



Office of Inspector General

July 16, 2014

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

SUBJECT: Review of the Millennium Challenge Account Employee Compensation (Report No. M-000-14-003-S).

Dear Mr. Khan:

This letter transmits the Office of Inspector General's nonaudit report on the "Review of the Millennium Challenge Account Employee Compensation." In finalizing the nonaudit report, we considered your written comments on our draft report and included those comments in their entirety in Appendix II of this report.

The report contains eight recommendations. Management decisions have been reached on Recommendations 1, 2, 3, 4, 5, 6, 7, and 8, and final action has been taken on 6. However, we disagree with MCC's management decision and final action on Recommendation 8.

We appreciate the cooperation and courtesy extended to our staff during this review.

Sincerely,

/s/

Melinda Dempsey
Deputy Assistant Inspector General
for Audit

SUMMARY

The Millennium Challenge Corporation (MCC) provides countries with funding for projects through 5-year compacts geared to stimulate economic growth. Each compact is administered through a Millennium Challenge Account (MCA) that the compact country's government establishes. The MCA has the legal authority to oversee implementation of the compact.

Though partner governments have flexibility in the way MCAs are structured, all MCAs so far have been newly established government units or departments with special authority to offer market-based compensation to attract qualified employees.

Hiring high-quality key staff and providing them competitive compensation is fundamental to the sound organizational effectiveness and management of MCAs; they are critical to the successful implementation of projects. Further, while MCAs must attract and retain quality key staff by offering them competitive compensation, it is vital that the compensation also be cost-effective to maximize funds available for compact implementation. For the purpose of this review, "cost-effective" means the best value for the money spent based on sound administrative and professional judgment.

Each MCA has a management unit that includes the following key staff positions:

- chief executive officer (sometimes referred to as the director general, national coordinator, or managing director)
- deputy chief executive officer (sometimes referred to as the chief operating officer)
- chief financial officer
- legal advisor
- director of procurement
- director of environmental and social assessment
- director of monitoring and evaluation
- project directors for each major project under the compact

These employees are responsible for managing the MCA and implementing the compact in coordination with the MCA board of directors and oversight by MCC headquarters, technical, and resident mission staff. Although MCA staff are employed by the host country's government, the MCAs are guided by certain MCC policies and procedures designed to ensure that compact funds are spent efficiently and effectively.

The compact country governments work with MCC to recruit key staff. Although these positions are competitively recruited locally, regionally, or internationally, depending on the availability of applicants with the necessary skills, it is common for the chief executive officer position to be filled by a person with close ties with the compact country government.

While MCAs are structured similarly, they vary greatly in the number of employees they have and their administrative budgets due to compact size and complexity. Based on an Office of Inspector General (OIG) survey conducted in September 2013,¹ the number of employees at MCAs (excluding consultants) ranged from 18 to 80. Ninety-nine percent of the key employees were from the MCA compact country, and 17 percent previously served as a member of the government's team that established the MCA compact.

MCA administrative budgets also varied widely from \$1,534,837 to \$47,652,628. Accordingly, MCA salary costs as a component of administrative costs ranged from 25 to 92 percent of the administrative budget—and on average constituted roughly 58 percent of MCA administrative budgets. Table 1 in Appendix III provides more detailed information on the administrative budgets and staffing costs.

The objective of this review was to determine whether MCC's compensation methodologies provided cost-effective staffing at the MCAs. OIG found that MCC could not be assured that its methodologies resulted in MCAs implementing cost-effective compensation practices. The MCAs developed and implemented compensation practices in different ways with limited input from compensation specialists. Therefore, MCC cannot be assured that MCAs were using cost-effective practices and that their administrative costs were reasonable.

In particular, OIG found the following issues when conducting this review.

- MCC gave limited guidance to MCAs on compensation practices (page 4). MCC's compensation methodologies, including its guidance, policies, and practices, did not provide specific criteria for MCAs to use when establishing their own policies and practices. Nor did MCC's guidance sufficiently address the specific roles and responsibilities of MCC and MCA officials involved in MCA compensation decisions.
- MCC did not maintain all MCA key personnel employment agreements at headquarters even though this was a MCC policy requirement (page 6).
- MCC employees did not systematically share their experiences and methodologies (page 7). Therefore, information about successful and unsuccessful practices was lost.
- MCAs did not always hire key staff before compacts entered into force (page 8). Filling these positions beforehand was critical for program implementation because it marks the start of the 5-year period MCAs have to complete projects.

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

1. Implement comprehensive, specific guidance for MCAs on key staff compensation practices such as determining salaries, conducting performance evaluations, and awarding performance-based bonuses, and (2) determine and document if and how MCC should use compensation specialists to help develop the guidance (page 5).
2. Require MCAs to establish the roles and responsibilities for all those involved in the oversight process for MCA key staff compensation decisions, and address the role of compensation specialists and how and when MCAs should use them, and (2) specify which

¹ See Table 4 in Appendix III for the OIG survey questions.

documents pertaining to MCA staffing and compensation should require a MCC formal no-objection (page 5).

3. Require MCAs to conduct and document periodic reviews to verify that Recommendations 1 and 2 are implemented (page 5).
4. Implement a training plan for MCA officials with oversight responsibilities for compensation practices and decisions (page 5).
5. Implement and document a comprehensive, systematic approach to confirm that compact records, including key staff records, are retained at MCC headquarters in compliance with its *Policy and Procedures for Compact-Related Federal Recordkeeping* (page 7).
6. Designate the responsibility for overseeing MCA compensation (page 7).
7. Implement a systematic method of sharing information about MCA compensation practices among headquarters and MCA employees (page 8).
8. Implement an action plan to hire key staff before a compact enters into force in accordance with MCC's *Guidelines for Accountable Entities and Implementation Structures* (page 8).

Detailed review results appear in the following section, and Appendix I describes the review scope and methodology. MCC's management comments are included in Appendix II without MCC's attachments, and our evaluation of management comments is included on page 10 of the report. Appendix III contains supplemental information referred to in this report.

REVIEW RESULTS

MCC Provided Limited Guidance on MCA Compensation Practices

Sound operational guidance is integral in assuring an organization's management that its operations are carried out effectively and efficiently, its assets are safeguarded, and its policies and procedures are carried out consistently.

MCC, however, provided limited guidance and training to MCAs on key staff compensation practices, such as establishing salaries and performance evaluations, determining performance-based bonuses, and monitoring salaries in the marketplace. Further, the guidance did not clearly define the roles and responsibilities of the officials involved with implementing compensation practices, nor did it address the role of compensation specialists in setting or implementing guidance. OIG found that MCC policies and MCA governing documents² had imprecise language related to MCA compensation criteria or did not address important issues. Nor was all of this information consolidated into one document.

Salaries. Though MCC guidance stated that MCAs could use salary surveys as a basis for determining salaries for key staff positions, it did not provide any guidance on how to prepare or use the surveys.

MCC and MCA Oversight. MCC provided limited guidance on the roles and responsibilities of those involved in MCA compensation decisions, such as the MCC staff, MCA board of directors, and the MCA fiscal agents who were hired to process payments on behalf of the MCAs. MCA officials said MCC's guidance was limited, and they needed a better understanding of compensation issues. MCC guidance did not require any of the MCC or MCA officials involved in compensation decisions to have a professional background or technical expertise in compensation and benefits, nor did it provide information on the role and use of compensation specialists.

Performance Evaluation Systems and Performance-Based Bonuses. MCC guidance did not provide standards for conducting performance-based evaluations of key staff positions or for determining performance-based bonuses.

Monitoring Salaries in the Marketplace. Monitoring changes in the marketplace would allow MCC to confirm that MCA salaries were competitive and in line with prevailing local wages, but MCC had no guidance on this subject.

MCC officials said they preferred not to give MCAs specific guidance; instead, MCC offered them the flexibility to develop and implement their own compensation practices. The officials said MCAs were country-led units that should have decision-making autonomy.

Although MCC officials said they recognized the need to provide proper oversight, they did not review the MCAs regularly to assess how compensation decisions were made.

² MCC Guidelines for Accountable Entities and Implementation Structures, MCC Cost Principles, MCC Standards of Clearance, MCC antifraud and corruption policy, MCA program implementation agreements, MCA fiscal accountability plans, MCA fiscal agent agreements, and MCA board by-laws.

OIG found that other donors, such as USAID and the World Bank, provided standard guidance on compensation issues for their local country staff tailored to address local labor laws, practices, and prevailing wages. Other donors also had compensation specialists involved with developing and implementing their respective policies and practices.

Without specific compensation guidance to follow and limited training, MCAs engaged in uneven compensation practices and ad hoc decision-making, thereby limiting MCC's assurance that cost-effective compensation practices were in place and that MCA administrative staffing costs were reasonable.

Moreover, varied understandings among MCAs about MCC's approval process for MCA key staff compensation practices resulted in an increased risk for improper, fraudulent behavior. For example, the chief executive officer of one MCA was terminated because of concerns over improper salary and bonus payments, due in part to weaknesses in oversight provided by MCC and MCA officials.

Even though MCA compensation practices will vary by MCA due to country-specific circumstances and labor laws, establishing specific guidance for the MCAs would give MCC greater assurance that its methodologies were cost-effective and consistently applied. To address this concern, OIG makes the following recommendations.

Recommendation 1. We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, (1) implement comprehensive, specific guidance for Millennium Challenge Accounts on key staff compensation practices such as determining salaries, conducting performance evaluations, and awarding performance-based bonuses, and (2) determine and document if and how the Millennium Challenge Corporation should use compensation specialists to help develop the guidance.

Recommendation 2. We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, require that (1) each Millennium Challenge Account establish the roles and responsibilities for all those involved in the oversight process for Millennium Challenge Account key staff compensation decisions, including the role of compensation specialists and how and when they should be utilized, and (2) the Millennium Challenge Corporation specify which documents pertaining to Millennium Challenge Account staffing and compensation should require a Millennium Challenge Corporation formal no-objection.

Recommendation 3. We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, require Millennium Challenge Accounts to conduct and document periodic reviews to verify and ensure that Recommendations 1 and 2 are implemented.

Recommendation 4. We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, implement a training plan for Millennium Challenge Account officials with oversight responsibilities for compensation practices and decisions.

MCC Did Not Maintain All MCA Key Personnel Employment Agreements at Headquarters

MCC's 2012 *Policy and Procedures for Compact-Related Federal Recordkeeping* states:³

It is essential that records related to the development, implementation and closure of Compacts are maintained in accordance with the Federal Records Act. MCC has determined that country-specific program records, defined here as "Compact Management Records," . . . must be maintained at MCC headquarters both during compact development and implementation, as well as after the program closure of the Compact.

MCC headquarters was required to maintain:

Form of Employment Agreement and any requested deviations, as well as any final Employment Agreements for key staff as defined in the Governance Documents specifically approved by MCC.

MCC, however, could not provide OIG with employment agreements for 7 of 11 closed compacts. One of the seven was eligible for a second compact. MCC also could not readily provide employee agreements for active compacts; the information came about 6 weeks after OIG's request.

MCC's delayed and incomplete response to OIG's request for MCA employment agreements was due to several factors. Some records were not being stored at headquarters as required, and MCC country teams had different methods for storing compact records. Additionally, MCC did not have a verification process in place to confirm that these records were being stored.

MCC officials said implementing their record-keeping policies had not been an organizational focus until recently. They added that they had been working to improve their data and records management over time, especially in response to the June 2013 Government Accountability Office *Review of Compact Records and Information Management Program for MCC*.⁴

Because MCC does not have an organized approach to record keeping for compact files—including MCA compensation files—it does not comply with its policy. In addition, MCC risks losing critical historical information that MCC officials could use when establishing new compacts. This is especially important for countries where MCC is establishing second compacts because they may have to spend resources unnecessarily to duplicate information related to country-specific compensation laws and practices. To address this deficiency, this review makes the following recommendation.

³ This policy was an updated version of MCC's 2007 *Recordkeeping Procedures for the Implementation of Compacts*, which included the same requirement for storing MCA key staff employment agreements.

⁴ The review also found that MCC does not require, and has not conducted, periodic reviews to determine whether it has received all compact management records from the accountable entities consistent with federal internal control standards. GAO recommended that MCC "develop a policy requiring—and conduct—periodic reviews of its compact management records to ensure they are complete."

Recommendation 5. *We recommend that the Vice President of Compact Operations document a comprehensive, systematic approach to confirm that compact records, including key staff records, are retained at Millennium Challenge Corporation headquarters in compliance with its Policy and Procedures for Compact-Related Federal Recordkeeping.*

MCC Did Not Systematically Share Information

Maintaining and sharing information are key aspects of managing an organization. Doing so in a systematic way increases organizational efficiency through reducing costs, facilitating decision-making, and enhancing innovation.

However, MCC's Department of Operations did not have a systematic approach for sharing information on MCA staffing processes and practices. Instead, MCC and MCA staff relied on information that they shared informally. For instance, when establishing an MCA, MCC and country officials were limited to their firsthand knowledge and experiences, and the ad hoc sharing of materials.

OIG also found that MCA officials from one country visited another MCA to learn about establishing an MCA office, but this was not standard practice. MCA officials whom OIG interviewed encouraged MCC to provide more information, training, and opportunities for peer-to-peer exchanges, especially because they had to develop some items from the beginning, which they said was time-consuming.

Furthermore, MCC officials said that various knowledge-sharing initiatives enacted in the past few years did not address the topic of MCA staffing and compensation. For example, an MCC official said that in 2009 MCC's Department of Compact Development began an effort to develop a "tool kit" focused on MCA staffing and compensation, but this never materialized. Similarly, in 2011 MCC developed a systematic approach to capture practices and processes of MCC administrative and technical functions, but it did not address the topic of MCA staffing and compensation.

As previously mentioned, several MCC employees, including those from country programs, fiscal accountability, and legal, are involved in making compensation decisions. However, MCC did not have one person responsible for overseeing MCA compensation, further complicating the easy exchange of information. MCC officials said instituting a systematic method for sharing information or appointing a MCC official for MCA compensation issues had not been an organizational focus.

Without a systematic approach for recording and sharing information about MCA staffing and compensation, good practices and important lessons learned were lost. Consequently, unnecessary amounts of MCC and MCA staff time and funds can be spent searching for similar information. To address this concern, this review makes the following recommendations.

Recommendation 6. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, designate the responsibility for overseeing Millennium Challenge Accounts compensation.*

Recommendation 7. *We recommend that the Millennium Challenge Corporation’s Vice President, Department of Compact Operations, implement a systematic method of sharing information about Millennium Challenge Account staffing and compensation materials, tools, and approaches among headquarters and Millennium Challenge Account employees.*

OTHER MATTER

MCA’s Did Not Always Hire Key Staff Before Implementation

MCC’s Guidelines for Accountable Entities and Implementation Structures states:

The appointment of key staff is subject to MCC approval. The process for selecting the key staff should commence as soon as possible and should be completed prior to entry into force of the Compact.

MCA officials said hiring key staff before entry-into-force was critical because it marks the official start of the 5-year period MCAs have to complete all compact projects. Recognizing this, MCC increased the preparation time given to MCAs between signing the compact and entering into force from 3 months in some of its earliest compacts to more than 1 year in more recent ones.⁵

However, OIG found that 8 of the 13 MCAs reviewed did not select all key staff before entry into force. The situation varied among MCAs as to the number, type, and the amount of time key staff positions remained unfilled; the latter usually ranged from 1 month to several months after entry into force, as shown in Table 2 in Appendix III. For instance, 5 of 13 key employees at one MCA were not selected before implementation, and in another MCA, at least 5 of 16 were selected 2 to 3 months after implementation, even though this MCA had more than 18 months to prepare for entry into force.

MCC officials said the staffing situation at each MCA was unique, and therefore, varying factors influenced the timing of hiring key staff. For instance, senior key staff positions such as the chief executive officer and deputy chief executive officer were hired first so they could provide input on the selection of other key staff. If their hiring was delayed—for example, because the accountable entity’s legal structure had not been finalized or because of difficulty finding appropriate candidates—this could cause a domino effect in hiring the rest the staff. MCC officials also said the recruitment search remained active until MCC and the MCA agreed that they had found the appropriate person, rather than appointing someone who might not be able to handle the job’s responsibilities.

By not having MCA key staff in place before implementation, MCC increased the risk that MCAs would not meet compact program goals and jeopardized the compact countries’ potential for economic growth. To address this concern, we make the following recommendation.

⁵ Go to <http://www.brookings.edu/research/papers/2008/12/millennium-challenge-rieffel>.

Recommendation 8. *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, implement an action plan to complete the hiring of key staff before compact implementation in accordance with its Guidelines for Accountable Entities and Implementation Structures.*

EVALUATION OF MANAGEMENT COMMENTS

OIG has reviewed MCC's comments in response to the draft report, which are included in their entirety in Appendix II. MCC agreed with Recommendations 1, 2, 3, 4, 5, 6, and 7, but disagreed with Recommendation 8. MCC took final action on Recommendation 6 and 8. Our evaluation of comments follows.

Recommendation 1. MCC agreed to evaluate its overall processes and procedures for MCA key staff compensation practices. The review will assess if and how MCC should use compensation specialist(s) to help develop MCC guidance on MCA compensation practices or implementation thereof. This review process has a completion target of September 30, 2014, and is intended to include recommendations to enhance the professionalization of the human resources function at MCAs. Upon completion of the review, MCC will establish a working group to develop comprehensive guidance on MCA compensation practices, processes, and procedures, and other review recommendation steps focused on human resources. OIG acknowledges MCC's management decision.

Recommendation 2. MCC agreed to give MCAs greater guidance on establishing the roles and responsibilities for all those involved with the oversight process for MCA key staff compensation, including information on when it may be necessary for MCAs to use a compensation specialist. The guidance also will reflect enhancements to MCC's formal oversight role on MCA human resources issues.

MCC has already begun to take steps to implement this recommendation. On April 1, 2014, MCC released a revised *Cost Principles for Accountable Entity Operations*, which addresses in more detail the issue of MCA employee compensation. MCC also revised its *Addendum to Section III, standards of clearance for key personnel*; it now requires additional MCC clearances and approvals on new MCA employee compensation packages. OIG acknowledges MCC's management decision.

Recommendation 3. MCC agreed that it needs to have MCAs conduct periodic reviews to verify that Recommendations 1 and 2 are implemented; therefore, it plans to establish a review process. MCC also stated that on August 7, 2013, OIG approved MCC *Guidelines for Financial Audits Contracted by Millennium Challenge Corporation's Accountable Entities*; this requires auditors to review MCA compensation structures as part of their periodic financial statement audits of MCAs. This is in addition to the revisions of *Addendum to Section III, standards of clearance for key personnel*, which now requires increased oversight and reporting requirements for new and existing MCA employee compensation packages. OIG acknowledges MCC's management decision.

Recommendation 4. MCC agreed that its Department of Compact Operations and its Office of General Counsel will codevelop and coimplement a training plan for each individual MCA's board of directors on MCA employee compensation by September 30, 2014. OIG acknowledges MCC's management decision.

Recommendation 5. MCC agreed that compact implementation support teams (ISTs) will retain MCA key staff selection and compensation records at MCC headquarters in Washington.

MCC will document the record retention process by September 30, 2014. OIG acknowledges MCC's management decision.

Recommendation 6. MCC agreed that each IST is responsible for overseeing compensation issues for each MCA. MCC's view is that the individual ISTs have the best knowledge of their respective compact partner country's unique local labor laws and practices. OIG acknowledges MCC's management decision and final action.

Recommendation 7. MCC agreed that it needs to share information on compact implementation processes more regularly, including MCA staffing and compensation materials, tools, and approaches among MCC and MCA employees. It is therefore developing a Web platform, MCA-1, for this purpose, and that is scheduled to be given to MCAs during the third quarter of FY 2014. However, MCC noted the sensitive, confidential nature of certain compensation documents would not lend themselves to being shared.

Additionally, MCC is considering expanding participation of its "fiscal college" training to include MCA employees of compacts that are in early development or in the closeout phase to facilitate greater exchange of information. OIG acknowledges MCC's management decision.

Recommendation 8. While MCC officials said they concur with OIG that key staff should be hired before a compact is implemented, they disagreed with our recommendation to develop an action plan to hire MCA key staff members before implementation in compliance with MCC's Guidelines for Accountable Entities and Implementation Structures. The officials said they already have sufficient processes in place to meet the hiring needs of compact programs.

Although OIG acknowledges MCC's management decision, we disagree with it. As we explained in the finding, 8 of the 13 MCAs we reviewed did not select all key staff before entry into force. Therefore, the processes in place are not working or are not being enforced. MCC officials should either adopt additional measures to ensure compliance with its policy, or consider revising it. Until we see a plan for how this problem will be addressed, we do not consider that final action has been taken.

SCOPE AND METHODOLOGY

Scope

OIG conducted this performance review in accordance with the quality standards for inspection and evaluation issued in 2011 by the Council of the Inspectors General on Integrity and Efficiency. These standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with the review objective. We believe that the evidence obtained provides that reasonable basis.

The review objective was to determine whether the compensation methodologies MCC used provide cost-effective staffing at the MCAs. For the purposes of the review, the term “cost-effective” meant whether MCC’s compensation-setting policies and procedures for MCAs were reasonable and based on sound administrative and professional judgment as outlined in *Cost Principles for Government Affiliates Involved in MCC Compact Implementation*.

We conducted our fieldwork in Washington, D.C., from July 26 to December 16, 2013. The review covered the following 26 MCC compacts:

- 15 active compacts, 14 of which were first compacts: Burkina Faso, Indonesia, Jordan, Lesotho, Malawi, Moldova, Mongolia, Morocco, Mozambique, Namibia, Philippines, Senegal, Tanzania, and Zambia; the second compact was Cape Verde II.
- 11 closed compacts: Armenia, Benin, Cape Verde, El Salvador, Georgia, Ghana, Honduras, Madagascar, Mali, Nicaragua, and Vanuatu.

We examined the internal control environment by identifying and assessing relevant controls. In particular, we reviewed the following processes:

- Staffing and salary setting procedures for MCA key staff positions.
- Approvals for MCA key staff employment contracts, performance evaluations, bonuses, and salary increases.

Methodology

To answer our review objective, we reviewed and analyzed the following documents:

- MCC and MCA policies and guidelines for staffing and setting compensation for MCA key staff positions
- MCA organizational plans and key staff position descriptions
- MCA salary surveys
- MCA key staff positions and employment contracts

- MCA human resources policies, including performance appraisals, promotion, bonus, retention, whenever available.

We interviewed certain MCC and MCA employees to gain an understanding of their interpretations of existing recruitment and compensation policies and practices, and the roles, responsibilities, and approval procedures of MCC and MCA officials for MCA key staff recruitment and compensation decisions. We interviewed MCC employees in the following technical capacities: country operations, fiscal accountability, and records management. We also had teleconferences with employees in MCA-Jordan, MCA-Philippines, and MCA-Zambia.

We sent a survey to all active MCAs, asking them for explanations and documentation about their key staff recruitment and compensation policies and practices. This showed us what they had in common and how they differed. The survey is in Table 4 in Appendix III.

We also sought to compare MCC's compensation policies and practices for MCAs to those of other U.S. Government agencies and multilateral organizations that employ locals in country offices. To do this, we interviewed human resources officials and compensation specialists, and reviewed documentation from the State Department, USAID, and the World Bank.

We did not use any statistical or judgmental sampling to conduct this review. As noted earlier, we surveyed all active MCAs. In addition, computerized processes were not a significant part of this review.



Memorandum

DATE: April 30, 2014

TO: Melinda Dempsey
Acting Deputy Assistant Inspector General
Office of Inspector General
Millennium Challenge Corporation

FROM: Jonathan o. Bloom
Acting Vice President
Department of Compact Operations
Millennium Challenge Corporation

RE: MCC's Response to the OIG's Draft Audit Report on the "Review of the Millennium Challenge Account Employee Compensation," Report No. M-000-14-00X-S, dated February 24, 2014.

The Millennium Challenge Corporation (MCC) appreciates the opportunity to comment on the Office of Inspector General's (OIG) draft "Review of the Millennium Challenge Account Employee Compensation."

Management Response to Recommendations:

OIG Recommendation #1: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, (1) implement comprehensive, specific guidance for Millennium Challenge Accounts on key staff compensation practices such as determining salaries, conducting performance evaluations, and awarding performance-based bonuses, and (2) determine and document if and how the Millennium Challenge Corporation should use compensation specialists to help develop the guidance.

MCC Management Response #1: MCC concurs with this Recommendation. In response to this OIG recommendation, and also as part of an internal Corrective Action Plan already under development in response to MCC's own review by its division of Investment and Risk Management ("IRM"), MCC plans to evaluate the overall process and procedures for initial set-up and approval of MCA compensation structures, subsequent modifications, and approval of key staff. At the end of this review, a working group will develop a comprehensive process and procedures to provide direction and oversight for the adoption of appropriate compensation packages for individual MCAs, which will include when and how compensation packages should be determined. This review will further recommend steps to professionalize the human resources process at individual MCAs. This review is targeted for completion on or before September 30, 2014.

The review will also consider whether the use of a compensation specialist for MCC in some form would be useful, given the diverse range of markets where MCC is engaged, and if so,

how that specialist should best be utilized.

This constitutes MCC's Management Decision.

OIG Recommendation #2: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, require that (1) each Millennium Challenge Account establish the roles and responsibilities for all those involved in the oversight process for Millennium Challenge Account key staff compensation decisions, including, the role of a compensation specialists and how and when they should be utilized; and (2) the Millennium Challenge Corporation specify which documents pertaining to Millennium Challenge Account employment and staffing should require a Millennium Challenge Corporation formal no-objection.

MCC Management Response #2: MCC concurs with this Recommendation. As an outcome from the Corrective Action Plan for recommendation # 1, MCC will also provide guidance to the MCAs in establishing roles and responsibilities for all those involved in the oversight process for MCA key staff compensation decisions and to enhance its formal MCC oversight on MCA human resource issues. MCC will also provide guidance on when it may be necessary to use a compensation specialist.. MCC's model varies from that of other international development partners, such as USAID. In MCC's case, the MCAs are not missions of MCC such as in USAID and nor is there are direct employer-employee relationship as with Department of State Locally Engaged Staff. By definition, MCAs are individual entities usually with a finite lifespan whose structures are customized to the complexity of the compact programs and labor market circumstances in the country. As such, MCC expects that there will be some variability in the compensation structures of the many MCAs we work with.

MCC is already implementing this recommendation through the April 1, 2014 version of MCC's *Cost Principles for Accountable Entity Operations* (see excerpt on Compensation as Attachment # 1).

Regarding (2) MCC concurs with the recommendation and has addressed it in full as outlined in Attachment 2 to this memorandum.

This constitutes Management Decision.

OIG Recommendation #3: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, require Millennium Challenge Accounts to conduct and document periodic reviews to verify and ensure that Recommendation #1 and #2 are implemented.

MCC Management Response #3: MCC concurs with this Recommendation.

As a result of the corrective action plan for Recommendations #1 and #2, MCC will provide concrete steps for ensuring that a review process is in place. Note that in addition, Section 4.5(g) of the OIG approved MCC *Guidelines for Financial Audits Contracted by the Millennium Challenge Corporation's Accountable Entities* (August 7, 2013) already requires auditors, as part of their periodic financial statement audits of MCAs, to review direct salary charges to determine whether salary rates are reasonable for MCA positions in accordance with those salary rates approved by MCC (when MCC approval is required), and that those salary charges are supported by appropriate payroll records; and, to determine whether allowances and fringe benefits received by MCA employees are in accordance with the agreements and applicable

laws and regulations.

In addition, and as of December 3, 2013, MCC has increased its oversight and reporting requirements for the selection of Key Staff, members of the Board of Directors, and final MCA Employment Agreements and subsequent revisions. For specific details, see Attachment 2.

This constitutes Management Decision.

OIG Recommendation #4: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, implement a training plan for Millennium Challenge Account officials with oversight responsibilities for compensation practices and decisions.

MCC Management Response #4: MCC concurs with this Recommendation. The existing level of compensation oversight by the MCAs can be enhanced and should not be left exclusively to the MCA. In its governance function, each MCA's Board of Directors has a significant fiduciary role. The Department of Compact Operations and the Office of General Counsel will jointly develop and implement a training plan for each MCA's Board to address its compensation oversight responsibilities by September 30, 2014.

This constitutes Management Decision.

OIG Recommendation #5: We recommend that the Vice President of Compact Operations document a comprehensive, systematic approach to confirm that compact records, including key staff records, are retained at Millennium Challenge Corporation headquarters in compliance with its Policy and Procedures for Compact-Related Federal Recordkeeping.

MCC Management Response #5: MCC concurs with this Recommendation. Retention of MCA key staff selection and compensation records are not consistently retained by various Implementation Support Teams ("IST") at MCC. Prior to November 1, 2013, MCC did not formally require that ISTs specifically require a non-objection on compensation of MCA key staff which explains why key selection/employment records were not consistently retained at MCC's headquarters. As noted in Response #1 above, MCC is conducting a comprehensive review of the processes related to MCA compensation packages. See also Attachment 2 for changes to the MCC approvals matrix designed to ensure retention of key staff records by MCC Implementation Support Teams (ISTs).

In addition, the response plan for OIG Recommendation #1 will specifically document the record retention process. This action will be completed no later than September 30, 2014.

This constitutes Management Decision.

OIG Recommendation #6: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, designate the responsibility for overseeing Millennium Challenge Accounts compensation.

MCC Management Response #6: MCC concurs with this Recommendation. The various MCC ISTs are vested with the responsibility to oversee MCA compensation. The ISTs are in the best oversight position since the context of MCA hiring varies widely from partner country to partner country and is driven by a wide range of factors such as complexity of the compact,

labor market conditions, etc.

In order to strengthen MCC's oversight of MCA compensation, MCC is also implementing the following updates:

- MCC recently updated its standards of clearance and the approvals matrix "*Addendum to the Section III, standards of clearance for key personnel*" (see Attachment 2)
- MCC recently revised its *Cost Principles for Accountable Entity Operations* to expand and provide specific guidance on oversight of MCA key staff compensation. MCC released the updated the *Cost Principles* on April 1, 2014.

This constitutes Management Decision and Final Action for this Recommendation.

OIG Recommendation #7: We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations, implement a systematic method of sharing information about Millennium Challenge Account staffing and compensation materials, tools, and approaches among headquarters and Millennium Challenge Account employees.

MCC Management Response #7: MCC concurs with this Recommendation.

MCC agrees that better methods of sharing information would be beneficial in some regards. MCC currently provides and shares tools. General guidance currently exists on www.mcc.gov for the development of Compacts and initial setup of MCAs. MCC also holds practice-related colleges each year to which key MCA staff are invited. The focus of these colleges is learning and information-sharing on relevant topics. The MCC website, and the transfer of knowledge and documentation between MCC-MCA counterparts already provide structured, systematic ways for sharing information between MCC headquarters and the MCAs.

The Millennium Challenge Corporation is planning to create a portal to enhance communication and sharing of information pertaining to MCAs' compact implementation processes (e.g., capacity-building materials, guidance, tools, procedures, etc.) via a web platform called "MCA-1". Each practice group (e.g. Fiscal Accountability, Procurement, etc.) will have a sub-site on "MCA-1" with sector-specific communication and information (i.e., capacity-building materials, guidance, tools, procedures, etc.). Fiscal Accountability will include on its sub-site compensation and staffing guidance, among other materials. In the near term "MCA-1" will facilitate information sharing between MCC and the MCAs as well as among MCAs via discussion forums. The MCA-1 platform is due to be rolled out to MCAs during Q3 FY2014.

Finally, in the interest of better transfer of knowledge across the full compact lifecycle, the MCC Fiscal Accountability practice will also consider expanding access to fiscal colleges to MCAs that are closing and MCAs that are still nascent.

MCC is aware of the sensitivity and confidentiality of some forms of compensation materials. It is important to note that much of an MCA's compensation practice is highly tailored to the country's local labor law, and the country's labor market conditions. Agreements between MCC and the host government on compensation-related information must be approached cautiously and managed carefully, as the information is sensitive, private, and may be legally protected.

This constitutes Management Decision.

OIG Recommendation #8: We recommend that the Millennium Challenge Corporation's Vice

President, Department of Compact Operations, implement an action plan to complete the hiring of key staff before compact implementation in accordance with its Guidelines for Accountable Entities and Implementation Structures.

MCC Management Response #8: MCC concurs with this Recommendation.

MCC concurs with the Recommendation, in so far as it concurs that key staff should be hired before compact implementation and that MCC has adequate policies and procedures in place to monitor compliance with such. Under a compact, an MCA should hire its key staff before entry into force of a compact pursuant to MCC's *Guidelines for Accountable Entities and Implementation Structures*. Under the Program Implementation Agreement, which agreement specifies the terms for implementing a compact, key staff must be hired as a condition to initial disbursement of program funding. Through these requirements, MCC exercises extensive oversight to ensure that each MCA is properly staffed at entry into force. For example, MCC works with MCAs to develop and implement a staffing or comparable plan when establishing the MCA. MCC believes these requirements and accompanying process are sufficient to meet the individual needs of each compact program. Any further process would undermine the flexibility that MCC must retain to modify and waive this requirement when circumstances warrant such. In some cases, MCC has determined that the needs of a program and its implementation readiness justify waiving this hiring requirement.

This constitutes Management Decision and Final Action for this Recommendation.

The actions specified above and associated Attachments constitute Management Decision on each of the Recommendations.

If you have any questions or require any additional information, please contact Mahmoud Bah, Fiscal Accountability Practice Lead at 202-521-3653.

Background on the Composition and Administrative Budgets of MCAs

Details on administrative and staffing costs for each MCA can be found in the tables below.

Table III-1. MCA Administrative Budgets for Active and Closed Compacts* (Unaudited)					
	Compact Country**	Compact Amount	Total MCA Administrative Budget***	Total Budgeted MCA Salary Costs per Administrative Budget	Percentage of Salaries per Administrative Budget
1	Honduras	205,000,000	9,267,500	8,340,750	90
2	Cape Verde	110,078,488	7,991,211	6,051,064	76
3	Georgia	395,300,000	11,754,839	7,124,160	61
4	Vanuatu	65,690,000	1,534,873	1,412,533	92
5	Armenia	235,650,000	5,717,500	3,626,242	63
6	Benin	307,298,040	29,129,057	17,304,887	59
7	El Salvador	460,940,000	18,705,630	9,367,108	50
8	Mali	460,811,164	16,162,967	8,010,127	50
9	Lesotho	362,551,000	17,381,140	11,887,348	68
10	Mongolia	284,911,363	25,756,663	9,897,280	38
11	Morocco	697,500,000	47,652,628	23,574,337	49
12	Mozambique	506,924,053	25,096,166	14,573,450	58
13	Tanzania	698,136,000	15,673,850	10,788,427	69
14	Burkina Faso	480,943,569	29,081,345	19,306,739	66
15	Namibia	304,500,000	31,212,319	23,652,123	76
16	Malawi	350,700,000	19,382,000	11,609,221	60
17	Moldova	262,000,000	14,676,275	3,666,849	25
18	Philippines	433,910,000	24,661,260	10,528,588	43
19	Zambia	354,757,640	25,369,300	14,813,076	58
20	Cape Verde II	66,230,000	6,003,561	4,468,722	74
	Totals:	7,043,831,317	382,210,084	220,003,031	58

* MCC provided data for the total administrative budgets and local MCA salary costs.

** MCC could not provide data for Ghana, Indonesia, Jordan, Madagascar, Nicaragua, and Senegal.

*** The amount does not include MCA funds spent on MCA consultants, fiscal or procurement agents, and audit activities.

Table III-2. Examples of MCA Key Staff Coming on Board After Entry Into Force					
	Country	Entry Into Force Date	Number of Total Key Staff	Key Staff Position	On Board Date
1	Burkina Faso	July 2009	10	Monitoring and Evaluation Director	October 2009
2	Indonesia	April 2013	16	Chief Economist	May 2013
				Procurement Modernization Project Director	May 2013
				Chief Financial Officer	May 2013
				Community-Based Nutrition Project Director	June 2013
				Legal Director	June 2013
3	Lesotho	September 2008	11	Procurement Director	October 2008
4	Moldova	September 2010	12	Roads Directors	October 2010
				Procurement Director	October 2010
5	Morocco	September 2008	13	Deputy Director General	November 2008
				Finance Director	March 2009
				Director of Financial Projects	February 2009
6	Namibia	September 2009	13	Deputy Chief Executive Officer Operations	November 2009
				Monitoring and Evaluation Director	March 2010
7	Philippines	May 2011	13	Management Information Systems Director	July 2011
				Secondary National Roads Project Director	June 2011
				Internal Auditor	September 2012
				Procurement Director	May 2012
				Environment and Social Performance Director	January 2012
8	Senegal	September 2010	12	Officer of Quality	October 2010

Table III-3. Recruitment Process for MCA Key Staff

During compact development, usually 6 to 9 months before signing a compact, MCC and the partner country work together to begin the recruitment process for MCA key staff. Although MCC officials said there is no one-size-fits-all approach to staffing the MCAs, the following are some of the major milestones or steps in the process:

1. To kick off the recruitment process, the MCC country team and the partner country's core team work together to develop position descriptions.
2. Though not a formal MCC requirement, MCC usually conducts a salary survey for key staff positions. It is either done in-house or contracted out to a local or international firm.

3. Though not a formal MCC requirement, it is common practice for the partner country to hire a firm to oversee the recruitment process for MCA key staff positions. The recruitment firm's duties vary from advertising, coordinating the interview process, and producing a report that ranks the interviewees.
4. Key staff positions are advertised locally, regionally, or internationally depending on whether the skills needed are readily available locally.
5. The MCA chief executive officer is the first key staff position appointed so that he/she can provide input on the selection process of other key staff. This can be done before the compact is signed if the legal structure of the accountable entity has already been formed.
6. Candidates are shortlisted, and interview panels are formed. They usually include the MCA CEO, MCA board members, and other technical experts. Though not a formal MCC requirement, the MCC country team lead for developing the compact and/or MCC technical personnel serve as observers on interview panels.
7. The recruitment firm drafts a report that ranks the interviewed applicants. This report is cleared by the interview panel and is sent subsequently to the MCC country team for approval.
8. Upon approval from the MCC country team, MCA offers employment letters to the selected candidates.

Table III-4. OIG Questionnaire for MCA Active Compacts

1. Can you please confirm the total number of MCA key staff positions?
2. What MCA key staff positions are occupied by country nationals? Do you have any positions occupied by noncountry nationals?
3. What MCA key staff positions are occupied by someone who previously served as a member of the compact development team?
4. What is the approval process for performance evaluation/appraisal and salary adjustments, including bonuses for the following positions (i.e., who approves performance evaluations, salary adjustments, bonuses):
 - a. MCA CEO or managing director
 - b. MCA deputy CEO or deputy managing director
 Please provide signed copies of your MCA CEO/managing director and deputy CEO's most recent performance appraisal.
5. Does the MCA have formal written guidance or policies in the five areas noted below. If yes, please provide OIG a copy of the policy and/or guidance:
 - a. Performance evaluation/appraisal
 - b. Bonus policy
 - c. Salary increases
 - d. Promotion
 - e. Retention
6. Has MCC provided MCA written policy that explicitly states which employee compensation

decisions made at the MCAs require MCC approval/no objection? If yes, please provide OIG a copy.

7. Does the MCA have an employee handbook? If yes, please provide OIG a copy.

8. Please provide OIG a copy of your fiscal accountability plan.

9. Has your MCA encountered any turnover of key staff? If yes, can you please indicate the position, duration of MCA key staff member in his/her position, and the reason for his/her departure.

10. Does the MCA board have a document that clearly delineates its roles and responsibilities in regard to MCA staffing and compensation? If yes, please provide OIG a copy.

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