



OFFICE OF INSPECTOR GENERAL

for the Millennium Challenge Corporation

REVIEW OF THE TERMINATION OF THE MILLENNIUM CHALLENGE CORPORATION COMPACT WITH MADAGASCAR

REVIEW REPORT NO. M-000-10-002-P
March 31, 2010

WASHINGTON, D.C.



*Office of Inspector General
for the Millennium Challenge Corporation*

March 31, 2010

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

Dear Mr. Yohannes:

This letter transmits the Office of the Inspector General's final report on the Review of the Termination of the Millennium Challenge Corporation Compact with Madagascar. 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 eight review recommendations to strengthen MCC's compact termination procedures. We consider that MCC has made management decisions for Recommendations No. 1 and 3 but final action will not be reached until MCC provides further documentation to support its statement. Although MCC agrees with Recommendations No. 2, 6, and 7, no management decisions or final actions will be taken until MCC provides evidence to support its statement and a timeframe of when it will resolve the recommendations. In addition, management decisions were not reached for Recommendations 4, 5, and 8 because MCC did not agree with the OIG's recommendations. Furthermore, MCC should provide further evidence to support its statement and establish a timeframe of when it will resolve the issues.

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

Sincerely,

/S/

Alvin A. Brown
Assistant Inspector General/MCC

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

CONTENTS

Summary of Results	1
Background	4
Review Objectives.....	5
Review Findings	6
Did the Millennium Challenge Corporation develop and execute policies and procedures to facilitate a timely and accountable termination of the MCC compact with Madagascar?	6
MCC’s Wind-Up Plan Did Not Adequately Address All Financial Matters.....	7
The Government of Madagascar Owes MCC Funds Paid as VAT Assessments	8
MCA-M Did Not Address VAT for the Sale of Assets	10
Logistical Constraints and Political Instability Prevented MCC from Obtaining Title of MCA-M’s Program Assets	11
MCC’s Guidance Did Not Cover Removal of Sensitive Data	12
MCA-M Did Not Follow All the Procedures to Transfer Program Assets in the Wind-up Plan	14
MCC Did Not Conduct a Thorough Due Diligence of NGOs That Received Project Assets	16
Did the Agriculture Business Investment Project (ABIP), together with the Land Tenure project, yield positive results in a selected area of project activity?	17
Underfunded NGOs Receiving Assets May Not Be Able to Further the Objectives of the ABIP and Land Tenure Projects.....	18
Evaluation of Management Comments	20
Appendix I – Scope and Methodology	23
Appendix II – Management Comments	25

SUMMARY OF RESULTS

On April 15, 2005, Madagascar became the first country to receive a Millennium Challenge Corporation (MCC) compact when MCC and the Republic of Madagascar signed a 4-year, \$110 million agreement. Of the compact amount, MCC allocated \$37.8 million for the Land Tenure Project, \$35.9 million for the Finance Project, and \$17.7 million Agricultural Business Investment Project (ABIP). The remainder of the funding covered administrative costs and monitoring and evaluation. The compact entered into force on July 27, 2005, and was subsequently amended on July 24, 2008, to extend the term from 4 to 5 years. The goal of the compact was to increase outcomes in rural areas of Madagascar by enhancing land security, increasing competition in the financial sector, and increasing investment in farms and other rural businesses (see page 4).

In March 2009, an undemocratic transfer of power occurred in the Republic of Madagascar that included actions taken by members of Madagascar's military in support of an opposition party leader. In response, the U.S. Department of State determined in early April 2009 that the events triggered a provision of U.S. law that prohibits the expenditure of funds appropriated by Congress to finance directly any assistance to the government of a country whose duly elected head of government has been disposed by military coup or decree. MCC applied relevant provisions of the Millennium Challenge Act of 2003, and on May 19, 2009, announced the MCC Board of Directors' decision to authorize the termination of the Madagascar Compact. MCC began to develop the Draft Wind-up Plan, which it began to implement in July 2009 (see page 4).

MCC determined that the compact would officially end August 31, 2009, and that all project wind-up activities, including disposition of project assets, would end December 3, 2009. As of September 2009, MCC had disbursed \$80.8 million to Madagascar. Of that amount, \$13.8 million was disbursed for the Agriculture Business Development Project (ABIP) and \$26.4 million was disbursed for the Land Tenure project. The remaining amount included Finance project expenses, and administrative and closeout activities (see page 4).

The objectives of this review were to determine whether (1) MCC developed and executed policies and procedures to facilitate a timely and accountable termination of the MCC compact with Madagascar; and (2) the ABIP, together with the Land Tenure project, yielded positive outcomes in a selected project activity (see page 5).

The review found that MCC had developed policies and procedures (Draft Wind-up Plan) to facilitate a timely termination of its compact with Madagascar. However, MCC's Draft Wind-up Plan guidance was incomplete and MCA-Madagascar (MCA-M) did not fully execute the existing procedures during closeout. Therefore, MCC did not facilitate an accountable termination of its compact with Madagascar (see page 6).

The review found that MCC did not address the financial requirements for termination in its Draft Wind-up Plan. During an audit conducted by an independent firm in Madagascar, auditors found that there was \$490,000 in MCA-M's account as of September 30, 2009 and MCC did not provide information on when these funds will be expended. As a result, MCC may have lost the opportunity to collect these funds and put them to better use (see page 8).

In addition, the Government of Madagascar (GOM) owed MCC more than \$3.8 million in value-added tax (VAT) assessments. MCC did not follow up on or collect the VAT from the GOM before the program terminated. MCC stated that there was no follow-up because of the strained relations between the new government and the U.S. Government, and it was unlikely that the VAT assessments would be collected (see page 9).

The Draft Wind-up Plan did not include a requirement for determining VAT liability for assets sold to former MCA-M staff and the public. Without a clear procedure for handling VAT, the recipients risk liability for VAT accrued from these asset sales. In addition, not all MCA-M assets were accounted for during the closeout period (see page 10).

Additionally, MCC chose not to obtain title of MCA-M's program assets. Consequently, it did not sell MCA-M's assets through a public auction at the U.S. Embassy in Madagascar. Instead, MCC required MCA-M to sell some of its program assets to its employees and the public. Furthermore, MCC instructed MCA-M to spend the proceeds from the sales instead of transferring them to the U.S. Treasury. If MCC continues this stance of not considering MCA assets as U.S. Government property, and does not use the U.S. Embassy public auction, there may be a risk that MCC will not be able to maximize the return or earnings from the public sales (see page 11).

MCC's Draft Wind-up Plan did not require that MCA-M remove sensitive data from its information technology systems. Without a written procedure that specifies the equipment to be cleaned of sensitive data, definitions of sensitive data, and a process to ensure that data removal is completed, MCC cannot ensure that sensitive data have been completely removed from program assets (see page 12).

MCA-M did not fully follow the asset disposition and inventory procedures from the Draft Wind-up Plan. For example, not all of MCA-M's assets are accounted for or inventoried, and MCA-M did not follow all the disposition procedures from the Draft Wind-up Plan. As a result, there was no accountability for these assets or any assurance that they will be at their locations once the nongovernmental organizations (NGO) begins managing these assets. Furthermore, failure to prepare procedures for compact closeout prior to closing the programs delayed the closeout process in Madagascar and caused unnecessary mistakes (see page 14).

Furthermore, MCA-M did not conduct a thorough due diligence of NGOs that received project assets. MCC guidance requires NGOs to state their legal corporation; however, none were required to provide evidence of legal incorporation within Madagascar. Without such evidence, MCA-M could not ensure that only NGOs that were eligible for or deserving of program assets received them (see page 16).

Finally, the ABIP and Land Tenure projects did not achieve all of their results for the periods through the first 3 months of Year 4, prior to the coup d'état on March 17, 2009. According to its monitoring and evaluation plan and Indicator Tracking Table, MCA-M did not achieve all targets for either the ABIP or Land Tenure projects. The transfer of assets to newly established NGOs may be risky and could result in NGOs not furthering compact objectives (see page 18).

This report includes eight recommendations to MCC's vice president of compact implementation to:

(1) determine the status of and collect the remaining funds in MCA-M's account;

- (2) include in the Guidelines for Program Closure of Millennium Challenge Compacts procedures to address the accrued interest and security deposits in the MCAs' accounts after compact closeout;
- (3) prepare guidance that implements a process to identify and collect VAT payments incorrectly made to compact countries;
- (4) collect the \$3.8 million value-added tax owed by the Government of Madagascar;
- (5) issue guidance clarifying how compacts are to handle VAT as it relates to the sale of assets;
- (6) include specific requirements on handling sensitive data in the next iteration of the Program Closure Guidelines;
- (7) require each MCA to request legal documentation from entities such as NGOs when considering them as recipients of compact property; and
- (8) require each MCA to transfer assets to experienced NGOs in order to ensure sustainability of the programs and proper use of assets (see pages 8, 9, 11, 13, 16 and 19).

Appendix II contains the management comments in their entirety. In its response, MCC agreed with five of the eight recommendations and disagreed with remaining three recommendations in the draft report. Management decisions were made for Recommendations No. 1 and 3, while Recommendations 2, 4, 5, 6, 7, and 8 required further documentation and timeframe before management decisions could be made.

BACKGROUND

On April 15, 2005, Madagascar became the first country to receive a compact when the Millennium Challenge Corporation (MCC) and the Republic of Madagascar signed a 4-year, \$110 million agreement. The compact entered into force on July 27, 2005, and Madagascar received its first disbursement from MCC on the same date. The compact was amended on July 24, 2008, to extend the term from 4 to 5 years. The goals of the compact were to increase incomes in rural areas by enhancing land security, increase competition in the financial sector, and increase investment in farms and other rural businesses. The Government of Madagascar designated the Millennium Challenge Account-Madagascar (MCA-M) as the accountable entity with legal authority to oversee the implementation of the compact programs during the compact period.

Madagascar's compact had three major projects: (1) the \$37.8 million Land Tenure Project, designed to formalize the country's titling and surveying systems, modernize the national land registry, and decentralize services to rural citizens; (2) the \$35.9 million Finance Project, designed to make financial services available to rural areas, improve credit skills, and create a streamlined national payments system to reduce check settlement delays from 45 to 3 days; and (3) the \$17.7 million Agricultural Business Investment Project (ABIP), designed to help farmers and entrepreneurs identify new markets and improve their production and marketing practices. The remainder of the funding covered administrative costs and monitoring and evaluation.

On March 17, 2009, the democratically elected president was overthrown in a military coup d'état. Following the coup, MCC instituted an operational hold on all compact activities in Madagascar, which instructed MCA-M not to sign new contracts, instructed the fiscal agent not to make payments without MCC's approval, and suspended all payments made directly to the Government of Madagascar. On May 19, 2009, the MCC Board of Directors authorized MCC to terminate the compact as of a date that would facilitate the orderly wind-up of the compact, no later than August 31. The MCC Board acted in accordance with Section 611(a)(2) of the Millennium Challenge Act of 2003, as amended, and MCC's Policy on Suspension or Termination of Assistance and/or Eligibility for Assistance, as then in effect. MCC began to develop the Draft Wind-up Plan, and began to implement it in July 2009. MCC also began working with MCA-M to bring the compact projects to a close, secure assets and records, and account for funds. The MCC compact with Madagascar terminated on August 31, 2009, with any residual actions final by December 2009.

As of September 2009, MCC had disbursed \$80.8 million out of \$110 million to Madagascar. Of that amount, \$13.8 million out of \$17.7 million was disbursed for the ABIP and \$26.4 million out of \$37.8 million for the Land Tenure project. The remaining amount included Finance project expenses and administrative and closeout activities.

REVIEW OBJECTIVES

The Office of the Inspector General for the Millennium Challenge Corporation conducted this review as part of its fiscal year 2010 audit plan. The objectives of this review were to answer the following questions:

- Did the Millennium Challenge Corporation develop and execute policies and procedures to facilitate a timely and accountable termination of the MCC compact with Madagascar?
- Did the Agriculture Business Investment Project, together with the Land Tenure project, yield positive results in a selected area of project activity?

REVIEW FINDINGS

Did the Millennium Challenge Corporation develop and execute policies and procedures to facilitate a timely and accountable termination of the MCC compact with Madagascar?

The review found that for the most part, the Millennium Challenge Corporation (MCC) developed policies and procedures to facilitate a timely termination of its compact with Madagascar. The procedures were contained in MCC's Draft Wind-up Plan dated July 17, 2009, and included requirements for the Millennium Challenge Account (MCA) to close out each compact-funded project by August 31, 2009, as well as guidance on the disposal of compact-funded assets. The guidance also included requirements for final reports to MCC and specified how official compact records were to be maintained.

MCC and the Millennium Challenge Account–Madagascar (MCA-M) were successful in several areas of the closeout process. MCA-M completed project closeout on schedule on August 31, 2009, with two contracts pending for termination. In addition, it was able to mitigate risks associated with giving assets to nongovernmental organizations (NGOs) that do not yet have management systems in place by finding umbrella NGOs to support new NGOs in order to pursue the original goals of the compact activities.

However, MCC's Draft Wind-up Plan guidance was incomplete and was not fully executed by MCA-M. Because of the incomplete procedures and the less-than-full execution by MCA-M during the closeout process, MCC did not facilitate an accountable termination of its compact with Madagascar. For example, MCC did not address the financial requirements for termination in its Draft Wind-up Plan. During an audit conducted by an independent firm in Madagascar, auditors found that there was \$490,000 in MCA-M's bank account as of September 30, 2009.

The review also found that the Government of Madagascar (GOM) owed MCC more than \$3.8 million in value-added tax (VAT) assessments. MCC did not have a process in place to follow up on or collect the VAT from the GOM. MCC stated that there was no follow-up because MCC had no legal or diplomatic authority to independently engage with the GOM, and it was unlikely that the VAT assessments would be collected.

The Draft Wind-up Plan also did not include a requirement for determining VAT liability for assets sold to former MCA-M staff and the public. Without a clear procedure for handling VAT, the recipients risk liability for VAT that accrues from these asset sales. The compact agreement precluded the GOM from assessing VAT on compact-funded assets used for program activities.

Additionally, the review found that MCC chose not to transfer title of MCA-M's program assets. Consequently, it did not sell MCA-M's assets through a public auction at the U.S. Embassy in Madagascar, but instead had MCA-M sell off some of its program assets to its employees and the public. Furthermore, MCC instructed MCA-M to spend the sale proceeds instead of transferring them to the U.S. Treasury. MCC explained that the proceeds from the public sales will be used to cover some of the costs for the compact closeout activities.

If MCC continues this stance of not considering the MCA's assets as U.S. Government property and does not use the U.S. Embassy public auction, there may be a risk that MCC will not be able to maximize the return from public sales in the future.

MCC did not include any requirement in the Draft Wind-up Plan that MCA-M must remove sensitive data from its information technology systems. Without a written procedure that specifies the equipment to be cleaned of sensitive data, definitions of sensitive data, and a process to ensure that the data removal is completed, MCC cannot ensure that sensitive data have been completely removed from program assets.

MCA-M did not fully follow the asset disposition and inventory procedures from the Draft Wind-up Plan. For example, not all of MCA-M's assets are accounted for or inventoried, and MCA-M did not follow all the disposition procedures from the Draft Wind-up Plan. As a result, there is no accountability for these assets or any assurance that they will be at their locations once the NGO begins managing these assets.

In addition, MCA-M did not require legal documents from NGOs that would receive its assets. Because these NGOs were not required to provide documentation to show proof that they were incorporated in Madagascar, NGOs that are not legally registered may receive these assets.

These issues are further discussed below.

MCC's Wind-Up Plan Did Not Adequately Address All Financial Matters

According to MCC's Guidelines for Program Closure of Millennium Challenge Compacts issued on September 8, 2009, the total of cash assets remaining in permitted account(s) on the Compact End Date (for MCA-M, it was August 31, 2009) may not exceed \$100,000 or as otherwise agreed. However, during an independent financial audit conducted by an auditing firm in Madagascar, the auditors found that there was \$490,000 in MCA-M's account as of September 2009. This issue occurred because the Wind-Up Plan did not address the cash on hand, bank balances, advances, accrued interest, and security deposits. As a result, MCC may have lost the opportunity to collect these funds and put them to better use.

According to MCC's Guidelines for Program Closure of Millennium Challenge Compacts issued on September 8, 2009, the total of cash assets remaining in permitted account(s) on the Compact End Date (for MCA-M, it was August 31, 2009) may not exceed US\$ 100,000 or as otherwise agreed. The guideline further states that "By 90 days after the Compact End Date, the balance(s) of the permitted account(s) and any petty cash boxes must be zero."

However, during an independent financial audit conducted by an auditing firm in Madagascar, the auditors found that there was \$490,000 in MCA-M's account as of September 30, 2009. In addition, there were outstanding advances, accrued interests, and security deposits that totaled \$75,527, which MCC disbursed and had not claimed as of December 2009. There is no confirmation from MCC regarding when these funds will

either be returned to MCC or the purpose of those funds. When terminating the compact, MCC did not address MCA-M's funds in its local bank account and funds that MCA-M was entitled, such as advances to vendors, accrued interest, and security deposits. Furthermore, MCA-M did not provide the independent auditors of the Fiscal Accountability Statement with any specific documentation that dealt with the method of collecting advances and security deposits or the return of cash and bank balances to the U.S. Treasury.

This issue occurred because the Draft Wind-Up Plan did not address the cash on hand, bank balances, advances, accrued interest, and security deposits. However, as noted above, the newly issued Guidelines for Program Closure of Millennium Challenge Compacts addresses petty cash and bank balances in the MCA's account, but it does not address the accrued interest and security deposits issues that occurred in Madagascar. In addition, although the Draft Wind-Up Plan covered a wide spectrum of processes for assets disposition, it did not address the financial implications of their disposition and wind-up procedures by collaborating with the Department of Administration and Finance who could have provided adequate guidance and better insurance for safeguarding the liquid assets of MCC in a timely manner. As a result, MCC may have lost the opportunity to collect these funds and put them to better use.

For this reason, this review makes the following recommendation.

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation determine the status of and collect the remaining funds in MCA-Madagascar's bank account.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation include in the Guidelines for Program Closure of Millennium Challenge Compacts procedures to address the advances, accrued interest, and security deposits in the MCAs' accounts after compact closeout.

The Government of Madagascar Owes MCC Funds Paid as VAT Assessments

The MCC compact with Madagascar states: "If a Tax has been levied and paid contrary to the requirements of this Section 2. 3(e), the Government shall refund promptly to MCC to an account designated by MCC or to others as MCC may direct the amount of such Tax in the currency of Madagascar." However, the Government of Madagascar (GOM) owed more than \$3.8 million in VAT assessed on contractors receiving compact funds. MCC has not pursued the matter with the new GOM, stating that it was unlikely that the amounts could be recovered. Without such guidance (Draft Wind-up Plan), MCC cannot ensure that payments owed by compact countries are recouped.

According to the MCC compact with Madagascar, "If a Tax has been levied and paid contrary to the requirements of this Section 2. 3(e), the Government shall refund promptly to MCC to an account designated by MCC or to others as MCC may direct the amount of such Tax in the currency of Madagascar, within fifteen (15) days after the Government is

notified, whether by MCC or otherwise, of such levy and tax payment; provided, however the Government shall apply national funds to satisfy its obligations under this Section 2.3(e)(iv) and no MCC Funding, Accrued Interest, or any assets goods, or property (real, tangible, or intangible) purchased or financed in whole or in part (directly or indirectly) by MCC Funding Program Assets may be applied by the Government in satisfaction of its obligations under this Section 2. 3(e)(iv).”

The GOM owed more than \$3.8 million in VAT assessed on contractors receiving compact funds. The GOM was precluded from assessing VAT on funding or assets procured with compact funds. However, Section 3 of MCA-M’s Fiscal Agent Report for the period September 2009 reported that VAT totaling more than \$3.8 million was due from the GOM. Further, MCC’s Compilation Completion Report¹ April 2005—August 2009 reported that the VAT reimbursement system was inefficient and that “MCC left it to the Government of Madagascar’s Tax Code to regulate the tax transactions during the Compact execution.” The report also stated that a simplified refund system could have been set up through an agreement between MCC and the GOM.

MCC has not pursued the matter with the new GOM, stating that it had no legal or diplomatic authority to engage with the new government and that it was unlikely that the amounts could be recovered. Furthermore, MCC does not have guidance to follow when compact governments do not refund owned VAT. Without such guidance, MCC cannot ensure that payments owed by compact countries are recouped.

For this reason, this review makes the following recommendation.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation’s Vice President for Compact Implementation prepare guidance that implements a process to identify and collect value-added tax payments improperly made to compact countries.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation’s Vice President for Compact Implementation collect the \$3.8 million value-added tax owed by the Government of Madagascar.

¹According to report section I. Introduction, the report summarized MCA-M achievements and impacts, sustainability plans for the remaining activities, and the future outcomes of the beneficiaries.

MCA-M Did Not Address VAT for the Sale of Assets

According to Section 2.3(e)(i)(1) to (4) of the Compact Agreement between MCC and Government of Madagascar (GOM), “The Government shall ensure that the Program, any Program Assets....shall be free from any taxes imposed under laws currently or hereafter in the Republic of Madagascar during the Compact Term.” However, the initial Draft Wind-up Plan provided to MCA-M did not include a discussion on value-added tax (VAT) that may have accrued from asset sales. The draft plan, dated July 17, 2009, focused on terminating program activities, payment of contractors, and disposing of the compact’s assets. The compact agreement did not address the sale of compact assets or the responsibility (if any) of the recipients of the assets for the VAT. MCA-M and MCC had several discussions on the VAT issue and decided that they were “neither a collector, nor assessor” of GOM taxes. In the absence of a clarified procedure for handling VAT issues, the asset recipient could be declared liable for the taxes to the GOM. MCC’s Office of Legal Counsel staff stated that clearly there is a liability for the VAT, but it will not be MCC’s liability.

The GOM had not assessed VAT on any of the assets purchased with compact funds in accordance with the Compact Agreement, Section 2.3(e)(i)(1) to (4), which states: (e) Taxation. “The Government shall ensure that the Program, any Program Assets....shall be free from any taxes imposed under laws currently or hereafter in the Republic of Madagascar during the Compact Term.” Section 2.3(e)(4) states that “taxes or duties levied on the purchase of goods or services financed by MCC Funding, including sales taxes, tourism taxes, value-added taxes (VAT) or other similar charges.”

The initial Draft Wind-up Plan provided to MCA-M did not discuss VAT that may have accrued from sales of some compact assets. The draft plan, dated July 17, 2009, focused on terminating program activities, paying contractors, and disposing of the compact's 18,000 assets. As part of the asset disposition, MCA decided to transfer the majority of assets to selected NGOs working in Madagascar, and to sell other assets such as cameras, computers, and other office equipment, as well as cell phones, to its staff. Remaining assets, including vehicles, were to be offered to the public or donated to NGOs. According to MCA, its staff purchased items that they were originally assigned and used while employed by MCA.

However, the compact agreement did not address the sale of compact assets or the responsibility, if any, of the recipients of the assets for the VAT. MCA and MCC had several discussions on the VAT issue and decided that they were “neither a collector, nor assessor” of GOM taxes and proceeded with the asset sales. Owing to the political situation in the country, the review team could not contact the relevant Malagasy government officials²; however, NGOs that received MCA assets stated that the GOM prohibited them from selling program assets within Madagascar. Further, MCC stated that there is a liability for the VAT, but it will not be MCC’s liability.

² According to the MCC, the U.S. Ambassador requested that the team refrain from visiting or interviewing officials or staff of the new government due to the strained relations caused by the coup d'état and termination of the compact.

Given the strained relationship between the new government and the U.S. Government, MCC should have included guidance on the issue and informed recipients of its asset sales of the potential liability to the GOM for the VAT. In the absence of a clarified procedure for handling VAT issues, disposing of future assets under such circumstances could be problematic. For this reason, this review makes the following recommendation.

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's Vice President of the Compact Implementation Department issue guidance clarifying how compacts address value-added tax as it relates to the sale of assets during early terminations.

Logistical Constraints and Political Instability Prevented MCC from Obtaining Title of MCA-M's Program Assets

Section 5.4(g) of the MCC compact with Madagascar states that upon the full or partial suspension or termination of this compact or any MCC Funding, MCC may, at its expense, direct that title to program assets be transferred to MCC. MCC chose not to transfer title of MCA-M's program assets, but instead allowed MCA-M to sell program assets to its employees and the public and use the proceeds for closeout expenses. MCC did not transfer the title of MCA-M's program assets because of the logistical constraints and political instability in Madagascar. As a result, the U.S. Embassy refused to sponsor the sale of MCA-M's assets, and MCA-M was then left with the option to sell some of the items to MCA-M employees. If MCC continues this stance of not considering the MCA's assets as U.S. Government property, and does not use the U.S. Embassy public auction, there may be a risk that MCC will not be able to maximize the return or earnings from public sales.

Compact section 5.4(e)(ii), as amended, states that compact funds may be used following suspension or termination to pay "reasonable expenditures (including administrative expenses) properly incurred in connection with the winding up of the Program." These types of payments are to be made only for appropriate expenditures incurred within 120 days after termination. In addition, the Draft Wind-up Plan stated that one option to dispose the MCA-M assets is to include them in the semiannual public sale sponsored by the U.S. Embassy. Section 5.4(g) of the original compact states that "Upon the full or partial suspension or termination of this Compact or any MCC Funding, MCC may, at its expense, direct that title to Program Assets be transferred to MCC if such Program Assets are in a deliverable state; provided for any Program Asset(s) partially purchased or financed (directly or indirectly) by MCC Funding, the Government shall reimburse to a U.S. Government account designated by MCC the cash equivalent of the portion of the value of such Program Asset(s)."

MCC chose not to transfer title of MCA-M's program assets, and did not sell them through a public auction at the U.S. Embassy in Madagascar, but instead had MCA-M sell some of its program assets to its employees and the public. Furthermore, MCC instructed MCA-M to spend the proceeds from the sales instead of transferring them to the U.S.

Treasury. MCC explained that the proceeds from the public sales will be used to cover some of the costs for the compact closeout activities.

MCC did not transfer the title of MCA-M's program assets because of the logistical constraints and political instability in Madagascar. MCC officials explained that Madagascar's distance from other compact countries prevented MCC from shipping program assets. In addition, owing to the schedule to terminate the projects and closure of both MCA-M and the MCC mission, there would not have been any MCC staff in Madagascar to ensure that MCC-owned assets were properly disposed. Furthermore, MCC could claim the title of the assets only by negotiating with the new Malagasy government. Because the State Department prevented any communication with the new government, MCC could not work with the government to transfer the title of MCA-M's assets. MCC also explained that since the assets were titled with MCA-M, it was considered more efficient for MCA-M to use the proceeds from the public sales to cover closeout expenses than for MCC to use the compact funds to pay for the expenses.

If MCC continues this stance of not considering the MCA's assets as U.S. Government property, and does not use the U.S. Embassy public auction, there may be a risk that MCC will not be able to maximize the return or earnings from the public sales. Furthermore, allowing MCAs to conduct public sales could result in mismanagement of items and U.S. Government funds.

The OIG is not making a recommendation related to this finding because MCC used the best available options when deciding not to transfer the title of the assets to its name.

MCC's Guidance Did Not Cover Removal of Sensitive Data

The U.S. Department of Commerce's National Institute of Standards and Technology (NIST) has recommended security controls for Federal information systems. NIST Special Publication 800-53, Revision 2, page F-49, states that controls over data sanitization should include sanitizing of digital and non-digital information system media prior to disposal or release for reuse. The initial Draft Wind-up Plan provided to MCA-M did not discuss removal of sensitive data from disposed assets. The draft guidance focused on terminating program activities, paying contractors, and disposing of the compact's assets. MCC did not include a requirement that MCA-M remove sensitive data from its information technology systems. Further, in light of the immediacy of the termination and the short timeframe to close out the program, MCA-M did not have the staff resources to ensure that the process was complete. However, without a written procedure that specifies the equipment to be cleaned of sensitive data, definitions of sensitive data, and a process to ensure that the data removal is completed, MCC cannot ensure that sensitive data have been completely removed from program assets, such as computers, cell and land phones, and other designated assets.

The National Institute of Standards and Technology (NIST) has recommended security controls for Federal information systems. NIST Special Publication 800-53, Revision 2, page F-49, states that controls over data sanitization should include sanitizing of digital and non-digital information system media prior to disposal or release for reuse.

Sanitization is the process of removing information from information system media in order to provide reasonable assurance, in proportion to the confidentiality of the information, that the information cannot be retrieved or reconstructed. Sanitization techniques, including clearing, purging, and destroying media information, prevent the disclosure of organizational information to unauthorized individuals when such media are reused or disposed.

The Draft Wind-up Plan provided to MCA-M did not discuss removal of sensitive data from disposed assets. The draft plan focused on terminating program activities, paying contractors, and disposing of the compact's assets. As part of the asset disposition, MCA decided to transfer the majority of assets to select NGOs working in Madagascar, and to sell other assets such as cameras, computers, and other office equipment, as well as cell phones, to its staff. Remaining assets, including vehicles, were to be offered to the public or donated to NGOs.

Although MCA-M staff stated that all computers had been cleaned of sensitive information, and the computer specialist acknowledged that he was clearing all computers of sensitive data, the requirement was not in MCC's guidance. The MCC director stated that he had personally checked a couple of computers that had sensitive data removed. In light of the immediacy of the termination and the short timeframe to close out the program, MCA-M did not have the staff resources to ensure that the process was complete. However, without a written procedure that specifies the equipment to be cleaned of sensitive data, definitions of sensitive data, and a process to ensure that the data removal is completed, MCC cannot ensure that sensitive data have been completely removed from program assets such as computers, cell and land phones, and other designated assets. Such data could include telephone numbers, pictures, e-mails, names and addresses, documents, and other information deemed sensitive. For future terminations and closeouts, MCC should include guidance that determines what constitutes sensitive data and what steps should be taken to desensitize designated assets.

For this reason, this review makes the following recommendation.

Recommendation No. 6: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation include specific requirements on removing sensitive data in the next iteration of the Program Closure Guidelines.

MCA-M Did Not Follow All the Procedures to Transfer Program Assets in the Draft Wind-up Plan

The Draft Wind-up Plan required MCA-M to inventory all program assets and determine how to dispose of them. In addition, the draft plan required MCA-M to identify all program assets and request MCC's approval of the disposal plan. However, MCA-M did not follow these procedures from the Draft Wind-up Plan. For example, not all of MCA-M's assets were accounted for or inventoried, and MCA-M did not follow all the disposition procedures from the Draft Wind-up Plan. MCA-M stated that because of security concerns, it could not inventory all of the motorcycles located in each land tenure office. Furthermore, MCA-M explained that MCC did not provide any guidance early in the closeout process. Because MCA-M did not inventory all of the program assets, there was no accountability for the assets. Furthermore, failure to prepare procedures for compact closeout, prior to closing the programs, delayed the closeout process in Madagascar and caused unnecessary mistakes.

The Draft Wind-up Plan required MCA-M to inventory all program assets and determine how to dispose of them. In addition, the draft plan required MCA-M to identify all program assets and request MCC's approval of the plan for their disposal. In preparing its Program Asset disposition proposal, MCA-Madagascar should use the following criteria as part of its evaluation of the appropriate method of disposition:

- The value of the Program Asset;
- The nature of the entity (if any) to which the Program Asset is proposed to be transferred;
- The potential use of the Program Asset for wind-up activities;
- The practicality of the proposed disposition;
- The risk of personal or asset safety in retrieving an asset for further disposition; and
- The ability to use the Program Asset to perpetuate the Compact objectives (without further MCC support or funding).

However, MCA-M did not follow these procedures from the Draft Wind-up Plan. Not all of MCA-M's assets are accounted for or inventoried. For example, an NGO managing the assets for the Land Tenure project did not conduct an inventory of all the assets it will manage from MCA-M. In addition to managing the assets of the land administration offices, this NGO will receive motorcycles from 235 local Land Tenure offices, which have not been inventoried. According to MCA records, the motorcycles have a net asset value of approximately \$144,000. In addition, MCA-M lost a total of \$102,000 (net asset value) out of \$6.6 million of several items, ranging from 19 laser printers to a motorcycle. Table 1 provides information on the disposition of MCA-M program assets.

Table 1. Compact Asset Disposition Results

Compact Assets	Net Asset Value
Discarded	\$12,705.00
Donated	\$67,377.00
Lost/No Information	\$102,058.00
Nontransferable	\$3,258,590.00
Sold	\$307,981.00
Transferred	\$2,912,633.00
Total	\$6,661,342.00

Furthermore, MCA-M did not follow all the disposition procedures in the Draft Wind-up Plan when disposing program assets. In particular, it did not:

1. Evaluate the ability of NGOs to use the program asset to perpetuate the compact objectives without further MCC support or funding. The two NGOs selected for review had inadequate explanations of how compact assets would be used to continue the goals of the terminated compact.
2. Include a basic needs justification in its disposition proposal for each entity that MCA-M proposed to donate program assets.
3. Provide MCC with a comprehensive list of all program assets, including asset description, assigned project/activity, physical location, purchase cost, date of acquisition, current value, and other relevant data required by MCC. Damaged or lost assets are to be documented separately. The list that was provided with an NGO's proposal had no values assigned to the assets designated for transfer.

Although all of the NGOs submitted the proposals, some proposals did not contain the required information. For example, one NGO provided a description of its capabilities to assist farmers in the countryside but did not specify what compact activities the assets would be used for as required by the selection criteria. In another example, the asset listing did not specify the value of the assets being transferred.

MCA-M stated that because of security reasons, it could not inventory all of the motorcycles located in each land tenure office. To explain why it did not follow all of the disposition procedures, MCA-M explained that, MCC did not provide any guidance early on in the closeout process. As a result, some decisions were made without input from MCC. Initial guidance was issued as a draft on July 17, 2009, and MCC did not have a formal closeout plan prior to compact termination. However, when MCC later provided sufficient guidance, the closeout process continued more efficiently.

Because MCA-M did not inventory all of the program assets, there was no accountability for these assets or any assurance that they will be at their locations once the NGO begins managing these assets. Furthermore, failure to prepare procedures for compact closeout prior to closing the programs delayed the closeout process in Madagascar and caused unnecessary mistakes. For example, several items were lost or discovered missing during inventory.

OIG is not making a recommendation for this finding because MCA-M no longer manages compact activities and MCC has now developed compact closeout guidance.

MCC Did Not Conduct a Thorough Due Diligence of NGOs That Received Project Assets

The NGO Selection Form that MCA-M completed for recipient NGOs requires NGOs to state their legal incorporation, ownership of recipient organization, and date of establishment. However, with the exception of the Land Tenure NGO, MCC did not require NGOs to provide legal documentation or certificate of their incorporation status in Madagascar. MCC did not request the documentation confirming the legal incorporation of these NGOs because they are entities with which MCA-M had worked in the past and MCA-M was under a time constraint. As a result, there may be a risk that NGOs could state that they are registered entities when they are not. If MCA does not complete thorough due diligence, NGOs that are not eligible for the assets may receive them, which could increase the risk that the NGOs will not further the objective of the compact.

The NGO Selection Form, which MCC developed to allow recipient NGOs to receive MCA-M assets, requires NGOs to state their legal incorporation, ownership of recipient organization, and date of establishment. However, with the exception of the Land Tenure NGO, MCC did not require these organizations to provide legal certification or documentation of their legal status as NGOs in Madagascar. In addition, although some of the NGOs will receive some information technology systems, the form did not require the NGOs to provide any information in their proposals to explain the information technology systems they have in their organization in order to determine whether the items they receive from MCA-M are compatible with what they already use.

MCC did not request the legal incorporation documentation of these NGOs because they are entities with which MCC had worked in the past. Although MCC has worked with some of these NGOs before, it did not have these legal documents. In addition, MCC was under time constraints to close the programs and dispose of its assets. MCC stated that in a normal closeout—where the compact ends as scheduled—a transfer of assets would not occur because typically, the assets would be transferred to implementing entities or other government entities, or to NGOs as previewed during project design.

If MCA does not complete thorough due diligence, NGOs that are not eligible for the assets may receive them, which could increase the risk that the NGOs will not further the objective of the compact. These NGOs could simply state that they are registered in the country without providing a legal document, thereby circumventing controls put into place to ensure that only registered entities would benefit from the compact assets.

For this reason, the review makes the following recommendation.

Recommendation No. 7: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation revise the non governmental Organizations Selection Form to include a requirement that each Millennium Challenge Account request legal documentation when considering nongovernmental Organizations as recipients of compact property for future project closeouts.

Did the Agriculture Business Investment Project (ABIP), together with the Land Tenure project, yield positive results in a selected area of project activity?

Although the Agricultural Business Investment (ABIP) and Land Tenure project yielded positive results in selected areas of project activity, the ABIP and Land Tenure projects did not achieve all of their results for the periods—Year 3 and first 3 months of Year 4—prior to the coup d'état on March 17, 2009. The coup d'état in Madagascar occurred 18 months before the completion of its compact. Although MCA-M continued to implement some projects, complete termination occurred in May 2009. As of September 2009, MCC had disbursed \$80.8 million of the compact amount of \$110 million to Madagascar. Of that amount, \$13.8 million out of \$17.7 million was disbursed for the ABIP and \$26.4 million out of \$37.8 million for the Land Tenure project.

The review team met with eight ABIP beneficiaries and four Land Tenure project beneficiaries in the Vakinankaratra region of Madagascar. Because the ABIP farmers used the skills they were taught, they explained that their income increased and livelihood has improved. Each farmer explained that the crop yields have increased and they were able to sell more products to the market.

In addition, MCC has ensured that the Land Tenure project continues even after compact termination. The local Land Tenure offices remain open and are issuing land certificates to applicants. Furthermore, beneficiaries from the Land Tenure project explained that their land certificates enabled them to prove that their land belonged to them. Before the MCA program, the beneficiaries experienced several land issues in terms of inheritance and land disputes. Receiving their land certificates helped them to resolve these conflicts and prevent new problems.



A local Land Tenure office in the Vakinankaratra region. Source: OIG/MCC, October 2009

However, according to MCA-M's monitoring and evaluation plan and Indicator Tracking Table (ITT), it did not achieve all of the targets for either the ABIP or Land Tenure projects when comparing the output and outcome indicators. For example, although it met the indicator—number of farmers receiving technical assistance (2 percent below the target, which is within our 10 percent material threshold limit)—most of the farmers who received technical assistance did not use the skills they learned. The ITT states that fewer than 35 percent of the farmers who represented the target of 6,821 employed the skills that they learned.

The Land Tenure project yielded the same results; seven of its indicators with targets were 13 percent or more below the target. This represented more than half of the indicators that had targets for Year 3 of the compact. However, MCC explained that it expected not to achieve the targets during Year 3 and moved to extend MCA-M's compact for a fifth year. In addition, it explained that Year 3 targets were not as important, and it focused on achieving targets in Years 4 and 5. It stated that it planned to increase implementation during the last 2 years because delays with procurement and contractors affected implementation in Year 3. However, the political situation in the country prevented it from achieving the targets during the last 2 years.

In addition, 25 percent of the ABIP NGOs and the only Land Tenure NGO that will receive assets from MCA-M are newly established. This may prevent the programs from furthering the compact objectives because NGOs did not have sources of funding. Although MCA-M did not achieve all of its targets during Year 3, the beneficiaries who received assistance from the ABIP and Land Tenure projects reported positive results.

Underfunded NGOs Receiving Assets May Not Be Able to Further the Objectives of the ABIP and Land Tenure Projects

According to the Draft Wind-up Plan, program assets may be transferred to an eligible entity in order to further compact objectives. MCC approved the transfer of MCA-M's assets to new NGOs that may not have a revenue base to continue the project implementation. Of the ABIP NGOs that will receive assets, 25 percent are new, and some did not have a revenue base. The NGO asset recipient for the Land Tenure project was also newly established. To explain this issue, MCC stated that for new NGOs, oversight is being provided by larger established NGOs or a relationship with an existing entity that has strong financial management experience. However, the oversight from established NGOs will not cover the expenses that new NGOs need to implement their programs. If assets are given to NGOs so new that they do not have a revenue base, there is an increased risk that the NGOs may not survive or sustain their programs.

According to the Draft Wind-up Plan, MCC expects that, in some cases, program assets will be donated to program beneficiaries, other donors, NGOs, or private entities in order to further the compact objectives, although without additional MCC funding or support. In other cases, program assets may be transferred to an eligible entity. In addition, certain special categories of program assets may be transferred to an eligible entity to preserve and manage the assets for a defined period after the compact termination date.

MCC approved the transfer of MCA-M's assets to NGOs that were new and did not have a revenue base to continue the project implementation. Of the ABIP NGOs that will receive assets, 25 percent are new and did not have a revenue base. In addition, one NGO asset recipient for the Land Tenure project was newly established and looking for funding prior to the closure of MCA-M. MCA-M and MCC officials explained that prior to the review team's arrival, the NGO's director mentioned that she tried to secure funding

from European donors. A new NGO that the team visited in the Vakinankaratra region explained that it was created as a result of the compact objective for ABIP, which was to make Agricultural Business Centers (ABC) sustainable. Since beneficiaries knew that MCA-M was going to terminate the program, they wanted the project to continue. However, at the time the review team was there, the NGO did not have funding and was looking for donors. Furthermore, employees were using their personal funds to operate the NGO.

To explain this issue, MCC stated that for new NGOs, oversight is being provided by larger established NGOs such as the Cooperative for Assistance and Relief Everywhere (CARE) or a relationship with an existing entity that has strong financial management experience. Certainly, the future of both new and established NGOs in Madagascar depends on the return of political stability to the country. However, oversight from established NGOs will not cover the expenses that the new NGOs will face when running programs. For example, an established NGO explained that although it will provide oversight to three new NGOs, it will not cover the cost of administrative fees for the assets they will receive. One such administrative requirement is to pay for titling of the cars that they receive, as well as to repair the cars.

MCA-M put some mechanisms in place to mitigate the risk of NGOs misusing the assets. For example, NGOs that did not meet all the required criteria—currently working on MCA-M activities, having a property management system in place, and being a registered NGO in Madagascar—had their assets transferred to an umbrella NGO. The umbrella NGO would transfer the assets to the NGO recipient after 1 year. However, these mechanisms do not take into consideration that because the new NGOs do not have a revenue base, they may not be able to use the assets as intended.

One of the goals for MCC and MCA-M was to further the compact program objectives by transferring assets to NGOs implementing comparable projects. However, if assets are given to NGOs so new that they do not have a revenue base, the NGOs may be unlikely to survive or sustain the programs. Furthermore, the new NGOs may resort to selling their assets in order to pay their staff.

For this reason, this review makes the following recommendation.

Recommendation No. 8: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation, when considering compact termination in the future, establish procedures to require that each Millennium Challenge Account transfer assets only to nongovernmental organizations that have the funding and human capital capacity to continue the compact objectives.

EVALUATION OF MANAGEMENT COMMENTS

MCC provided written comments to our draft report that are included in their entirety in Appendix II. In its response, MCC agreed with five of the eight recommendations and disagreed with remaining three recommendations in the draft report. In addition, MCC stated that it plans to take into consideration the OIG's recommendations as it prepares to revise its Guidelines for Program Closure of Millennium Challenge Compacts, which was first published in September 2009.

MCC disagreed with the OIG's overall conclusion that MCC did not facilitate an accountable termination of its compact with Madagascar and expressed its concerns that the report did not take into consideration the context and timeline in which it terminated the compact in Madagascar. However, the OIG mentioned the political instability in Madagascar on pages 1—Summary of Results—and 4—Background—of the report, which prompted the termination of the compact. The OIG also recognized the issue of political instability as one of MCC's most serious management and performance challenges for fiscal year 2009³. In addition, the OIG agreed with MCC's statement that it worked diligently to terminate the compact; however, its reference to Table 1 of the report, which refers to 1.5 percent of assets lost or unaccounted for, were not the only unaccounted assets (see page 14). This was not intended to represent the only loss of assets. This was merely the information provided to the OIG at the time of the review. There may have been additional loss that did not come to our attention during the audit. In addition, the OIG used this table to illustrate the consequences of not following the Draft Wind-up Plan.

MCC provided the following comments to the recommendations:

In response to Recommendation No. 1, MCC agrees with the recommendation and mentions that it has determined the status of and collected the remaining funds in MCA-Madagascar's bank account. It explained that the cash available as of September 30, 2009 (\$490,000) was used to pay final allowable administrative wind-up expenses prior to the closure in November 2009. The remaining funds of \$27,339.29 were remitted by MCA-Madagascar's bank on November 26, 2009 and deposited into the U.S. Department of Treasury on December 10, 2009. The OIG considers that MCC has made a management decision, but final action will not be reached until MCC provides us documentation for the allowable wind-up expenses and the funds that were remitted into the U.S. Treasury.

MCC agrees with Recommendation No. 2 and states that it will include specific language regarding procedures to address advances, accrued interest, and security deposits when the Guidelines are revised. It explains that the Guidelines already establish basic procedural guidance for cash and cash equivalent assets, including accrued interest. The OIG considers that MCC has not met a management decision and final action until MCC

³ Excerpt from *Statement by the Office of Inspector General on the Millennium Challenge Corporation's Most Serious Management Performance Challenges in Fiscal Year 2009* issued in November 2009.

provides a timeframe in which it would revise the Guidelines to include addressing advances, accrued interest, and security deposits.

In response to Recommendation No. 3, MCC agrees, and has already developed mechanisms in every partner country that receives MCC assistance. It explains that these methods are designed to ensure that assistance is delivered free of not only value-added, but of all taxes, customs duties, and any other similar charges. MCC developed the specific mechanisms on a country-by-country basis following due diligence into a particular country's system of taxes. Furthermore, MCC, MCA-Madagascar, and the Government of Madagascar (prior to the coup) established a process at the beginning of compact implementation by which the Government will reimburse value-added taxes. During the compact and prior to the coup, the Government followed the process and when it fell behind on its reimbursement obligations, MCC withheld further compact reimbursement obligations. However, MCC lost its leverage to withhold compact disbursements following compact termination. The OIG considers that MCC has made a management decision, but final action will not be reached until MCC provides the mechanisms it has developed to ensure that assistance is delivered free of not only value-added, but of all taxes, customs duties, and any other similar charges.

MCC disagrees with Recommendation No. 4 because value-added taxes were paid by contractors and not MCA-Madagascar, who received the invoices. As a result, the Government of Madagascar is not legally required to reimburse MCC, nor is collection by MCC appropriate, since the reimbursements are owed to contractors. Furthermore, MCC stated that it has no diplomatic or other authority to independently engage with the post-coup Government of Madagascar. Therefore, MCC lacks the ability to compel the Government to reimburse the value-added tax receipts owed to the contractors who performed work for MCA-Madagascar. Although the OIG agrees that MCC has no diplomatic authority to engage with the post-coup Government, it does not agree that the Government of Madagascar owes the contractors the reimbursement of the value-added taxes because the contractors receive payments from the compact funds—paid to them by MCA-Madagascar. While the OIG has not conducted a full audit of the invoices, our experience has shown that the contractors cannot sustain such an expense without receiving the full payment from their invoices. For this reason, no management decision or final action were reached and the OIG requests that MCC provides evidence that value-added taxes were not included in payments to the contractors.

MCC also disagrees with Recommendation No. 5 and refers to the Millennium Challenge Act of 2003 (the "Act"), as amended (§ 609(c)), and as reflected in the terms of the Madagascar compact (§ 2.3(e)), states that transactions involving "program assets" are to be free from taxes. It explains that when program assets were sold as part of compact termination in Madagascar, they were converted through that sale to a non-compact program use. MCC's interpretation of the statute and the compact is that the assets thereby lost their character as program assets. As such, the favorable tax treatment mandated by the Act and the compact no longer applied to transactions involving those assets. MCC also stated that it would be inappropriate for MCC to issue any guidance on the treatment of taxes that may be assessed on transactions involving assets other than program assets. A management decision and final action will not be made on this recommendation until MCC provides the OIG with support of its interpretation of the MCA Act section 609(c).

In response to Recommendation No. 6, MCC agrees with the recommendation and will include requirements on removing sensitive data in the Guidelines when they are revised. It further states that while the revised Guidelines should include specific guidance on removing sensitive data, MCC does not believe there was a major risk in Madagascar because MCA-Madagascar followed the procedures and MCC reviewed its work. The OIG agrees with the action that MCC has proposed to resolve this recommendation. However, management decision and final action will not be made on this recommendation until MCC provides the OIG with a timeframe in which it will revise its Guidelines to include the removal of sensitive data.

MCC agrees with Recommendation No. 7 and states that it will consider requiring each MCA to request legal documentation when considering NGOs as recipients of compact property for future project closeouts when the Guidelines are revised. A management decision and final action will not be made on this recommendation until MCC provides a clear timeframe as to when it will revise the Guidelines to include the requirement that each MCA request legal documentation when considering NGOs as recipients of compact property for future project closeouts.

In response to Recommendation No. 8, MCC disagrees with the recommendation because it states that it must retain flexibility to review constraints posed by the termination and the situation on the ground in order to determine the best asset disposition plan. MCC explained that it developed procedures tailored for MCA-Madagascar that allowed it to have first-hand knowledge of the nongovernmental organizations' (NGOs) capacity and evaluate their potential for sustained efforts to reach the compact objectives. However, during the audit, the OIG found that some of the organizations did not have adequate funding at that time to fully function and achieve the compact objectives for their particular projects. In addition, MCC mentions that one of the nongovernmental organizations, Ezaka ho Fampandrosoana ny Ambanivohitra (EFA), the newly created land nongovernmental organization, has been able to negotiate several contracts and secure funding for at least two years of operation. However, there are other newly developed NGOs, particularly those in the ABIP project, which did not have as much resources as EFA to generate revenue after receiving the assets from MCA-Madagascar. Management decision and final action will not be reached on this recommendation until MCC establishes procedures to require that each Millennium Challenge Account transfers assets only to nongovernmental organizations that have the funding and human capital capacity to continue the compact objectives.

SCOPE AND METHODOLOGY

Scope

The Office of the Inspector General conducted a review, versus an audit, of the Millennium Challenge Corporation (MCC). Hence, it was not done in accordance with generally accepted Government auditing standards. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objective(s). The team reviewed selected MCC procedures used to terminate the compact and determine if the Land Tenure and Agricultural Business Investment Project (ABIP) had positive outcomes when the compact was terminated. As of September 2009, MCC had disbursed \$80.8 to Madagascar. Of that amount, \$13.8 out of \$17.7 million was disbursed for the ABIP and \$26.4 out of \$37.8 million for the Land Tenure project.

The review was conducted in Washington, DC, and in Madagascar during the team's site visit in October 2009. In addition, the team visited Millennium Challenge Account-Madagascar (MCA-M) offices and beneficiaries in or near the cities of Antananarivo and Antsirabe. Auditors also met with and interviewed MCA-M's procurement agent, Gesellschaft fur Technische Zusammenarbeit, and MCA-M's fiscal agent, Business Intelligence Systems GmbH.

To reach its conclusions, the team conducted an review of selected actionable procedures that both MCC and MCA-M were required to complete by August 31, 2009. The review team interviewed MCC staff, MCA-M personnel, beneficiaries, and implementing partners. The review team also reviewed and analyzed records and reports provided by MCC and MCA-M.

The team was unable to contact or interview any Government of Madagascar officials involved in compact activities. According to the MCC Resident Country Director, the U.S. Ambassador had requested that the team refrain from visiting or interviewing officials or staff of the new government due to the strained relations caused by the coup d'état and termination of the compact.

Methodology

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

- Whether MCC developed and executed policies and procedures to facilitate a timely and accountable termination of the MCC compact with Madagascar; and
- Whether the ABIP, together with the Land Tenure project, yielded positive outcomes in a selected area of project activity.

Specifically, the review team did the following:

- Interviewed applicable MCC and MCA-M staff involved in the compact termination and the ABIP and Land Tenure projects;

- Tested selected actionable procedures—as stated in the Draft Wind-up Plan—that MCC and MCA-M were required to complete;
- Reviewed relevant documents, interviewed relevant individuals, and conducted site visits to one of the intervention zones within Madagascar;
- Determined the outcome of not achieving the planned results for the ABIP and Land Tenure project by the target dates; and
- Applied a standard materiality threshold of 10 percent for reporting purposes.

MANAGEMENT COMMENTS



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Daniel W. Yohannes
Chief Executive Officer

March 25, 2010

Mr. Alvin Brown
Assistant Inspector General
Office of Inspector General
U.S. Agency for International Development
1401 H Street NW, Suite 770
Washington D.C. 20005

Dear Mr. Brown:

The Millennium Challenge Corporation (MCC) appreciates the opportunity to respond to the Office of Inspector General's (OIG) draft report entitled "Review of the Termination of the Millennium Challenge Corporation Compact with Madagascar." (Report No. M-000-10-00X-P) As noted in our responses set out below, MCC plans to take into consideration the OIG recommendations as we prepare revisions to our Guidelines for Program Closure of Millennium Challenge Compacts (the Guidelines), first published in September 2009.

MCC disagrees, however, with the OIG's overall conclusion that "MCC did not facilitate an accountable termination of its compact with Madagascar." In particular, I am disappointed that the report does not take sufficient account of the context and timeline under which this program closeout occurred. It is well documented that MCC's decision to terminate the Madagascar compact during the fourth year of implementation was based on an undemocratic transfer of power supported by factions within Madagascar's military—actions the U.S. Department of State subsequently determined amounted to a coup d'état. This determination placed profound limitations on MCC's abilities to closeout its assistance program in Madagascar, both in terms of process (MCC was prohibited from communicating with or otherwise engaging any level of government in Madagascar) and timing (the State Department's determination mandated closeout be completed within eight months).

Despite unique and onerous conditions, MCC worked diligently to ensure that the compact was terminated in a manner that prioritized public safety and security, protected

assets that were purchased with U.S. taxpayer funds, mitigated environmental risks, and ensured sustainable continuation of compact activities to the extent possible. For example, as shown in Table 1 of the OIG report, only 1.5 percent (or \$102,058) of the assets were lost or unaccounted for, which MCC considers strong performance given the circumstances.

MCC's specific responses to the eight recommendations in the report are detailed below.

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation determine the status of and collect the remaining funds in MCA-Madagascar's bank account.

MCC Management Response: We agree with this recommendation. MCC has determined the status of and collected the remaining funds in MCA-Madagascar's bank account. Therefore, this recommendation should be closed. The cash available as of September 30, 2009 (\$490,000) was used to pay final allowable administrative wind-up expenses prior to the MCA-Madagascar office closure in November 2009. The remaining funds (\$27,339.29) were remitted by MCA-Madagascar's bank on November 26, 2009 and deposited into the U.S. Department of Treasury on December 10, 2009. This bank remittance complied with *MCC Guidance for MCA-Madagascar Disposition of Compact Program Assets*. Section 5 of this MCC guidance required that "by 90 days after the Compact Termination Date, the balance of the permitted account(s) and any petty cash and regional activity funds must be zero."

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation include in the Guidelines for Program Closure of Millennium Challenge Compacts procedures to address the advances, accrued interests, and security deposits in the MCAs' accounts after compact closeout.

MCC Management Response: MCC agrees to include specific language regarding procedures to address advances, accrued interest, and security deposits when the Guidelines are revised. The Guidelines already establish basic procedural guidance for cash and cash equivalent assets, including accrued interest.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation prepare guidance that implements a process to identify and collect value-added tax payments improperly made to compact countries.

MCC Management Response: MCC agrees with this recommendation and has already developed mechanisms in every partner country that receives MCC assistance; these mechanisms are designed to ensure that assistance is delivered free of not only value-added, but of all taxes, customs duties, and any other similar charges. The specifics of these mechanisms are developed on a country-by-country basis following due diligence into a particular country's system of taxes. The specific process by which value-added taxes were to be reimbursed during compact implementation in Madagascar was established at the beginning of compact implementation after it was agreed to among MCC, MCA-Madagascar, and the Government of Madagascar (prior to the coup). In the ordinary functioning of the Madagascar compact, this process was followed and enforced by MCC. For example, when the Government of Madagascar fell behind on its reimbursement obligations during compact implementation, MCC withheld further compact disbursements until the Government of Madagascar took appropriate steps to

comply with its tax reimbursement obligations. The leverage to withhold compact disbursements was, of course, lost following compact termination.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation collect the \$3.8 million value-added tax owed by the Government of Madagascar.

MCC Management Response: MCC disagrees with this recommendation. MCC agrees that it would be optimal if the Government of Madagascar was to reimburse the value-added tax receipts owed to various contractors that did business with MCA-Madagascar. As previously explained to OIG, VAT assessments were not paid by MCC, but rather by contractors using compact funds. Thus, no reimbursement to MCC is legally required, nor is collection by MCC appropriate, since the reimbursements are owed to contractors. As noted in its response to Recommendation No. 3 above, MCC ensured that such reimbursements were made during implementation of the compact prior to its termination. However, MCC has no diplomatic or other authority to independently engage with the post-coup Government of Madagascar. As such, MCC currently lacks the ability to compel the Government of Madagascar to reimburse the value-added tax receipts owed to contractors who performed work for MCA-Madagascar.

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's Vice President of the Compact Implementation Department issue guidance clarifying how compacts address value-added tax as it relates to the sale of assets during early terminations.

MCC Management Response: MCC disagrees with this recommendation. Per the relevant provision of the Millennium Challenge Act of 2003 (the "Act"), as amended (§ 609(c)), and as reflected in the terms of the Madagascar compact (§ 2.3(e)), transactions involving "program assets" are to be free from taxes. However, when program assets were sold as part of compact termination in Madagascar, they were converted through that sale to a non-compact program use. MCC's interpretation of the statute and the compact is that the assets thereby lost their character as program assets. As such, the favorable tax treatment mandated by the Act and the compact no longer applied to transactions involving those assets. In MCC's view, it would be inappropriate for MCC to issue any guidance on the treatment of taxes that may be assessed on transactions involving assets other than program assets.

Recommendation No. 6: We recommend that the Millennium Challenge Corporation's Vice President for Compact [sic] include specific requirements on removing sensitive data in the next iteration of the Program Closure Guidelines.

MCC Management Response: MCC agrees with this recommendation and will include requirements on removing sensitive data in the Guidelines when they are revised. As noted in the report, MCA-Madagascar did remove sensitive data from equipment that was sold or transferred and the MCC Resident Country Director conducted spot checks to ensure this happened. While MCC is in agreement that the next version of the Guidelines should include specific guidance on removing sensitive data, we do not believe this was a major risk in the Madagascar case, as this practice was followed by MCA-Madagascar and reviewed by MCC.

Recommendation No. 7: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation revise the nongovernmental Organizations Selection Form to include a requirement that each Millennium Challenge Account request legal documentation when considering nongovernmental organizations as recipients of compact property for future project closeouts.

MCC Management Response: MCC agrees with this recommendation and will consider it when the Guidelines are revised. In the case of Madagascar, MCC does not view this as a significant risk, as all of the nongovernmental organizations that received assets were known to both MCA-Madagascar and to MCC staff with significant experience in Madagascar.

Recommendation No. 8: We recommend that the Millennium Challenge Corporation's Vice President for Compact Implementation, when considering compact termination in the future, establish procedures to require that each Millennium Challenge Account transfer assets only to nongovernmental organizations that have the funding and human capital capacity to continue the compact objectives.

MCC Management Response: MCC disagrees with this recommendation. In the case of an early compact termination, MCC must retain the flexibility to review the constraints posed by the termination and the situation on the ground in order to determine the best asset disposition plan given the circumstances.

When evaluating how to transfer assets in the Madagascar closeout, MCA-Madagascar and MCC selected nongovernmental organizations that were determined to have the best possibility of continuing to serve compact beneficiaries and to achieve compact objectives. MCA-Madagascar and MCC's actions conformed to the general intent of this recommendation. However, MCC must have the ability to strike a balance between sustainability of compact objectives and nongovernmental organization funding and human capital capacity. To that end, MCC developed procedures in the case of Madagascar that allowed MCA-Madagascar and the MCC Resident Country Mission to provide objective first-hand knowledge of nongovernmental organizations capacity and to evaluate their potential for sustained efforts to reach compact objectives.

According to information received from Madagascar, all of the nongovernmental organizations that received MCA-Madagascar assets continue to provide services. Ezaka ho Fampanandrosoana ny Ambanivohitra (EFA), the newly created land nongovernmental organization, has been able to negotiate several contracts and secure funding for at least two years of operation, despite the continuing difficult political circumstances.

Thank you for the opportunity to comment on the report. Please contact Dennis Nolan, MCC's Deputy Chief Financial Officer, if you have further questions or concerns.

Sincerely,

/ S /

Daniel W. Yohannes
Chief Executive Officer

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave., NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig