



OFFICE OF INSPECTOR GENERAL

For the Millennium Challenge Corporation

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION PROGRAMS IN CAPE VERDE

AUDIT REPORT NO. M-000-09-002-P
March 31, 2009

WASHINGTON, DC



*Office of Inspector General
for the Millennium Challenge Corporation*

March 31, 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 the Inspector General's final report on the Audit of the Millennium Challenge Corporation's programs in Cape Verde. In finalizing the report, we considered your written comments to our draft and included those comments in their entirety in Appendix II of this report.

The report contains seven audit recommendations for corrective action. We consider that management decision and final action have been reached for Recommendations 1, 2, 3, 4, and 6 because MCC has provided the OIG with documentation to show as evidence of their improvement. In addition, management decision was reached for Recommendations 5 and 7 but final action will not be taken until MCC provides additional documentation as support of its improvement.

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

Sincerely,

Alvin A. Brown /s/
Assistant Inspector General
Millennium Challenge Corporation

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SUMMARY OF RESULTS

On July 4, 2005, the Millennium Challenge Corporation (MCC) and the Government of Cape Verde signed a 5-year agreement totaling approximately \$110 million, which entered into force on October 17, 2005. The goal of the compact is to encourage economic growth and reduce poverty by increasing agriculture production in specific key areas, increase integration of the internal market, reduce transportation costs, and develop the private sector. The Cape Verdean government designated the Millennium Challenge Account–Cape Verde (MCA-CV) as the accountable entity that would have the legal authority to oversee the compact during the compact period (see page 2).

The objectives of the audit were to determine whether (1) the MCC program in Cape Verde is achieving its targets, and (2) MCC’s reporting on the program in Cape Verde provided stakeholders with complete and accurate information on the progress of the program and the results achieved (see page 3).

The audit team found that the MCA-CV is not achieving all of its targets. Specifically, although MCA-CV has begun implementing the Watershed Management & Agricultural Support (WMAS) project, the program has experienced several limitations that may affect the project’s success. For example, the farmers may not be able to fully benefit from the drip irrigation system if they are unable to receive water from the dikes and reservoirs. In addition, the monitoring and evaluation (M&E) plan does not measure the success of the program, which may prevent MCC from readily determining the effectiveness of the compact programs and lead to poor management of the program. The infrastructure projects experienced problems during compact implementation because MCC completed its due diligence and entered into force before the pre-feasibility studies were completed, in accordance with its practice. As a result, MCC did not become aware that the road designs were incomplete until construction had begun. This caused significant delays and contributed to the re-scoping of the project which resulted in a reduction of the number of roads and the port projects funded by MCC. Although the compact was budgeted to fund five roads, MCC will now fund three. Furthermore, MCC did not provide the correct date for the cumulative disbursement reported in its Quarterly Status Reports (QSR), which could confuse the public; especially those using the information for further analysis (see pages 5, 8, 9 and 12).

The report includes seven recommendations to MCC’s vice president of Compact Implementation and the Congressional and Public Affairs departments: (1) require the Government of Cape Verde to provide a formal statement showing how it will fund the remaining portions of the WMAS project; (2) require MCA-CV to revise its current head of household list and include all local residents who are eligible to apply for the loans; (3) department request MCA-CV to develop--and provide to MCC--a set of requirements to prevent farmers from obtaining loans for drip irrigation if they do not have adequate access to water; (4) provide documentation on the location or spending of \$73,864 that was obligated to the microfinance institution, Soldifogo; (5) develop a policy to clarify the modification of the Indicator Tracking Tables and the M&E plan; (6) develop a policy to conduct a pre-feasibility study prior to entry into force; and (7) specify, in its Quarterly Status Reports, the dates that the cumulative disbursements represent (see pages 7, 8, 9, 11, and 12).

BACKGROUND

Established in January 2004 by the Millennium Challenge Act of 2003, the Millennium Challenge Corporation (MCC) is a U.S. Government corporation designed to work with some of the poorest countries in the world. Based on its performance against MCC's 16 policy indicators¹, a country may become eligible to receive a compact, which is a 5-year agreement between MCC and the country to fund specific programs to reduce poverty and stimulate economic growth. One of MCC's goals is to assist eligible countries that have developed well-designed programs with clear objectives, benchmarks to measure progress, and a plan for effective monitoring and objective evaluation of results.

On July 4, 2005, MCC and the Government of Cape Verde signed a 5-year agreement totaling approximately \$110 million, which entered into force on October 17, 2005, and is scheduled to end on October 17, 2010. The goals of the Cape Verde compact are as follows:

- Encourage economic growth and reduce poverty by increasing agriculture production in specific key areas,
- Increase integration of the internal market,
- Reduce transportation costs, and
- Develop the private sector.

The Cape Verdean government designated the Millennium Challenge Account-Cape Verde (MCA-CV) as the accountable entity that would have the legal authority to oversee the compact during the compact period.

MCA-CV intends to implement three different projects. The first is the Water Management and Agricultural Support (WMAS) project, totaling approximately \$10.8 million. This project will focus on increasing the irrigation of crops, providing technical assistance to farmers to improve agriculture, and increasing access to credit for agricultural businesses. The second is the Infrastructure project, totaling approximately \$78.8 million. This project will focus on renovating the Port of Praia, constructing five roads, and building four bridges to strengthen the fishing and agricultural communities. The last is the Private Sector Development project, totaling approximately \$7.2 million. This project will focus on increasing the competitive advantage through private investment, increasing access to credit through the development of microfinance institutions, and increasing financial intermediation by expanding access to the primary market for Government securities.²

Section 609(b) (1)(C) of the Millennium Challenge Act requires the eligible countries to establish regular benchmarks to measure progress toward achieving objectives. MCA-CV achieves this requirement by creating a monitoring and evaluation (M&E) plan that includes project objectives, performance indicators, and targets to efficiently and effectively monitor the compact. In addition, MCC is required to submit an annual report

¹ When MCC selected Cape Verde as an eligible country, its decision was based on 16 indicators. In fiscal year (FY) 2007, MCC began to use 17 indicators to select eligible countries.

² The remaining \$13.3 million relates to the following: \$4.9 million for monitoring and evaluation and \$8.4 million for program administration.

to Congress, and include in the report an assessment of the progress that the country makes during each year toward achieving the compact objectives. MCC works with the country to ensure that proposed programs are reasonable, measurable, and attainable.

AUDIT OBJECTIVES

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

- Is the Millennium Challenge Corporation program in Cape Verde achieving its targets?
- Did the Millennium Challenge Corporation's reporting on the program in Cape Verde provide stakeholders with complete and accurate information on the progress of the program and the results achieved?

Appendix I contains a discussion of the audit's scope and methodology.

AUDIT FINDINGS

Is the Millennium Challenge Corporation program in Cape Verde achieving its targets?

The MCA-CV program is not achieving all of its targets. Specifically, none of the targets have been met for the Watershed Management & Agricultural Support (WMAS) projects and Infrastructure projects. In addition, indicators and targets have not been finalized, for the Private Sector Development (PSD) project. Furthermore, at the time of the audit, MCA-CV and MCC were in the process of revising the scope of the project. Lastly, MCC and MCA-CV were still revising the M&E plan during fieldwork.

In January 2008, MCC and MCA-CV substantially reduced the scope of the compact programs, particularly for the Infrastructure and PSD projects. According to MCC, the scope was reduced as a result of delays and budget shortfalls. The Infrastructure component required several revisions because of budget constraints and delays; specifically, MCC decided to fund the construction of three roads instead of five and to complete one, instead of two phases of the port project. For the PSD component, MCA-CV will implement only \$2.08 million of the originally budgeted \$7.2 million because funding was allocated to other compact projects, specifically the port project. As a result of the project being re-scoped, MCC re-analyzed its projected impact of the compact; the projections were reduced from an estimated annual income of \$10 million in 5 years to \$6.9 million in 5 years.

Although MCA-CV is currently implementing three WMAS project activities, it has experienced several limitations that may affect the projects' success. In fact, MCC and MCA-CV have identified a potential problem that may arise in the future as the project's implementation continues. First, farmers have begun to apply for drip irrigation loans even though the waterworks construction is not complete. Second, MCA-CV lacks a system to select all eligible loan applicants. As a result, some loan applicants in the intervention areas may not be eligible to apply for micro-credit loans if their names do not appear on the Ministry of Agriculture's head of household list. Finally, according to MCC, the projects may experience a possible budget shortfall owing to the devaluation of the U.S. dollar.

In addition, the M&E plan—the compact's primary management tool—was ineffective. Contrary to MCC's Guidelines for Monitoring and Evaluation, MCC has approved changes to the indicators and targets that MCA-CV made to the Indicator Tracking Table³ each quarter. These changes prevent the MCC and MCA-CV from determining the compact program's success.

Lastly, even though infrastructure projects were assessed during compact development, in accordance with its compact implementation process, MCC completed its due diligence and entered into force before the pre-feasibility studies were completed. As a result, the infrastructure project suffered a cost increase because the roads were redesigned during compact implementation. This led to budget shortfalls and ultimately

³ The Indicator Tracking Table reports specific results against projected targets, explaining significant deviations from the targets.

contributed to MCC and MCA-CV reducing the number of roads and activities on the port being funded by MCC.

These issues, which affected the MCA-CV program's M&E plan and the Cape Verdean Compact program's efficiency and effectiveness, are discussed below.

The Watershed Management and Agricultural Support Program May Not Achieve Its Targets

Summary: MCC has experienced several impediments to the implementation of the Watershed Management and Agricultural Support (WMAS) project activities, which may affect the project's success. According to the revised M&E plan, dated December 11, 2008, the WMAS project is designed to increase agricultural productivity in three specific intervention areas in the islands of Santo Antão, Fogo, and São Nicolau, with a targeted increase in income in these areas of US\$700,000 by Year 5. Several causes, such as devaluation of the U.S. dollar, time constraints, and the lack of a system to select all eligible loan applicants, may prevent the project from being successful. As a result, the project may not achieve its targets or have a significant impact in the targeted areas by the end of the compact.

MCA-CV's implementation of the WMAS project has experienced numerous impediments that may affect the project's success. In fact, MCC and MCA-CV have identified a potential problem that may arise in the future as the project's implementation continues. MCA-CV may encounter possible funding shortfalls for several activities of the WMAS project and may need the Government of Cape Verde to fund the remainder of the project once MCC depletes its funding. MCA-CV will need an additional \$1.5 million to complete the remainder of the activities, mainly the water distribution system and materials for the postharvest center.

Second, although an MCC official stated that construction of all watershed infrastructures will not be completed until May 2009, MCA-CV has begun implementing the Access to Credit activity, thereby encouraging farmers to apply for loans even though agribusiness training and dike, reservoir, and water distribution system⁴ construction has not been completed in all the intervention areas. At the end of October 2008, 9 of the 17 farmers on the island of Fogo who applied for loans to purchase drip irrigation materials did not have access to water. Logically, farmers should have access to



The top of a completed reservoir, coupled with drip irrigation equipment, which will bring more water to arid farmland. Photograph taken by an OIG auditor in October 2008.

⁴ Farmers need the water distribution system (i.e., the water meters and valves) to receive water at their farms.

water before receiving loans to purchase drip irrigation materials (see chart 1).

Finally, at the time of the audit, there was not a system in place to determine which farmer resided in the intervention areas. According to MCC officials, all farmers and agribusinesses who are Cape Verdean nationals and are assisted by MCA-CV programs in the intervention areas of Santo Antão, Fogo, and São Nicolau are eligible borrowers. However, the household list that the credit providers will use to determine loan eligibility contains only the names of the heads of households in these areas. Furthermore, because the loans are not restricted to the heads of households, the list from Caixa Economica—the entity responsible for managing the project—should include not merely the head of household, but every farmer who works in the intervention areas.

According to the revised M&E plan, dated December 11, 2008, the WMAS project is designed to increase agricultural productivity in three specific intervention areas in the islands of Santo Antão, Fogo, and São Nicolau in the short to medium term, with a targeted increase in income in these areas of \$700,000 by Year 5.

Several factors contributed to the WMAS impediments. First, according to MCA-CV officials, the devaluation of the U.S. dollar caused the funding shortfall for some activities within the WMAS project and funding may not be sufficient to pay for all the components of the project. The officials explained that MCC and the Government of Cape Verde have taken steps to prevent this from happening, such as proposing that the Government fund the remaining works needed in the islands of Fogo and São Nicolau and purchase equipment for the three postharvest centers. The Government also sent a letter to MCC confirming its commitment to fund the remaining portion of the program once MCC depletes its funding. However, the letter did not specify how the government will allocate funds for the project.

Furthermore, MCC did not provide sufficient oversight in the implementation of the WMAS project activities. It is MCC's policy to give the compact country ownership of implementing the projects, and as the result, sometimes does not focus on activities where the MCA has contracted work. Consequently, MCC overlooked how Caixa Economica and Soldifogo, the microfinance institution (MFI) who first received funding for the access to credit program, disbursed funds to 17 loan applicants. Although MCC and MCA-CV decided not to issue the funds since construction was not complete, MCC could not provide information about who made the decision or who currently holds the funds: Caixa Economica or the MFI.⁵ In addition, MCC could not track the funding for a \$73,864 loan obligated to the MFI Soldifogo for the 17 farmers in Fogo. Furthermore, MCC could not provide the Office of Inspector General with any mechanism that will be used to prevent MFIs from granting loans to farmers whose areas do not have constructed watershed infrastructures. Lastly, MCC and MCA-CV could not explain why all the farmers were not included on the list, nor were they aware of this problem.

Lastly, project delays also contributed to the WMAS project's challenges. According to MCC and MCA-CV officials, introduction of a new procurement system and procedures to the Ministry of Agriculture and local offices prolonged the learning curve and delayed implementation. In addition, it took several months to obtain the necessary approvals from the Ministry of Agriculture to begin environmental studies, which MCC required

⁵ According to the contract between MCA-CV and Caixa Economica, Caixa Economica is required to hold the funds until the MFI is ready to issue the funds to the loan applicant.

before MCA-CV could begin construction of the dikes and reservoirs. Furthermore, it took additional time to negotiate with the farmers for land for the reservoirs.

As the result of the project's ongoing limitations, WMAS may not achieve its intended impact. For example, even though MCA-CV could finish building the dikes and reservoirs, the farmers may not be able to benefit fully from the drip irrigation system if it does not have pipes and other filtration systems to connect to the farms. In addition, MCA-CV could finish constructing the postharvest centers, but the centers would not be functional without the necessary equipment such as storage and packaging materials; hence, farmers will not be able to preserve their crops before sending them to the market. For these reasons, this audit report makes the following recommendations:

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department require the Government of Cape Verde to provide a formal statement showing how it will fund the remaining portions of the WMAS project⁶.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department require the Millennium Challenge Account-Cape Verde to revise its current head of household list and include all local residents who are eligible to apply for the loans.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department request MCA-CV to develop--and provide to MCC--a set of requirements to prevent farmers from obtaining loans for drip irrigation if they do not have adequate access to water.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department provide documentation on the location or spending of \$73,864 that was obligated to the microfinance institution, Soldifogo⁷.

⁶ As the result of the OIG's finding, MCC has provided documentation from the Government of Cape Verde, which explains how it will fund the remaining portion of the WMAS project.

⁷ As the result of the OIG's finding, MCC has received documents from Caixa Economica that shows that 8 of the loan applicants received funding because they had access to water, while 9 loan applicants were denied funding until they had access to water or drip irrigation. Furthermore, MCC provided support to show that Caixa Economica has received the remainder of funding that it disbursed to Soldifogo.

The Monitoring and Evaluation Plan for MCA-CV May Not Measure Program Success

Summary: The Monitoring and Evaluation (M&E) Plan, one of the compact's management tools, does not measure the success of MCA-CV programs. Specifically, MCA-CV made changes to the indicators and targets for each quarter and failed to submit all Indicator Tracking Tables (ITT). Although MCC stated that it withheld funds from MCA-CV because it did not submit its quarterly M&E tracking documents on time, further review of supporting documents revealed that funds were not withheld. The MCA-CV agreement dictates that monitoring and evaluation is a key component of the compact, as it allows program managers to identify problems early on and make corrections during implementation in order to improve the ultimate impact of programs. The changes made and the lack of tracking documents hindered MCA-CV and MCC from identifying problems and mitigating risks during implementation.

The M&E plan for the Cape Verde compact, at the time of the audit, does not measure the compact's success. Many of the targets and indicators in the Indicator Tracking Tables⁸ (ITT), the mechanism used to track M&E Plan results, changed in quarters 8, 10, and 11. These were the only quarters that MCA-CV submitted ITTs to MCC during this audit period. In addition, MCA-CV began submitting ITTs when it was in the process of revising its M&E plan. When revised M&E plans were compared to the ITTs, very few of the indicators and targets matched.

According to the Disbursement Agreement between MCC and MCA-CV, as a conditions precedent, MCA-CV shall submit any applicable reporting set forth in its M&E Plan for the relevant disbursement period. Hence, MCC stated that it withheld funding for M&E expenses from MCA-CV for not submitting the ITTs during quarters 1 through 7.⁹ However, review of supporting documentation revealed that M&E expenses totaling approximately \$512,000 were never withheld.

According to the compact agreement and MCC's *Guidelines for Monitoring and Evaluation Plans*:

the managing unit shall conduct regular assessments of program performance to inform MCA-Cape Verde, Project Managers, and MCC of the progress under the program and to alert these parties of any problems, so as to be able to make any mid-course corrections during implementation in order to improve the ultimate impact of programs. The assessment will report actual results compared to the targets on the indicators referenced in the monitoring component, explain deviations between these actual results and targets, and in general, serve as a management tool for implementation of the program. With respect to any data and reports received by MCA-CV, MCA-CV shall promptly deliver such reports to MCC along with any other related documents, as specified in Annex-III or as may be requested from time to time by MCC.

⁸ The Indicator Tracking Table reports specific results against projected targets, explaining significant deviations from the targets.

⁹ MCA-CV did not submit the quarter 9 ITT to MCC because both entities were working to revise the indicators and targets during this period.

MCC does not have a policy that specifies certain guidelines its staff should follow when revising indicators and targets in its M&E plans or ITTs. Nevertheless, MCC mentioned that minor changes can be made to ITTs without making changes to the M&E Plan. An MCC official explained that when the M&E Plan is revised, the changes made to the various ITTs will be incorporated into the revised M&E Plan and MCC is aware of the changes that are being made, because its staff works closely with MCA-CV. However, MCC is currently working on a policy that addresses M&E issues, particularly, making revisions to the indicators and targets of an M&E plan.

As a result of the numerous changes, MCC cannot readily determine the effectiveness of the compact programs or determine whether any mid-course corrections might be needed to improve the programs' ultimate impact. These changes can also lead to poor management of the compact programs because the M&E plan is considered the primary management tool. For these reasons, this audit makes the following recommendation:

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department develop a policy to clarify the modification of the Indicator Tracking Tables and the Monitoring and Evaluation Plan.

Infrastructure Projects Experienced Many Problems During Compact Implementation

Summary: MCC did not perform a complete due diligence process of the infrastructure projects. According to the Memorandum of Understanding between MCC and the U.S. Army Corps of Engineers (USACE), due diligence should have included an assessment of all project documents. Because the infrastructure projects in the Cape Verde compact were the first to be undertaken by MCC, there was not a clear compact development policy, which would include conducting a thorough pre-feasibility study prior to signing the compact or entry into force. As a result, construction delays occurred, and costs increased by approximately \$6.0 million because of the redesign of the roads and additional building materials, equipment, and resources needed to build each road. The five roads that MCA-CV initially intended to build were reduced to three roads to offset funding shortfalls.

MCC did not perform a complete due diligence process of the infrastructure projects. Primarily, the roads included in the infrastructure projects were selected from an existing project under the World Bank. During compact development, a World Bank consultant was acquired to conduct a (1) feasibility study, (2) environmental impact report, (3) final designs, and (4) construction documents for the road projects. MCC employed U.S. Army Corps of Engineers (USACE) to review project documents prepared by the consultant to identify any problems with the project and ensure that the consultant performed quality work. However, at the time that USACE completed the review; the consultant had fulfilled only 75 percent of the designs for the roads, and did not have the final road designs prepared.

Even though a clear compact development policy was not in place when this compact was signed, the Memorandum of Understanding between MCC and USACE outlined

their expectations for performing technical assistance for MCC in the following areas:

- Technical feasibility study
- Technical solutions
- Project engineering
- Project budget
- Project timeline
- Environmental and social impact assessments
- Consultation
- Road safety issues
- Project implementation capabilities.



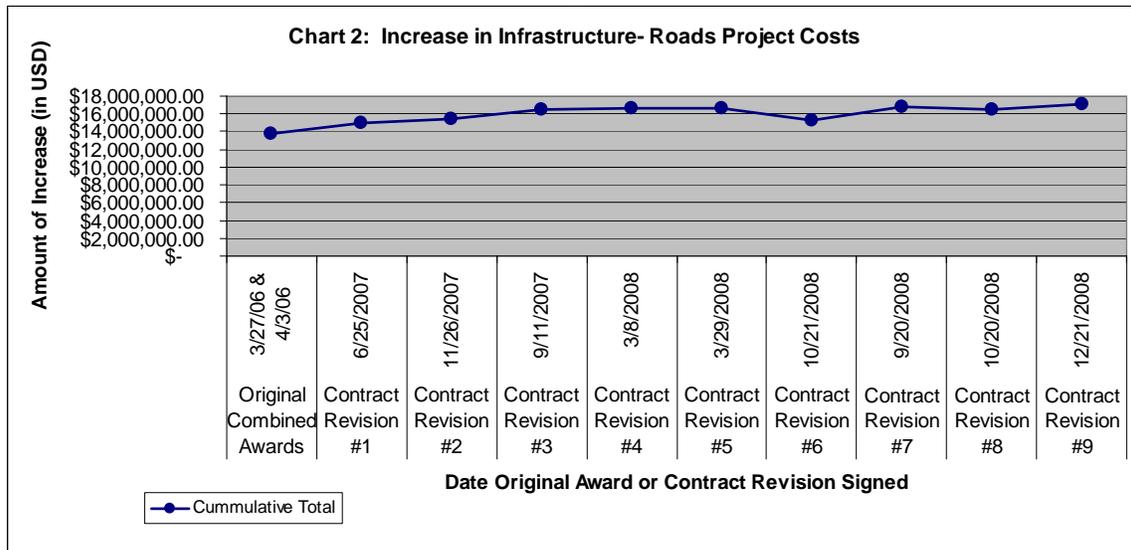
A photograph of the completed portion of Road 4 being built on the island of Santiago. This picture was taken by an OIG auditor in October 2008.

Because the infrastructure projects in the Cape Verde compact were the first to be undertaken by MCC, there was not a clear compact development policy, which would include conducting a thorough pre-feasibility study prior to signing the compact or entry into force. MCC hired USACE to conduct due diligence on the roads. According to the Memorandum of Understanding between MCC and USACE, MCC wanted the review of the consultant's work completed as soon as possible so that it could sign a compact with Cape Verde. However, MCC signed the compact before completing the pre-feasibility stage knowing that there was a certain amount of risk involved. For example, the supervisory firm and contractor for the roads project discovered that the designs provided to them by the World Bank consultant were incomplete. As the incomplete designs were not identified during pre-feasibility studies, numerous pricing disputes arose between the contractor and the supervisory firm for additional work not included in the original contract.

As a result of an unclear compact development policy, the MCA-CV redesigned the roads, which caused the execution of numerous contract revisions, and project costs increased from \$13.8 to \$17.1—a \$3.3 million increase—(24%)¹⁰ (see chart 2). Project costs included the redesign and additional resources, such as personnel, equipment, and building materials, needed to build the roads. Because of the increased costs of the projects and the lack of additional funding, MCC and MCA-CV decided to rescope the infrastructure project; the five roads were reduced to three, and the budgeted costs for the omitted roads were reallocated to the remaining three roads. According to the supervisory firm for the roads project, numerous contract revisions would not have been needed if the original designs were not incomplete. Therefore, we are making the following recommendation:

¹⁰ This amount includes variation orders (contract revisions) signed through December 21, 2008, because the value of the variation orders created after June 30, 2008, was significant. The Inspector General used an average daily exchange rate of 78 Cape Verde escudos to 1 U.S. dollar. Based on historical currency exchange rates from March 30, 2008 to December 21, 2008.

Chart 2. Increase in Infrastructure/Roads Project Costs



Recommendation No. 6: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department develop a policy to conduct a pre-feasibility study prior to entry into force.

Did the Millennium Challenge Corporation’s reporting on the program in Cape Verde provide stakeholders with complete and accurate information on the progress of the program and the results achieved?

MCC provided complete information of the results of the compact programs in Cape Verde to its stakeholders, such as Congress and non-governmental organizations (NGOs); however, MCC reported ambiguous dates of its financial data in its Quarterly Status Report (QSR) that it provides to Congress and the public. In terms of the progress of the compact programs, MCC uses quarterly reports and other management tools used to track implementation in its report to Congress as well as its quarterly status reports (QSR). In addition to reporting on MCA-CV’s progress in the QSR, MCC also provided success stories on one of the compact programs that it funded (E-Government System), where citizens in both the country and those living abroad could access personal files, such as birth certificates, online. The audit team visited the office to confirm the information provided in MCC’s Success Stories.

However, when reporting its financial information, MCC does not always specify the correct date from which the information was drawn. This lack of information may confuse stakeholders who use this information to conduct their own analysis.

MCC Does Not Specify the Date of Financial Data in Its Reports

Summary: MCC did not provide the correct date for the cumulative disbursement reported in its Quarterly Status Reports (QSR). According to the Millennium Challenge Act of 2003, Section 612(a)(1)(B), MCC shall make available to the public, on at least a quarterly basis, the amount of assistance provided to the entity. Several changes to the reporting process during the year contributed to the inaccurate reporting of financial data. As a result, the information may be confusing to stakeholders and prompt them to make inaccurate decisions.

MCC did not provide the correct date for the cumulative disbursement reported in its Quarterly Status Reports (QSR). MCC stated that the data in the reports reflected cumulative disbursement as of the last day of the previous quarter. However, the financial data do not always reflect the last date of the prior quarter. For example, in its January to March 2008 QSR, MCC reported the “Disbursement to Date” amount as \$15,286,599, even though the data are based on figures from February 15, 2008.

According to the Millennium Challenge Act of 2003 Section 612(a)(1)(B),
the Corporation shall make available to the public on at least a quarterly basis,
the amount of assistance provided to the entity.

MCC did not have a consistent process of reporting financial data in its Quarterly Status Reports (QSR). The inconsistent reporting was primarily due to several changes in its reporting process during the past fiscal year. MCC stated that the different divisions within the corporation requested various disbursement and redisbursement information at various times of the year, and that the Administration and Finance department, which provides the data, does not always know how that information will be used.

As MCC’s stakeholders use the data to analyze compact programs, the inconsistent reporting of financial data could confuse the public. Therefore, we are making the following recommendation:

Recommendation No. 7: We recommend that the Millennium Challenge Corporation’s vice president of the Congressional and Public Affairs department specify, in its Quarterly Status Reports, the dates that the cumulative disbursements represent.

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 five out of the seven recommendations in the draft report.

In response to Recommendation No. 1, MCC agreed with the recommendation and considers this recommendation already closed because it provided the OIG with copies of the letters from MCA-CV and the Minister of Agriculture who pledged to provide approximately 106 million CVE to finance the water distribution system and postharvest centers in Sao Nicolau and Fogo. The OIG agrees and considers that management decision was made and final action taken on the recommendation.

In response to Recommendation No. 2, MCC concurred with the recommendation; however, it stated that it had a system in place at the time of the audit to determine which farmers resided in the intervention areas. It further explained that the system only identified heads of households. Although the OIG agrees that MCC identified the head of households, MCC did not have a comprehensive system that could identify other potential loan applicants who lived in the intervention areas. The OIG agrees that MCC provided documentation dated March 5, 2009--after the audit fieldwork. The OIG considers that management decision was made and final action taken on the recommendation.

In response to Recommendation No. 3, MCC did not concur with the recommendation. It stated that it provided the OIG with information on March 5, 2009 (after the completion of the audit fieldwork) that of the seventeen (17) loan applicants, the microfinance institution, SOLDIFOGO provided eight (8) loans to farmers who had sufficient access to water from non-MCA sources, while nine (9) loans were not made and the balance of the funds were returned to by SOLDIFOGO to Caixa Economica until water becomes available.

During the OIG's visit to Cape Verde in October 2008, we were informed that seventeen (17) farmers had been approved for loans by SOLDIFOGO. In a meeting with MCC on January 13, 2009, it confirmed that the farmers applied for loans to purchase drip irrigation equipments even though they did not have access to water, and MCA-CV decided not to issue the funds to the loan applicants since they did not have access to water. It was not until March 5, 2009 (after the audit fieldwork ended) that MCC informed the OIG it had disbursed funds to eight (8) of the loan applicants. As the OIG has received documentation to support MCC's statement, it considers that management decision was made and final action taken on the recommendation.

In response to Recommendation No. 4, MCC did not concur; however, MCC has provided the OIG with a letter, dated January 15, 2009, written by Caixa Economica to SOLDIFOGO requiring the latter to return remaining funds within 30 days or pay a penalty fee of one percent. As the OIG has received the document, it considers that management decision was made and final action taken on the recommendation.

In response to Recommendation No. 5, MCC concurs with the recommendation and is currently updating its M&E guidelines to reflect a consistent process for M&E Plan modifications. However, it does not agree that the M&E Plan is the compact's primary management tool. The OIG agrees with MCC and will revise the statement by stating the M&E Plan is one of MCC's management tools. Management decision was made, but final action was not reached on this recommendation because MCC has not finalized its revision of the M&E guidelines.

In response to Recommendation No. 6, MCC concurs with the principle of the recommendation and has already incorporated a pre-feasibility study into its compact development process. However, it believed that the OIG miscalculated the projected costs and would like to review the OIG's data to support our finding. The OIG agrees with MCC's calculation and has made the revision in the final report. As the OIG has received the document, it considers that management decision was made and final action taken on the recommendation.

In response to Recommendation No. 7, MCC concurs with the recommendation and has made the changes to its Quarterly Status Report to include the dates for the cumulative disbursements. Although the OIG considers that MCC has made a management decision on this recommendation, final action for the will require that MCC provide a copy of the most recent Quarterly Status Report to the OIG.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General conducted this performance audit of the Millennium Challenge Corporation's (MCC) program in Cape Verde 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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective(s). The audit reviewed the targets from entry into force on October 17, 2005, through June 30, 2008. Through June 30, 2008, MCC had disbursed \$17.6 million of the \$110 million in compact funds to Millennium Challenge Account-Cape Verde (MCA-CV).

We conducted the audit at MCC headquarters in Washington, DC, and at MCA-CV in Praia, Cape Verde, during a site visit in October 2008. During the site visit, we interviewed farmer beneficiaries in Santo Antão, who participated in the agribusiness training. We also met with contractors for the roads and bridges, and visited the sites.

To reach our conclusions regarding MCA-CV's two projects, we relied on interviews with MCC staff, MCA-CV staff, contractors, and implementing entities. We used these interviews to help assess the program's work plans, financial reports, quarterly progress reports, the Monitoring and Evaluation plan, and information shared with Congress and the public. We also examined supporting documentation from the contractors and implementing entities' reports and MCA-CV quarterly progress reports.

We examined the internal control environment by identifying and assessing the relevant controls. We tested for various controls, including supporting documentation, verification procedures, and guidance. In addition, we reviewed prior audit reports that considered relevant findings.

Methodology

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

- Whether MCA-CV had established plans and milestones to monitor and implement the compact's projects;
- Whether the program was on schedule according to the established plan and milestones; and
- Whether data reported by MCC, MCA-CV, and the implementing partners to Congress and the public reflected the program's progress.

Specifically, we performed the following activities:

- Interviewed MCC personnel, MCA-CV staff, and implementing partners to gain an understanding of the overall objectives of the program and its challenges;
- Conducted a detailed examination of supporting documentation for the three projects to verify that intended results were being achieved. The examination consisted of reviewing relevant documentation, conducting interviews, and making site visits;
- Interviewed beneficiaries to determine how MCC-funded programs had affected their lives; and
- Determined the potential impact of achieving or not achieving selected milestones and targets.

MANAGEMENT COMMENTS



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Date: March 30, 2009

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

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

Subject: Management Response to the Draft Audit of MCC Programs in Cape Verde

This memorandum serves as the Management Response of the Millennium Challenge Corporation (MCC) to the Office of the Inspector General's (MCC OIG) draft audit of MCC programs in Cape Verde. Where MCC is able to make a management decision we have done so in this response. In other cases we will issue a determination as part of MCC's Management Decision to the final audit report.

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department require the Government of Cape Verde to provide a formal statement showing how it will fund the remaining portions of the WMAS project.

MCC Response: MCC concurs with this recommendation, and considers it to already be closed. MCC provided the OIG on March 3, 2009 with copies of letters from MCA-CV and the Minister of Agriculture pledging to provide approximately 106 million CVE to finance the water distribution systems and postharvest centers on Sao Nicolau and Fogo. This amount is approximately equal to \$1.3 million to \$1.5 million and is sufficient to cover the shortfall.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department require the Millennium Challenge Account-Cape Verde to revise its current head of household list and include all local residents who are eligible to apply for the loans.

MCC Response: MCC concurs with the recommendation however we do want to point out that there was a system in place at the time of the audit to determine which farmers resided in the intervention areas. This system however was not comprehensive as it only identified heads of households. MCC notified the OIG in writing (dated March 5, 2009) that MCA Cape Verde is developing additional procedures that will enable the local delegate of the

Ministry of Agriculture to confirm that the applicant is an eligible farmer with a farm in the watershed area.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department request MCA-CV to develop, and provide to MCC, a set of requirements to prevent farmers from obtaining loans for drip irrigation if construction of the dikes and reservoirs is not complete and water distribution systems are not installed in the intervention area.

MCC Response: MCC does not concur with this recommendation, and disagrees with its underlying findings.

The OIG Report states that “At the end of October 2008, 17 farmers on the island of Fogo have applied for loans to purchase drip irrigation materials even though the dike, reservoir, and water distribution systems in that area are not complete. Logically, farmers should have access to water—water at the gate—before receiving loans to purchase drip irrigation materials.”

MCC informed the OIG on March 5, 2009 that of the seventeen (17) loans applied for, the microfinance institution SOLDIFOGO made eight (8) loans upon determining that those farmers had sufficient access to water from non-MCA sources. Nine (9) loans were not made and the balance of funds was to be returned by SOLDIFOGO to Caixa Economica until water becomes available. Because microfinance institutions (including SOLDIFOGO) in accordance with the delegate of the ministry of agriculture are ensuring that sufficient access to water is available before approving loans, MCC does not concur that an additional set of requirements as recommended is needed at this time.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department provide documentation on the location or spending of \$73,864 that was obligated to the microfinance institution Soldifogo.

MCC Response: MCC does not concur with this recommendation. As we stated above, we do not agree that there is an issue with the microfinance institutions giving loans before water is available and therefore do not think this recommendation is warranted.

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department develop a policy to clarify the modification of the Indicator Tracking Tables and the Monitoring and Evaluation Plan.

MCC Response: MCC concurs with the recommendation and is currently updating its M&E guidelines to reflect a consistent process for M&E Plan modifications. However, MCC does not agree with the OIG's characterization of the M&E plan as the compact's primary management tool as stated by the OIG in this report (under the M&E Plan section). MCC considers the M&E plan one of several management tools – the MCA project-level detailed work plans and detailed financial plans being others – used together in MCC's oversight of the program. The Indicator Tracking Table (ITT) is the primary performance reporting tool.

Recommendation No. 6: We recommend that the Millennium Challenge Corporation's vice president of the Compact Implementation department develops a policy to conduct a pre-feasibility study prior to entry into force.

MCC Response: MCC concurs in principle with the recommendation, and has already incorporated into its compact development process a pre-feasibility study step. Conducting such studies is now part of the process for all new compacts. However, we do not concur with the underlying finding in this report which is the OIG's basis for its recommendation. As we state below we believe the OIG may have miscalculated the projected costs, and MCC requests that the OIG provide additional data to support its finding.

According to the OIG Report: "As a result of unclear compact development policy, the MCA-CV redesigned the roads, which caused the execution of numerous contract revisions, and project costs increase from \$13.8 million to \$19.8--a \$6.0 million increase— (44%) (see chart 2). Project costs included the redesign and additional resources, such as personnel, equipment, and building materials, needed to build the roads."

MCC has not previously seen this data, but understands that these figures represent both the construction and supervision contracts for the Roads Activity, including 9 Variation Orders through December 2008, using an average exchange rate of 78 CVE to \$1 USD. MCC does not believe the second figure is accurate. MCC agrees with an initial total of \$13.8 for the contracts, but calculates an adjusted cost of \$17.1 million, an increase of approximately \$3.3 million or 24%. However, without access to OIG data we cannot identify the source of the apparent miscalculation.

Recommendation No. 7: We recommend that the Millennium Challenge Corporation's vice president of the Congressional and Public Affairs department specify, in its Quarterly Status Reports, the dates that the cumulative disbursements represent.

MCC Response: MCC concurs with the recommendation and has made changes to its quarterly status report to include the dates for the cumulative disbursements.

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