



Millennium Challenge Corporation

Reducing Poverty Through Growth

Office of Inspector General Semiannual Report to Congress



October 1, 2004 - March 31, 2005



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*Office of Inspector General
for the
Millennium Challenge Corporation*

April 29, 2005

The Honorable Condoleezza Rice
Chair, Board of Directors
The Honorable Paul V. Applegarth,
Chief Executive Officer
Millennium Challenge Corporation
P.O. Box 12825
Arlington, VA 22219-2825

Dear Madam Secretary and Mr. Applegarth:

I am pleased to present to you and the Congress of the United States our second independent report on the accomplishments of the Office of Inspector General for the six-month period ended March 31, 2005. This report is issued in compliance with the Inspector General Act of 1978, as amended.

During this period, we continued our policy of proactive involvement with the Corporation in order to fulfill our responsibilities under the Consolidated Appropriations Act of 2004 (Public Law 108-199), which designated the USAID Inspector General as the Inspector General for the Millennium Challenge Corporation.

We issued an audit report on the Corporation's fiscal year 2004 financial statements, which included the auditor's opinion that the statements fairly presented the Corporation's financial position in all material respects. We also issued three other reports addressing the Corporation's ethics training and financial disclosure reporting; internal control structure; and progress in achieving its planned organizational structure and beginning its assistance programs.

I appreciate the courtesy and assistance extended to my staff during our work with your organization. The OIG remains committed to helping the Millennium Challenge Corporation achieve ultimate efficiency and effectiveness in its operations.

Sincerely,

Bruce N. Crandlemire, CPA
Acting Inspector General

Acronyms

ADF	African Development Foundation
AIG/MCC	Assistant Inspector General/Millennium Challenge Corporation
CEO	Chief Executive Officer
Corporation	Millennium Challenge Corporation
DOI	Department of Interior
FISMA	Federal Information Security Management Act
GAO	Government Accountability Office
IAF	Inter-American Foundation
IG Act	Inspector General Act of 1978
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
NBC	National Business Center
OIG	Office of Inspector General
OMB	Office of Management and Budget
USAID	United States Agency for International Development

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Reporting Requirements

The Inspector General Act of 1978, as amended, requires each Inspector General to submit semiannual reports to the Congress summarizing the activities of the office during the preceding six-month period. The required reporting areas, as prescribed under Section 5(a) of the Act, include the following:

Reporting Requirement	Location
Significant Problems, Abuses and Deficiencies	Nothing to Report
Recommendations for Corrective Actions	Page 12
Summary of Each Significant Report	Page 12
List of Audit Reports Issued	Appendix A Page 20
Summary of Each Audit Report over Six Months Old for Which No Management Decision Has Been Made	Nothing to Report
Significant Prior Recommendations on Which Corrective Action Has Not Been Completed	Appendix A Page 20
Statistical Table of Reports with Questioned and Unsupported Costs	Nothing to Report
Statistical Table of Reports with Recommendations That Funds Be Put to Better Use	Nothing to Report
Summary of Instances in Which Information or Assistance was Refused	Appendix B Page 21
Decisions and Reasons for Significant Revised Management Decisions	Appendix B Page 21
Significant Management Decisions with Which the Inspector General Disagrees	Appendix B Page 21
Remediation Plan Information (Required under the Federal Financial Management Improvement Act of 1996)	Appendix B Page 21
Matters Referred to Prosecutive Authorities and the Prosecutions and Convictions Which Resulted	Appendix C Page 22

Executive Summary

This semiannual report highlights significant events regarding the Office of Inspector General (OIG) and presents the results of the OIG's activities and efforts with respect to the Millennium Challenge Corporation (MCC or Corporation) for the six-month period ended March 31, 2005. During this reporting period we continued our policy of early and proactive involvement with MCC, focusing on preventing fraud, safeguarding resources, and helping the Corporation succeed in its mission.

During this reporting period, the Office of the Inspector General issued four reports with six recommendations that addressed the Corporation's accounting and financial reporting; its employee financial disclosure reporting; its progress in establishing internal controls, and its progress in achieving its planned organizational structure and beginning its assistance programs. No investigations were initiated during this reporting period. Because of continued cooperation, the OIG and MCC management have reached "management decisions" or "final action" on each of the recommendations issued.

One of the reports issued was MCC's first financial statement audit. Effective January 23, 2004, the Consolidated Appropriations Act of 2004 (Public Law 108-199) established the Millennium Challenge Corporation (MCC) and designated the USAID Inspector General as its Inspector General. One year later, on January 27, 2005, the Assistant Inspector General for MCC (AIG/MCC) issued the first-ever financial statement audit report for the MCC. That report noted that the MCC financial statements presented fairly, in all material respects, the financial position of the Corporation

at September 30, 2004, and cash flow for the nine months ended September 30, 2004, in conformity with accounting principles generally accepted in the United States. That represents a major milestone for the MCC, and we applaud its management and staff for their efforts. (See page 4)

In November 2004 the AIG/MCC published its first Annual Audit Plan detailing the audit and investigative activities planned for fiscal year 2005. The final product was a collaborative effort with MCC senior management, who helped identify areas that would benefit from audit scrutiny, and who provided valuable input on the timing of our interventions. The plan addresses four strategic goals: keeping the Corporation and Congress informed; ensuring sound accounting and reporting; preventing fraud and safeguarding resources; and helping the Corporation become an efficient and successful organization.

On March 14, 2005 the Millennium Challenge Corporation's Board of Directors approved the Corporation's first Compact - a four-year \$110 million Compact with the Republic of Madagascar. The Corporation and the Government of Madagascar plan to sign the Compact in April 2005.

Overview

In addition to the MCC, the USAID Office of Inspector General (OIG) is responsible for providing audit and investigative services to the United States Agency for International Development (USAID), the African Development Foundation (ADF), and the Inter-American Foundation (IAF). Each of these agencies disburses and manages U.S. international development assistance.

Mission

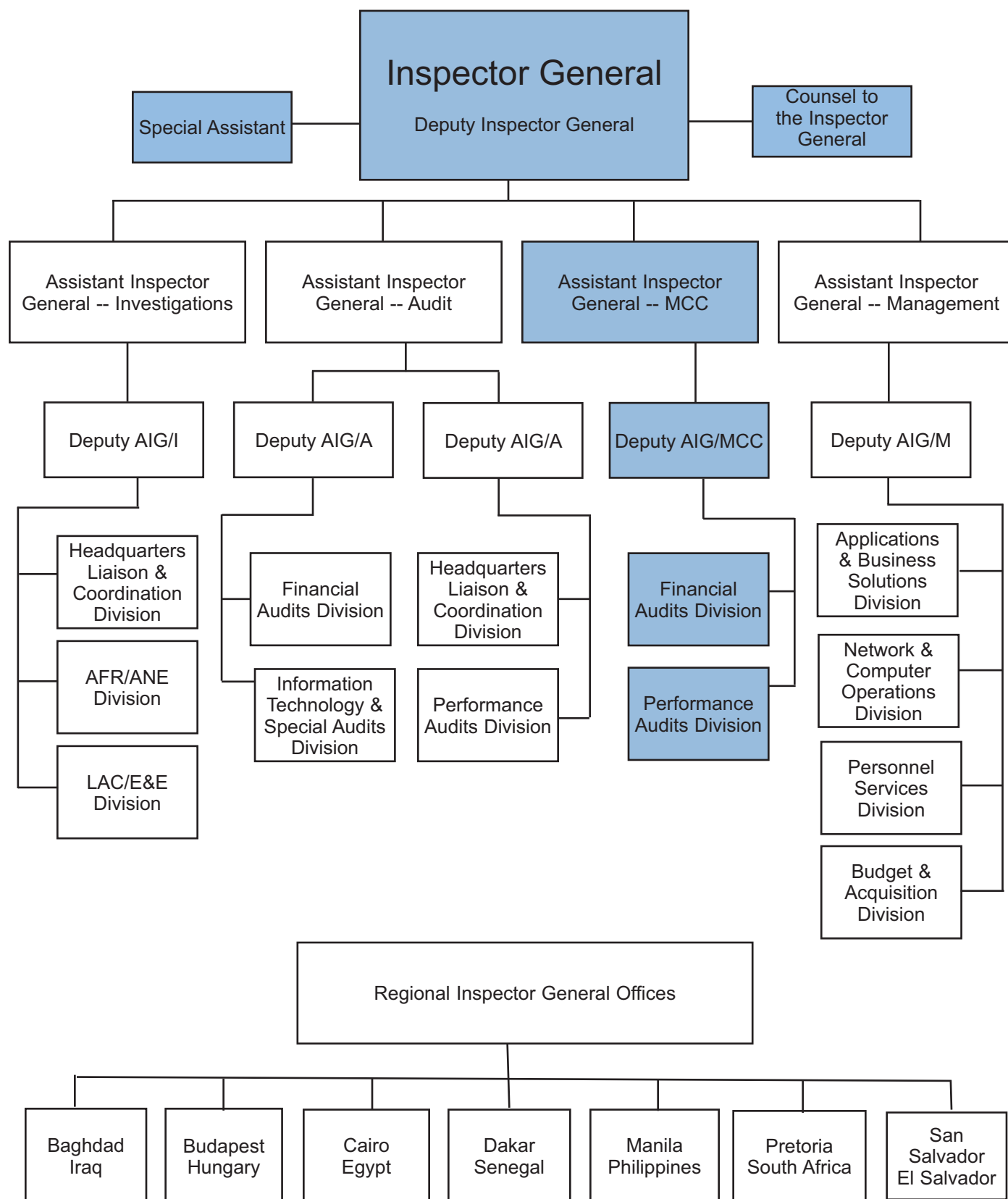
The Inspector General Act of 1978 (IG Act), as amended, established OIGs as independent and objective units created to (1) conduct and supervise audits and investigations relating to the programs and operations of their respective establishments; (2) provide leadership and coordination and recommend policies for activities designed to promote economy, efficiency, and effectiveness and prevent and detect fraud and abuse in the establishment's programs; and (3) provide a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of the establishment's programs and operations and the necessity for and progress of corrective action.

Organization

The OIG is organized into four areas of responsibility, with Assistant Inspectors General for each area: Investigations, Audit, MCC and Management. There are seven overseas field offices, each headed by a Regional Inspector General, located in Baghdad, Iraq; Budapest, Hungary; Cairo, Egypt; Dakar, Senegal; Manila, Philippines; Pretoria, South Africa; and San Salvador, El Salvador. These regional offices maintain close working relationships with the USAID missions in their regions and their presence in the field enables auditors and investigators to carry out the OIG's responsibilities efficiently.

OIG activities for the MCC are lead by an Assistant Inspector General (AIG/MCC). The AIG/MCC oversees a Deputy Assistant Inspector General, who is responsible for a Financial Audits Division and a Performance Audits Division. As the Corporation develops and expands its programs, the AIG/MCC will continue to draw on support from external audit firms when appropriate and the OIG's overseas and Washington offices as necessary in order to accomplish our oversight responsibilities. For example, the reports issued this reporting period on MCC's compliance with ethics training and financial disclosure reporting and MCC's internal control structure were accomplished with support from the OIG's Washington audit offices. The audit of MCC's fiscal year 2004 financial statements was done by an independent CPA firm under a contract overseen by AIG/MCC's Financial Audits Division. Finally, our fraud-awareness briefing to the MCC personnel included presenters from our OIG Investigations unit.

USAID Office of Inspector General



MCC Gets Unqualified Opinion on Its First Financial Statement Audit

In January 2005 AIG/MCC completed an audit of the Millennium Challenge Corporation's fiscal year 2004 Financial Statements. The Corporation was established on January 23, 2004, and this was the first audit of its financial statements. AIG/MCC contracted with a Certified Public Accounting firm to perform the audit work, which was done at MCC's headquarters in Arlington, Virginia, and at the Corporation's financial services provider, the National Business Center (NBC),¹ in Denver, Colorado.

The Certified Public Accounting firm that did the audit concluded that the Corporation's financial statements "...present fairly, in all material respects, the financial position of the Corporation at September 30, 2004, and cash flow for the nine months ended September 30, 2004, in conformity with accounting principles generally accepted in the United States of America."

The MCC does not have its own financial system, but rather contracts with the Department of Interior's National Business Center to provide accounting and electronic information services. The auditor reported that the NBC had not conducted an internal control review of its Federal Financials System (a new Oracle system), nor had MCC requested NBC to do such a review. OMB Circular A-127, Financial Management Systems, requires that an agency conduct an internal control review of all Federal financial systems in accordance with the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The FMFIA requires, in essence, that each executive agency shall, on the basis of an evaluation, prepare a statement that the agency's

system of internal accounting and administrative controls provides reasonable assurances that (1) obligations and costs are in compliance with applicable law; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The fact that an internal control review had not been done was considered a reportable condition by the auditor because it could adversely affect the Corporation's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Therefore, we recommended that the Corporation direct the National Business Center to conduct an internal control review of its Oracle Federal Financials System. The MCC agreed with this recommendation and, based on discussions with NBC, the review is expected to be completed in fiscal year 2005.

¹ NBC is an administrative and computer information service provider for the Department of Interior and other federal agencies.



Laying the Groundwork for Fraud Prevention and Safeguarding the Resources of the Millennium Challenge Corporation

Background

The Millennium Challenge Corporation is an Independent Government Corporation established by Congress in January 2004. As such it is subject to the regulations of the Government Corporation Control Act which provides it some flexibility compared to Federal agencies, however, MCC is subject to many similar laws and regulations as Federal agencies. MCC is still in the process of identifying which laws and regulations it is subject to.

Since the Corporation has been established for just over one year, its expenditures have been primarily for administrative items. Although the Corporation has signed no country Compacts nor incurred any program expenses as of March 31, 2005, it has approved a Compact which is expected to be signed in April 2005, and it is conducting reviews and due diligence activities in several countries in anticipation that Compacts will be signed with those countries. By the end of calendar 2005, MCC plans to become fully staffed, moving from about 110 to 200 full-time staff. This number includes country resident representatives, who will provide an on-the-ground presence to oversee activities in Compact countries.

Building Safeguards for Fraud Prevention and Protecting Millennium Challenge Corporation Resources

The overriding goal of the OIG is to help the Corporation become a viable, secure, and successful organization by conducting systemic reviews and, where warranted, recommending changes that will lead to improvements within the Corporation's programs and operations. Our activities are pre-designed to prevent and detect fraud, waste and abuse; safeguard MCC resources; and ensure the economy, efficiency and effectiveness of MCC's administrative and program operations. We build safeguards for fraud prevention and resource protection through our early collaborative and proactive involvement with MCC management concerning the nature, timing and depth of our audit and investigative programs. Resource protection is further enhanced through close and frequent interaction with other Federal Government organizations, to coordinate oversight efforts and establish reporting requirements. Some Federal Government organizations will provide support to or implement certain MCC programs. For example, the U.S. Agency for International Development will administer the MCC Threshold program.² As of March 31, 2005, \$40 million has been allocated for that program.

² The Threshold program is a program to assist countries that are not quite eligible to apply for MCC assistance to become eligible.

During this six-month period we focused our efforts on preventing misuse of MCC resources by directing our proactive and early involvement to the greatest vulnerabilities of MCC program and administrative activities. The OIG has taken the approach that early involvement in MCC activities will help ensure good oversight. As the Corporation develops its program and operating concepts and procedures, we work closely with its executives and managers in order to enhance our knowledge of the Corporation's programs, activities, and vulnerabilities including its administrative and accounting processes. In a proactive and collaborative manner, we seek to establish a framework for providing early feedback to ensure that MCC administrative functions and programs are based on a solid foundation of effective controls.

As the Corporation moves forward with its country Compact program, it will be operating in an overseas environment that is complex with differences in language, laws and accountability standards and it will face the issue of potential corruption. With this in mind, the OIG presented a fraud-awareness briefing to Corporation staff to enhance their understanding of fraud indicators and the potential for fraud occurring in the Corporation's program and administrative activities.

Program Activities

The Millennium Challenge Corporation is a new organization which has not yet reached its optimum stage of organizational development and which will be implementing development Compact programs based on an innovative development assistance model that has not previously been tested. These programs will be implemented in countries where varying degrees of corruption are prevalent and standards of accountability vary. Furthermore, the Compact programs will be overseen by an MCC staff with varying levels of government and private sector experience, which could add to the programs' potential vulnerabilities.

Although the Corporation has not signed any Compacts nor implemented any assistance programs as of March 31, 2005, it is carrying out due diligence and country review activities in several countries. The OIG has been involved in that process by reviewing MCC's initial draft Compact with an emphasis on making sure that the Compact contains, among other things:

- Appropriate audit clauses to ensure that OIG can exercise its audit oversight responsibilities and provide MCC with reasonable assurances of its programs' integrity.
- Adequate descriptions of how funds will flow from MCC to the implementing organizations and where accountability will be vested.
- Adequate descriptions of what entities will be responsible for audits. For example, audits may be conducted by audit firms contracted by the fund recipient or by audit firms contracted by MCC or the OIG.
- Adequate descriptions of what audit standards will be followed, such as host country standards or international standards.

For some Compacts or Compact activities, it may be appropriate to have concurrent rather than annual or periodic audits done in order to have better assurance of the program's integrity. The need for more frequent or concurrent audits/reviews will depend on the program and accountability risks identified during MCC's due diligence activities of proposed country programs, the related accountability models that will be used and the proposed implementation staff. Regardless of the frequency of audits the OIG will develop the appropriate level of oversight. To encourage further management safeguards to address perceived vulnerabilities, we have:

- Invited MCC to provide extensive input into our audit planning process to ensure that

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our audit and investigative activities address relevant areas of risk and vulnerability.

- Reviewed the MCC's plans for implementing its country assistance programs and planned controls over its ongoing monitoring, evaluation and performance reporting on country programs.
- Developed and provided the MCC with a matrix for use in tracking all audit recommendations.

Administrative Activities

The Corporation is a new organization; it is experiencing inherent conditions that render it vulnerable to possible misuse of its resources. For example, it is still developing and refining its administrative procedures and determining exactly which laws and Federal regulations to which it is subject. Organization-wide internal control procedures have not been established and documented, nor has an assessment been done of the Corporation's internal control system.

The Corporation's expenditures as of March 31, 2005, have been primarily for salaries, travel, office rent, information technology, accounting services, and other administrative services. MCC has outsourced its payroll management, accounting, financial statement preparation and its human resources management to the Department of Interior's National Business Center (NBC) through interagency agreements. By contracting its administrative services to a third party, the Corporation does not have direct day-to-day control over its information processing. For example, the report on internal controls accompanying the financial statement audit of the Corporation's fiscal year 2004 financial statements noted that the Corporation's service provider, NBC, had not had an internal control review done on a new Oracle Federal Financials System that was being used to provide MCC's financial information. As a result, neither NBC nor MCC, have a comprehensive

understanding of the system's internal controls and the risk involved in processing system transactions.

To help the MCC build safeguards over its administrative activities and to address the lack of a fully documented and monitored internal control structure, the OIG has performed the following audit and review activities during this reporting period:

- Initiated our second review of the Corporation's information security program as required by the Federal Information Security Management Act (page 11).
- Contracted with a Certified Public Accounting firm to conduct an audit of MCC's fiscal year 2004 financial statements, which included the auditor's report on MCC internal controls, with a recommendation that MCC require that the NBC have an internal control review done on its Oracle Federal Financials System, a recommendation that MCC agreed to implement (page 12).
- Performed an audit of the Corporation's efforts to establish its internal control structure (page 13).
- Reviewed the Corporation's progress in developing its organizational structure and implementing its country assistance programs (page 14).
- Audited the Corporation's efforts to implement its employee integrity program as required by the Office of Government Ethics (page 16).
- Provided feedback on the completeness and adequacy of disclosures in MCC required annual reporting to the Office of Management and Budget.

Coordination with Other Government Units

The MCC was given broad flexibility to accomplish its mandate and establish itself as a model organization that is transparent, embraces accountability and is results-oriented. Support of this unique development concept requires that we establish clear expectations and avoid duplication of effort with other government units that have oversight responsibilities. Specifically, the Inspector General Act of 1978, as amended, requires that “In carrying out responsibilities established under this Act, each Inspector General shall give particular regard to the activities of the Comptroller General of the United States with a view toward avoiding duplication and ensuring effective coordination and cooperation.” We have established an extensive coordination schedule with the Government Accountability Office (GAO) to include regular meetings at the management level and quarterly meetings at the executive level. Moreover, the GAO participates in our annual planning conference as a part of our coordination efforts.

Our coordination with the Office of Management and Budget (OMB) revolves around obtaining a clear understanding of the financial and program management regulations applicable to the MCC in keeping with its broad program flexibilities and where there are areas that require debate, initiating early dialogue to ensure compliance with important reporting time lines.

The Government Accountability Office

The GAO, as the Congressional oversight agency, has the authority and responsibility to review Federal programs and to respond to special requests of the Congress. In May 2004, at the request of the Chairman of the Senate Foreign Relations Committee, GAO initiated a review of the Corporation to determine:

1. How MCC is being managed in terms of its governance structure, human capital, accountability mechanisms, and financial management;
2. How MCC selects eligible countries and negotiates Compacts;
3. How assistance under the Compacts will be monitored and evaluated; and
4. To what extent MCA funding and program activities will be coordinated with other U.S. Government agencies and other donors.

As we plan and initiate our audit work at MCC, we coordinate with GAO on an ongoing basis to ensure there is no duplication of effort while making sure that all relevant areas relating to MCC are covered. For example, we discuss such areas as access to MCC information, work plans to ensure that there is no duplication of effort and that all relevant areas are covered, MCC management issues, and the progress and results of our ongoing oversight work.

As a result of these activities we are able to establish a reasonable degree of assurance that the Corporation’s risks and vulnerabilities are being addressed and reported to the Corporation and to the Congress.

The Office of Management and Budget

OMB’s predominant mission is to assist the President in overseeing the preparation of the Federal budget and to supervise the administration of Executive Branch agencies. OMB evaluates the effectiveness of agency programs, policies, and procedures, and ensures that agency reports and rules are consistent with Administration policies. OMB also oversees and coordinates the Administration’s procurement, financial management, information, and regulatory policies.

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To keep abreast of current OMB guidelines and expectations as they relate to MCC operations and to our audit work, the OIG has established an extensive working relationship with OMB. For instance, our meetings and communications with OMB officials during the past six months resulted in the following:

- Reaching a consensus with the Corporation to accelerate the preparation and audit of the Corporation's fiscal year 2004 financial statements from 180 days, as permitted under the Government Corporation Control Act, to 90 days after its fiscal year end. We will continue our efforts to help the MCC meet the Federal Government norm under the Government Management Reform Act (GMRA) of having audited financial statements by 45 days after its fiscal year end.
- Through dialogue with the Corporation and OMB, we have reached an understanding of MCC's reporting expectations under the Government Performance and Results Act.
- Through dialogue and coordination with OMB, we have reached an understanding of MCC's report content and reporting timeline under the Federal Managers' Financial Integrity Act.

These and other coordination and interaction activities with OMB help provide reasonable assurances that the Corporation is in compliance with applicable OMB requirements.

Other Federal Agencies

Several Federal agencies will be responsible for administering MCC funds. For example USAID is providing technical assistance to MCC threshold countries to help them become eligible for MCC Compacts. USAID has been provided \$40 million of MCC funds for this activity, and we have taken steps to ensure that those funds will be audited as the threshold activities move forward. Other Federal agencies that will be disbursing MCC funds include

the Army Corps of Engineers, the Department of Agriculture, and the Treasury Department. We have notified the Inspectors General of these agencies of the existence of these agreements and we will be coordinating the oversight of agreement funds with them.

Four Strategic Objectives to Address MCC Challenges

Introduction

Management challenges are risks and vulnerabilities that need to be addressed by management. Having been established just over one year ago, the Millennium Challenge Corporation faces the normal challenges of any new organization: developing financial systems, hiring staff, determining applicable laws and regulations, developing internal controls, and developing an effective program management and oversight methodology. In the near future the Corporation will also face the challenges of implementing new and innovative programs in complex overseas environments, with differences in language, laws and accountability standards as well as varying degrees of corruption in many of the countries where it will likely implement programs.

To clearly understand these challenges and to select the appropriate OIG response to them, we undertake an extensive annual planning process, obtaining views and concerns on issues affecting the Corporation as well as soliciting feedback on the usefulness of our work. Participants in this planning process include congressional staff, representatives of OMB and GAO, and senior management of the MCC. In his presentation at our planning conference, the Corporation's CEO lauded the cooperation between the OIG and the MCC and indicated that the OIG plays a particularly useful role in supporting the Corporation's overall development. Other MCC senior management identified potential areas that would benefit from audit oversight and the need to be flexible in timing our work to correspond with the likely pace of funds disbursements.



Photograph of James Ebbitt, Former Acting Inspector General; Paul Applegarth, CEO, Millennium Challenge Corporation; and Henry Barrett, Assistant Inspector General/MCC at the OIG Annual Planning Conference.

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The OIG has four strategic goals consistent with the IG Act of 1978, as amended under which we conduct audits and reviews to help the Corporation address and overcome its management challenges.

Keeping the Head of the Corporation and Congress Fully Informed on the Status of the MCC's Administration and Operations and the Need for Corrective Action

This strategic goal is designed to make sure that potential management challenges, and progress thereon are addressed early and openly, by communicating on an ongoing basis with Corporation management and the Congress to keep them abreast of OIG activities relevant to MCC. Specifically, the OIG will:

- Prepare and submit semiannual reports to Congress as required. The IG Act requires that the OIG provide Congress with written reports of its activities and accomplishments every six months. The reports include our audit and investigative highlights as well as summaries of significant audits conducted during the reporting period. This is our second Semiannual Report to Congress and covers the period ending March 31, 2005.
- Present timely briefings to the Board, Chief Executive Officer and key MCC officials on critical problem areas identified by OIG audits and investigations. We have not met with the Board of Directors this reporting period. We have regular scheduled meetings with the Chief Executive Officer (CEO) and frequent interactions with MCC senior management. In our meetings with the CEO, we discussed significant audits as well as the status of the Corporation's management controls, and program oversight and monitoring efforts. We will seek a meeting with the Board of Directors and we will continue to brief the CEO and senior MCC

staff to bring matters of importance to the attention of MCC management in a time frame that will enable those managers to take effective remedial action.

- Continue to present timely briefings to key congressional staff on the status of significant OIG audit and investigative activities, problems and issues identified by these efforts, and the necessity for and progress of corrective actions being taken by MCC. We have made one formal briefing to congressional staffers on how the OIG has organized itself to carry out our IG Act responsibilities at the MCC, as well as discussions on MCC efforts to staff-up its operations, establish effective internal controls and the MCC compact development process.
- Conduct audits and distribute audit reports to MCC management and congressional staff in a timely manner. All non classified audit and review reports are transmitted to appropriate congressional committees. These reports are also made compliant with the Americans with Disabilities Act and posted to the OIG website at www.usaid.gov/oig.

Promoting Sound Accounting and Reporting On Financial Activities and Information Security

This strategic goal addresses the Corporation's challenges of developing effective financial management systems and the related internal controls. These systems should be designed to ensure that MCC prepares, records and reports reliable financial data relating to its administrative and program operations. The OIG initiated two audits this period to address these two challenges. One was an audit of the MCC's compliance with the Federal Information Security Management Act of 2002 (FISMA) and the other was the Financial Statement audit.

The FISMA audit began in February of 2005 and was underway at the end of this reporting period. It is the second audit of the Corporation's compliance with the provisions of FISMA. The first audit, reported on in September, 2004, noted that, although the Corporation reported on its information security program in accordance with FISMA, it had not documented its information systems security program. That report contained one recommendation for the Corporation to document an information systems security program in accordance with FISMA. MCC Management accepted the recommendation. However, the current audit now underway, found that as of March 31, 2005, the Corporation had still not documented its information system as recommended in the prior audit report (Appendix A, page 20).

Audit of Millennium Challenge Corporation's Consolidated Financial Statements, Internal Controls, and Compliance for the Nine Month Period Ending September 30, 2004

An audit of MCC's consolidated financial statements, internal controls, and compliance for the nine-month period ending September 30, 2004, was performed, under OIG oversight, by a non-federal audit firm. The firm provided an unqualified opinion on the financial statements. This represents an important accomplishment for the Millennium Challenge Corporation, as this was the first audit of financial statements prepared by the Millennium Challenge Corporation. In its report, the audit firm identified one reportable condition in internal controls resulting in one instance of noncompliance related to the review of its financial and accounting system.

The MCC does not have its own financial system and contracts with the Department of Interior's National Business Center (NBC) to provide accounting and financial management services, including usage of its Oracle Federal Financials

System application. However, the NBC had not conducted an internal control review, such as a Statement of Auditing Standards (SAS) 70 review, of this system, nor had MCC requested that NBC do such a review.

OMB Circular A-127, Financial Management Systems, requires that an agency conduct an internal control review of all federal financial systems in accordance with the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

The independent auditor concluded that because an internal control review of the Oracle Federal Financials System application was not done, the Corporation's financial management system was not in substantial compliance with FFMIA³ and OMB Circular A-127 and that this condition could adversely affect the Corporation's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

The OIG recommended that the Corporation direct the National Business Center to conduct an internal control review of its Oracle Federal Financials System. MCC management agreed with this recommendation and, based on discussions with NBC, a system review is expected to be completed in fiscal year 2005.

(Report No. M-000-05-001-C)

Promoting Economy, Efficiency, and Effectiveness, and Assessing Program Results

This strategic goal addresses the Corporation's challenges related to human resources, determining the applicability of laws and regulations, and developing an effective management oversight methodology. We have undertaken the following audits to

³ FFMIA, the Federal Financial Management Improvement Act of 1996 requires that the financial system comply with OMB Circular A-127.

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better understand management's response to these challenges and to provide management with recommendations to address the vulnerabilities associated with them.

Audit of the Millennium Challenge Corporation's Efforts to Establish its Internal Control Structure

The Office of Inspector General for the Millennium Challenge Corporation conducted an audit of MCC's efforts to establish its internal control structure in order to determine if the Corporation implemented a system of internal controls consistent with the requirements of the Federal Managers' Financial Integrity Act and Office of Management and Budget guidance. The audit found that MCC had not implemented a system of internal controls consistent with the requirements of the guidance.

Internal controls are a major part of managing an organization and comprise the plans, policies, and procedures used to meet the organization's mission, goals and objectives. Internal controls include the plan of organization and methods and procedures adopted by management to ensure that its goals are met. They are used to provide reasonable assurance that (1) programs achieve their intended results, (2) resources are used consistent with the organization's mission, (3) programs and resources are protected from waste, fraud, and mismanagement, (4) laws and regulations are followed, and (5) reliable and timely information is obtained, maintained, reported and used for decision-making and controlling program costs.

The importance of internal controls is addressed, both explicitly and implicitly, in various laws, regulations and Federal guidance. The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires the heads of executive agencies to annually evaluate the adequacy of the agency's internal accounting and administrative controls and report whether the controls meet Federal standards. The FMFIA requirements are extended to government

corporations such as the MCC by the Government Corporation Control Act which requires the head of the management of a corporation to include a statement on internal accounting and administrative systems, consistent with FMFIA requirements, in the corporation's annual management report to Congress.⁴ The Office of Management and Budget (OMB) provides guidance and reporting requirements for annual internal control evaluations.⁵ Lastly, the U.S. Comptroller General has established standards for internal control in the Federal Government.⁶ Within these mandates, Government organizations are expected to establish, assess, correct and report on the adequacy of their internal controls.

Although MCC had established a number of individual internal control procedures covering its administrative operations, it did not document its system of internal controls covering all aspects of its program and operations nor did it establish a defined timeframe for doing so. Also, MCC had not conducted an assessment of the adequacy of its internal control system at its fiscal year end.

The audit report contained two recommendations which required the Corporation to (1) formalize and document its administrative and program internal control system and establish a defined timeline for completing this activity, and (2) conduct an evaluation of its internal control system consistent with the FMFIA and OMB implementing guidance. Management agreed and both recommendations have a management decision to implement them.

(Report No. M-000-05-002-P)

⁴ *The Government Corporation Control Act requires corporations to submit an annual management report to the Congress not later than 180 days after the end of the government corporation's fiscal year.*

⁵ *Office of Management and Budget, Circular A-123, Management Accountability and Control (Revised June 21, 1995).*

⁶ *U.S. General Accounting Office, Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1 (November 1999). The General Accounting Office (GAO) changed its name to the Government Accountability Office in 2004. The U.S. Comptroller General is the head of the GAO.*

Review of the Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs as of February 28, 2005

The Office of Inspector General for the Millennium Challenge Corporation conducted a second review of the Corporation during February-March 2005. The purpose of the review was to evaluate the progress MCC has made in achieving its planned organizational structure, developing its compact preparation and negotiation process, and complying with the Millennium Challenge Act of 2003 and other applicable laws and regulations. The review found that MCC had made significant progress in each of these areas.

MCC had established an organizational structure consisting of the Chief Executive Officer and eight Vice Presidencies. By December 2005, it planned to reach a full staffing level of 200 U.S. staff positions. As of February 28, 2005, MCC had filled 110 of the planned staff positions through a combination of U.S. direct hires, personal service contractors, specialized contractors and detailees. MCC also planned to send country resident representatives overseas, assisted by an unspecified number of local personal service contractors, to provide an on-the-ground presence to oversee the activities in the compact countries. To enhance its technical expertise in selected areas, MCC entered into interagency agreements with other U.S. Government agencies and may enter into more as the need arises.

Regarding its compact development process, MCC's Board selected 16 countries as eligible to submit assistance proposals under fiscal year 2004 funding and 16 countries under fiscal year 2005 funding (including 15 of the fiscal year 2004 countries with one additional country). MCC records indicate that by the end of February 2005, 15 of

the 16 countries eligible for fiscal year 2004 funding had submitted at least an initial draft proposal and most of these countries have submitted more refined draft proposals with assistance from MCC. Although MCC had not signed a compact with any of its eligible countries as of the end of February 2005, MCC officials indicated that they had made considerable progress toward finalizing as many as five compacts in the next few months and expected the first compact would be signed with Madagascar in April 2005⁷ with planned initial disbursements to be made within two months of compact signing. Equally important, MCC had established a foundation for the future by substantially creating the procedures and documents it will use in developing and negotiating compacts with its eligible countries and adjustments and changes can be expected as MCC gains more experience and a track record with the implementation of its first country programs. MCC has invested extensive time and resources in developing its "due diligence" process—the appraisal process where MCC supports the development of a country's proposal and identifies potential fiscal and procurement agents and issues of concern to be addressed before signing a compact to ensure sound investment of U.S. funding.

In addition to progress in developing and negotiating compacts with eligible countries, MCC has moved forward in establishing its Threshold Program to assist selected countries that are committed to undertaking necessary reforms to improve policy performance so that they might eventually qualify for assistance as an eligible country. The Act allows up to ten percent of available funding to be used for this program and the MCC Board selected 7 countries in fiscal year 2004 and 12 countries in fiscal year 2005 (which included 6 countries from fiscal year 2004) to participate in the program. In October 2004, MCC signed a memorandum of agreement with the U.S. Agency for International Development (USAID) to allocate up to \$40 million

⁷ Subsequent to our review cutoff date, March 14, 2005, MCC's Board of Directors approved MCC's first Millennium Challenge compact with the country of Madagascar.

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for USAID to administer the program. MCC and USAID personnel have worked closely in explaining and promoting the program with officials of the selected countries. As of February 28, 2005, MCC had received concept papers from each of the seven fiscal year 2004 Threshold Program countries. Subsequent to our review, MCC's investment committee approved four of the concept papers allowing those countries to proceed toward preparing program plans for possible MCC approval and funding before the end of fiscal year 2005.

MCC continued its progress in complying with the provisions in the Act and continued to assess the applicability of other Federal laws and regulations to its operations. For example, as required by the Act, MCC's Board selected countries eligible to submit compact proposals under fiscal year 2005 funding and it selected countries eligible to submit proposals under MCC's Threshold Program for fiscal years 2004 and 2005. Additionally, MCC made proper notifications to Congress on the selection of the eligible countries and on MCC's intent to enter into compact negotiations with a number of those countries. MCC also notified Congress of its intent to allocate fiscal year 2004 funds to three U.S. Government agencies for assistance in carrying out its program, and it published information in the Federal Register as required.

However, while MCC officials reported that the MCC has followed the Federal Acquisition Regulation (FAR) since its inception, MCC recently issued an internal memorandum stating that language in the Act constitutes "character and necessity"⁸ language which exempts MCC from the general statutory and regulatory provisions governing Federal procurement when developing its own procurement policies and procedures. OIG's interpretation of the Government Accountability Office's Principles of Federal Appropriation Law cited in MCC's opinion is that "character and

necessity" language is intended to apply to laws of a fiscal nature and not to procurement laws and regulations. GAO's guidance specifically states that Federal procurement laws and regulations are expressly applicable to wholly-owned government corporations. Accordingly, the report contained a recommendation that MCC request the advice of appropriate authorities on whether the Act's language exempts MCC from general statutory and regulatory provisions governing Federal procurement.

MCC indicated that it will take the recommendation under advisement and further stated that it intends to continue following the requirements of the FAR. Given that MCC intends to continue following the FAR and the fact that this review report puts MCC on notice of the OIG's position that "character and necessity" language would not give authority to deviate from general procurement statutes or the FAR, we consider MCC's comments to be generally responsive to the recommendation and consider that final action has been taken on the recommendation.

(Audit Report No. M-000-05-001-S)

Preserve and Protect the Millennium Challenge Corporation's Program and Employee Integrity

This strategic goal is designed to foster the integrity of program and operational activities. Although not a management challenge, our focus on the prevention of fraud and protection of resources are to ensure MCC's employees and programs are of the highest integrity and to enhance the awareness of MCC staff to potential indicators of fraud. Our work during this period consisted of one audit and a fraud-awareness briefing.

⁸ "Character and necessity" language refers to a provision in government corporation's authorizing legislation that is interpreted by GAO as providing the government corporation fiscal autonomy. Fiscal autonomy allows government corporations to use its funds for expenses otherwise unallowable by Federal agencies.

Audit of Millennium Challenge Corporation's Compliance with the Requirements for Annual Ethics Training and Financial Disclosure Reports for Selected Employees

The Inspector General for MCC conducted this audit as a part of its fiscal year 2005 audit plan to determine whether the Corporation complied with Federal requirements for financial disclosure reporting and annual ethics training for selected employees.

The Office of Government Ethics (OGE) provides overall policy direction to Federal agencies regarding their ethics programs. That policy requires that each agency develop an annual ethics training program for its employees. The training program must include, at least, an initial agency ethics orientation for all employees and annual ethics training for covered employees. The head of each agency has primary responsibility for the day-to-day administration of the ethics program for the employees who carry out the substantive programs of that agency. The head of each agency selects an individual employee to serve as the agency's Designated Agency Ethics Official (DAEO). MCC's DAEO is the Assistant General Counsel for Administration, who is assisted by staff in the Office of General Counsel. Ethics activities managed by MCC's ethics staff and reviewed in this audit were (1) collection of public financial disclosure reports, (2) collection of confidential financial disclosure reports and (3) annual ethics training.

The audit found that MCC complied with federal regulations for annual ethics training but did not collect public financial disclosure reports for four of its employees within specified timeframes including allowable extensions and did not collect or waive the required late filing fee. Three employees were new entrants and filed their public financial disclosure reports more than 150 days after being employed with MCC. The fourth employee was an

incumbent filer hired from another agency in late May 2004 and did not file until 201 days after being employed with MCC.

The audit report recommended that the Millennium Challenge Corporation (1) collect the required late-filing fee from the three new entrant employees who filed their public financial disclosure reports after the required deadline and (2) modify its financial disclosure reporting procedures to specifically address how it will obtain reports for its incumbent public filers.

Two other areas noted during the audit were that the Corporation did not have procedures for (1) documenting reviews of the financial disclosure reports of MCC government board members who file disclosure reports with their respective organizations and (2) identifying how it will handle the financial disclosure reporting requirements of employees detailed from other government agencies.

MCC took appropriate actions concerning the two recommendations. For the first recommendation, it waived the late filing fees for the cases cited and modified its written procedures which will reduce the number of public filers in the future. For the second recommendation, MCC revised its procedures to address how it will obtain reports for its incumbent public filers. As a result, final action has been taken on both recommendations upon report issuance.

(Audit Report No. M-000-05-001-P)

Investigations: Prevention and Fraud Awareness

OIG investigative priorities are twofold: first, to preserve and protect program and employee integrity within the Millennium Challenge Corporation; and second, to prevent fraud, waste, and abuse within MCC programs and operations. During the current reporting period, the OIG has placed emphasis on preventive strategies as part

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of our oversight responsibilities. Use of proactive preventive strategies has proven to be very effective in combating fraud, waste and abuse.

Accordingly, the OIG has employed a number of strategies. For example, fraud-awareness training is given to employees, contractors, grantees and others. This training alerts participants to fraudulent practices and schemes and advises them on how to report fraud if it is encountered. When requested the training is tailored for presentation for specific groups, such as contracting officers or Cognizant Technical Officers. Most important, investigations resulting in criminal and/or civil prosecution are publicized on the Agency's website and other publications calling attention to prosecutive action taken against individuals or organizations convicted of fraud. The publication of prosecutive actions serves as a deterrent to fraud, waste and abuse.

In addition, the OIG has developed several publications and promotional materials. The newest publication, "What an Investigation Means to You," outlines the types of activities that the OIG investigates, the purpose of its investigations, the investigative process and the employee's role in that process. Another publication, "What to Report," provides specific guidelines for making complaints to the OIG Hotline. The "Fraud Indicators" publication encourages the reader to explore

various techniques to identify indications of fraud. Furthermore, OIG Hotline posters, flyers, and cards available in different languages have been distributed to the OIG's overseas offices. In an effort to expand our outreach efforts, these materials were produced in English, Spanish, French and Arabic. On March 16, 2005, the OIG represented by staff from the Assistant Inspector General for Investigations and the Assistant Inspector General for the Millennium Challenge Corporation, presented a briefing on fraud awareness to approximately 16 members of the Corporation.

MCC was advised of the mission of the Assistant Inspector General for Investigations (Investigations), which focuses on the preservation and protection of program and employee integrity relative to the activities of USAID, the MCC, the African Development Foundation, and the Inter-American Foundation. It is the responsibility of Investigations to (1) investigate allegations of fraud, waste and abuse in programs and operations, giving priority to cases involving major fraud; (2) prevent fraud, waste and abuse in programs; and (3) preserve and protect employee integrity by conducting and concluding investigations of employee integrity efficiently and expeditiously. Investigations employs both proactive and reactive strategies to carry out its mission.



Photograph of the second fraud awareness briefing presented to MCC staff.

A P P E N D I C E S

Semiannual Report to the Congress

REPORTS ISSUED

October 1, 2004 through March 31, 2005

Report Number	Date of Report	Report Title	Amount of Findings (\$000)	Type of Findings
M-000-05-001-C	01/27/2005	Audit of the Millennium Challenge Corporation's Consolidated Financial Statements, Internal Controls, and Compliance for the Nine month Period Ending September 30, 2004		
M-000-05-001-P	03/31/2005	Audit of Millennium Challenge Corporation's Compliance with Federal Requirements for Annual Ethics Training and Financial Disclosure Reports for Selected Employees		
M-000-05-002-P	03/31/2005	Audit of the Millennium Challenge Corporation's Efforts to Establish Its Internal Control Structure		
M-000-05-001-S	03/31/2005	Review of Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs As of February 28, 2005		

SIGNIFICANT AUDIT RECOMMENDATIONS DESCRIBED IN PREVIOUS SEMIANNUAL REPORT WITHOUT FINAL ACTION

As of March 31, 2005

Report Number	Subject of Report	Issue Date	Rec. No.	Management Decision Date	Final Action Target Date
M-000-04-001-P	Documenting an agency-wide information system security program in accordance with the requirements of the Federal Information Security Management Act of 2002	09/30/2004	1	09/30/2004	

Reporting Requirements

Summary of Instances in Which Information or Assistance Was Refused

The Inspector General Act of 1978 (Public Law 95-452), as amended, requires the identification of any reports made to the head of the agency describing where information or assistance was refused or not provided. During this reporting period, there were no reports to the Millennium Challenge Corporation describing instances where information or assistance was unreasonably refused or not provided.

Decisions and Reasons for Significant Revised Management Decisions

The Inspector General Act requires that each Inspector General's Semiannual Report to the U.S. Congress include a description and explanation of significant revisions of management decisions. During this reporting period, there were no significant revisions of management decisions.

Significant Management Decisions with Which the Inspector General Disagrees

The Inspector General Act requires that each Inspector General's Semiannual Report to the U.S. Congress include information concerning any significant management decisions with which the OIG is in disagreement. During this reporting period, there were no management decisions with which the OIG disagreed.

Remediation Plan

The Inspector General Act requires an update on issues outstanding under a remediation plan required by the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA requires agencies to substantially comply with (1) Federal financial management system requirements, (2) Federal Accounting Standards, and (3) the U.S. Standard General Ledger at the transaction level. According to OMB Circular No. A-11, an agency that is not substantially compliant with FFMIA must prepare a remediation plan. The purpose of the remediation plan is to identify fiscal year activities planned and

underway that will allow an agency to achieve substantial compliance with FFMIA.

During our fiscal year 2004 financial statement audit, the Millennium Challenge Corporation's (Corporation) first financial statement audit, it was determined that the Corporation's financial management system was not in substantial compliance with the Federal financial management system requirements under the Federal Financial Management Improvement Act (FFMIA) of 1996 and OMB Circular A-127, Financial Management Systems.

The Federal Financial Management Improvement Act financial system requirements state that a system should comply with OMB Circular A-127, Financial Management Systems. The Circular requires an agency to conduct an internal control review of all federal financial systems in accordance with FFMIA.

The Corporation does not have its own financial system. The Corporation contracted with the Department of Interior, National Business Center (NBC) to provide accounting and IT services including usage of its Oracle Federal Financials System application. However, the NBC did not conduct an internal control review, such as a Statement of Auditing Standards (SAS) 70 review, of the Oracle Federal Financials System nor had MCC requested NBC to do such a review.

By not completing an internal control review of the financial system, management does not have a comprehensive understanding of the system's internal controls and the risk involved in conducting system transactions. Per the Corporation, they are the first organization to use the system. It is a new system for NBC.

MCC's management has agreed to request the National Business Center (NBC) to conduct an internal control review of the Oracle Financial System called for by OMB Circular A-127 during fiscal year 2005.

OIG STATISTICAL SUMMARY*As of March 31, 2005***INVESTIGATIVE ACTIONS****NOTHING TO REPORT**

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THE SEMIANNUAL REPORT TO THE CONGRESS
IS AVAILABLE ON THE INTERNET AT
www.usaid.gov/oig/public/semiann/mcc1.htm