



*Office of Inspector General*

November 16, 2009

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

Dear Mr. Mans:

The enclosed statement summarizes the Office of Inspector General's (OIG) conclusions on the most serious management and performance challenges facing the Millennium Challenge Corporation (MCC). Our decisions on which challenges to report were based primarily on audit, evaluation, or investigative work we have performed and additional analysis of MCC operations. More challenges may exist in areas that we have not yet reviewed, and other significant findings may result from further work.

The Reports Consolidation Act of 2000 (Public Law 106-531) requires that agency performance and accountability reports include a statement prepared by each agency's inspector general, summarizing the most serious management and performance challenges facing the agency and reporting the agency's progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2009 performance and accountability report or agency financial report.

We have discussed the management and performance challenges summarized in this statement with the responsible MCC officials. If you have any questions or wish to discuss the statement further, please contact me or Alvin Brown, the Assistant Inspector General for MCC.

Sincerely,

/s/

Donald A. Gambatesa  
Inspector General

Enclosure

**Statement by the Office of Inspector General on the  
Millennium Challenge Corporation's  
Most Serious Management and Performance Challenges  
Fiscal Year 2009**

The Office of Inspector General (OIG) has determined that the Millennium Challenge Corporation (MCC) faces management and performance challenges in the following areas:

- MCC Suspended, Terminated, and Canceled Planned Compact Activities
- Threshold Programs for Compact Eligibility
- Financial Management
- Information Technology Management

For fiscal year (FY) 2009, the Office of Inspector General (OIG) is reporting “MCC Suspended, Terminated, and Canceled Planned Compact Activities” and “Threshold Programs” as serious management and performance challenges for the first time. OIG initially reported challenges in the “Financial Management” and the “Information Technology Management” areas in FY 2008. While MCC has made some improvements in the areas of financial management and information technology management, both continue to represent serious management challenges for MCC.

We had reported “Implementation of Compacts” as a serious management challenge for MCC in FY 2008. At that time, MCC was experiencing serious management challenges due to the low rate of disbursements and the increasing costs associated with infrastructure projects. MCC has increased its rate of disbursements through the implementation of a new compact development process. As a result of these improvements, we have not included “Implementation of Compacts” as a serious management challenge for FY 2009. OIG will continue to monitor the implementation of compacts.

**MCC Suspended, Terminated, and Canceled Planned Compact Activities**

In 2009, MCC suspended, terminated, or canceled a total of \$340 million in planned activities in 5 of the 19 compact countries because of political unrest in and around those countries. MCC has suspended or terminated activities because of the removal of democratically elected leaders (in two cases) and patterns of undemocratic actions involving the 2008 elections (in two other cases). As a result, activities totaling \$152 million were terminated. In another case, a neighboring country would not allow the compact country to meet the compact requirements, which resulted in the cancellation of a \$188 million project. During FY 2009, MCC has suspended, terminated, or canceled compact activities in the following countries:

- **Madagascar.** On March 17, 2009, Madagascar removed its democratically elected president from office. MCC’s board determined that the nature of the actions taken represented a pattern of actions inconsistent with MCC’s eligibility indicator for the “Ruling Justly” category. As a result, MCC placed an operational hold on activities on

- March 20, 2009. The compact was terminated on August 31, 2009. As a result, MCC will deobligate \$21 million to \$23 million.
- **Honduras.** On June 28, 2009, Honduras removed its democratically elected president from office. The Government of Honduras (GOH) failed to address concerns regarding its commitment to democracy. MCC continued to assist the GOH with an agricultural irrigation project to maintain poverty reduction for the rural poor. In September 2009, the MCC board terminated a component of a rural roads rehabilitation project that had not yet begun, which resulted in a reduction of \$11 million (approximately 5 percent) of the initial compact.
- **Nicaragua.** Because of a pattern of undemocratic actions involving elections in late 2008, MCC partially terminated its compact with Nicaragua. In February 2009, the MCC board voted to terminate funding for a property regularization project implemented by the Government of Nicaragua and for a major road rehabilitation activity that had not begun. MCC will complete the projects that were underway, including rehabilitation of roads that were already under contract and rural business development projects that have a direct impact on the rural poor. As a result of the termination, the total assistance was reduced by approximately \$61 million (approximately 35 percent) of the initial compact of \$175 million.
- **Armenia.** Because of a pattern of undemocratic actions involving elections in early 2008, MCC placed an operational hold on a rural roads rehabilitation project. The MCC board confirmed the operational hold in February 2009. MCC will continue the irrigated agriculture project to maintain poverty reduction for the rural poor. At this late stage in the compact, it will be impossible to restart the rural roads rehabilitation project. Accordingly, the initial compact amount of \$235 million will be reduced by \$59 million (approximately 25 percent).
- **Mongolia.** On April 27, 2009, the Government of Mongolia officially notified MCC of its need to cancel a rail project that had accounted for \$188 million of the \$285 million compact. The rail project was canceled because the Russian members of UBTZ, the joint Mongolian-Russian rail company, would not allow an audit of the company to proceed. Although MCC is considering alternative projects to fund in Mongolia, it has told the Government of Mongolia that there is no guarantee that all of the funds will remain in the compact.

The actions mentioned above represent very serious management challenges that will persist because of the nature of MCC's mission. MCC has established a set of indicators that a country must meet in order to become eligible for a compact. However, because MCC operates in the dynamic environments of developing countries, the political environment will be an ongoing management challenge as compacts are carried out over a 5-year period.

## Threshold Programs for Compact Eligibility

As stated in our audit of the Threshold Program (M-009-003-P, April 29, 2009), MCC had provided about \$440 million in funding for Threshold Programs to assist 12 countries to become compact eligible. However, we found no clear indication that the MCC Threshold Program was assisting countries in becoming eligible. For example:

- Eight of the 12 countries that will complete the threshold programs as of the end of FY 2009 became compact eligible before completing their threshold programs (for those completed by the end of FY 2009). Three of the eight countries became eligible as early as 1 month before or after their threshold program started.
- Three of the 12 countries did not become compact eligible. Two of the three countries did not become eligible after completing their first threshold programs; instead, MCC approved another threshold agreement (stage II).
- One of the 12 countries received compact assistance about 11 months before its threshold program ended.

Some countries have also become compact eligible and received compacts without participating in the Threshold Program. MCC measured the program results by changes in the countries' "Control of Corruption" indicator scores, but the changes were not clearly attributable to MCC's efforts. MCC is reviewing the Threshold Program to determine whether the existing program can achieve the objective of helping countries become compact eligible.

## Financial Management

For FY 2009—the sixth consecutive year—OIG has issued unqualified opinions on MCC's FY financial statements. Notwithstanding these unqualified opinions and the progress that MCC has made in establishing and maintaining financial management processes, MCC's quality control over quarterly and yearend financial reporting is not sufficient to enable it to detect errors and misstatements and to make corrections in a timely manner. MCC does not perform sufficiently detailed quality-control reviews over yearend MCC trial balances and financial statements submitted for review and audit.

The vast majority of MCC's activities and expenses occur in the compact and threshold programs. These programs are implemented by MCC's Millennium Challenge Account (MCA) entities and USAID's overseas missions. MCC did not adequately monitor these organizations' ongoing activities or the financial information being reported on its own financial statements. The MCA entities responsible for implementing the compact programs, as well as the USAID missions responsible for implementing MCC's threshold programs, did not respond adequately to requests for supporting documentation for expenses reported to MCC. During our audit, we noted the following weaknesses:

- **MCA Audits Lack Timely Completion and Monitoring.** Audits performed by independent auditors of the controls, transactions, and balances of MCA entities have not

been completed and submitted to OIG in a timely manner. In addition, MCC has not monitored the start and completion of these audits adequately to ensure a timely submission of audit reports and notification of findings. This situation increases MCC's risk of not being informed of MCA entity activities that would affect timely preparation of financial statements.

To ensure sufficient internal control over the MCA entities, MCC requires semiannual audits to be conducted for the 6-month periods ending in June and December of each year. The audit results assure MCC of the validity and accuracy of payments and advances that are processed for the MCA entities and reported in its financial statements. This assurance is needed because neither MCC nor its accounting service provider, the U.S. Department of Interior's National Business Center, reviews or maintains invoices and other underlying supporting documentation for transactions. Instead, MCC relies on approved request documents submitted by personnel of the MCA entity.

- **Transactions Lack Adequate Documentation.** MCA entities and threshold missions did not provide or respond to requests for supporting documentation in a timely manner for all expenses and undelivered orders. The audit team informed MCC that, prior to yearend testing, documentation would be requested from MCA entities and threshold missions to substantiate yearend balances and that responses would be required within 5 days to meet tight audit deadlines. This detailed written information was communicated to all points of contact for MCA entities and USAID threshold missions.

Upon submission of the supporting documents, some MCA entities and threshold missions responded in a timely manner, but others provided incorrect or insufficient documentation or none at all. MCC was advised of the lack of responses and in turn sent several emails to MCA entities and threshold missions requesting their cooperation. However, significant numbers of transactions remained unsupported at the conclusion of audit fieldwork. These issues were raised, and recommendations made, in the audit of MCC's FY 2009 Financial Statements (M-000-010-001-C, November 16, 2009).

In conclusion, MCC officials commented that MCC will implement measures to improve quality control in accordance with OIG's recommendations.

## **Information Technology Management**

Although MCC has made improvements to strengthen its information security program, it is still not fully compliant with the key components of the Federal Information Security Management Act of 2002 (FISMA). FISMA requires agencies to (1) develop, document, and implement agencywide information security programs to protect their information and information systems, including those provided or managed by another agency, contractor, or other source; (2) obtain an annual independent evaluation of information security programs and practices; and (3) assess compliance with the requirements of the act. Although MCC is making progress in complying with these requirements, weaknesses remain.

MCC developed and implemented a comprehensive plan that addressed all but one of the FY 2008 FISMA audit findings. However, the FY 2009 FISMA audit found several areas in which MCC needs to strengthen existing policies and develop procedures to fully comply with requirements of the National Institute of Standards and Technology and the Office of Management and Budget. MCC noted that it has a comprehensive plan to address all of the FY 2009 FISMA audit findings by April 2010.