



**USAID**  
FROM THE AMERICAN PEOPLE

**UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL  
FOR THE  
MILLENNIUM CHALLENGE CORPORATION**

**SEMIANNUAL REPORT  
TO THE CONGRESS**

**October 1, 2006 - March 31, 2007**

# MISSION

## **Mission**

The mission of the Office of Inspector General (OIG) is to contribute to and support integrity, efficiency, and effectiveness in all activities of the organizations for which it has oversight responsibilities.

## **Values**

In accomplishing our mission, OIG is committed to the following:

- Integrity
- Excellence
- Teamwork

## **Strategic Goals**

- Promote sound accounting and reporting on financial activities and information security.
- Promote economy, efficiency, and effectiveness, and assess program results.
- Preserve and protect program and employee integrity.

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# MESSAGE FROM THE INSPECTOR GENERAL

This *Semiannual Report to the Congress* (SARC) presents information about the work of the United States Agency for International Development (USAID), Office of Inspector General (OIG) in providing oversight for the Millennium Challenge Corporation (MCC) during the six-month period ending on March 31, 2007. It is issued in accordance with the requirements of the Inspector General Act of 1978, as amended, and specifically addresses our responsibilities for MCC.

The work reported was planned and executed in support of OIG's three strategic goals for MCC:

- Promote sound accounting and reporting on financial activities and information security.
- Promote economy, efficiency, and effectiveness, and assess program results.
- Preserve and protect program and employee integrity.

This report describes significant OIG activity and achievements in support of these goals.

Donald A. Gambatesa  
Inspector General



# EXECUTIVE SUMMARY

OIG's collaborative working relationship with MCC continues to achieve positive results. During this reporting period, management decision was reached on 13 recommendations. Final action was recorded on 20 recommendations. OIG results achieved under each of the goals are described below.

## **Strategic Goal 1: Promote sound accounting and reporting on financial activities and information security.**

OIG continues to address MCC's challenge in developing effective financial management systems and related internal controls and worked with foreign accounting firms overseeing financial audits conducted on OIG's behalf during this reporting period. Before qualification, OIG assesses local firms for eligibility to perform audits, reviews documents to facilitate the in-country audit process, and evaluates audit products for quality. During this period, OIG issued seven reports addressing MCC's financial activities: the audit of the financial statements for the period ending on September 30, 2006; a report on MCC's withholdings/contributions for the employee benefit program; a risk assessment of MCC's Vanuatu financial operations; and four Fund Accountability Statement (FAS) audits.

MCC's financial statements for fiscal year 2006 were audited under OIG oversight by a nonfederal accounting

firm. The audit firm identified six reportable conditions in MCC's internal controls process for financial reporting and operations which included five material weaknesses and three instances of noncompliance with laws, regulations, contracts, and grant agreements.

OIG made 12 recommendations, and final action was taken on all but two recommendations.

During this reporting period, OIG work continued in support of the requirements for audits under Compact agreements, which are the grant instruments used for recipient countries. Audits of the funds managed by the Compact recipients were issued for the first time, and the findings were significant.

Work continued in the information security area relative to findings of the Federal Information Security Management Act (FISMA) audit from the previous period. Final action was taken on seven recommendations.

## **Strategic Goal 2: Promote economy, efficiency, and effectiveness, and assess program results.**

OIG surveyed MCC's Trade Capacity Building (TCB) program activities in response to a request from members of the Committee on Small Business, U.S. House of Representatives to determine if MCC's programs support the implementation of free-trade agreements. OIG also issued an

audit of MCC's due-diligence process leading to Compact awards. Results of Compact countries will be the subject of future audits because Compacts are in the early stages of disbursing funds and initiating activities in the recipient countries.

## **Strategic Goal 3: Preserve and protect program and employee integrity.**

Fraud awareness training was conducted in two countries. The briefings highlighted potential contracting irregularities and educated those who have responsibility for administering MCC programs on potential vulnerabilities.





# SUMMARY OF RESULTS

## Strategic Goal I: Promote sound accounting and reporting on financial activities and information security.

OIG is pursuing an aggressive financial management audit program to identify deficiencies that can be addressed as MCC enters each new phase of Compact administration. Efforts are aimed at establishing sound financial accounting methodologies for the long term. One key area for financial management is MCC's process and procedures for disbursing funds to Compact recipients, for which OIG made several recommendations.

OIG's information security work during this period focused on recommendations to MCC in previous audits. MCC and OIG have achieved significant results on follow-up of outstanding recommendations.

## SIGNIFICANT OIG WORK

### *Consolidated Financial Statements, Internal Controls, and Compliance for Fiscal Years 2006 and 2005*

OIG issued an unqualified opinion on MCC's financial-statement audit for fiscal year 2006. This annual audit has three components: review of the assets and liability accounts of MCC as presented in the financial statements; review of the internal control process; and review of the organization's compliance with rules, regulations, and laws.

The audit was conducted by a nonfederal audit firm, which found that the financial statements were presented in conformity with generally accepted accounting principles. The opinion included six reportable conditions which included five material weaknesses and three instances of noncompliance with laws, regulations, contracts, and grant agreements. The material weaknesses identified in MCC's internal controls increased

risks such as misstating amounts in the financial statements, unauthorized transactions, omissions, potential fund-control violations, and noncompliance.

OIG reviewed the audit report and made 12 recommendations for addressing weaknesses in MCC's financial management operations. Two of the recommendations are pending final action.

MCC continues to address fiscal year 2005 financial-statement audit recommendations concerning cash management. MCC is preparing a description of the methodology it will use to implement the recommendation for developing policies and procedures to ensure that the payment schedules and other agreements entered into with grantees reflect the Department of Treasury requirements for advances and immediate cash needs.

(Audit Report No. M-000-07-0001-F)

### *Financial Audits of Compact Funds – Fund Accountability Statement Audits*

OIG responsibilities include financial audits of U.S. Government funds provided under MCC's Compact agreements. Those Compact grants contain a provision for financial audits of funds held by the Accountable Entity<sup>1</sup> that manages the funds. Compacts currently require such audits at

1. The Accountable Entity is an entity established by the recipient government to manage the MCC-funded program. The recipient government delegates responsibilities to an Accountable Entity.

least once a year. However, MCC is requiring the recipient countries to perform audits twice a year.

As part of its quality assurance program, OIG continues to identify and approve audit firms overseas that are qualified to perform the audits. Qualification requires consideration of compliance with elements of professional auditing standards. In all cases, OIG staff travel to the country to conduct the assessments. In addition, OIG reviews the statements of work and resulting audit work performed on the accounts. These audits review the entity's FAS, internal controls, and compliance with material provisions, and OIG issues the audit with recommendations to MCC for overseeing the resolution of identified weaknesses and questioned costs.

During this period, OIG qualified audit firms in two additional countries, bringing the total number of Compact countries with qualified audit firms to 11. Emphasis continues on building relationships with other organizations having experience or interest in international auditing of development projects.

OIG reviewed and issued the first audits performed by local audit firms. FAS audit reports for Madagascar, Cape Verde, Honduras, and Georgia were completed during this reporting period. MCC must work with the Accountable Entities to resolve the audit findings.

### **Risk Assessment of Millennium Challenge Account Vanuatu's Financial Operations**

During this period, OIG performed a risk assessment of the \$65.7 million Compact program during the Millennium Challenge Account (MCA) Vanuatu's implementation to detect vulnerabilities in cash management and procurement.

OIG held several meetings with various individuals involved in developing the proposal and providing assistance in the compact activities; with key staff to discuss policies and procedures; and with fiscal and procurement agents to review progress in building an organizational structure and to assess their role in understanding responsibilities for complying with MCC's requirements.

OIG found that MCA Vanuatu had moderate risk in cash management and procurement. No recommendations were made.

(Report No. M-000-07-003-F)

### **Review of MCC's Benefits Withholdings/Contributions and the Supplemental Semiannual Headcount Report Submitted to the Office of Personnel Management**

OIG oversaw a nonfederal account firm's review of "Agreed Upon Procedures of MCC's Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report" submitted by

MCC to the Office of Personnel Management (OPM) for the period ending on June 10, 2006.

The review was conducted at the request of MCC to ensure that certain personnel deductions were being managed correctly. The nonfederal auditor tested MCC personnel documentation on the basis of the sampling outlined in the "Agreed Upon Procedures"; interviewed human resources and payroll personnel and reviewed policies and procedures to identify material weaknesses and their causes; and reviewed official personnel files, performed recalculations, and verified withholdings and contributions with the general ledger and official OPM reports.

There were no findings in the report, which was issued without recommendations.

(Report No: M-000-07-002-F)

## **OTHER WORK THIS PERIOD**

OIG continues to work with MCC after an audit is completed to ensure that proposed actions in response to recommendations will be effective in resolving identified weaknesses. Specific emphasis is on recommendations resulting from legislatively required audits, including the FISMA audit.

The FISMA audit requirements are designed to identify weaknesses that must be corrected to protect MCC's information technology and system assets.

Follow-up efforts have been focused on the FISMA audit of the previous period, with much work directed at

resolution of outstanding actions. Ongoing collaboration is essential to the integrity of the audit process and has tangible benefits for MCC and OIG. During this period, the collective effort resulted in final action on seven recommendations and reflects considerable work addressing information technology security agencywide.

Significant work was conducted to follow up on recommendations made in “Risk Assessment of MCA Cape Verde’s Financial Operations.” However, MCC was unable to reach management decision on recommendations concerning management of cash advances to and by Compact recipients and secondary recipients. OIG requested MCC’s action on report recommendations after three months and again after four months.<sup>2</sup> OIG continues to work with MCC on these recommendations from this audit.

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2. OIG letter to MCC Chief Executive Officer, Ambassador John J. Danilovich, dated March 2, 2007.



## Strategic Goal 2: Promote economy, efficiency, and effectiveness, and assess program results.

OIG directs efforts toward evaluating MCC's response to management challenges and providing recommendations for addressing vulnerabilities. The challenges relate to human capital, application of laws and regulations, and development of effective management-oversight methodologies and programs.

### SIGNIFICANT OIG WORK

#### ***Survey of MCC's Trade Capacity Building Programs for Supporting Implementation of Free Trade Agreements***

OIG surveyed MCC Trade Capacity Building (TCB) programs in response to a request by three members of the House Small Business Committee. TCB programs assist developing countries by building trade competitiveness, improving standards for traded goods, and improving customs procedures. TCB activities are categorized as physical-infrastructure development, financial-sector development and good governance, trade-related agriculture, and business services and training. MCC's mission focuses on promoting sustainable economic growth that reduces

poverty through investments in areas such as agriculture, education, private-sector development, and capacity building, providing monetary assistance through Compact and threshold agreements to eligible countries that have well-designed programs. During 2005, MCC reported in the TCB database \$368.9 million in funding for TCB-related activities for Madagascar, Honduras, and Nicaragua. The activities were related primarily to infrastructure and agriculture projects.

OIG conducted the survey to determine whether MCC provided guidance to eligible countries on TCB programs; whether the programs supported implementation of free trade agreements with its Compact countries; whether the 2006 National Export Strategy reflected MCC's current and planned TCB accomplishments; and the status of MCC's small-business trade matchmaking efforts.

OIG concluded that MCC does not have a specific, identifiable TCB program and therefore did not provide guidance to eligible countries on trade-related activities. Furthermore, MCC's programs do not directly support free trade agreements, although the countries' proposed programs may complement established trade agreements. In addition, the 2006

National Export Strategy report does not reflect MCC's planned TCB accomplishments but reports on MCC's current TCB activities from fiscal year 2005. Finally, MCC does not have a small-business trade matchmaking program but encourages the participation of small businesses in procurement ventures that will enable the small businesses to compete with larger firms both in the United States and overseas.

(Survey Report No. M-000-07-001-S)

#### ***Audit of the Millennium Challenge Corporation's Due-Diligence Review Process Leading to Compact Awards***

OIG audited MCC's due-diligence review process leading to Compact awards to determine the methodology that MCC used in evaluating country proposals for funding and whether MCC evaluated the proposals in compliance with its policies and procedures.

OIG found that the due-diligence process was effective. MCC assessed country proposals in compliance with its policies and procedures with one exception. Specifically, MCC did not provide timely information on a proposed project in one country for the country's analysis and comment before Compact negotiation. In another country, a sustainability gap in the proposal was identified during the due-diligence process, and MCC worked to develop a solution for helping ensure the success of its investment. In addition, the due-diligence process was aided in one country by the

### **Management of Conditions Precedent<sup>3</sup> in MCC Compact Agreements**

During this reporting period, OIG conducted fieldwork in Cape Verde, Georgia, Honduras, and Nicaragua in March 2007 in support of this audit. The audit is designed to determine if MCC ensured that all required conditions were met before Compact agreements went into effect or disbursements were made to Compact countries. It also will address the thoroughness of MCC's review of required documents to ensure that the Compact countries have met all the required conditions.



Photograph of an OIG auditor with irrigation specialists at the proposed irrigation project site. The Government of Armenia provided specialists in irrigation with extensive experience to help develop the project proposals.

country counterparts' expertise and knowledge of the proposed projects. Their use assisted in the timely and efficient execution of the due-diligence process.

OIG identified two issues that warrant MCC management's consideration: (1) MCC's due-diligence budgeting process; and (2) the English language capacity of officials reviewing MCC-related documents.

OIG recommended that MCC develop and issue guidance to staff for establishing time frames for receipt of consultant reports and for providing such reports to prospective countries in sufficient time for Compact negotiation.

Management decision was reached on the recommendation.

(Audit Report No. M-000-07-001-P)

3. Conditions precedent is a legal term coined by MCC that certain conditions, a process, or performance must take place before the Compact becomes a binding agreement and before MCC is obligated to make disbursements to the Compact country.

**Strategic Goal 3:  
Preserve and protect program and employee integrity.**

local government, implementing agencies, audit firm staff, foreign government officials, and Supreme Audit Institute members.

OIG employs proactive strategies to prevent fraud. For example, fraud awareness training given to employees, contractors, grantees, and others alerts them to fraudulent practices and schemes and advises them on how to report fraud. OIG's fraud-awareness program focuses on prevention of fraud

and protection of resources and consists of briefings and a manual that highlights potential contracting irregularities. OIG plans briefings at MCC headquarters as needed and with MCA entities of host countries and other interested parties. During this reporting period, OIG conducted fraud-awareness briefings in Armenia and Mali for

**FRAUD AWARENESS BRIEFINGS WORLDWIDE  
AS OF MARCH 31, 2007**

Month	Location	Sessions	Attendees	Professional Affiliation
<b>OCT</b>				Nothing to Report
<b>NOV</b>	Yerevan, Armenia	1	40	USAID and MCA Personnel MCA Personnel Local Accounting Firms Ministry of Finance representatives
<b>DEC</b>				Nothing to Report
<b>JAN</b>	Bamako, Mali	1	31	MCC, USAID, and MCA Personnel Local Accounting Firms Ministry of Finance representatives
<b>FEB</b>				Nothing to Report
<b>MAR</b>				Nothing to Report
	<b>TOTAL</b>	<b>2</b>	<b>71</b>	







# **REPORTING REQUIREMENTS**



## FINANCIAL AUDIT REPORTS ISSUED October 1, 2006 through March 31, 2007

<i>Report Number</i>	<i>Date of Report</i>	<i>Report Title</i>	<i>Amount of Findings</i>	<i>Type of Findings</i>
M-000-07-001-F	11/14/06	Audit of the MCC's Due Diligence Review Process Leading to Compact Awards		
M-000-07-002-F	01/05/07	Agreed Upon Procedures Performed on the MCC's Retirement, Health Benefits, and Life Insurance Withholdings/Contributions and the Supplemental Semiannual Headcount Report Submitted to the Office of Personnel Management for the period ending June 10, 2006		
M-000-07-003-F	01/11/07	Risk Assessment of MCC's Vanuatu's Financial Operations		

QC--Questioned Costs  
UN--Unsupported Costs  
Note: UN is part of QC

## PERFORMANCE AUDIT REPORTS ISSUED October 1, 2006 through March 31, 2007

<i>Report Number</i>	<i>Date of Report</i>	<i>Report Title</i>	<i>Amount of Findings</i>	<i>Type of Findings</i>
M-000-07-001-S	12/01/06	Survey of the MCC's Trade Capacity Building Programs to Support Implementation of Free Trade		
M-000-07-001-P	03/02/07	Audit of the MCC's Due Diligence Review Process Leading to Compact Awards		

QC--Questioned Costs  
 UN--Unsupported Costs  
 Note: UN is part of QC

## MISCELLANEOUS AUDIT REPORTS ISSUED

### October 1, 2006 through March 31, 2007

Report Number	Date of Report	Report Title	Amount of Findings	Type of Findings
M-000-07-001-N	12/21/06	Audit of the Fund Accountability Statement of the MCC Resources Managed by MCA-Madagascar Under the Compact Agreement Dated April 18, 2005 Between MCC and the Government of the Republic of Madagascar for the Period from July 27, 2005 to June 30, 2006	\$6,617	QC UN
M-000-07-002-N	01/11/07	Audit of the Fund Accountability Statement of the MCC Resources Managed by MCA-Cape Verde Under the Compact Agreement dated July 4, 2005, between MCC and the Government of the Republic of Cape Verde for the period from October 17, 2005 to June 30, 2006	\$4,366	QC UN
M-000-07-003-N	02/07/07	Independent Auditor's Report on the Financial Audit of the MCC Resources Managed by Millennium Account-Honduras (MCA-Honduras), Under the Compact Agreement Between the MCC and MCA-Honduras from February 22, 2006 - June 30, 2006		
M-000-07-004-N	02/27/07	Audit of the Fund Accountability Statement of the MCC Resources Managed by Millennium Challenge - Georgia (MCA-Georgia), Under the Compact Agreement Dated September 12, 2005, Between the MCC and the Government of Georgia for the Period from April 7, 2006, to June 30, 2006		

QC--Questioned Costs  
 UN--Unsupported Costs  
 Note: UN is part of QC

**AUDIT REPORTS OVER SIX MONTHS OLD  
WITH NO MANAGEMENT DECISION  
As of March 31, 2007**

<i>Report Number</i>	<i>Report Title</i>	<i>Date of Report</i>	<i>Current Recommendation Status</i>	<i>Desired Decision Target Date</i>
M-000-06-001-C	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	12/06/05	3.1*	04/07
M-000-06-004-F	Risk Assessment of Millennium Challenge Account Cape Verde's Financial Operations	09/26/06	I and 3	04/07

\* The management decision previously recorded for recommendation 3.1, "Audit of the MCC's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2005, and the nine-month period ending September 20, 2004," Report No. M-000-06-001-C, December 6, 2005, was rescinded by MCC on March 8, 2007. MCC has determined that the 2005 management decision does not reflect their current position. The management decision was rescinded and accordingly, the OIG records reflect that Management Decision is pending.

**SIGNIFICANT AUDIT RECOMMENDATIONS  
DESCRIBED IN PREVIOUS SEMIANNUAL  
REPORTS WITHOUT FINAL ACTION  
As of March 31, 2007**

<b>Report Number</b>	<b>Subject of Report</b>	<b>Rec. No.</b>	<b>Issue Date</b>	<b>Management Decision Date</b>	<b>Final Action Target Date</b>
M-000-05-003-P	Audit of the Millennium Challenge Corporation's Compliance with Provisions of the Federal Information Security Management Act of 2002	8	06/20/05	06/20/05	04/07
M-000-06-001-C	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	3.1 5.2	12/06/05	* 12/06/05	04/07 04/07
M-000-06-003-F	Risk Assessment of Millennium Challenge Corporation's MCA Madagascar Financial Operations	1 2	03/28/06	03/28/06 03/28/06	08/07 08/07
M-000-06-001-S	Review of the Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs	1.2 2 3 4	05/16/06	05/16/06 05/16/06 05/16/06 05/16/06	05/07 05/07 05/07 05/07
M-519-06-002-P	Audit of the General and Application Controls of the Government of El Salvador's Integrated Financial Administration System	1 2	07/07/06	07/07/06 07/07/06	07/07 07/07
M-000-06-004-F	Risk Assessment of Millennium Challenge Account Cape Verde's Financial Operations	1 2 3	09/26/06	* 09/26/06 *	04/07 09/07 04/07
M-000-06-002-P	Audit of the Millennium Challenge Corporation's Management of Section 609(g) Funds	1 2 3 4	09/28/06	09/28/06 09/28/06 09/28/06 09/28/06	09/07 09/07 09/07 09/07
M-000-06-003-P	Audit of the MCC's Compliance with the Provisions of the Federal Information Security Management Act of 2002 for Fiscal Year 2006	1	09/29/06	09/29/06	09/07

\* MCC has not reached management decision on this audit recommendation.

**REPORTS ISSUED WITH QUESTIONED  
AND UNSUPPORTED COSTS  
October 1, 2006 through March 31, 2007**

<i>Reports</i>	<i>Number of Audit Reports</i>	<i>Questioned Costs</i>	<i>Unsupported Costs<sup>*</sup></i>
A. For which no management decision had been made as of October 1, 2006	0	\$0	\$0
B. Add: Reports issued October 1, 2006 through March 31, 2007	2	\$10,983	\$7,083
Subtotal	2	\$10,983	\$7,083
C. Less: Reports with a management decision made October 1, 2006 through March 31, 2007	0	\$0	\$0
i. Value of Recommendations Disallowed by Agency Officials	0	\$0	\$0
ii. Value of Recommendations Allowed by Agency Officials	0	\$0	\$0
D. For which no management decision had been made as of March 31, 2007	0	\$0	\$0

\* Unsupported Costs are included in Questioned Costs, but are provided as additional information as required by the Inspector General Act Amendments of 1988 (P.L. 100-504).



**REPORTS ISSUED WITH RECOMMENDATIONS  
THAT FUNDS BE PUT TO BETTER USE  
October 1, 2006 through March 31, 2007**

<i>Reports</i>	<i>Number of Audit Reports</i>	<i>Dollar Value</i>
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NOTHING TO REPORT





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# Inspector General **HOTLINE**

OIG's Hotline makes it easy to report allegations of fraud, waste, abuse, mismanagement or misconduct in programs and operations of the USAID, IAF, ADF, and MCC. Employees, contractors, program participants and the general public may report allegations directly by e-mail, telephone, or mail to:

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

E-mail [ig.hotline@usaid.gov](mailto:ig.hotline@usaid.gov)

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



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The Semiannual Report to the Congress is available on the internet at  
[www.usaid.gov/oig/public/semiann/mcc1.htm](http://www.usaid.gov/oig/public/semiann/mcc1.htm)