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OFFICE OF INSPECTOR GENERAL FOR THE MILLENNIUM CHALLENGE CORPORATION

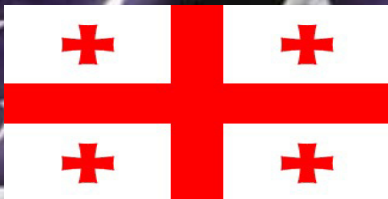
SEMIANNUAL REPORT TO THE CONGRESS



NICARAGUA



ARMENIA



GEORGIA



MADAGASCAR



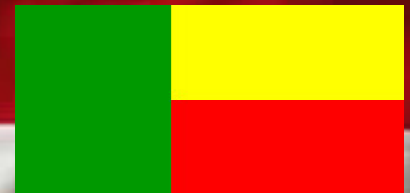
CAPEVERDE



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HONDURAS



BENIN

October 1, 2005 - March 31, 2006



Inspector General HOTLINE

The Office of Inspector General (OIG) maintains a Hotline to make it easy to report allegations of fraud, waste, abuse, mismanagement or misconduct in the programs and operations of the United States Agency for International Development (USAID), the Inter-American Foundation (IAF), the African Development Foundation (ADF), and the Millennium Challenge Corporation (MCC). USAID, IAF, ADF and MCC employees, contractors, and program participants or the general public may report allegations directly to the OIG. The Inspector General Act of 1978 and other laws protect persons making hotline complaints. Submit complaints by e-mail, telephone, or mail to:

Phone 1-202-712-1023
1-800-230-6539

E-mail ig.hotline@usaid.gov

Mail USAID OIG HOTLINE
P.O. Box 657
Washington, DC 20044-0657



Individuals who contact the Hotline are not required to identify themselves. However, OIG encourages those who report allegations to identify themselves so they can be contacted if additional questions arise as OIG evaluates their allegations. Pursuant to the Inspector General Act of 1978, the Inspector General will not disclose the identity of an individual who provides information unless that individual consents or unless the Inspector General determines that such disclosure is unavoidable during the course of an investigation. You may request confidentiality when using the telephone or mail. E-mail complaints cannot be kept confidential because electronic e-mail systems are not secure.

During the current reporting period, OIG received 3,826 hotline contacts. Of these, 53 were referred for possible case openings, 205 were referred to USAID, seven were referred to other federal agencies, four were referred to other law enforcement agencies, and five were found to be unsubstantiated. The remaining contacts were solicitations for money advertisements, or requests for general information or other non-OIG-related matters.

MESSAGE FROM THE INSPECTOR GENERAL

This Semiannual Report to the Congress (SARC) highlights the work of the United States Agency for International Development, Office of Inspector General (USAID/OIG) for the Millennium Challenge Corporation (MCC) during the October 2005 to March 2006 timeframe.

Included are the results of four audit reports and notes that MCC reached final action on a number of audit recommendations during this reporting period. By doing so, MCC has

demonstrated its continuing commitment to accountability. It is also worth noting that MCC Audit Committee had its first meeting with OIG in February 2006.

In response to findings in our audit of MCC's fiscal year 2005 financial statements, we will continue to work with MCC management on internal controls. By doing so, we will help MCC strengthen its internal controls process and avoid potential issues in future financial statement audits.

OIG is prepared to meet the Corporation's expanding audit needs by focusing on program risk as disbursements increase across a range of programs. OIG is committed to fair and transparent oversight and the OIG staff and I look forward to working with you on the challenges ahead of us.

/s/

Donald A. Gambatesa
Inspector General

Acronyms and Abbreviations

ADF	African Development Foundation
AIG/MCC	Assistant Inspector General/Millennium Challenge Corporation
BIANCO	Bureau of Independent Anti-Corruption
CEO	Chief Executive Officer
Corporation	Millennium Challenge Corporation
FAP	Fiscal Accountability Plan
FAR	Federal Acquisition Regulations
FISMA	Federal Information Security Management Act of 2002
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
SAI	Supreme Audit Institutions
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	Nothing to Report
Summary of Each Significant Report	Pages 11 - 14
List of Audit Reports Issued	Appendix A Page 18
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 B Page 19
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 C Page 20
Decisions and Reasons for Significant Revised Management Decisions	Appendix C Page 20
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Remediation Plan Information (Required under the Federal Financial Management Improvement Act of 1996)	Appendix C Page 20
Matters Referred to Prosecutive Authorities and the Prosecutions and Convictions Which Resulted	Appendix D Page 21

EXECUTIVE SUMMARY

This semiannual report highlights significant events regarding the Office of Inspector General (OIG) and presents the results of OIG's activities pertaining to the Millennium Challenge Corporation (MCC or Corporation) for the six-month period ended March 31, 2006. During the reporting period, OIG continued to focus on MCC's Compact accountability and effective use of resources, and on helping the Corporation succeed in its mission.

In February the Inspector General and OIG staff attended the first meeting of the Corporation's newly appointed Audit Committee. During this meeting, attendees discussed the status of OIG audits, audit recommendations, and planned future audit activities.

On March 30, 2006, OIG staff presented a briefing to representatives from countries eligible for future MCC Compacts. At this briefing, OIG explained its role and responsibility for audits and investigations, including visiting country implementing agencies, approving audit firms, and overseeing audits related to the Compacts.

During this reporting period, OIG teams visited two Compact countries—Madagascar and Cape Verde—and two prospective Compact countries—Lesotho and Senegal. OIG made the visits to assess auditing capabilities of local accounting firms; select and approve firms for performing financial audits of MCC Compacts; assess general program implementation capabilities; and gain understanding of the planned program activities in those countries. One of those visits resulted in an audit report on financial risks and vulnerabilities in Madagascar. Also, to assist program managers in meeting audit responsibilities, OIG updated and issued OIG guidelines for auditing MCC Compact programs.

During this reporting period, OIG issued four reports concerning:

- MCC's contract management system,
- MCC's employee benefits program,
- MCC's potential financial and program risk and vulnerabilities in Madagascar, and
- audit of MCC's fiscal year 2005 financial statements.

The four reports contained 16 recommendations to correct accountability and administrative problems. OIG and MCC management have reached "management decisions" on all 16 of the recommendations, and final action has been completed on 10 of the recommendations.

OIG also presented fraud awareness briefings to MCC staff in Washington, D.C., Madagascar and Cape Verde.

As of March 31, 2006, the Corporation had signed eight Compacts with a value of \$1.5 billion. These Compacts are with Armenia, Benin, Cape Verde, Georgia, Honduras, Madagascar, Nicaragua, and Vanuatu.

To assist selected countries (Threshold Countries)¹ to become eligible for Compact funding, MCC's Board of Directors has approved \$185 million for the United States Agency for International Development (USAID) to use in providing eligibility assistance. As of March 31, 2006, MCC has approved five countries for Threshold funding: Burkina Faso, Malawi, Albania, Paraguay and Tanzania.

1. The Threshold Program helps ineligible countries become eligible to apply for MCC assistance.

OVERVIEW

The USAID Office of Inspector General (OIG) is responsible for providing audit and investigative services to the United States Agency for International Development, the African Development Foundation (ADF), the Inter-American Foundation (IAF), and the Millennium Challenge Corporation. 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 to (1) promote economy, efficiency and effectiveness in the administration of programs and (2) detect and prevent fraud and abuse in program operations. The IG Act requires Inspectors General to keep management and the Congress fully and currently informed about problems and deficiencies relating to the administration of programs and operations and the necessity for, and progress of, corrective action.

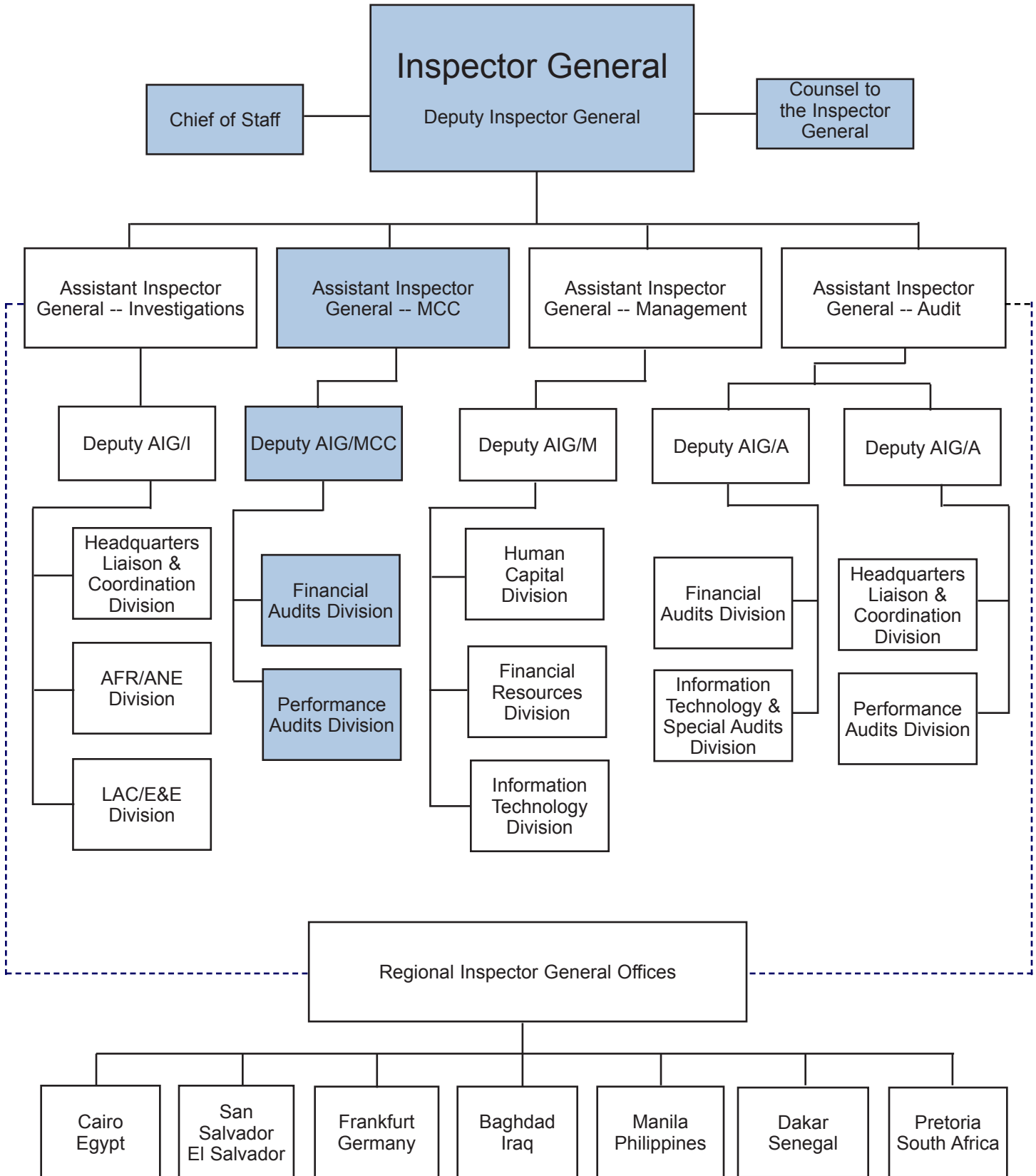
ORGANIZATION

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 Cairo, Egypt; San Salvador, El Salvador; Frankfurt, Germany; Baghdad, Iraq; Manila, Philippines; Dakar, Senegal; and Pretoria, South Africa. These regional offices maintain close working relationships with USAID and enable auditors and investigators to carry out OIG's responsibilities efficiently.

OIG activities for MCC are managed by an Assistant Inspector General (AIG/MCC). This unit has two divisions, Financial Audits and Performance Audits. As the Corporation continues to develop and expand its programs, the unit is expanding its staff to provide effective audit oversight of the Corporation's worldwide programs. As of March 31, 2006, the OIG unit for MCC consists of eight full-time employees and one part-time employee, an increase of three since

September 30, 2005. The unit will continue to draw support from OIG's Washington and overseas offices, as well as external audit firms. For example, the required annual audit of MCC's compliance with provisions of the Federal Information Security Management Act (FISMA) is accomplished with support from OIG's Washington audit offices. Additionally, audits of the Corporation's employee benefits program and the fiscal year 2005 financial statements were performed by a certified public accounting firm. The fraud awareness briefings to MCC personnel and host country entities included presenters from the OIG Investigations unit and Regional Inspector General offices.

USAID OFFICE OF INSPECTOR GENERAL



HIGHLIGHTS

Final action taken on 20 of the 28 outstanding OIG audit recommendations

THE CORPORATION

The Millennium Challenge Corporation was created in January 2004 as an Independent Government Corporation to provide development assistance to reduce poverty in countries that meet MCC's criteria of governing justly, investing in their people, and encouraging economic freedom. The Corporation is located in Washington, D.C. with approximately 200 full-time employees. It plans to increase its staff to about 300 employees during 2006.

The Corporation contracts with the Department of Interior's National Business Center in Denver, Colorado for its accounting, payroll and other administrative services.² The Corporation has agreements with the Army Corp of Engineers, Department of Agriculture, Treasury Department, Department of Transportation, and the Bureau of Census for technical services supporting Compact implementation. MCC also has an agreement with USAID for managing individual country Threshold programs.

MCC ACHIEVEMENTS THIS SIX-MONTH PERIOD

During the period October 1, 2005 to March 31, 2006:

- Secretary Rice in her capacity as MCC Board Chair appointed an Audit Committee, made up of Board members, to assist in the general supervision and oversight of: MCC's administrative and financial controls, the integrity of MCC's financial statements and accounting methodology, and the performance of MCC audit functions carried out by the Inspector General for MCC;
- MCC developed a system for managing final actions on OIG audit recommendations;
- MCC took final action on 20 of the 28 outstanding OIG audit recommendations;
- The MCC Board approved Threshold agreements valued at approximately \$95 million with Albania, (\$13.9 million), Paraguay (\$34.7 million), Burkina Faso (\$12.9 million), and Malawi (\$20.9 million), and Tanzania (\$11.2 million). Those agreements will target activities designed to help those countries become eligible for a future Compact.
- MCC signed three Compact agreements for a total of eight, as of March 31, 2006.
- Armenia for \$235 million to reduce rural poverty by strengthening the performance of the agricultural sector. The program will seek to improve rural roads and irrigation infrastructure, provide technical assistance, and provide financial support to water supply entities, farmers, and commercial agribusinesses. The program is expected to directly impact approximately 750,000 people, or 75 percent of the rural population, increasing their annual income by an estimated \$36 million in 2010 and over \$113 million in 2015.
- Benin for \$307 million to improve its physical and institutional infrastructure by focusing on access to land, financial services, justice, and markets. The program is expected to benefit up to five million Beninese and lift an estimated 250,000 of its citizens out of poverty by the year 2015.
- Vanuatu for \$66 million to improve Vanuatu's transportation infrastructure, including roads, wharfs, an airstrip and warehouses. The project will also seek to improve Vanuatu's Public Works Department. The program is expected to benefit more than 65,000 rural poor inhabitants.

The three compact agreements signed from October 1, 2005 to March 31, 2006, include:

2. The National Business Center is an administrative and computer information service provider for the Department of Interior and other Federal agencies.

SECTION 609(g) FUNDING

Section 609(g) of the Millennium Challenge Act gives MCC the authority to enter into contracts or grant agreements for any eligible country to assist in facilitating the development and implementation of a Compact between the United States and the eligible country. In so doing, MCC funds projects such as feasibility studies, and surveys in order to ensure the sustainability of the proposed project in the Compact. The general categories to which the 609(g) funding funds include: program development, project preparation, monitoring and evaluation, management support, and bridge funding.

As of March 28, 2006, MCC has committed to provide \$35.2 million in 609(g) funding to 11 eligible countries—Benin, Lesotho, Ghana, Mozambique, Nicaragua, Georgia, Senegal, Mali, Cape Verde, Madagascar, and Armenia—of which two received post-Compact funding, termed Bridge funding. MCC provides Bridge funding to countries after they have signed their compact and need money to set-up their offices. The amount of Bridge funding is subtracted from the total Compact amount that the country receives from MCC. In addition, although MCC has agreed to provide 609(g) funding to these countries, it has only disbursed the funding to few countries. Furthermore, MCC does not disburse the full amount at once, but in portions, according to the work that is being conducted at a specified period of time.

Before MCC considers providing funding, the country team prepares a formal request for MCC Investment Committee (who approves or rejects proposals). After the Investment Committee makes its decision, it informs Congress through a Congressional Notification. From that point, MCC provides several key documents to the country, such as the grant and implementation agreements or memorandum of understanding. However, if the funding is for discrete purposes, MCC does not use these documents. Thereafter, MCC determines whether it or the recipient country should be the fiscal and procurement agent.

PROMOTING EFFECTIVE USE OF MCC RESOURCES AND IMPROVING PROSPECTS FOR SUCCESSFUL PROGRAM IMPLEMENTATION

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 other Federal agencies. However, MCC is subject to many of the laws and regulations that apply to most Federal agencies, including the requirements for accountability and sound management. MCC has identified the specific laws and regulations to which it is subject.

As the Corporation develops its program and operating concepts and procedures, OIG works closely with its executives and managers to enhance our knowledge of the Corporation's programs, activities, and vulnerabilities, including its administrative and accounting processes. OIG has taken and continues to take the approach that early involvement in MCC activities will help ensure good management. We seek to establish a framework for providing early feedback to help MCC ensure that MCC administrative functions and Compact programs are based on a solid foundation of effective accountability.

STRENGTHENING ACCOUNTABILITY THROUGH OVERSIGHT VISITS TO COMPACT COUNTRIES

Our overriding goal is to support management in the delivery of its programs by helping management ensure that the Corporation operates efficiently, effectively and with integrity. Our activities are designed to prevent and detect fraud, waste and abuse; ensure the effective use of MCC resources; and ensure the economy, efficiency and effectiveness of MCC's administrative and program operations.

As of March 31, 2006, the Corporation had signed eight country Compacts with a total value of \$1.5 billion and has made program-related disbursements of more than \$13 million under three of those Compacts.

MCC is still a relatively new organization which has not yet reached its optimum stage of organizational development and which is implementing development Compact programs based on an innovative development assistance model that has not been fully tested. These programs are being implemented in countries where varying degrees of corruption are prevalent and standards of accountability vary.

Given these inherent vulnerabilities of the Corporation's programs, OIG has continued its collaborative approach with MCC to ensure the programs are effective. During the past six-month period, OIG assessed the oversight capabilities of Compact-implementing entities and the auditing capabilities of potential auditing firms and government audit institutions in Madagascar, Lesotho and Cape Verde.

OIG Visits Madagascar

In November 2005, OIG made an oversight visit to the Republic of Madagascar to assess progress in implementing the activities under Madagascar's compact agreement with MCC. During that visit, OIG met with various individuals involved with developing the proposal and providing assistance in the compact activities. Several discussions were held with key staff of the newly created Millennium Challenge Account (MCA) Madagascar (the Compact implementing organization) to discuss policies and procedures and implementation activities. OIG also met with key staff of MCA/Madagascar's fiscal and procurement agent to review the progress in building its organizational structure and developing policies and procedures to comply with MCC's requirements, and to assess their understanding of their role, responsibilities and familiarity with MCC's criteria. Also, OIG met with

USAID/Madagascar to discuss its involvement and coordination efforts with MCC and the assistance it is providing under the pre-Compact funding assistance.

In December 2005, OIG performed a risk assessment of MCA Madagascar, the implementing organization for MCC's \$110 million Compact program in Madagascar, to identify and evaluate vulnerabilities in high-risk areas. The risk assessment was performed during the MCA Madagascar initial implementation phase. OIG's review disclosed that MCA Madagascar had high vulnerabilities in several critical areas that could adversely impact its financial operations.



Photograph of one of the two USAID OIG briefings to MCA staff, SAI, Cape Verde Ministry of Finance personnel and local accounting firms. OIG presented information on fraud detection and prevention and audit guidelines that will be used to audit recipients of MCC funds.

The results of our Madagascar risk assessment are discussed in greater detail on page 12.

Concurrent with the risk assessment in Madagascar, OIG presented a fraud awareness briefing to the Bureau of Independent Anti-Corruption (BIANCO) of Madagascar and to the MCA Madagascar staff. BIANCO is an independent government organization created in 2003 to fight corruption.

The fraud awareness briefings focused on the role of OIG in helping MCC management design and implement controls and processes to prevent fraudulent activities, and in investigating potentially fraudulent activities when they do occur. The briefing presented indicators of fraud as well as environments that promote fraud. The briefings explained that it is the USAID Office of Investigations' (Investigations)

responsibility to (1) investigate allegations of fraud, waste and abuse in programs and operations; (2) help MCC management prevent fraud, waste and abuse in programs; and (3) preserve and protect employee integrity by conducting investigations of employee integrity.

OIG Visits Cape Verde

OIG conducted a risk assessment of Millennium Challenge Account (MCA), Cape Verde, the implementing organization for MCC's \$110 million Compact program in Cape Verde, to identify high-risk areas. The risk assessment was performed during the MCA Cape Verde implementation phase. At the end of March 2006, OIG staff were in the process of completing their analysis.

During a visit to Cape Verde, OIG staff presented briefings on fraud awareness and MCC audit guidelines. Attending these briefings were MCA/Cape Verde personnel, local accounting firms, and Ministry of Finance staff. The fraud awareness briefing focused on the role of the USAID OIG offices to prevent and investigate fraudulent activities. The briefing presented indicators of fraud as well as environments that promote fraud. OIG team provided training on the audit requirements for projects funded with MCC assistance. The presentation covered audit standards, the reporting process, and IG quality control procedures over audits of MCC assistance.

To ensure management accountability of the U.S. assistance to Cape Verde, OIG evaluated local accounting firms in Lisbon, Portugal and Cape Verde to audit MCC assistance. The team also met with the president of Tribunal de

Contas de Cabo Verde, the Cape Verde Supreme Audit Institution, and his key staff to gain an understanding of the professional and regulatory environment in which audits are conducted in Cape Verde.

OIG Visits the Kingdom of Lesotho

In November 2005, OIG staff visited the Kingdom of Lesotho to review the management and implementation of the activities funded under the \$1.39 million 609(g)³ grant designed to assist with the Compact development process. During the visit, OIG staff interviewed government officials to obtain the country's perspective of working with MCC and the challenges it faced in developing a proposal meeting MCC's criteria.

OIG staff also interviewed procurement evaluation committee members responsible for selecting consultants to conduct the 609(g)-funded studies to determine their understanding of the procurement guidelines and the policy and procedures for evaluations. Furthermore, OIG observed a consultative process held in a remote village in Lesotho. Several villages were represented at the meeting, which provided a platform for identifying community needs and making corresponding action plans. The meeting was led by the Director of Planning of the Ministry of Local Government. The MCA Coordinator and MCC's Country Director addressed the gathering and talked about MCC's goals and objectives and how MCC could assist them in meeting their needs.

Some of the needs identified were (1) water in the villages, (2) bridges and roads, (3) proper sanitation facilities, and (3) getting products to markets.



Photograph of village residents discussing local needs in anticipation of a future MCC Compact.



Photograph of voting system used by villagers to identify priorities for potential development assistance funding. Village representatives vote by placing stones in cans which represent different program options.

3. 609(g) is a provision in the Millennium Challenge Act whereby MCC may provide funds to an eligible country to facilitate the development and implementation of a Compact

- **Establish extensive coordination process with GAO**
- **Initiate early dialogue with OMB**
- **Exchange information with other OIG's on interagency agreements**

Several of the villagers expressed their dissatisfaction about the long distances they had to walk to get to a river that was oftentimes very low or dried up. Other villagers wanted to know how soon solutions to the needs that they identified would be implemented. After the needs were identified, the villagers voted on them and will submit action plans to the local district. Below is a picture of the voting process the villagers used. Each can represents an identified need, and the villagers vote by dropping stones in the cans representing that need.

STRENGTHENING ACCOUNTABILITY THROUGH COORDINATION WITH OTHER GOVERNMENT ENTITIES

The Congress gave MCC 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, (Section 4.(c)) as amended, requires that “In carrying out the duties and 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 insuring effective coordination and cooperation.”

The Government Accountability Office

OIG has established an extensive coordination process with the Government Accountability Office (GAO), which includes ongoing interaction with GAO staff involved in responding to Congressional requests for oversight of MCC's operations. OIG's coordination with GAO provides reasonable assurance that all relevant areas of MCC's activities are receiving oversight while avoiding duplication of effort.

The Office of Management and Budget

OIG coordinates with the Office of Management and Budget (OMB) by obtaining a clear understanding of the financial and program management regulations applicable to MCC in keeping with its broad program flexibilities. Where there are areas that require interpretation, OIG initiates early dialogue with OMB and MCC management to help ensure compliance with important reporting

time lines. Moreover, as part of OIG coordination efforts, OMB officials participated in our annual planning conference.

COORDINATION WITH OTHER FEDERAL AGENCIES ON ACCOUNTABILITY FOR MCC APPROPRIATIONS

MCC has entered into a number of interagency agreements with other Federal entities to help implement its programs. For funds transferred from MCC to USAID, the oversight responsibility remains with the Inspector General for USAID.

Other recipients of MCC funds include the Army Corps of Engineers, Department of Agriculture, Treasury Department, Department of Transportation, and Bureau of Census. OIG's role will be to contact the Inspector General offices in those agencies to exchange information about the interagency agreements in an effort to advance accountability for MCC funds.

STRATEGIC OBJECTIVES TO ADDRESS MANAGEMENT CHALLENGES

INTRODUCTION

Management challenges are defined as risks and vulnerabilities that need to be addressed by management. Having been established for just over two years, the Millennium Challenge Corporation faces the normal challenges of any new organization: developing financial systems, hiring staff, determining applicability of laws and regulations, developing internal controls, and developing an effective program management and oversight methodology. And having signed eight Compacts, the Corporation is dealing with 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, OIG undertakes 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 representatives of USAID and Office of Management and Budget, and senior managers of MCC.

The Corporation is dealing with the challenges of implementing new and innovative programs in complex overseas environments...

In addition, OIG has four goals consistent with the IG Act of 1978, as amended, under which it conducts audits and reviews to help the Corporation address and overcome its management challenges. These four goals are to:

- Keep the Chief Executive Officer of the Corporation and Congress fully informed on the status of MCC's administration and operations and the need for corrective actions,
- Promote sound accounting and reporting on financial activities and information security,
- Promote economy, efficiency and effectiveness and assess program results, and
- Preserve and protect MCC's program and employee integrity.

Activities undertaken to meet these goals included ongoing dialogue with the General Accountability Office; conducting a fraud-awareness briefing in March 2006; meeting with the recently appointed Audit Committee; working with Corporation management to develop effective audit recom-

mendation follow-up procedures; and issuing four audit reports with recommendations to improve the Corporation's operations.

KEEP THE CHIEF EXECUTIVE OFFICER OF THE CORPORATION AND CONGRESS FULLY INFORMED ON THE STATUS OF MCC'S ADMINISTRATION AND OPERATIONS AND THE NEED FOR CORRECTIVE ACTIONS

This 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. Specifically, OIG:

- Prepares and submits semiannual reports to Congress. The IG Act requires that OIG provide Congress with written reports of its activities and accomplishments every six months. The reports include OIG audit and investigative highlights as well as summaries of significant audits performed

during the reporting period. This is the fourth Semiannual Report to Congress and covers the period ending March 31, 2006.

- Presents timely briefings to the Board, Chief Executive Officer (CEO), and key MCC officials on critical problem areas identified by OIG audits and investigations. For example, in February, OIG met with the Board's Audit Committee to introduce OIG staff and brief the Committee members on the status of OIG audits, audit recommendations and other audit-related matters. OIG had frequent meetings with the CEO and continuing interactions with MCC senior management. In its meetings with the CEO, the OIG discussed significant audits and the status of the Corporation's management controls, as well as program oversight and monitoring efforts.
- Conducts audits and distributes audit reports to MCC management and congressional staff in a timely manner. All non-classified reports are transmitted to appropriate congressional committees. These reports are in compliance with the Americans with Disabilities Act and are posted to the OIG website at www.usaid.gov/oig.

PROMOTE SOUND ACCOUNTING AND REPORTING ON FINANCIAL ACTIVITIES AND INFORMATION SECURITY

This 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 completed three audits this period to address these challenges: an audit of MCC's Fiscal Year 2005 Financial Statements, an agreed-upon procedures audit covering MCC employee benefits program, and a Risk Assessment of MCC's Compact program in Madagascar. Additionally, one risk assessment of MCC's program in Cape Verde was underway at the end of March 2006.

Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2005, and the Nine-Month Period Ending September 30, 2004

In its audit of the Millennium Challenge Corporation's financial statements for the period ending September 30, 2005, and the nine-month period ended September 30, 2004, the external auditors found that:

- The financial statements were fairly presented in conformity with U.S. generally accepted accounting principles
- There were four reportable conditions regarding the controls over financial reporting and its operations. One of the four reportable conditions is a material weakness
- There were three instances of noncompliance with laws and regulations related to the review of its financial and accounting system.

The material weakness and the reportable conditions identified in the internal controls relate to MCC's need to develop written policies and procedures to streamline its financial operations. The absence of a complete set of effective written policies and procedures for these operations increased the risk of errors, improper recording, unauthorized transactions, omissions, potential funds control violations, and noncompliance with laws and regulations.

The external auditors reported the following internal control weaknesses or reportable conditions:

1. Policies and procedures were not always complete and consistent (material weakness)
2. Policies and procedures for managing travel and related disbursements do not permit the effective and efficient management of travel (reportable condition)

3. Policies and Procedures for disbursing advances to grantees do not accommodate effective cash management nor the appropriate recording of custodial interest receivable and payable (reportable condition and noncompliance)
4. Policies and Procedures for managing its financial operations are inadequate (reportable condition)

OIG also reported the following instances of noncompliance with laws, regulations, contracts, and grant agreements, inclusive of those referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA), and disclosed instances of noncompliance or other matters that are required to be reported herein under Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, Audit Requirements for Federal Financial Statements:

1. MCC did not fully comply with requirements mandated by the Federal Financial Management Improvement Act (FFMIA) and Government Performance Results Act (GPRA) (material noncompliance).
2. MCC did not fully comply with Federal Information Security Management Act FISMA (material noncompliance).
3. MCC policies for disbursing advances to grantees did not accommodate effective cash management nor the appro-

priate recording of custodial interest receivable and payable (reportable condition and noncompliance).

The report contained five recommendations for MCC to strengthen its policies and procedures to address the internal control weaknesses and the instances of noncompliance identified above. Management accepted the five recommendations and management decisions were reached on all five recommendations.

(Report No. M-000-06-001-C)

Audit of the Millennium Challenge Corporation's Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report Submitted to the Office of Personnel Management (OPM) for the Period Ended February 19, 2005

The Office of Inspector General (OIG) contracted with an independent certified public accounting firm to perform Agreed-Upon Procedures for the Millennium Challenge Corporation's (MCC) Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report submitted by MCC to OPM for the period ended February 19, 2005. The contract required that the audit be performed in accordance with generally accepted auditing standards; generally accepted government auditing standards; and Office of Management and Budget (OMB)

Bulletin 01-02, Audit Requirements for Federal Financial Statements as amended by M-04-22 on July 27, 2004.

In its report on the Agreed-Upon Procedures of MCC's Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report submitted to OPM by MCC for the period ended February 19, 2005, OIG found that the information appeared reasonable based on the sample selected and the Agreed-Upon Procedures performed.

Based upon the sample reviewed by the auditors and the Agreed-Upon Procedures performed, the Retirement, Health Benefits, and Life Insurance Withholdings/Contributions as well as enrollment information submitted via the Semiannual Headcount Report appeared reasonable. Therefore, the audit report contains no findings or recommendations.

(Report No. M-000-06-002-F)

Risk Assessment of MCA Madagascar's Financial Operations

OIG performed a risk assessment of MCA Madagascar from December 12 thru December 16, 2005, to evaluate and identify vulnerabilities in high risk areas that may impact MCA Madagascar's financial operations. The risk assessment was performed during MCA Madagascar initial implementation phase to detect vulnerabilities early that may prevent MCA Madagascar from establishing effective financial operations. Based on a preliminary assessment of MCA Madagascar's

High risk associated with MCA Madagascar's overall financial operations

operations, OIG determined that the most critical financial areas were procurement, cash management, and disbursements. OIG designed its risk assessment to identify and evaluate vulnerabilities in these areas. The review covered MCA Madagascar's operations from inception through December 9, 2005. The objective of this review was to determine whether MCA Madagascar had vulnerabilities that may adversely impact their financial operations. The OIG found that MCA Madagascar had high vulnerabilities in several critical areas that may adversely impact their financial operations.

Objective

Does MCA Madagascar have vulnerabilities that may adversely impact its financial operations?

OIG found that MCA Madagascar did have high vulnerabilities in several critical areas that may adversely impact their financial operations.

Weaknesses in the Millennium Challenge Corporation's oversight of MCA Madagascar's initial implementation phase hindered implementation of effective financial policies and procedures. The Compact requires MCA Madagascar to implement a

Fiscal Accountability Plan (FAP) to establish financial policies, procedures, controls and processes for performing financial operations.

Although not required by MCC until January 27, 2006, at the time of the audit field work MCA Madagascar had not implemented a comprehensive FAP. OIG determined that the risk associated with MCA Madagascar's overall financial operations was high because the delay in implementing a FAP may have hampered their ability to accurately account for and safeguard funds disbursed under the Compact agreement. OIG found that the absence of a comprehensive FAP resulted in key financial operations being performed inconsistently and not in compliance with the Compact agreement. Specifically,

- MCA Madagascar did not have a consistent process for making disbursements.
- MCA Madagascar's accounting system did not record commitments or obligations.
- MCA Madagascar did not have standard procedures for managing property purchased with MCA funds.

These concerns were discussed with MCA Madagascar and MCC management. They generally agreed with OIG results of the risk assessment and have begun to implement corrective actions.

(Report No. M-000-06-003-F)

PROMOTE ECONOMY, EFFICIENCY, AND EFFECTIVENESS, AND ASSESS PROGRAM RESULTS

This goal addresses the Corporation's challenges related to human resources, determining the applicability of laws and regulations, and developing an effective management oversight methodology. OIG has undertaken the following audits to better understand management's response to these challenges and to provide management with recommendations to address the vulnerabilities associated with them.

Audit of Millennium Challenge Corporation's Contract Award Process

The Millennium Challenge Corporation was established in January 2004 to further global development by promoting economic growth, eliminating extreme poverty, and strengthening good governance, economic freedom, and investments in people. Since its inception, MCC has dedicated its resources to establishing its operations and developing the infrastructure it needs to conduct business. In its first year of operations, MCC's procurement function was staffed primarily with a series of temporary contractor employees

under the direction of a contracting officer. As of June 30, 2005, MCC's Acquisitions Office included four full-time direct-hire contracting officers and specialists, and one personal services contractor. In addition, until March 31, 2005, MCC had an agreement with the U.S. Department of Interior's National Business Center to provide assistance with award solicitations and other procurement activities.

MCC's Acquisitions Office has the responsibility for procuring all supplies and services for the various program offices of MCC. From MCC's inception until May 10, 2005, MCC made approximately 200 awards, including contracts, purchase orders, agreements with other Federal agencies, and blanket purchase orders. Many of these awards were for smaller purchases such as a \$30 newspaper subscription, but they also included awards exceeding \$1 million.

OIG conducted this audit to determine if MCC complied with applicable laws and regulations in awarding its contracts.

The audit concluded that MCC has followed many of the requirements of procurement laws and regulations including parts or sections of the Federal Acquisition Regulation (FAR) and in its first 18 months of operation has established a fully functioning procurement activity that has made the numerous awards expected for a new Federal entity. Initially, MCC officials believed that Federal procurement requirements did not apply to MCC and specifically claimed an exemption from following

FAR Sub-parts 4.6 and Part 19 that implement the Federal Procurement Data System contract action reporting requirement and the Small Business Act, respectively.

During OIG's audit fieldwork, MCC officials stated that they had been following the FAR requirements regardless of their applicability. However, subsequent to the completion of audit fieldwork, MCC advised that there was misperception among some MCC staff that MCC was following the FAR voluntarily but was not legally required to do so. In response to our recommendation, MCC issued a memorandum to its staff emphasizing that the FAR applies to all MCC domestic procurement activities as a matter of law. Other problem areas, as well as areas for suggested improvement, involving the procurement function include:

- Justifications for several sole-source procurements were inadequate, overstated, and insufficiently documented
- Non-procurement personnel either did not follow procurement regulations or their actions created the appearance of partiality
- Policies and procedures regarding the use of personal services contractors have not yet been established

- A non-citizen was allowed to work in MCC headquarters without MCC ensuring the individual was eligible to work in the U.S.

The audit report contains nine recommendations to address the problem areas and areas for suggested improvement. The recommendations for MCC include establishing a small business procurement preference program and annual procurement preference goals, establishing policies on preparing supporting documentation for sole source procurements, incorporating additional policies into training classes for non-procurement personnel, and establishing a policy on the use of personal services contractors. MCC has accepted and implemented corrective action on all of the recommendations.

(Report No. M-000-06-001-P)

Misperception among MCC staff results in issuance of a memorandum emphasizing applicability of FAR to all MCC domestic procurement activities.

**PRESERVE AND PROTECT
THE MILLENNIUM
CHALLENGE
CORPORATION'S
PROGRAM AND
EMPLOYEE INTEGRITY**

This goal is designed to foster the integrity of program and operational activities. OIG's focus on the prevention of fraud and protection of resources is 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. To achieve this goal, OIG presented its third fraud awareness briefing to MCC staff.

*Investigations: Prevention and
Fraud Awareness*

On March 22, 2006, OIG presented a briefing on fraud awareness to an audience of approximately 40 members of the Corporation. In addition, OIG presented fraud awareness briefings in Madagascar and Cape Verde.

A P P E N D I C E S

REPORTS ISSUED

October 1, 2005 through March 31, 2006

<i>Report Number</i>	<i>Date of Report</i>	<i>Report Title</i>	<i>Amount of Findings (\$000s)</i>	<i>Type of Findings</i>
M-000-06-001-P	10/11/2005	Audit of the Millennium Challenge Corporation's Contract Award Process		
M-000-06-001-C	12/06/2005	Audit of Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2005, and the Nine Month Period Ending September 30, 2004		
M-000-06-002-F	02/28/2006	Audit of the Millennium Challenge Corporation's Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report Submitted to the Office of Personnel Management (OPM) for the Period Ended February 19, 2005		
M-000-06-003-F	03/28/2006	Risk Assessment of MCA Madagascar's Financial Operations		

**SIGNIFICANT AUDIT RECOMMENDATIONS
DESCRIBED IN PREVIOUS SEMIANNUAL
REPORTS WITHOUT FINAL ACTION
As of March 31, 2006**

<i>Report Number</i>	<i>Subject of Report</i>	<i>Issue Date</i>	<i>Rec. No.</i>	<i>Management Decision Date</i>	<i>Final Action Target Date</i>
M-000-05-002-P	Formalize and document MCC's administrative and program internal control system and establish a defined timetable for completing the process	03/31/2005	1	03/31/2005	
M-000-05-003-P	Establish and document plans to ensure continuity of operations for information systems	06/20/2005	8	06/20/2005	

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 an 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 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.

Our fiscal year 2004 financial statement audit, the Millennium Challenge Corporation's first financial statement audit, noted that the Corporation's financial management system was not in substantial compliance with the federal financial management system requirements under FFMIA and OMB Circular A-127, Financial Management Systems.

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

MCC does not have its own financial system. Instead, MCC has contracted with the Department of Interior's National Business Center (NBC) to provide accounting and IT services, including usage of NBC's 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 the Oracle Federal Financials System, nor had MCC requested NBC to conduct such a review.

The result of omitting such a review is that management would not have a comprehensive understanding of the system's internal controls and the risks involved in conducting system transactions. According to MCC, it was the first organization to use the system, which is a new system for NBC.

As recommended in OIG's audit report of MCC's fiscal year 2004 financial statements, a SAS 70 review was completed in September 2005. The fiscal year 2005 audit noted that MCC was still not in full compliance with FFMIA. For example MCC's procurement system had not been approved by the Federal government, and its E-Travel system was not integrated with the Oracle Federal Financial System.

MCC's management agreed to address these issues under its remediation plan which will be reviewed in the next financial statement audit.

OIG STATISTICAL SUMMARY
USAID
As of March 31, 2006
INVESTIGATIVE ACTIONS

NOTHING TO REPORT

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Avenue, NW
Room 6.06D
Washington, DC 20523
www.usaid.gov/oig

The Semiannual Report to the Congress is available on the Internet at
www.usaid.gov/oig/public/semiann/mcc1.htm