



# OFFICE OF INSPECTOR GENERAL

---

## AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION'S FUNDING OF ACTIVITIES IN MONGOLIA

AUDIT REPORT NO. M-000-12-001-P  
MARCH 22, 2012

WASHINGTON, D.C.



*Office of Inspector General*

March 22, 2012

Mr. Daniel Yohannes  
Chief Executive Officer  
Millennium Challenge Corporation  
875 15<sup>th</sup> Street, NW  
Washington, DC 20005

Dear Mr. Yohannes:

This letter transmits the Office of Inspector General's report on the *Audit of the Millennium Challenge Corporation's Funding of Activities in Mongolia*. In finalizing the 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 four recommendations to strengthen the Millennium Challenge Corporation's policies and procedures. We consider that management decisions have been reached on Recommendations 1, 2, and 4, and final action has been reached on Recommendation 3.

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

Sincerely,

/s/

Mark Norman  
Acting Deputy Assistant Inspector General for Audit  
Millennium Challenge Corporation

# CONTENTS

- Summary of Results** ..... 1
- Audit Findings** ..... 5
  - MCC’s Procurement Policies May Not Be Consistent..... 5
  - Number of Subcontractors Reported on the  
Choir-Sainshand Road Project Was Inconsistent ..... 5
  - MCC Property Rights Registration Activity  
May Not Meet Its Goal ..... 6
  - Well Houses May Lack Proper Ventilation ..... 7
- Evaluation of Management Comments** ..... 9
- Appendix I – Scope and Methodology** ..... 10
- Appendix II – Management Comments** ..... 12

# SUMMARY OF RESULTS

On October 22, 2007, the Millennium Challenge Corporation (MCC) signed a 5-year, \$285 million compact with the Government of Mongolia aimed at reducing poverty and promoting sustainable economic growth through investments in four projects. At the request of the Government of Mongolia, one of the projects, a \$188 million rail project, was later canceled and two new projects were added through an amendment to the compact in January 2010. The amended compact includes the following five projects:

1. A \$28 million Property Rights Project to improve the land privatization and registration system, privatize and register approximately 75,000 land plots, and to lease approximately 465 tracts of rangeland to groups of herders.
2. A \$39 million Health Project to address the high and growing incidence of noncommunicable diseases and injuries and ensure that Mongolians become healthier and more productive as they enter the marketplace.
3. A \$48 million Vocational Education Project to prepare more Mongolians to qualify for more demanding and financially rewarding market-oriented jobs.
4. A \$47 million Energy and Environment Project (added through the amendment) to increase the adoption of energy-efficient products and homes, and to support the development of renewable energy.
5. An \$80 million North-South Road Project (added through the amendment) to construct a 176-kilometer road between the towns of Choir and Sainshand, to construct and rehabilitate bridges and a road near Ulaanbataar, and to provide technical assistance to the Government of Mongolia to help improve road maintenance.<sup>1</sup>

The Millennium Challenge Account-Mongolia (MCA-M) is the host-government entity charged with implementing the terms of the compact. The compact entered into force on September 17, 2008, and will conclude in September 2013. As of June 30, 2011, MCA-M had committed nearly \$121 million for the Mongolia compact.

The objective of this audit was to determine whether the North-South Road Project and Property Rights Project were on schedule to achieve their project activity goals.

**North-South Road Project.** The Office of Inspector General (OIG) found that the North-South Road Project is behind schedule by at least 1 year and faces significant risks to completing and achieving its project activity goals. MCC expected that road construction would be well under way by the time of the OIG audit in September 2011. Instead, only a nominal amount of work was done on the Choir-Sainshand road, and no work was done on the construction and rehabilitation of bridges and a road near Ulaanbataar during the 2011 construction season. MCA-M plans to focus on the third project activity—providing technical assistance to the Government of Mongolia—after progress is made with the road construction activity.

---

<sup>1</sup> Of the compact's total \$285 million, \$43 million is used primarily for compact administration.

The North-South Road Project has been delayed because of difficulties with contractors and the time required for the procurement process. For example, the contractor initially hired to build the Choir-Sainshand road entered into bankruptcy in April 2010 and was terminated in May 2011 after 1 year on the job. MCA-M then hired three smaller road contractors to perform a nominal amount of work during the summer of 2011 in an attempt to salvage some of the 2011 construction season. However, the contractors were inexperienced, and MCC expects that they will finish only about 20 percent of the work planned. MCA-M plans to hold another procurement to find new contractors to continue work on the Choir-Sainshand road project.

Another factor leading to a delay in the North-South Road Project is that the contractor originally selected for the construction and rehabilitation of bridges and a road near Ulaanbataar failed to provide a performance security as a financial guarantee for the work and therefore was unable to proceed. Because the procurement process takes several months and the construction season in Mongolia is limited generally to the summer, the 2011 construction season for this activity was lost because of the failed procurement. MCA-M then divided this activity into two segments and attempted to find new contractors. As of October 2011, however, MCA-M had not found qualified contractors for the road portion of this activity. MCC officials said that the road portion may be considered for elimination, and if eliminated, funding for it may be transferred to the Choir-Sainshand road project activity.

The project activity delays have contributed to a projected budget shortfall of at least \$12 million. To help address the time constraints on the North-South Road Project, MCA-M divided the procurements for the road construction activities into multiple lots so that contractors could work concurrently. However, this approach increased costs, and the compact may not have the funding needed to complete all project activities within the limited time remaining.

Although the North-South Road Project faces many challenges, MCC and MCA-M officials have a plan for moving forward and will take actions based on the results of the procurement process. As a result, OIG is not making recommendations on the overall management of the North-South Road Project at this time.

However, the audit did find that:

- MCC's procurement policies may not be consistent (page 5). While MCC's procurement guidelines require subcontracts to follow MCC's fundamental procurement principles, MCC officials determined that a restriction against contracts to government-owned enterprises does not apply to subcontractors.
- The number of subcontractors working on the Choir-Sainshand road project was not consistently reported to OIG (page 5). Although MCC's procurement guidelines require MCAs to approve subcontracts worth more than \$100,000, MCA-M may not have had accurate information regarding the number of subcontractors working on the Choir-Sainshand road project.

**Property Rights Project.** The Property Rights Project is behind schedule on all three project activities and will not meet all of its goals. For example, improvements to the land privatization and registration system were delayed because the Government of Mongolia was late in meeting its obligations. MCA-M is now moving forward with this activity. In addition, as discussed on page 6, MCC had intended to register 30,000 land plots by September 2011, but none were registered by that time and MCC reduced the number of plots to be registered. Finally, MCC delayed progress on the land-leasing activity in order to address concerns regarding

nonparticipants who might be adversely affected by the project. The number of tracts to be leased on this activity has been reduced from 465 to 399, as discussed below.

The number of tracts to be leased on the land-leasing activity was reduced for two reasons. First, when concerns were raised during implementation about the eligibility of the tracts under consideration, MCC and MCA-M stopped the project and conducted field verification tests to verify that the eligible land tracts were not occupied by other herders. As a result of the field verification tests, approximately 30 percent of the tracts were found ineligible and were dropped. MCC originally planned to identify an excessive amount of eligible land tracts and hold a lottery to select participants, but after the tracts were dropped there were no longer enough tracts to hold a lottery. The number of eligible tracts remaining was just below the total planned amount.

The second reason the number of tracts was reduced was that four local governments with jurisdiction over 50 eligible tracts withdrew from the program before the leases were to be signed. According to MCC, the withdrawals occurred for a variety of reasons, such as concerns that the leases would restrict the local governments' abilities to allocate land to other Mongolians. Also, because of the delay in completing the leasing process, the districts made alternative plans for some of the land, which made it unavailable for the project. Since the number of tracts was reduced, the activity is now expected to reach 14 percent fewer groups of herders than originally intended.

Although the land-leasing activity is behind schedule, MCC and MCA-M have taken steps and developed a plan to complete it before the compact ends. As a result, OIG is not making recommendations on the management of the land-leasing activity at this time.

However, the audit did find that:

- Another component of the Property Rights Project, the privatization and registration activity, may not meet its goal (page 6). MCC changed the focus of the registration activity by adding the verification of current land plot registrations. Also, MCC reduced the number of new plots to be registered. These changes were necessary because, when planning the activity, MCC relied on data provided by another donor that was later found to be inaccurate.
- Well houses constructed as part of the land-leasing activity may lack proper ventilation (page 7). Four of six well houses OIG visited did not contain appropriate ventilation for gasoline-powered generators.<sup>2</sup>

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

1. Review and clarify the Material Interim Amendment to the *Program Procurement Guidelines* that addresses government-owned enterprises and its applicability to subcontractors (page 5).
2. Review and document MCA-M's procedures for identifying, reviewing, and approving all subcontracts worth more than \$100,000, to confirm that they are in accordance with the *Program Procurement Guidelines* (page 6).

---

<sup>2</sup> One of the wells used electric power rather than a gasoline-powered generator, and one generator was not in place because the well was not operating.

3. Develop a written plan for assessing the quality of data obtained from information management systems that is used during the due diligence phase of new compact development (page 6).
4. Direct MCA-M to inspect all well houses to confirm that the generator exhaust fumes are properly vented and that no safety hazard exists, and communicate the ventilation concern to the Government of Mongolia in writing (page 8).

Detailed findings appear in the following section. Appendix I describes the audit scope and methodology. Appendix II presents MCC's comments. Our evaluation of management comments is on page 9.

# AUDIT FINDINGS

## **MCC's Procurement Policies May Not be Consistent**

MCC's *Program Procurement Guidelines*<sup>3</sup> state that:

Every contract or *subcontract* for goods, works, consultant, or non-consultant services with any party that receives MCC funding shall require the contracting party to follow the fundamental procurement principles promoting transparency, openness, competition and fairness to the maximum extent possible. [emphasis added]

The guidelines also state that government-owned enterprises are not eligible to compete for MCC-funded contracts and may not be party to any MCC-funded contracts. MCC amended the *Program Procurement Guidelines* to institute this restriction against government-owned enterprises to ensure a level playing field for commercial firms from all countries.

One of the Choir-Sainshand road contractors hired a subcontractor that had not been evaluated to establish its ownership. The subcontractor had not been evaluated because MCC determined that the restriction against government-owned enterprises did not apply to subcontractors. This determination, however, does not seem consistent with the requirement that subcontracts follow MCC's fundamental procurement principles. Without consistent implementation of the procurement guidelines, MCAs could be using subcontractors that are government-owned enterprises and MCC may not be ensuring a level playing field for commercial firms from all countries. To address this concern, this audit makes the following recommendation.

***Recommendation 1.*** *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations review and clarify the Material Interim Amendment to the Program Procurement Guidelines that addresses government-owned enterprises and its applicability to subcontractors.*

## **Number of Subcontractors Reported on the Choir-Sainshand Road Project Was Inconsistent**

MCC's *Program Procurement Guidelines* state that contractors must obtain the MCA's written approval for any subcontract worth more than \$100,000.

OIG was unable to determine how many subcontracts worth more than \$100,000 were awarded on the Choir-Sainshand road project. MCA-M officials told OIG that only one contractor on the Choir-Sainshand road project had requested and received approval for a \$2 million subcontract. However, the road construction contractors told OIG that as many as three other subcontractors also were working on the project. The highway project manager—a contractor hired to help manage the North-South Road Project—was uncertain about exactly how many subcontractors were working on the Choir-Sainshand project. Furthermore, the contracts between the road

---

<sup>3</sup> *Program Procurement Guidelines*, Part 6, "Subcontracting," October 23, 2009.

construction contractors and MCA-M stated that approval of subcontracts was required for amounts worth more than \$300,000, rather than the \$100,000 stated in the *Program Procurement Guidelines*.

The procedures established by MCA-M did not ensure that subcontracts worth more than \$100,000 were approved. As a result, MCA-M may not have had accurate information regarding the number of subcontractors working on the Choir-Sainshand road project. Without accurate information and the appropriate approval of subcontractors, as required by the *Program Procurement Guidelines*, MCC funds could be used to hire unqualified or banned subcontractors, thereby jeopardizing project completion. To address this concern, this audit makes the following recommendation.

***Recommendation 2.*** *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations review and document Millennium Challenge Account-Mongolia's procedures for identifying, reviewing, and approving all subcontracts in excess of \$100,000 to confirm that they are in accordance with the Program Procurement Guidelines.*

## **MCC Property Rights Registration Activity May Not Meet Its Goal**

According to the compact, the Property Rights Project will privatize and register approximately 75,000 land plots of low- and middle-income households with the Government of Mongolia. This activity is behind schedule and may not meet its goal. No land plots had been registered by September 2011, even though the project had a target of 30,000. Originally, MCC intended to register 75,000 new land registrants, but MCC reduced this number to approximately 53,000 after discovering that the data on the total number of unregistered plots was inaccurate. When MCC reduced the number of new land plots, it also broadened the focus of the registration activity to include verifying the accuracy of those already registered.

The project activity will register fewer new land plots because MCC relied on unverified data during the due diligence process. The data came from an information management system created by another donor. MCC officials said they relied on the data because the donor was a major foreign organization that had been working in Mongolia for many years. However, during project implementation, MCC found that the data were inaccurate, and had to change the focus of the project.

Although the total number of beneficiaries may increase because of the verification activity, and verifying the accuracy of existing registrations is an important objective, MCC nonetheless changed the focus of the registration activity. As a result, approximately 22,000 residents may no longer obtain assistance in registering their land plots. To address this concern, this audit makes the following recommendation.

***Recommendation 3.*** *We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations develop a written plan for assessing the quality of data obtained from information management systems that is used during the due diligence phase of new compact development.*

## Well Houses May Lack Proper Ventilation

MCC's authorizing legislation prohibits assistance to any project "likely to cause a significant environmental, health, or safety hazard."<sup>4</sup> As part of the land-leasing activity, groups of herders that sign leases will have wells installed on the land. The well house design does not include a specific ventilation system for fumes from the gasoline generators installed inside the well houses that are used to power the wells. Instead, the building contracts require that "wall penetration will be made in a suitable location for an exhaust vent for the portable generator."<sup>5</sup> In other words, a hole will be made in the well house's wall.

In four of six well houses that OIG visited, the wall penetration for an exhaust vent did not align with the generator's exhaust pipe; an example of this is shown in the photograph below.



**The blue pen protrudes from the generator's exhaust pipe to illustrate that the pipe does not align with the wall penetration on the left. (OIG photograph, September 9, 2011)**

Well houses, like the one below, are small, enclosed structures in which herders will spend time operating the gasoline generators.

---

<sup>4</sup> The Millennium Challenge Act of 2003, Section 605 (e), point 3.

<sup>5</sup> MCA-M contract for well construction and rehabilitation work.



**OIG visited well houses like this one.  
(OIG photograph, September 9, 2011)**

MCC was aware of the potential hazard of operating a gasoline engine in an enclosed space, but said that MCA-M was reluctant to add more technical specifications than those included in the contracts because the exact means of venting exhaust would vary with the model of generator used. However, because additional technical specifications are not included, some well houses may not have proper ventilation. The herders operating the wells may be in the well houses for a few hours; if the houses are not properly ventilated carbon monoxide poisoning could occur, causing serious illness or even death. The design of the wells and well houses has been shared with the Government of Mongolia for use elsewhere. To address this concern, this audit makes the following recommendation.

***Recommendation 4.*** We recommend that the Millennium Challenge Corporation's Vice President, Department of Compact Operations direct the Millennium Challenge Account-Mongolia to inspect all well houses to confirm that the generator exhaust fumes are properly vented and that no safety hazard exists, and communicate the ventilation concern to the Government of Mongolia in writing.

# EVALUATION OF MANAGEMENT COMMENTS

MCC provided written comments on the draft report that are included in their entirety in Appendix II of this report. MCC agreed with all four recommendations. Management decisions have been reached on Recommendations 1, 2, and 4, and final action has been reached on Recommendation 3.

MCC agreed with Recommendation 1, to review and clarify the Material Interim Amendment to the *Program Procurement Guidelines* that addresses government-owned enterprises and its applicability to subcontractors. MCC will conduct an internal review of the amendment and its applicability to subcontractors and expects to take final action within 9 months. OIG considers that a management decision has been reached on this recommendation. Final action will occur when MCC completes its internal review.

MCC agreed with Recommendation 2, to review and document MCA-M's procedures for identifying, reviewing, and approving all subcontracts worth more than \$100,000 to confirm that they are in accordance with the *Program Procurement Guidelines*. MCC will require MCA-M to develop a written procedure for this process within 60 days. OIG considers that a management decision has been reached on this recommendation. Final action will occur when MCC completes its review of MCA-M's procedures.

MCC agreed with Recommendation 3, to develop a written plan for assessing the quality of data obtained from information management systems that is used during due diligence for new compacts. MCC updated its *Compact Development Guidance* in January 2012 to strengthen the requirements for the technical review of projects before signing compacts. MCC said that the guidance applies to all data gathered during due diligence, whether from information management systems or other sources. While OIG supports MCC's efforts to strengthen the due diligence process, MCC's continued vigilance is necessary to ensure that data obtained from information management systems is properly assessed. However, based on MCC's updated *Compact Development Guidance*, final action has been reached on this recommendation.

MCC agreed with Recommendation 4, to inspect all well houses to confirm that the generator exhaust fumes are properly vented and that no safety hazard exists and to communicate the ventilation concern to the Government of Mongolia in writing. MCC has developed a plan to inspect the well houses, take corrective action when necessary, and communicate the concern to the Government of Mongolia in writing. OIG considers that a management decision has been reached on this recommendation. Final action will occur when MCC has implemented its plan.

# SCOPE AND METHODOLOGY

## Scope

OIG conducted this audit of MCC's funding of activities in Mongolia in accordance with *Generally Accepted Government Auditing Standards*. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our audit objectives. We believe that the evidence obtained provides that reasonable basis.

MCC signed a compact with the Government of Mongolia for approximately \$285 million that entered into force in September 2008. This audit focused on the nearly \$80 million North-South Road Project and the nearly \$28 million Property Rights Project, both of which have encountered significant difficulties and represent almost 40 percent of the total compact funding.

We conducted our fieldwork from June 16 to November 1, 2011, at MCC headquarters in Washington, D.C., with a visit to MCA-M in Ulaanbaatar from August 29 to September 16, 2011. In Mongolia, we conducted site visits to the North-South Road and Property Rights Projects.

To answer the audit objective, we met with MCC officials to gain an understanding of compact activities. We conducted a site visit to Mongolia to observe ongoing activities and interview MCA-M staff, contractors, and program beneficiaries. We met with subject matter experts and analyzed reports and documents to identify concerns. During the property rights site visit, we interviewed both project officials and beneficiaries.

We examined the internal control environment by identifying and assessing the relevant controls, including supporting documentation for the due diligence process and supervisory controls on the road construction project. We also tested controls in place for effectively awarding, managing, and monitoring selected health and education grants and for awarding property leases.

## Methodology

The audit team met with MCC staff in Mongolia and in Washington, D.C. In addition, we conducted a statistical sample, with a 90 percent confidence level, of completed health and education grants and signed peri-urban leases to test internal controls.

To answer the audit objective, we established audit steps to determine whether MCC and MCA-M were on schedule to achieve the project activity goals. Specifically, we performed the following activities:

- Interviewed MCC and MCA-M officials to gain an understanding of the project activities.
- Interviewed contractors, Mongolian government officials, and other donors to gain their perspectives on the risks facing the projects.
- Reviewed documents supporting the project activities, including the compact, due diligence

documents, the monitoring and evaluation plan, contracts, progress reports, and environmental management plans.

- Conducted a statistical sample to select a percentage of health and education grants for testing to assess whether the internal controls in place were effective.
- Conducted a statistical sample to select a percentage of property rights leases for testing to assess whether the internal controls in place were effective.
- Reviewed documents supporting the procurement process.

# MANAGEMENT COMMENTS



MILLENNIUM  
CHALLENGE CORPORATION  
UNITED STATES OF AMERICA

DATE: February 24, 2012

TO: Mark Norman, Acting Assistant Inspector General  
Office of Inspector General  
U.S. Agency for International Development

FROM: Jonathan Brooks, Acting Deputy Vice President (Managing Director) /s/  
Europe, Asia Pacific, and Latin America  
Department of Compact Operations  
Millennium Challenge Corporation

Dear Mr. Norman:

The Millennium Challenge Corporation (MCC) appreciates the opportunity to respond to the Office of Inspector General's (OIG) draft report entitled "Audit of the Millennium Challenge Corporation's Funding of Activities in Mongolia", dated January 5, 2012.

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

***Recommendation 1: We recommend that the Millennium Challenge Corporation's Vice President for the Department of Compact Operations review and clarify the Material Interim Amendment to the Program Procurement Guidelines that addresses government-owned enterprises and its applicability to subcontractors.***

**MCC Response:** MCC agrees with the recommendation and will conduct an internal review to clarify the Material Interim Amendment to the Program Procurement Guidelines and its applicability to subcontractors. MCC considers this its management decision and will take final action within nine months.

***Recommendation 2: We recommend that the Millennium Challenge Corporation's Vice President for the Department of Compact Operations review and document Millennium Challenge Account-Mongolia's procedures for identifying, reviewing, and approving all subcontracts in excess of \$100,000 to confirm that they are in accordance with the Program Procurement Guidelines.***

**MCC Response:** MCC agrees with the recommendation, and will require MCA-Mongolia to develop within 60 days a written procedure for identifying, reviewing, and approving all subcontracts in excess of \$100,000 to confirm that such subcontracts are in accordance with

the Program Procurement Guidelines. MCC will consider its review of MCA-Mongolia's procedures to ensure that they are compliant with the Program Procurement Guidelines as its management decision and final action.

***Recommendation 3: We recommend that the Millennium Challenge Corporation's Vice President for the Department of Compact Operations develop a written plan for assessing the quality of data obtained from information management systems that is used during due diligence for new compacts.***

**MCC Response:** MCC agrees with the recommendation. In 2008, after the Mongolia Compact was developed, MCC conducted a comprehensive review of compact development and determined that its due diligence of proposed projects required strengthening. On the basis of that review, MCC issued new Compact Development Guidelines, including strengthened requirements for the technical review of projects in advance of compact signing. In 2011, MCC conducted a subsequent review of compact development to improve the time and cost-effectiveness of the compact development process and to strengthen MCC's guidelines in order to produce high-quality compact proposals. As a result of the 2011 review, MCC's due diligence guidelines for all potential project areas were updated and strengthened, and are now in force and posted on MCC's public website. The updated [\*Millennium Challenge Corporation Compact Development Guidance\*](#), revised January 2012, constitutes MCC's written plan for assessing the quality of data used during due diligence for new compact proposal, and as such MCC considers that final action has been taken to address this recommendation.

***Recommendation 4: We recommend that the Millennium Challenge Corporation's Vice President for the Department of Compact Operations direct the Millennium Challenge Account-Mongolia to inspect all well houses to confirm that the generator exhaust fumes are properly vented and that no safety hazard exists and communicate the ventilation concern to the Government of Mongolia in writing.***

**MCC Response:** MCC agrees with the recommendation and will: (i) commission an independent specialist to review the well house ventilation design and identify improvements; (ii) communicate the concern to the Government of Mongolia in writing; (iii) direct MCA-Mongolia to inspect all well houses and take any corrective action on those houses with ventilation problems; and (iv) direct MCA-Mongolia to construct future well houses with proper ventilation. Items (i) and (ii) will be completed in March 2012, Item (iii) will be completed in June 2012; and Item (iv) will be an ongoing effort in 2012 and 2013.

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