



*Office of Inspector General*

October 28, 2011

Mr. Daniel W. Yohannes  
Chief Executive Officer  
Millennium Challenge Corporation  
875 15th Street NW  
Washington, DC 20005

Dear Mr. Yohannes:

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 audits and additional analyses performed on MCC's 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 2011 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 Mark Norman, the Deputy Assistant Inspector General for MCC.

Sincerely,

/s/

Michael Carroll  
Acting Inspector General

Enclosure

# **MILLENNIUM CHALLENGE CORPORATION'S MOST SERIOUS MANAGEMENT AND PERFORMANCE CHALLENGES**

## **Fiscal Year 2011**

The Office of Inspector General (OIG) has determined that the Millennium Challenge Corporation's (MCC) most serious management and performance challenges for fiscal year (FY) 2011 are in the following areas:

- Financial Management
- Information Technology Management
- Country Compact Implementation
- Political Instability that Has Caused MCC to Place on Hold, Suspend, Terminate, or Cancel Planned Compact Activity

### **Financial Management**

Financial management is critical to providing reliable financial information, managing results, and ensuring the effectiveness and efficiency of operations, including the use of an entity's resources. Significant MCC activities, liabilities, and expenses occur in the compact programs implemented by various Millennium Challenge Accounts (MCAs) across the globe.

We first reported financial management as a management challenge in FY 2008. OIG issued a qualified opinion on MCC's financial statements in FY 2010. The audit report included three material internal control weaknesses that resulted in MCC's FY 2009 expenses being materially understated and FY 2010 expenses being overstated.

During FY 2011, MCC undertook major efforts to address the issues that led to the qualification on MCC's financial statements in FY 2010. These efforts are highlighted below. However, our current audit identified issues that indicate ongoing challenges in MCC's ability to prepare complete and reliable financial statements. The challenges include the following:

- MCA audits do not address compliance with MCC's financial reporting requirements. The work performed during the FY 2011 audit of internal controls identified exceptions where MCA-generated estimates were not always consistent with subsequent payment testing.
- MCC's financial management system follows the guidance prescribed by the Federal Accounting Standards Advisory Board, whereas the MCAs follow an Other Comprehensive Basis of Accounting.
- MCC does not review the underlying documents for payments to vendors before payments are made by MCC or the National Business Center. Instead, MCC relies on approved payment request forms submitted by personnel of the MCA entity.

- MCAs are requesting disbursements from the National Business Center, MCC's service provider, as expenses instead of advance payments to the vendors. MCC then improperly records these advance payments as expenses, based on reporting from each MCA. This practice may lead MCC to overstate its expenses and understate its advances during the fiscal year.
- The processes, policies and financial systems from one MCA to another are not consistent. This results in monitoring and financial management challenges for MCC. MCC would benefit from centralized and standardized reporting that meets its needs and requirements.
- MCC's Accounting and Finance Office continues to rely on manual financial reporting processes and quality control. This is a significant weakness because manual processes are vulnerable to human error.

MCC has taken the following actions to address its serious management challenges:

- MCC has instituted and continues to improve its monitoring of MCAs' ongoing activities and financial information, as well as the propriety of recording and reporting their financial information into MCC financial systems and financial statements. MCC's management has developed and continues to refine procedures to provide a framework for developing more reasonable estimates of accrued liabilities for MCA activities. These procedures include adopting and enhancing validation techniques, revising related policies and procedures, extensive training of MCA recipients in reporting requirements, and adopting internal quality control measures.
- MCC also requested that MCAs separately report quarterly advances to contractors using a new form in March 2011. This new form is used as a secondary source for information validation purposes only. MCC uses this form to adjust its records and reclassify expenses to advances at the end of each quarter.

However, the effectiveness of the new validation process is questionable; during FY 2011 testing, we noted that not all MCAs followed the new process. As a result, we still consider the area of financial management to be a serious management challenge.

## **Information Technology Management**

Beginning in FY 2008, OIG has reported information technology (IT) management challenges affecting MCC. Last year, OIG reported MCC's privacy program and IT project management as two new challenge areas. In FY 2010, MCC reported that the privacy program was a material weakness. However, in the past year MCC has reported that final action was taken on all 18 recommendations in OIG's July 2010 audit report. Therefore, OIG does not consider the privacy program to be a management challenge for FY 2011. OIG continues to consider IT project management as a challenge, but views it as part of a broader area: IT governance.

**IT Governance.** In June 2011, an OIG contractor reported that weaknesses in MCC's IT governance processes may (1) increase IT project costs, (2) lengthen deployment, and (3) deliver solutions that do not satisfy business needs. Similarly, in January 2011, OIG reported that such risks led MCC to spend more than \$6.9 million for a system that only partially met its needs. Between the two reports, OIG made 32 recommendations to help MCC achieve an appropriate level of IT governance and control. In response, MCC developed a 17-month plan as a roadmap to improve IT management. The plan identifies a four-phased approach based on budget impact, sequencing of activities, and resource requirements. MCC plans to complete the final phase by December 2012.

## **Country Compact Implementation**

We first reported that MCC was experiencing serious management challenges with compact implementation in FY 2008. At that time, the challenges involved a low rate of disbursements and increasing costs associated with infrastructure projects. In response to these issues, MCC began and continues to rescope its compacts and focus on projects that are most likely to be completed. In 2008, MCC developed and implemented a new compact development process in an effort to improve its compact implementation process. However, subsequent OIG audits continued to report that MCC was not achieving intended results because compacts were being rescoped.

In a March 2011 audit, we recommended and MCC agreed to identify the requisite studies that will be completed prior to compact signing in an effort to reduce problems during implementation. OIG believes that more planning and the completion of more feasibility studies will enable MCC to better implement projects as intended by the compact.

During the past 6 months, MCC conducted the first comprehensive management review of its compact development process since 2008. The review focused on identifying ways that MCC can minimize compact development timelines and costs while maintaining the quality of due diligence and project implementation. The review generated a series of recommendations aimed at accelerating the start-up phase of compact development, improving compact quality and implementation readiness, and imposing target timelines and budget constraints.

## **Political Instability Has Caused MCC to Place on Hold, Suspend, Terminate, or Cancel Planned Compact Activities**

OIG first reported political instability as a serious management challenge in 2009. In 2009, OIG reported that MCC suspended, terminated, or canceled a total of \$340 million in planned activities in 5 of the 19 compact countries because of internal or regional political instability. MCC placed on hold, suspended, terminated, or canceled 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). Even though MCC did not suspend, terminate, or cancel any compact activities in 2010, we continued to report this issue as a serious management challenge.

In 2011, MCC placed its compact activities in Malawi on hold. MCC signed a 5-year, \$350 million compact with the Government of Malawi on April 7, 2011. In July 2011, in response to a pattern of actions inconsistent with MCC's criteria for democratic governance, MCC placed an immediate hold on all program operations in order to review its partnership with Malawi. In part, the review will consider whether to recommend to its Board of Directors that MCC suspend or terminate its assistance.

According to MCC officials, MCC has established a set of policy indicators that a country must meet in order to become eligible for a compact. MCC compacts require countries to maintain and improve their performance on the policy areas measured by the indicators throughout the life of the compact. Because of weak democratic governance in some of MCC's partner countries, this very serious management challenge will remain a concern.