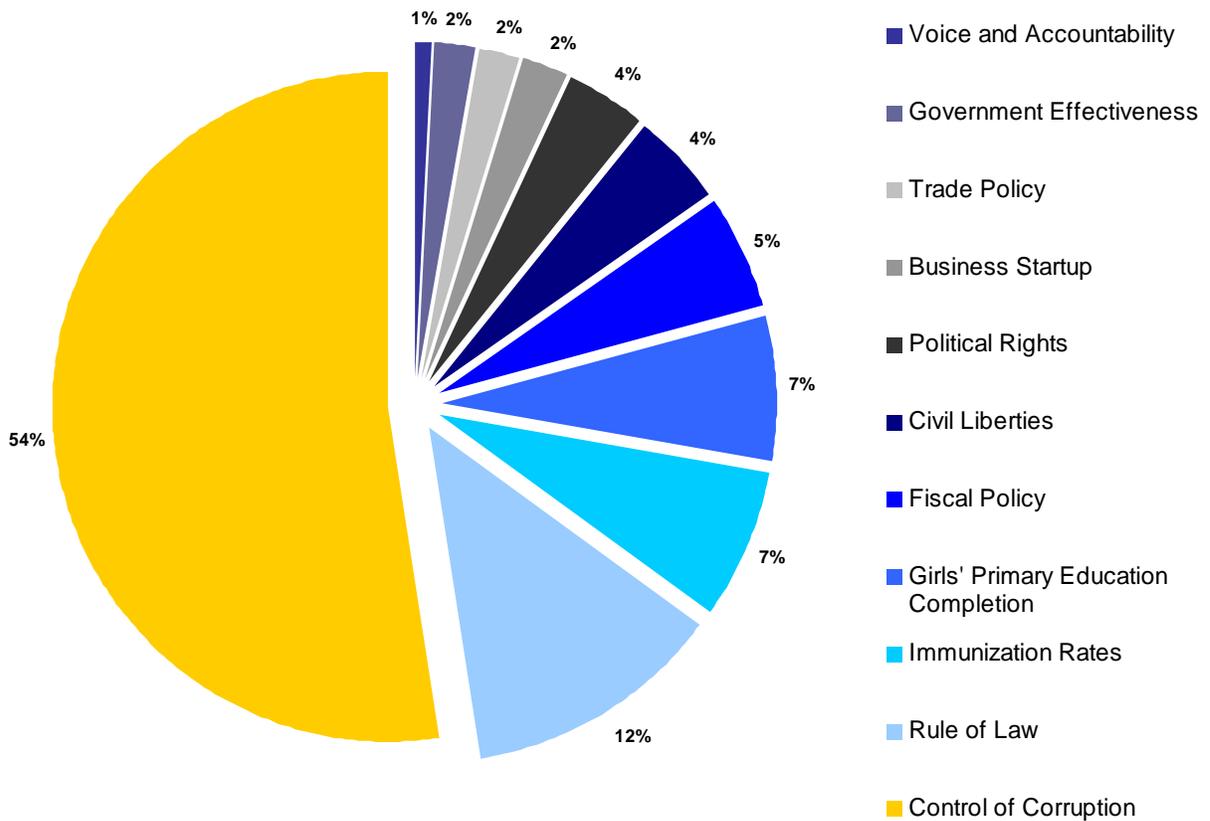
MCC concurs with this recommendation and will develop more definitive guidance for data quality reviews by August 31, 2009.

THRESHOLD PROGRAM COUNTRIES

Threshold Program Country		Program Amount (millions)	Threshold Start Date	Threshold End Date
1	Burkina Faso	\$12.9	July 22, 2005	September 30, 2008
2	Malawi	20.9	September 23, 2005	September 30, 2008
3	Albania	13.9	April 3, 2006	November 15, 2008
4	Tanzania	11.2	May 3, 2006	December 30, 2008
5	Paraguay	34.6	May 8, 2006	May 31, 2009
6	Zambia	22.7	May 22, 2006	February 28, 2009
7	Philippines	20.7	July 26, 2006	May 29, 2009
8	Jordan	25.0	October 17, 2006	August 29, 2009
9	Indonesia	55.0	November 17, 2006	September 30, 2009
10	Ukraine	45.0	December 4, 2006	September 30, 2009
11	Moldova	24.7	December 15, 2006	September 30, 2009
12	Kenya	12.7	March 23, 2007	September 30, 2009
13	Uganda	10.4	March 29, 2007	December 31, 2009
14	Guyana	6.7	August 23, 2007	February 23, 2010
15	São Tomé and Príncipe	7.4	November 9, 2007	January 31, 2010
16	Kyrgyz Republic	16.0	March 14, 2008	June 30, 2010
17	Niger	23.0	March 17, 2008	September 30, 2011
18	Peru	35.6	June 10, 2008	January 31, 2010
19	Rwanda	24.7	September 24, 2008	December 31, 2011
20	Albania Stage II	15.7	September 29, 2008	February 28, 2011
Total		\$438.8		

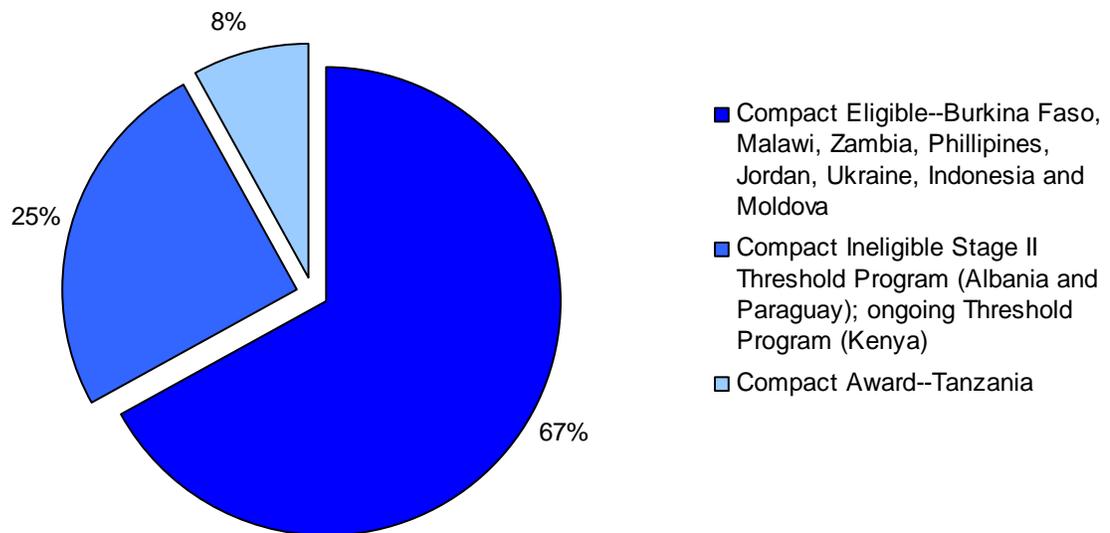
Source: OIG based on Millennium Challenge Corporation data.

THRESHOLD PROGRAM FUNDS BY POLICY INDICATOR (FY 2008)



Source: OIG based on Millennium Challenge Corporation data (Control of Corruption indicator - rounded).

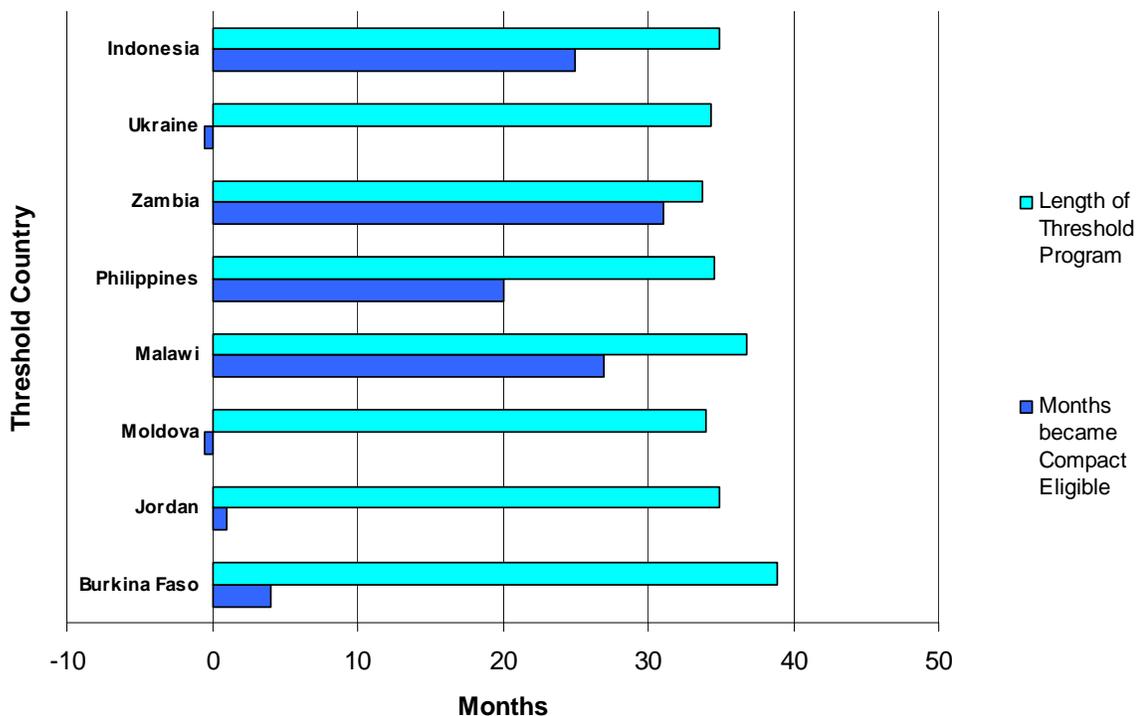
COMPACT STATUS DURING THRESHOLD PROGRAM



Notes: MCC awarded Burkina Faso a compact in July 2008. Ukraine was determined to be compact ineligible in December 2008.

Source: OIG based on Millennium Challenge Corporation data.

Number of Months Threshold Countries Became Compact Eligible Before or After Signing SOAG



The Strategic Objective Grant Agreement (SOAG) states that the completion date of a Threshold Program is the date the parties estimate that all activities necessary to achieve the objective and results will be completed. Therefore, a Threshold Program can be longer than 24 months but typically less than 3 years.

**U.S. Agency for International Development
Office of Inspector General
for the Millennium Challenge Corporation**

1401 H Street, N.W. Suite 770

Washington, DC 20005

Tel: (202) 216-6960

Fax: (202) 216-6984

www.usaid.gov/oig