Revenue Administration Reform Project in the Philippines Would Have Benefited From Consolidating Its Sustainability Efforts
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MEMORANDUM

DATE: February 15, 2017

TO: Millennium Challenge Corporation Acting Vice President, Department of Compact Operations, Kyeh Kim

FROM: Deputy Assistant Inspector General for the Millennium Challenge Corporation, Donell Ries

SUBJECT: MILLENNIUM CHALLENGE CORPORATION’S REVENUE ADMINISTRATION REFORM PROJECT IN THE PHILIPPINES WOULD HAVE BENEFITED FROM CONSOLIDATING ITS SUSTAINABILITY EFFORTS (M-000-17-004-C)

This letter transmits the final report on the subject audit. The report contains two recommendations to improve sustainability planning for future country compacts.

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA) to conduct an audit of the sustainability of selected Millennium Challenge Corporation projects in the Philippines. After conducting a risk assessment of the three projects under the Philippines compact, CLA decided in conjunction with OIG to audit the sustainability of the Revenue Administration Reform Project.

OIG found no instances in which the contractor did not comply, in all material respects, with Government Auditing Standards. Your written comments on the draft are included in their entirety in appendix III.

Recommendation 1. We recommend that MCC’s Vice President of Compact Operations develop and implement policy and operational guidance from the findings and recommendations made in its October 2012 Operations Review to improve sustainability planning.

Recommendation 2. We recommend that MCC’s Vice President of Compact Operations
develop and implement policy and operational guidance that require countries in future compacts to develop and annually update sustainability plans that specifically identify the risks and challenges to sustainability and proposed options to manage and mitigate these risks, as recommended in the Operations Review. In addition, such plans should establish (1) a clear vision of goals to be achieved, (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures and (3) a mechanism to monitor and report progress on sustainability measures.

After reviewing the information provided in response to the draft report, we acknowledge management decisions on recommendations 1 and 2 and will require evidence of final action regarding both of these before OIG can consider them closed.

We appreciate the cooperation and assistance you and your staff extended to OIG and CLA during this audit.

Attachment
Millennium Challenge Corporation’s
Revenue Administration Reform Project in the Philippines Would
Have Benefited From Consolidating its Sustainability Efforts

Final Report
February 2017
Millennium Challenge Corporation’s Revenue Administration Reform Project in the Philippines Would Have Benefited From Consolidating its Sustainability Efforts

EXECUTIVE SUMMARY

Why We Did This Review

CliftonLarsonAllen LLP (CLA) was engaged by the United States Agency for International Development (USAID) Office of Inspector General (OIG) to conduct an audit of the sustainability of the Millennium Challenge Corporation’s (MCC) Revenue Administration Reform Project (RARP), which was implemented by the Millennium Challenge Account – Philippines (MCA-P) from May 2011 to May 2016. MCC funding for the RARP during the compact period was budgeted at $54 million. The audit objective was to determine whether MCC and MCA-P designed and implemented sustainability measures for RARP’s activities, through the implementation of the electronic Tax Information System (eTIS) and the Case Management System (CMS). Both of those systems aimed to improve tax administration and anti-corruption policies and practices. Funding for the RARP was provided by MCC in a compact agreement with MCA-P that entered into force on May 25, 2011.

We performed our audit in accordance with Government Auditing Standards from December 3, 2015 through May 31, 2016.

What We Found

Although the Philippine Bureau of Internal Revenue (BIR) designed and implemented some sustainability measures, such as the addition and training of staff and developed procedures to help ensure the continuity of RARP’s activities after the Philippines Compact ended, MCC and MCA-P did not ensure that a consolidated plan was developed to address the significant risks for fully implementing and sustaining the activities.

For example, at the end of the Compact, two systems critical to RARP’s success, eTIS and CMS had not been fully implemented after MCC spent more than $44 million on these systems.¹ Further, there was no consolidated plan developed to ensure that their implementation would be

¹The $44 million spent was the actual and forecasted cash disbursements over the compact period, as reported by MCA-P in March 2016 but CLA could not verify this amount because it was provided after completion of the audit.
completed. Such a plan would have identified actions needed to fully implement and sustain the systems, measures for how those actions would be achieved, risks that could impact their implementation, and ways to mitigate those risks. Instead, these systems were implemented without clear goals and schedules and sustainability measures were fragmented in various RARP budget and planning documents, which will make it difficult for the Philippine government to manage their full implementation and sustainability.

To illustrate, BIR developed a strategic plan for 2016-2020 that identified priority projects and established eTIS as the number three priority activity. In a separate action, the BIR Commissioner wrote a letter expressing BIR’s commitment to the continued funding of efforts after the compact to further enhance eTIS. However, there is no assurance that these and other measures will be completed. In addition, MCC and MCA-P did not require BIR to consolidate the measures into a plan that provided (1) a clear vision of goals to be achieved; (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures; and (3) a mechanism to monitor and report on progress of sustainability measures. Without such a consolidated plan, tracking, assessing and determining whether sustainability measures are completed would be difficult to decipher. For example, measuring revenue growth from tax reforms is critical to determining the effectiveness and impact of RARP activities. However, the BIR has limited ability to measure such growth. As a result, it will be difficult to determine whether the activities under RARP will result in an expected $160.1 million increase to the Philippine government in income through increased collections of tax revenue and improved efficiency through public sector revenue administration and tax payer compliance. According to MCC, revenue growth is difficult to measure because of the many different factors that affect revenue collection and the nature of reform projects.

In an October 2012 Operations Review, MCC acknowledged that it could improve sustainability planning for compacts. However, MCC has yet to update its policies and guidance to include the review’s findings and recommendations on improving sustainability. The purposes of the review were to (1) come to a more consistent understanding of, and develop a common definition of, what it means for a project to be sustainable; (2) assess how effective MCC has been in incorporating sustainability into project design and implementation; and (3) provide recommendations for improving the design and implementation of projects for sustainable results. The Operation Review’s findings represent best practices for sustainability planning and can be applied to RARP. One key recommendation was that accountability mechanisms like sustainability and contingency plans need to be in place to ensure sustainability and related risks are addressed in designing and implementing project activities.

**What We Recommend**

We recommend that MCC’s Vice President of Compact Operations:

**Recommendation 1**: Develop and implement policy and operational guidance from the findings and recommendations made in its October 2012 Operations Review to improve sustainability planning.

**Recommendation 2**: Develop and implement policy and operational guidance that require countries in future compacts to develop and annually update sustainability plans that
specifically identify the risks and challenges to sustainability and proposed options to manage and mitigate these risks, as recommended in the Operations Review. In addition, such plans should establish (1) a clear vision of goals to be achieved, (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures and (3) a mechanism to monitor and report on progress of sustainability measures.

Detailed findings appear in the following section. Appendix I describes the audit scope and methodology, Appendix II provides a listing of USAID OIG reports that have noted problems with the sustainability of MCC compact activities. Appendix III presents MCC’s written comments to this draft report. We did not audit the comments received from MCC.

This report is for the purpose of concluding on the audit objective described above. Accordingly, this report is not suitable for any other purpose.

We appreciate the assistance we received from the staff of MCC and the MCA-Philippines.

Signed

CliftonLarsonAllen LLP
Arlington, VA
January 26, 2017
INTRODUCTION

MCC signed a five (5)-year, $434 million\(^2\) compact with the Government of the Philippines in 2010. The compact’s goal was to reduce poverty through economic growth through three projects:

- The Secondary National Roads Development Project ($214 million), which aimed to reduce transportation costs and improve access to markets and social services through the rehabilitation of an existing 222 kilometer road segment on the island of Samar.
- The KALAHI-CIDDS Project ($120 million), which sought to improve the responsiveness of local governments to enhance economic self-reliance in rural areas by targeting poor communities for small-scale community-driven projects.
- The Revenue Administration Reform Project ($54 million), which aimed to increase tax revenues and reduce tax evasion and revenue agent-related corruption by increasing the efficiency and sustainability of revenue collection through a redesign and computerization of business practices.

MCA-P was the host government entity charged with implementing the terms of the compact. The compact entered into force on May 25, 2011 and ended on May 25, 2016. As of March 10, 2016, MCA-P had committed about $418 million\(^3\) (96 percent) of the compact’s funding. The USAID Office of Inspector General engaged CLA to conduct an audit of the RARP to determine whether MCC and MCA-P designed and implemented sustainability measures for RARP’s activities. RARP’s activities included the implementation of the eTIS and CMS. eTIS was intended to replace the existing Integrated Tax System and CMS to monitor complaints, investigations, cases filed, and their resolutions. We focused on assessing efforts and measures undertaken to implement and sustain eTIS and CMS and the risks and challenges affecting their implementation and sustainability.

BIR and the Revenue Integrity Protection Service (RIPS), an anti-corruption unit within the Department of Finance (DOF), are responsible for conducting project activities.

As illustrated in Figure 1, BIR’s activities consisted of the following three items: (1) implementing eTIS; (2) utilizing computerized automated auditing tools and techniques in BIR’s large taxpayer unit; and (3) implementing a public awareness campaign. Through MCA-P, BIR used MCC funding to implement eTIS, and the Government of the Philippines gave MCC permission to use MCC funding to fund IMF technical assistance such as supporting the costs of an International Monetary Fund (IMF) resident advisor on tax administration, short-term IMF tax administration specialists, and other systems and technology consultants. In addition, it was used for training BIR staff and procuring equipment related to the implementation of eTIS. IMF was also required to provide annual progress reports to MCC on BIR’s performance in implementing eTIS and tax administration reforms.

\(^{2}\) The compact amount, as well as its breakdown by projects was from the original compact. The compact also included additional funding of over $8 million for monitoring and evaluation and over $36 million for compact administration and oversight. During the implementation period, there were mid-year adjustments to align funding to the status of the projects.

\(^{3}\) Source: MCA-P Disbursement Request, March 10, 2016. CLA did not audit the amount and did not perform additional procedures to determine whether this amount is materially correct.
RIPS activities funded under RARP included the acquisition and customization of case management software, a related data depository system, and staff training. These activities are intended to strengthen its surveillance and discipline of DOF and its attached agencies through administrative actions, such as temporary suspensions or dismissals.

![Figure 1. RARP Activities](image-url)
SUSTAINABILITY ACTIONS FOR RARP LACKED CONSOLIDATED PLANS, GOALS, AND MEASURES TO ENSURE SUSTAINABILITY

BIR developed several sustainability actions and measures for the implementation of RARP activities, but MCC did not require BIR to develop the consolidated plans, measures, and mechanisms needed to assess their effectiveness and progress. The importance of consolidated sustainability plans was highlighted in a MCC study that set forth best practices for sustainability planning in MCC compacts, including consolidated plans and measures. RARP would have benefited from the inclusion of these best practices in the development of sustainability measures to address continuing risks and challenges, especially concerning the implementation of the eTIS and CMS systems.

MCC Did Not Require Sustainability Plans

Although sustainability is referred to throughout the Philippines Compact documents, MCC did not require BIR or RIPS to develop sustainability and contingency plans for the extensive program of change management and the detailed implementation planning needed for eTIS and CMS. Further, none of the major RARP activities had sustainability plans that addressed how (1) the activity’s impact on the projects would be sustained and (2) risks and challenges to the sustainability of the project would be managed and mitigated. BIR officials said that the Compact did not require sustainability plans to be developed for their implementation. They cited references to the priority of eTIS in various budget and strategic planning documents as demonstrating BIR support for their sustainability.

The Monitoring and Evaluation Plan for the Philippines Compact defined sustainability as the measure in which the projects and their impact will continue after external support is withdrawn. With respect to RARP’s sustainability, the Compact stated that a critical ingredient to the success of this complex undertaking was the continued commitment of the DOF to embark on a program that is likely to meet with staff as well as taxpayer resistance and to manage the personnel, organizational, and technical issues that will require both vision and resolve. Further, maintaining that commitment over the course of the Compact Term will be a test of BIR’s and the Department of Finance’s management skills and staff capacity. The MCC Philippines Investment Memo further noted that, ultimately, it will be the political will, or the lack thereof, of the successive governments of the Philippines that will be the impetus for either continuing to improve on tax reform and anti-corruption efforts or reverting to the pre-RARP and pre-RIPS status quo.

MCC officials agreed that there was no requirement in the Philippines Compact documents for BIR to develop sustainability plans to minimize the risks to sustainability. According to the MCC Resident Country Director, the Compact was developed on the principle of country ownership and that under the MCC model it is up to the host country to build in procedures for sustainability. The MCC RARP Project Lead also said that the sustainability of eTIS falls squarely on the BIR and the Philippine government after the end of the Compact. However, according to a January 2016 MCA-P email correspondence, MCC asked if a written BIR sustainability plan for eTIS existed. BIR officials responded that there was no written plan, but that eTIS was included in several BIR official plans as a priority project.

Sustainability Measures Were Fragmented and Lacked Mechanisms To Assess Their Effectiveness and Progress

MCC officials cited several actions and references to the priority of RARP activities in various
budget and planning documents as demonstrating BIR support for their sustainability. However, these references and measures were fragmented in these various documents that make managing sustainability difficult and were not consolidated into a plan that provides (1) a clear vision of goals to be achieved; (2) a mechanism to assess the completeness, robustness, and cohesiveness of sustainability measures; and (3) a mechanism to monitor and report on progress of sustainability measures. MCC cited the following actions and references as examples of sustainability measures:

- The BIR’s 2016-2020 strategic plan prepared with the assistance of the IMF. This plan includes a list of priority projects. On that list, eTIS (optimization, nationwide rollout and eTIS-2), Value Added Tax (VAT) audit implementation, tasks related to Arrears Management, and Expansion of Satellite Computer Assisted Auditing Tools and Techniques (CAATTs) Offices in Regional Offices.

- Staffing plans for the nationwide rollout of both new VAT Audit and new Arrears Management procedures and the prerequisite approvals for post-Compact implementation by both the BIR and the Department of Budget and Management. At the end of the compact, job descriptions and procedures manuals for both had been prepared and training provided. A steering committee was in place to oversee the rollout which was planned to occur over the 12-18 month period following the compact end. A total of 283 positions are being created as part of this effort and funded by the BIR.

- A letter from the BIR Commissioner committing the BIR to continued post-compact funding of efforts to further enhance eTIS. This indication of commitment was required as an assurance for MCA-P to continue project funding for eTIS developments after BIR did not meet several deadlines. The BIR transferred money to a unit of Department of Budget and Management that will manage the BIR’s first procurement for post-Compact enhancement of eTIS. The procurement was launched in June 2016.

- Procedures Manual and related training provided by the Change Management consultant. The BIR plans in the future to rely to a greater extent on its own staff resources to undertake change management tasks related to change management using this manual as a guide.

- Expansion of CAATTs to additional BIR offices of techniques and tools for use by auditors. The beneficiary offices are providing dedicated space, security, and staffing to support the expansion.

- Training of BIR staff by the Public Awareness Campaign consultant to enable the BIR to be more self-reliant in managing future campaigns. The BIR’s budget request for 2017 would maintain funding for design and implementation at approximately the same level as the funding provided through the Compact during the 2016 campaign.
• The Independent Assurer provided training to BIR staff on Independent Validation and Verification tasks to enable the agency to be more self-reliant going forward. They also prepared and reviewed IT staff training material with the BIR for: infrastructure security, application security, and performance testing.

• The Software developer presented the BIR with: a Systems Maintenance and Strategy Schedule, A Technical and Help Desk Manual, and a Configuration Management Manual. MCA-P also funded the purchase of new software for the Help Desk. The Help Desk’s job is to assist users and relay problems to BIR’s systems staff. This contributes to buy-in and sustainability.

• The Compliance Improvement Strategy Council was established during the life of the Compact and operates as a free-standing unit fully funded by the BIR.

• To assist with the BIR’s efforts to improve its auditing capacity, the MCA-P funded training from the U.S. Treasury’s Office of Technical Assistance.

Despite these measures, the May 2016 IMF annual progress report noted that in terms of sustainability of reforms, the BIR’s management practices showed little evidence of cohesive corporate commitment to, and oversight over, the overall reform program. Disciplined project and program management that IMF assistance introduced had almost disappeared and there was not much evidence of effective project planning, regular monitoring and reporting on progress. Improvement was needed in these areas so that BIR management can fully understand ongoing reforms, monitor their progress, and hold project sponsors and managers accountable. IMF further noted that weak oversight and ineffective internal reporting systems will make it very difficult to manage and monitor actions needed to sustain and build on the progress being made on the project.

**Measures Are Not Adequate to Determine Revenue Growth from RARP Activities**

Adequate measures and monitoring mechanisms are not in place for all activities. For example, there is limited ability to determine revenue growth attributable to tax reforms because MCC key performance indicators used to measure RARP-related revenue growth have shortcomings, and the BIR’s ability to measure revenue growth linked to reforms. MCC emphasized RARP’s impact on economic growth because of anticipated increased tax revenues from the sustainability of tax administration reforms implemented under the project. It is therefore important that tax revenue growth from RARP reforms be measured to determine their impact.

MCC stated that attributing revenue growth from tax reforms is very difficult because of the nature of reform projects and the many different factors that affect BIR revenue collection, including economic growth in the Philippines. MCC also noted that to attribute revenue growth from tax reforms, it would have to estimate what revenue growth would have been in the absence of these reforms.

Of the three projects in the Philippines compact, MCC determined that RARP would potentially
have a greater impact on economic growth with an economic rate of return (ERR) of over 40 percent. RARP is national in scope and was anticipated to benefit the majority of the Philippine population because of the project’s objective to increase tax revenues over time. Increased revenue, in turn, could be used for social welfare and development programs. MCC, in its Table of Key Performance Indicators for the Philippines compact, estimated a $160.1 million increase in income over the 20 year life of the investment generated by a projected increase in collected tax revenue and improved efficiency through public sector revenue administration and tax payer compliance.

IMF’s 2016 annual progress report recognized the growth in revenue from RARP, noting that the BIR had come a very long way since the inception of the project in January 2011. Revenue performance had improved markedly, new techniques and procedures had been adopted that uncovered very large amounts of outstanding tax debt and identified, through audits, large amounts of undeclared VAT. Successes of the Arrears Management and VAT audit pilots were also noted by the IMF as major highlights during the second phase of the project.

The BIR’s reported increase in tax revenue collections from 2012-2014 is shown in the following table.

<table>
<thead>
<tr>
<th>IMPLEMENTING OFFICE</th>
<th>CY 2012</th>
<th>Growth % from 2012 to 2013</th>
<th>CY 2013</th>
<th>Growth % from 2013 to 2014</th>
<th>CY 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Taxpayers Service</td>
<td>649,964.74</td>
<td>16%</td>
<td>755,259.42</td>
<td>9%</td>
<td>824,511.83</td>
</tr>
<tr>
<td>Revenue Region</td>
<td>369,341.78</td>
<td>15%</td>
<td>424,257.05</td>
<td>12%</td>
<td>473,749.69</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,019,306.52</strong></td>
<td><strong>16%</strong></td>
<td><strong>1,179,516.47</strong></td>
<td><strong>10%</strong></td>
<td><strong>1,298,261.52</strong></td>
</tr>
</tbody>
</table>

As shown in Table 1, tax revenue collections increased by 16 percent from 2012 to 2013 and by 10 percent from 2013 to 2014. However, what portion of this revenue growth was directly attributable to RARP is difficult to substantiate. IMF consultants said that IMF’s reforms have had an impact in increasing revenue, but that the BIR did not have the ability to specifically identify the increased amount from RARP’s activities. MCC acknowledged that revenue attribution to reforms can be difficult in most cases, but identified a few key performance indicators regarding tax revenue from RARP. For example, one indicator identified is revenue from new and existing business registrants. However, MCC did not identify how much revenue was collected from business registrants as a baseline at the beginning of the compact nor a target goal for increased revenue from these registrants at the end of the compact. According to MCC, there was no baseline or target because there was no clear target from the ERR analysis. MCC noted that the benefits in this ERR were driven primarily by indirect benefits that are difficult or impossible to attribute to any particular project activity.

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4 To assess a country compact’s likely impact, MCC performs economic analysis estimating the compact’s ERR and effects on income and poverty. The ERR analysis provides an estimate of the total increase in incomes attributable to a proposed MCC-funded activity relative to the total costs.

5 CLA did not independently audit the estimate of $160.1 million in income and did not perform additional procedures to determine whether this estimate is materially correct.

6 The IMF 2016 progress report noted that, according to data provided by BIR, arrears of approximately PHP 9.2 billion was collected from March 2013 to March 2016.
MCA-P’s Monitoring and Evaluation plan identified as a key question the extent to which RARP has increased tax revenue collection. However, no evaluation study of RARP tax revenue growth was conducted during the compact. MCA-P’s Monitoring and Evaluation Director said that studies on RARP during the compact were limited to quantitative and qualitative studies of the 2014 baseline data from surveys of businesses, individual taxpayers, and DOF employees. There were no plans for evaluation studies of tax revenue growth during or after the compact.

In addition, the BIR does not appear to have the ability to measure revenue growth attributable to reforms. The Monitoring and Evaluation Director said that MCA-P had difficulty in obtaining timely information from the BIR on RARP’s progress on indicators. According to IMF consultants, while reforms have had some impact in increasing revenue, estimates of the amounts are largely anecdotal because the BIR does not have the ability to identify the specific amounts from RARP’s activities. Revenue growth can be caused by a number of factors unrelated to RARP reforms and some of the reforms, like eTIS and CAATTs will not be fully implemented until after the compact.

MCC concurred that attributing revenue growth to the project would be speculative. MCC noted that because the reform project was implemented at either a national level (e.g., Public Affairs Campaign) or within unique Revenue District Offices (metro Manila), there was no counterfactual or control group against which to measure revenue growth (in the absence of the project). According to MCC Monitoring and Evaluation policy, MCC balances the expected accountability and learning benefits with the evaluation costs to determine what type of evaluation approach is appropriate. Impact evaluations are performed when their costs are warranted by the expected accountability and learning. In this case, MCC did not feel that benefits outweighed the costs of a study regarding revenue growth from RARP. If tracking this information is necessary, MCC stated it would monitor the BIR’s collection statistics by region to watch the trends in tax revenue.

**MCC Study Determined Sustainability Planning Can Be Improved**

To help improve the sustainability of compact activities, MCC issued the results of an Operations Review (OR) on sustainability in compact projects in October 2012. The OR emphasized the importance of more rigorous and systematic sustainability planning for country compacts and resulted in a number of key findings and recommendations to improve MCC sustainability planning. Moreover, the OR identified elements critical to sustainability planning that were absent from MCC sustainability planning for RARP. However, according to MCC officials, the OR did not result in binding policy changes or revisions to operational guidance.

One key finding from the OR was that MCC did not have a consistent definition or approach to sustainability, which made it difficult to ensure that sustainability was being incorporated into compacts. One reason provided was that MCC does not explicitly plan for or monitor for sustainability. Another was that once a project moves into implementation, management focus tends to shift away from enhancing design in favor of execution.

The OR recommendations included suggestions to (1) develop a framework for, and to elevate the importance of, sustainability in compact development and implementation, (2) include sustainability plans and contingency plans in compact approval documents, (3) establish methods to monitor for and audit for sustainability, and (4) increase capacity within both the MCC and MCAs to evaluate and assess project sustainability. The OR also noted that the addition of draft sustainability plans and contingency plans in the Investment Memo, Compact, and any
Modification Memos that describe risks to the sustainability of project outcomes, mitigants, and proposed options in the event those risks materialize would add value in affirming that due diligence was complete and project design well-articulated. As noted by OR stakeholders, sustainability plans reflected a raised and high standard for MCC and for country partners and beneficiaries so they could gain lasting results.

The OR is applicable to RARP because it identified elements critical to sustainability planning that were absent from MCC and MCA-P sustainability planning for RARP. For example, the OR stated that accountability mechanisms like sustainability plans need to be in place to ensure sustainability and related risks are addressed in project design and implementation. Identifying responsibility for sustainability at both MCC and MCA-P is fundamental to improving the sustainability of outcomes. A framework of what sustainability entails needs to be clearly communicated from the outset of each compact document and any changes to projects must be evaluated and communicated.

Subsequent to the OR, in June 2013, a “MCC Points of Contact practice group” had a series of workshops on the issues presented in the OR and was to develop an action memo on recommendations and next steps. Several MCC Country, Development, and Transaction teams participated to develop best practices and incorporate sustainability planning into the compact lifespan, from development to implementation, closure and beyond. However, according to MCC officials, while some of the OR recommendations have been incorporated in MCC business practices, the review did not result in any binding policy or operational guidance changes. MCC officials stated that the MCC OR findings and recommendations regarding developing stand-alone sustainability plans for country compacts were not applicable to the Philippines compact because the OR was done about two years after the Philippines compact was signed.

However, MCC has developed sustainability plans for other compacts that identified risks and actions to address risks as called for in the OR. A September 2015 OIG review of MCC’s Moldova compact found that sustainability measures could be improved for Water Users Associations Training. In its response to the OIG report, MCC stated that MCC and MCA-Moldova conducted sustainability workshops in Moldova in 2013 to identify the biggest risks to sustainability of compact investments. Following the workshops, MCC and MCC-Moldova developed a sustainability plan in which potential risks were a top priority. As a result of this plan and focus, MCC noted that a strong path to sustainability was established.

Other GAO and OIG reports have also found that MCC could improve sustainability measures. An April 2016 Congressional Research Service report on MCC noted that U.S. Government Accountability Office (GAO) reports on completed compacts have questioned the effectiveness of MCC sustainability efforts it examined. For example, in a review of MCC transportation infrastructure projects in Georgia and Benin, GAO recommended that to ensure sustainability of compact projects, MCC should evaluate the tools it uses to ensure that partner countries have adequate resources to operate and maintain MCC-funded infrastructure. MCC agreed with the recommendation, but it did not commit to take any action to address the effectiveness of its tools to ensure its projects’ sustainability. Appendix II has a listing of OIG reports that have noted problems with the sustainability of MCC compact activities.

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Sustainability Risks and Challenges for Implementing Key Information Systems

RARP reforms of the Philippine tax system are dependent on the successful implementation of two critical information systems—eTIS and CMS. The goal of eTIS is to automate and computerize tax administration operations and replace the existing national system, the Integrated Tax System (ITS) in two deliverables with “eTIS-1” to be implemented at selected sites and “eTIS-2” to be the long-term national system. CMS was established to support Department of Finance initiatives to detect and deter corruption within its revenue agencies. RARP provided funding to acquire and customize CMS and to provide training to strengthen its surveillance capacity and increase the number of resolved cases.

Both eTIS and CMS incurred implementation delays during the compact and as discussed below face many significant risks and challenges to being fully implemented. For example, there was no clear vision for what eTIS’s full implementation should look like or how CMS would be funded to implement additional system enhancements. Further, without a consolidated plan to manage these implementation and sustainability risks, it will difficult for the Philippine government to ensure the systems are fully implemented and that MCC’s investments are sustained after the end of the compact.

**eTIS**

MCC did not establish clear goals for eTIS implementation. MCC officials said that the compact did not delineate the extent of the system that was required to be completed by the end of the compact. There is no mention in the compact of specific modules, the extent of deployment, or other specification of what eTIS should look like at the end of the compact. According to MCC officials, eTIS implementation was conceived as a “perpetual work-in-progress” with a succession of refinements and new versions of eTIS that would be required for the foreseeable future. As a result, system development will continue after the compact.

The delivery of the eTIS system was to be accomplished with a series of releases to provide “modules” relating to core tax administration functions. These include registration, return filing and processing, collections, remittance and reconciliation, audit and audit case management, some taxpayer accounting, associated reports as well as the necessary batch and online architectures and procedures for system administration. eTIS “optimization” was also necessary to provide the architectural platform upgrade needed to ensure a faster system.

However, there were numerous and lengthy delays to eTIS’ deployment to regional pilot offices because of undetected performance issues and testing issues and the BIR lacked a plan to adequately anticipate and adapt to these implementation problems. IMF annual reports noted these delays and raised concern about how they prevented integration with new procedures relating to core tax administration functions. New business procedures developed under the IMF were dependent on the full range of functionality expected under eTIS-2, and their integration with eTIS will now not occur until after the compact. To IMF, this represented “shrinkage” of the original scope of the project from national to only selected office implementation. IMF officials noted that full eTIS optimization and nation-wide rollout would not occur until well after the end of the compact with continuing risks to its sustainability regarding uncertainty of continued funding and adequate technical and procurement support.

There were also a number of changing requirements to the scope of eTIS implementation. MCA-P and BIR contractors did not fulfill requirements to complete, test, or deploy eTIS modules in
accordance with software delivery schedules and performance issues continued. In June 2015, MCC and MCA-P made a decision to scale back on the scope of eTIS because deadlines for key deliverables were not met and bids for procurement for optimization came in above budget. As a result, eTIS-2 and optimization were removed from consideration for compact funding and resulted in a reallocation of MCC funding for eTIS. According to an April 2016 audit of MCC’s Fund Accountability Statement, MCC approved the reallocation of $10.2 million of program funding from RARP to the other projects in the compact. As a result, the BIR lost the opportunity to use $10.2 million in MCC funding for eTIS’s optimization and will now have to use its own funds for this purpose.

Infrastructure and performance issues also affected eTIS implementation. According to an April 2016 eTIS go-live assessment done by PricewaterhouseCoopers for MCA-P, inadequate network bandwidth for the BIR offices also impacted the efficiency of business operations for the BIR to facilitate tax filing and increase tax revenue collection. eTIS performance issues and response times were reported by eTIS users at several regional districts and revenue regions. To deal with the slow response times, some users were encoding tax data into Excel spreadsheets and then copying the data into eTIS. BIR officials indicated they were aware of these performance issues and were in discussions to change telecom service providers and reduce the number of network “hops”, which is expected to improve system performance. The BIR has also invested in upgrading the bandwidth of all pilot offices during the compact and several other infrastructure upgrades.

According to MCC, as of the compact’s end date, May 25, 2016, the core eTIS modules were operational. However, all potential modules and elements of the eTIS-2 system have not been fully implemented and system development will continue after the compact. According to MCC, eTIS implementation was started by BIR prior to the Compact and could not be restarted to reflect new goals so all potential modules were unable to be fully implemented and developed prior to the end of the compact. BIR was only able to fully deploy modules at certain pilot sites. MCC officials state that they are fully aware of the government’s challenges in further enhancing the system, but believe that commitments are in place to ensure eTIS implementation is continued.

IMF’s 2016 annual report noted that the BIR’s schedule for deployment of eTIS-1, its optimization and eTIS-2 procurement means that the legacy system, ITS, will have to remain in tandem with eTIS-1 until at least 2018. Therefore, according to the IMF the BIR will continue for at least another two years to be at risk of an ITS failure. Such an event would also adversely impact the myriad of stand-alone BIR systems that interface with ITS and eTIS databases. According to IMF, there does not appear to be a contingency plan for this situation.

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11 $9.8 million was reallocated from the BIR RARP activity and $423,000 was reallocated from the RIPS RARP activity.

12 MCA-P appointed PricewaterhouseCoopers Private Limited (PwC India) as an Independent Assurer for the eTIS-1 project. PwC’s scope involved the testing or verifying whether the system delivered by the eTIS-1 supplier was in conformity with the requirements specifications signed off between the BIR and eTIS-1 supplier. PwC conducted a post go-live assessment of the eTIS modules at the select pilot locations of the BIR in February-March 2016.
RIPS CMS

At the time of our audit, the current RIPS CMS solution was not yet fully mature, and RIPS officials had not identified how CMS would be funded to implement additional system enhancements. RIPS’s system development, staffing, and funding challenges have affected the development and continued sustainability of CMS. For example:

- CMS was still in production at the time of our audit and was only in use since December 2015. It was not being used for cases and was still undergoing testing. According to MCC, required data and information for CMS was not yet fully digitized and additional modifications identified could not be tested and implemented before the end of the compact.

- As of May 2016, RIPS staffing was below its authorized level of 35 positions with an actual staffing level of 29 personnel. Limited staffing has affected meeting Key Performance Indicators such as the number of personnel charged with graft, corruption, lifestyle and/or criminal cases and the number of successful case resolutions.

- Future RIPS funding is uncertain, given that annual appropriations have to be approved, resulting in potential maintenance and staffing constraints. According to the RIPS Executive Director, funding has been very limited from the budget. RIPS has submitted proposals in its 2017 budget for increased staffing. MCC acknowledged that the Philippine DOF needs to provide adequate resources to RIPS for its sustainability.
CONCLUSIONS

Ensuring that U.S. taxpayer-funded development projects are fully implemented and then sustained by host governments is a continual challenge to international development agencies. MCC’s implementation of RARP activities in the Philippines was no exception. While some sustainability measures were designed and implemented for RARP’s activities, the measures were fragmented in various budget and planning documents that will make managing the full implementation and sustainability of MCC’s investments in the Philippines difficult.

Past GAO and OIG reports have found that MCC could improve sustainability measures. In an October 2012 Operations Review performed by MCC staff, MCC also acknowledged that it could improve sustainability planning for compacts. One key recommendation was that accountability mechanisms like sustainability plans need to be in place to ensure sustainability and related risks are addressed in designing and implementing project activities. Having such plans that provide (1) a clear vision of goals to be achieved, (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures, and (3) a mechanism to monitor and report on the progress of sustainability measures would help lessen the challenges that host governments face in sustaining MCC’s activities well after MCC funding has ended.
RECOMMENDATIONS

To improve sustainability planning for future Country Compacts, we recommend that MCC’s Vice President of Compact Operations:

**Recommendation 1:** Develop and implement policy and operational guidance from the findings and recommendations made in its October 2012 Operations Review to improve sustainability planning.

**Recommendation 2:** Develop and implement policy and operational guidance that require countries in future compacts to develop and annually update sustainability plans that specifically identify the risks and challenges to sustainability and proposed options to manage and mitigate these risks, as recommended in the Operations Review. In addition, such plans should establish (1) a clear vision of goals to be achieved, (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures and (3) a mechanism to monitor and report on progress of sustainability measures.
EVALUATION OF MCC MANAGEMENT COMMENTS ON THE DRAFT REPORT

We provided MCC with our draft report on December 5, 2016 and on January 6, 2017, received its written response, which is included as an appendix to this report. MCC did not concur with the recommendations as specifically written. However, MCC stated it in its response that it concurred with the spirit of our recommendations, has carefully considered the 2012 OR findings, and is taking action to implement several measures in 2017 to improve MCC sustainability planning for future compacts. With respect to the first recommendation on developing and implementing policy and operational guidance from the OR to improve sustainability planning, MCC stated that it is developing several guidance documents in 2017 to respond to concerns raised in the OR regarding sustainability. With respect to the second recommendation on developing and implementing policy and operational guidance requiring countries in future compacts to develop and annually update sustainability plans, MCC stated it will convene a working group to develop guidance for the oversight of sustainability planning and implementation. MCC plans to approve new guidance in the fall of 2017.

MCC did not concur with our findings as written that (1) creation of single, consolidated sustainability plan is the best way to ensure effective mitigation of sustainability risks, (2) MCC cannot determine revenue growth directly attributable to RARP, and (3) reliance on an internal MCC review document from 2012 (the OR) as the basis for formulating recommendations on sustainability. With respect to the first finding, MCC stated the MCA-P and BIR held extensive discussions about sustainability planning during the compact and developed sustainability measures that were memorialized in the Program Closure Plan drafted after our audit fieldwork and prior to the compact end date. We recognized that these measures addressed sustainability but, we believe that consolidating sustainability efforts is a best practice for the reasons set out in the report. With respect to the second finding, MCC noted the difficulty in attributing revenue increases to the RARP program with precision because RARP was a reform initiative of national scope in a sector influenced by many variables.

MCC also noted that tax arrears collection was one area where the link between reform and significant increased revenue is stronger. Our audit report recognized these challenges and the success of the arrears collections. With respect to the third finding, MCC stated that it is incorrect to assume that OR recommendations represent best practices that require corrective action, rather the OR documents are internal documents meant to stimulate discussion on areas of risk facing the agency. Nevertheless, as noted in the report, stakeholders such as MCC Country, Development, and Transaction teams participating in the OR characterized the effort as developing best practices to improve sustainability planning over the compact lifespan. As noted above, in response to our recommendations, MCC is taking steps to improve sustainability planning in future compacts.

We have reprinted MCC’s comments in appendix III. We have also incorporated technical comments from MCC in our report where appropriate.
APPENDIX I - SCOPE AND METHODOLOGY

Scope
Our audit objective was to determine whether the Millennium Challenge Corporation (MCC) and MCA-P designed and implemented sustainability measures for RARP activities through the implementation of the electronic Tax Information System (eTIS) and the Case Management System (CMS) to improve tax administration and anti-corruption policies and practices.

We conducted this performance audit in accordance with Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Methodology
In planning and performing the audit, we reviewed documentation related to the Philippines Compact, MCC sustainability studies and practices, MCC and MCA-P monitoring and evaluation of RARP, the BIR activities in implementing eTIS, computerized automated auditing tools and techniques, and the Public Awareness Campaigns, RIPS implementation of the Case Management system, its staffing, and caseload, and IMF technical assistance related to RARP. We also reviewed several GAO and USAID OIG reports on MCC’s funding of compacts in other countries.

We conducted our fieldwork at MCC’s headquarters in Washington, D.C. from December 2015 to May 2016, and conducted site visits in Manila, Philippines from April 18-29, 2016. While in the Philippines, we visited the offices of the MCA-Philippines, the Philippine Government Bureau of Internal Revenue and its Revenue Regions 5, 6, and 8, and Revenue District Offices 47, 49, and 50 in the metro Manila area. We also visited the office of RIPS in the Philippine Government Department of Finance and met with the IMF technical advisor and consultants in Manila.

To answer the objective, we interviewed MCC, MCA-P, Philippine Government officials in BIR and RIPS, and the IMF technical assistance advisor and consultants to collect and evaluate information on (1) implementation of eTIS, CAATTs, and CMS to reengineer and computerize its tax administration policies, (2) sustainability measures and plans developed for these activities, (3) progress of the RIPS in addressing corruption in revenue agencies, and (4) monitoring and evaluation of these activities. We also reviewed and analyzed documentation associated with these activities to gain an understanding of project design, implementation, and risks and challenges to their implementation and sustainability. As noted above, we also conducted site visits at selected Revenue Regional offices and Revenue District offices to assess implementation and expansion of these activities and reforms at regional offices.
APPENDIX II - USAID OIG REPORTS NOTING MCC COMPACT SUSTAINABILITY ISSUES

1. Review of the Millennium Challenge Corporation’s Transition to High-Value Agriculture Project in Moldova, Report no. M-000-15-005-S, July 28, 2015. The OIG reported that the sustainability of irrigation systems was at risk because the water user associations charged with managing and maintaining them had not received all planned training or experience on operating them.

2. Review of the Millennium Challenge Corporation-Funded Small-Scale Fisheries Project in Morocco, Report No. M-00-15-004-S, March 30, 2015. The OIG reported that the sustainability of certain project activities was at risk. Under the first Morocco compact, 15 of 30 completed fishery infrastructure projects were not operational (fully functioning) at compact end, including boat landing sites, ports, and wholesale fish markets. Delivery of planned sustainability benefits would not occur unless the projects become operational.

3. Audit of the Millennium Challenge Corporation-Funded Program in Namibia, Report No. M-000-14-002-P, December 17, 2013. The OIG found that MCC needed to improve the quality of construction and renovation of schools in Namibia. The drainage around the new schools and latrines was not always sufficient to prevent flooding caused by heavy rains and masonry workmanship was of poor quality. Improved project execution could better ensure the long-term sustainability of the schools.

4. Audit of the Millennium Challenge Corporation-Funded Program in Senegal, Report No. M-000-13-001-S, March 18, 2013. The OIG found that funds made available by the Senegalese Government were inadequate to provide annual maintenance for an MCC-funded roads project. Similarly, the long-term sustainability of MCC-funded irrigation works was also at risk due to inadequate maintenance services and funding. OIG also reported that MCC is taking action to ensure that adequate funding is available to maintain the investments in roads and irrigation.

5. Audit of the Millennium Challenge Corporation-Funded Fruit Tree Productivity Project in Morocco. Report No. M-000-12-005-P, June 16, 2012. The OIG found that the sustainability of an MCC-funded fruit tree productivity project in Morocco was at risk because olive trees may receive less maintenance than outlined in the project’s design.
MEMORANDUM

Date: January 6, 2017

To: Donell Ries
Deputy Assistant Inspector General for the Millennium Challenge Corporation

From: Kyeh Kim
Digitally signed by Kyeh Kim
DN: cn=KyehKim,o=Millennium Challenge Corporation, ou=DCO, email=kimk@mcc.gov,c=US

Date: 2017.01.0616:16:01 -05'00'

Acting Vice President, Department of Compact Operations
Millennium Challenge Corporation

Subject: MCC Management Response to Report No. M-000-17-00X-C

The Millennium Challenge Corporation (MCC) appreciates the opportunity to respond to the Office of Inspector General’s (OIG) draft report on sustainability planning in the Revenue Administration Reform Project funded under MCC’s compact with the Republic of the Philippines, prepared by the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA), under contract with OIG. MCC thanks the auditors for incorporating a number of MCC’s August 5, 2016 comments on CLA’s Exit Conference document in the draft audit report, including the listing of ten examples of the extensive measures integrated throughout all facets of the Revenue Administration Reform Project (RARP) to sustain the investments and benefits of the project.

MCC agrees that attention to sustainability throughout the compact lifecycle is critical. MCC’s efforts to improve the sustainability of our programs are ongoing, and the agency has given careful consideration to how the analysis offered by this audit may strengthen our work. At the same time, MCC maintains differences of opinion with respect to several aspects of this particular audit. Specifically:

- MCC does not concur with CLA’s assertion that creation of a single, consolidated sustainability plan is necessarily the best way to ensure effective mitigation of sustainability risks in all instances;
- MCC does not concur with CLA’s assertion that MCC cannot determine revenue growth that is directly attributable to RARP, and that this represents a failure of MCC’s monitoring function; and
- MCC does not concur with CLA’s reliance on an internal MCC review document from 2012 as the basis for formulating recommendations on sustainability.

The logic and evidence underpinning MCC’s positions on these three key elements are elaborated below.
MCC integrated sustainability planning throughout design and implementation, and compiled all relevant ongoing commitments and understandings into the Program Closure Plan.

CLA asserts that MCC did not require the Bureau of Internal Revenue (BIR) or the Revenue Integrity Protection Service (RIPS) to develop sustainability plans and asserts that the absence of a single, consolidated sustainability plan constitutes a weakness in MCC’s sustainability planning process. MCC continues to believe this assertion places form over substance, while underplaying significant actions and commitments undertaken to ensure program sustainability.

The Philippines Program Implementation Agreement included several conditions precedent that were specifically designed to demonstrate commitment from the Government of the Philippines and to improve the likelihood that RARP’s reforms would be sustainable. This included clear requirements for certain staffing and funding levels for the relevant office within BIR, as well as for RIPS. The compact also included certain covenants to be maintained for the duration of the compact to ensure that, among other things, RIPS was fully exercising its authority to proactively pursue graft-related programs, policies, and procedures. In addition, during RARP implementation, MCC and MCA-P specifically sought and successfully received a letter from the BIR Commissioner committing the BIR to continuing post-compact funding for eTIS enhancements. MCC and MCA-P also successfully pushed BIR to transfer money for the procurement of follow-on eTIS software development resources to a separate unit to ensure availability of funds after compact closure.

Under MCC’s guidance, MCA-P and BIR held extensive discussions about sustainability planning at every step of implementation. Such discussions included a 2014 workshop to develop a strategic plan that specifically included sustainability measures. The results of the workshop formed part of the MCA-P strategic work plan for 2015 and up to the end of the closure period, and were memorialized in the Program Closure Plan (PCP) that MCA-P drafted subsequent to the audit fieldwork and prior to the compact end date. As a result of MCA-P’s intentional and strategic sustainability planning with BIR, numerous sustainability measures were developed and woven directly into RARP. Such measures were comprehensive, covering areas including staffing (e.g., 283 positions created and funded by BIR); training (e.g., training programs for staff developed and executed); infrastructure (e.g., dedicated office space secured for expanded services under RARP); technology (e.g., software acquired to enhance BIR operations, IT staff training materials developed); and funding (e.g., commitment secured from BIR and Secretary of Finance that BIR would continue eTIS implementation “to achieve the activity’s post-compact objectives”).

In addition, MCC recorded BIR’s key sustainability commitments and consolidated relevant documents into a single packet for transmission to the Philippine government at close-out. For example:

- The Program Closure Plan (PCP) memorialized key sustainability measures and commitments that MCC and MCA-P developed jointly in consultation with BIR;
- An August 24, 2016 “Implementation Letter regarding Approval of the Program Closure Plan” outlined BIR’s commitment to “continue the implementation of eTIS after the compact and will roll out eTIS’ respective components to achieve the activity’s post-compact objectives.” MCC ensured that the letter was countersigned by the Minister of Finance;
- MCC’s Post-Compact Monitoring & Evaluation (M&E) plan captured key post-compact sustainability measures, including for the Philippine government to monitor and report on
“progress of additional work agreed with the BIR to further enhance the capability of eTIS and the usage of CAATTS.” (p. 1 of Post-Compact Monitoring and Evaluation Plan). MCC ensured that an M&E letter adopting the Post-Compact M&E Plan was signed by BIR and countersigned by the Secretary of Finance; and

- On October 11, 2016, MCC sent a letter entitled “Compact Closure, Sustainability, and Post-Compact Engagement” to the Secretary of Finance that reinforced MCC’s expectations on sustainability. The accompanying 236-page packet included the aforementioned documents, as well as other records to help the Philippine government track its continuing obligations.

MCC has, and will continue to, closely monitor RARP and the Philippine government’s work on post-compact sustainability to the greatest extent permitted by MCC’s statute.

Rather than fully recognizing the evidence presented to demonstrate the many sustainability measures that have been integrated into the project, CLA asserts, without providing supporting evidence, that RARP’s integrated approach to sustainability planning is less effective than a standalone sustainability plan.

**MCC’s decision to forego a costly impact evaluation was reasonable as a matter of business judgment, and, given the ability to directly attribute sufficient revenue growth, to provide economic justification for the investment.**

CLA asserts that MCC cannot determine revenue growth that is directly attributable to RARP with precision, and that this represents a failure of MCC’s monitoring function. MCC disagrees with CLA’s conclusion.

MCC’s investment criteria require an estimated economic rate of return (ERR) of 10%, and estimates of the ERR for RARP exceeded 40%. In estimating this ERR, MCC assumed the project will increase the revenue share in GDP from 9.6% to 9.9% (about $400 million, or 20 billion PHP) over a period of 8 years.

In the Monitoring and Evaluation Plan on the MCC’s website, Annex B, “Indicators Definition and Tracking Tables,” for the indicator “Revenue from new and existing business registrants,” there are a baseline of PHP 822,624 million and a year five target of PHP 1,969,999 million. The year five actual for this indicator was PHP 1,441,571 million. The actual minus the baseline represents an increase of PHP 618,947 million. MCC would not be able to attribute this increase to the project, though, because BIR revenue collection has been growing annually from between -3% to 20% since 2004. This indicator is an important one because it alerts MCC to the trend in tax revenues during the project.

<table>
<thead>
<tr>
<th>BIR Revenue Collection</th>
<th>Percent change (annual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004 469,587,360,000</td>
<td></td>
</tr>
<tr>
<td>2005 544,306,730,000</td>
<td>16%</td>
</tr>
<tr>
<td>2006 653,281,950,000</td>
<td>20%</td>
</tr>
</tbody>
</table>

2004 to 2009 data from BIR website:
<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>717,233,580,000</td>
<td>10%</td>
</tr>
<tr>
<td>2008</td>
<td>780,055,790,000</td>
<td>9%</td>
</tr>
<tr>
<td>2009</td>
<td>755,561,370,000</td>
<td>-3%</td>
</tr>
<tr>
<td>2010</td>
<td>822,624,000,000</td>
<td>9%</td>
</tr>
<tr>
<td>2011</td>
<td>924,146,000,000</td>
<td>12%</td>
</tr>
<tr>
<td>2012</td>
<td>1,057,920,000,000</td>
<td>14%</td>
</tr>
<tr>
<td>2013</td>
<td>1,216,660,000,000</td>
<td>15%</td>
</tr>
<tr>
<td>2014</td>
<td>1,334,760,000,000</td>
<td>10%</td>
</tr>
<tr>
<td>2015</td>
<td>1,441,571,450,000</td>
<td>8%</td>
</tr>
<tr>
<td>Year-5 Target</td>
<td>1,969,999,000,000</td>
<td></td>
</tr>
</tbody>
</table>

2010 to 2015 data from Indicator Tracking Table data submitted by MCA Philippines

To attribute the 20 billion PHP increase in revenue predicted by the project, the impact evaluation would have to be able to identify a 20 billion PHP increase in a revenue trend that is already increasing by up to about 100 billion PHP annually.

It is difficult to assign revenue increases to the RARP program with surgical precision because RARP was a reform initiative of national scope (i.e.: no counterfactual or control group) in a sector influenced by many variables. According to MCC’s Monitoring and Evaluation Policy (page 18), MCC defines Impact Evaluation as “a study that measures the changes...that are attributable to a defined intervention. Impact evaluations require a credible and rigorously defined counterfactual...” MCC exercises business judgment in determining which impact evaluations are appropriate, balancing expected accountability and learning benefits against the evaluation costs. In this case, MCC believed that a costly Impact Evaluation to calculate precise impact was not appropriate. Even though there was no Impact Evaluation, MCC did track important indicators and project performance via the Monitoring and Evaluation Plan and IMF reports.

There are some aspects of the RARP project that were added after the original ERR was calculated, like arrears collection, for which the link between the reform and the increased revenue is stronger. The amount of revenue that BIR raised after CY2014 was very significant. In particular:

- The total arrears inventory grew 19.6% from December 2014 to December 2015 alone. The increase in the debt inventory from December 2011 to December 2015 was PHP 143.75 billion [$2.88 bn\(^1\)], or 164 percent, for a total debt inventory of PHP 380.22 billion [$7.62 bn]. Of the total outstanding debt, 44 percent [$3.36 bn] has been assessed as potentially recoverable.
- From January 2013 to December 2015 alone, additional VAT deficiency assessments were issued for PHP 22.86 billion [$458.2 mn], and actual collections were PHP 5.19 billion [$104 mn]. Broken down by year:

\(1\) All conversions to USD assume exchange rate of 49.89 PHP per USD (fx rate as of December 21, 2016).
Assessments of VAT deficiencies grew by 101% year-on-year between 2013 and 2015 (from PHP 2.743 bn ($54.98 mn) in 2013 to PHP 9.040 bn ($181.2 mn) in 2014 and PHP 11.076 bn ($222 mn) in 2015).

Actual collections of VAT deficiencies grew 61.6% year-on-year between 2013 and 2015, from PHP 959 mn ($19.2 mn) in 2013 to PHP 1.725 bn ($34.6 mn) in 2014 and PHP 2.507 bn ($50.25 mn) in 2015.

In this context, MCC’s decision to forego a costly impact evaluation—and instead track these specific tax revenues during compact implementation—was reasonable.

**MCC management has considered recommendations from the 2012 Operations Review, along with findings from other audits, evaluations and independent reviews, to enhance the effectiveness and sustainability of programs.**

CLA cites a MCC 2012 Operational Review (OR) as primary support for its conclusion that MCC failed to ensure RARP’s sustainability when it did not produce a single, consolidated sustainability plan. CLA’s argument incorrectly assumes that OR recommendations represent best practice, and that an MCC management decision to not implement any OR recommendation therefore requires corrective action. MCC disagrees with this assessment.

Far from representing best practices that MCC should adopt as a matter of course, Operations Review documents at MCC were intentionally designed as pre-decisional, internal learning documents meant to stimulate staff and management discussion on important areas of risk facing the agency. Written by small groups of staff tasked with identifying potential options for further deliberation and discussion by MCC management, ORs were meant to explore critical issues in MCC operations and practice with the intention of creating a process for sharing experiences more systematically, identifying risks and successful risk mitigation strategies, and developing improved practices. They did not intend to, and they did not, represent best practices for incorporation into MCC policies or guidance.

As internal review and learning documents, Operations Reviews were designed to promote consideration of a broader range of ideas and alternatives, spurring innovative approaches to solving common problems encountered in international economic development. If the expectation had been that each of the recommendations in these reports would be worked into future iterations of policy and guidance, this would have placed a chilling effect on the types of recommendations under consideration, as well as on the internal clearance process for these documents, ultimately limiting the learning outcomes and undermining the entire purpose of the internal reviews.

**CLA’s Recommendations**

As discussed below in MCC’s responses to the auditors’ recommendations, the Department of Compact Operations (DCO) has already undertaken a number of actions to enhance sustainability planning practices. MCC agrees that continued attention to sustainability is essential and that further improvement in this area is possible. Management Decision on each recommendation is given below.

**Recommendation 1:** Develop and implement policy and operational guidance from the findings and recommendations made in its October 2012 Operations Review to improve sustainability planning.
MCC Response:

As stated above, Operations Review documents at MCC were pre-decisional, internal learning documents meant to stimulate staff and management discussion on important areas of risk facing the agency. These reviews were not ever considered decisional. The 2012 Operations Review was no exception.

Despite this important clarification on the status and purpose of ORs, DCO concurs with the spirit of this recommendation. DCO management has carefully considered the findings of the 2012 Operations Review, and in response to this audit recommendation:

- DCO has already developed a framework/typology to orient MCC’s sustainability efforts and analysis. This framework, which was developed by an internal working group, was approved by DCO management, but has not yet been cleared and approved by the agency as a whole. By September 30, 2017, DCO plans to seek agency-wide comment and approval on the sustainability typology, as well as develop a plan to more fully integrate this typology as a tool for analytical use in both compact development and implementation.
- MCC has approved new investment criteria to guide all MCC investments. There is a firm roll-out plan in place for 2017. The new criteria will require teams think through sustainability issues before compacts are signed or enter into force, ensuring MCC’s work is better designed for sustainability from the start.
- MCC is developing new Compact Development Guidelines with an explicit section on sustainability of investments. DCO plans to issue these guidelines in February 2017.
- MCC is developing new guidelines to structure MCC’s quarterly portfolio review process, to ensure ongoing management attention to all areas of sustainability during compact implementation. These new guidelines include specific annual reporting on sustainability risks and mitigation measures. DCO plans to issue these guidelines in March 2017.

MCC management believes that the guidance documents listed above represent a strong management response to concerns raised in the 2012 OR regarding sustainability.

Recommendation 2: Develop and implement policy and operational guidance that require countries in future compacts to develop and annually update sustainability plans that specifically identify the risks and challenges to sustainability and proposed options to manage and mitigate these risks, as recommended in the Operations Review. In addition, such plans should establish (1) a clear vision of goals to be achieved, (2) a mechanism to assess their effectiveness in terms of the completeness, robustness, and cohesiveness of sustainability measures and (3) a mechanism to monitor and report on progress of sustainability measures.

MCC Response:

While MCC concurs with the spirit of this recommendation, we would suggest that operational guidance should instead focus on the following factors, which MCC has identified as being appropriate for our model:

- During compact development, planning for sustainability must be a component of all investment decisions. Careful attention needs to be placed on government commitments and partnerships.
MCC believes these elements are best addressed through the Investment Management Committee, applying the new investment criteria and utilizing the new guidance for compact development mentioned above.

- During the first few years of compact implementation, sustainability needs to be built into the program review cycle and management oversight mechanisms. However, MCC management believes the Quarterly Portfolio Reviews are the appropriate frequency and depth to address sustainability. As indicated above, supplemental QPR guidance will be approved and effective by March 2017.

- MCC management believes that planning to mitigate sustainability risks requires clear attention to partnerships and to government commitments. This includes ensuring the legal and institutional agreements are in place to support program continuity and resourcing, as was done in the Philippines RARP project.

In response to this recommendation, MCC has convened a working group to develop guidance for sustainability planning that is planned to be approved in the fall of 2017.

Thank you again for the opportunity to share our comments on the draft report. The actions specified above and documentation attached constitute management decision for these recommendations.

If you have any questions, comments or concerns, please contact Heather Hanson, Managing Director of Portfolio Administration (DCO), at 202-521-3567 or hansonhd@mcc.gov; or Jude Koval, Director of Internal Controls and Audit Compliance (A&F/ICAC), at 202-521-7280 or kovaljg@mcc.gov.

Cc: Thomas Yatsco, Assistant Inspector General, OIG
    Gary Middleton, Director, Performance Audits, OIG
    Fatema Sumar, Deputy Vice President, (DCO/EAPLA), MCC
    Caroline Nguyen, Managing Director, (DCO/EAPLA), MCC
    Jude Koval, Director of Internal Controls and Audit Compliance, (A&F/ICAC), MCC
**ABBREVIATIONS**

The following abbreviations appear in this report:

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIR</td>
<td>Bureau of Internal Revenue</td>
</tr>
<tr>
<td>CAATTs</td>
<td>Computerized Automated Auditing Tools and Techniques</td>
</tr>
<tr>
<td>CMS</td>
<td>Case Management System</td>
</tr>
<tr>
<td>DOF</td>
<td>Department of Finance</td>
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<tr>
<td>eTIS</td>
<td>electronic Tax Information System</td>
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<tr>
<td>GAO</td>
<td>Government Accountability Office</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<td>Integrated Tax System</td>
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<tr>
<td>KALAHI-CIDDS</td>
<td>Kapit-Bisig Laban sa Kahirapan - Comprehensive Integrated Delivery of Social Service</td>
</tr>
<tr>
<td>MCA-P</td>
<td>Millennium Challenge Account-Philippines</td>
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<td>MCC</td>
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<td>OR</td>
<td>Operations Review</td>
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<tr>
<td>PAC</td>
<td>Public Awareness Campaign</td>
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<tr>
<td>PwC</td>
<td>PricewaterhouseCoopers</td>
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<tr>
<td>RARP</td>
<td>Revenue Administration Reform Project</td>
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<tr>
<td>RIPS</td>
<td>Revenue Integrity Protection Service</td>
</tr>
<tr>
<td>VAT</td>
<td>Value Added Tax</td>
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