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FROM THE AMERICAN PEOPLE

OFFICE OF INSPECTOR GENERAL
FOR THE
MILLENNIUM CHALLENGE CORPORATION

SEMIANNUAL REPORT TO THE CONGRESS

April 1, 2005 - September 30, 2005





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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:

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 Washington, DC 20044-0657



Individuals who contact the Hotline are not required to identify themselves. However, the 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.



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*Office of Inspector General
for the
Millennium Challenge Corporation*

October 28, 2005

The Honorable Condoleezza Rice
Secretary of State & Chair, Board of Directors
Mr. Charles O. Sethness
Acting Chief Executive Officer
Millennium Challenge Corporation
875 Fifteenth Street, NW
Washington, DC 20005

Dear Madam Secretary and Mr. Sethness:

I am pleased to present to you and the Congress of the United States our third independent report on the accomplishments of the Office of the Inspector General (OIG) in reviewing the activities of the Millennium Challenge Corporation (MCC). This report is for the six-month period ending September 30, 2005, and is issued in compliance with the Inspector General Act of 1978, as amended.

We continued our proactive involvement with the Corporation and the Board of Directors in order to fulfill our responsibilities under the Consolidated Appropriations Act of 2004 (Public Law 108-199), which designated the U.S. Agency for International Development Inspector General as the Inspector General for the MCC. For example, in May 2005, Madam Secretary, the former Acting Inspector General and staff from this office briefed you on our role with the Corporation. OIG staff attended the Board meeting in May 2005, and later briefed Board members on our audit plans and budget request for fiscal year 2006.

During this reporting period, we visited two countries that had recently signed Compacts to assess plans and capabilities for accountability and audit oversight. And we issued three audit reports including recommendations to improve information security, procurement management, and coordination with other donors.

I appreciate the courtesy and assistance extended to OIG 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,

Paula F. Hayes
Acting Deputy Inspector General

Acronyms

ADF	African Development Foundation
AIG/MCC	Assistant Inspector General/Millennium Challenge Corporation
CEO	Chief Executive Officer
CSC	Le Conseil Supérieur de la Comptabilité (Madagascar Accounting Standards Body)
DOI	Department of Interior
FAR	Federal Acquisition Regulations
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
OECFM	L'Ordre des Experts Comptables et Financiers de Madagascar (Madagascar Professional Association of Accountants)
OIG	Office of Inspector General
OMB	Office of Management and Budget
SAI	Supreme Audit Institution
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	Page 6
Recommendations for Corrective Actions	Page 16
Summary of Each Significant Report	Page 16
List of Audit Reports Issued	Appendix A Page 22
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 22
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 23
Decisions and Reasons for Significant Revised Management Decisions	Appendix B Page 23
Significant Management Decisions with Which the Inspector General Disagrees	Appendix B Page 23
Remediation Plan Information (Required under the Federal Financial Management Improvement Act of 1996)	Appendix B Page 23
Matters Referred to Prosecutive Authorities and the Prosecutions and Convictions Which Resulted	Nothing to Report

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) for the six-month period ended September 30, 2005. During this reporting period, we continued our policy of early and proactive involvement with MCC, focusing on Compact accountability, safeguarding resources, and helping MCC succeed in its mission.

In May 2005 we attended MCC Board meeting and met with the new Secretary of State and Chair of the Board to brief her on OIG policies and operating preferences and to learn her concerns and areas of interest regarding MCC. We also visited two countries with which MCC had recently signed Compacts to assess the implementing agencies' accountability capabilities and local accounting firms' auditing capabilities. To assist program managers in meeting audit responsibilities, we developed guidelines for auditing the Compact programs.

During this reporting period, the Office of Inspector General issued two reports addressing MCC's information and information system security, and its coordination with other donors. We also initiated audits of MCC's employee benefits program; its contract management system; its progress in achieving its planned organizational structure and beginning its assistance programs, and its fiscal year 2005 financial statements. No investigations were initiated during this reporting period. The two reports contained nine recommendations to correct noted problems. Because of continued cooperation, the OIG and MCC management have reached "management decisions" on eight of the recommendations, and "final action" has been completed on the other.

One of the reports issued was on our second audit of MCC's compliance with provisions of the Federal Information Security Management Act of 2002. That audit concluded that, while MCC partially met the FISMA requirements by reporting on its information security program in fiscal year

2004 and planning to do so in fiscal year 2005, it had not established and documented its information security program as required by FISMA. Consequently, MCC's operations and assets are at risk of fraud, misuse, and disruption. The audit report included eight recommendations to assist MCC in strengthening its information security program. MCC Management agreed with the audit findings and agreed to implement all eight recommendations. As a result, a management decision has been reached on each of the eight recommendations. (See page 16)

Another audit, currently in process, highlighted several contracting weaknesses, especially MCC's need to define and adhere to the Federal Acquisitions Regulations (FAR) that govern its procurement operations. The FAR states that wholly owned Government Corporations are subject to its requirements. That audit report is expected to contain several recommendations, one of which will be that MCC acknowledge the applicability of Federal procurement laws and disseminate that acknowledgement to MCC staff. (See page 6)

As of September 30, 2005, MCC had signed five Compacts with a value of \$905 million. These Compacts are with Madagascar, Honduras, Cape Verde, Nicaragua, and Georgia. MCC plans to sign Compacts with four additional countries by the end of December 2005.

To assist selected countries (Threshold Countries) 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, of which \$80 million has been allocated to USAID as of September 30, 2005.

Overview

In addition to MCC, 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), and the Inter-American Foundation (IAF). Each of these agencies disburses and manages U.S. international development assistance.

Mission

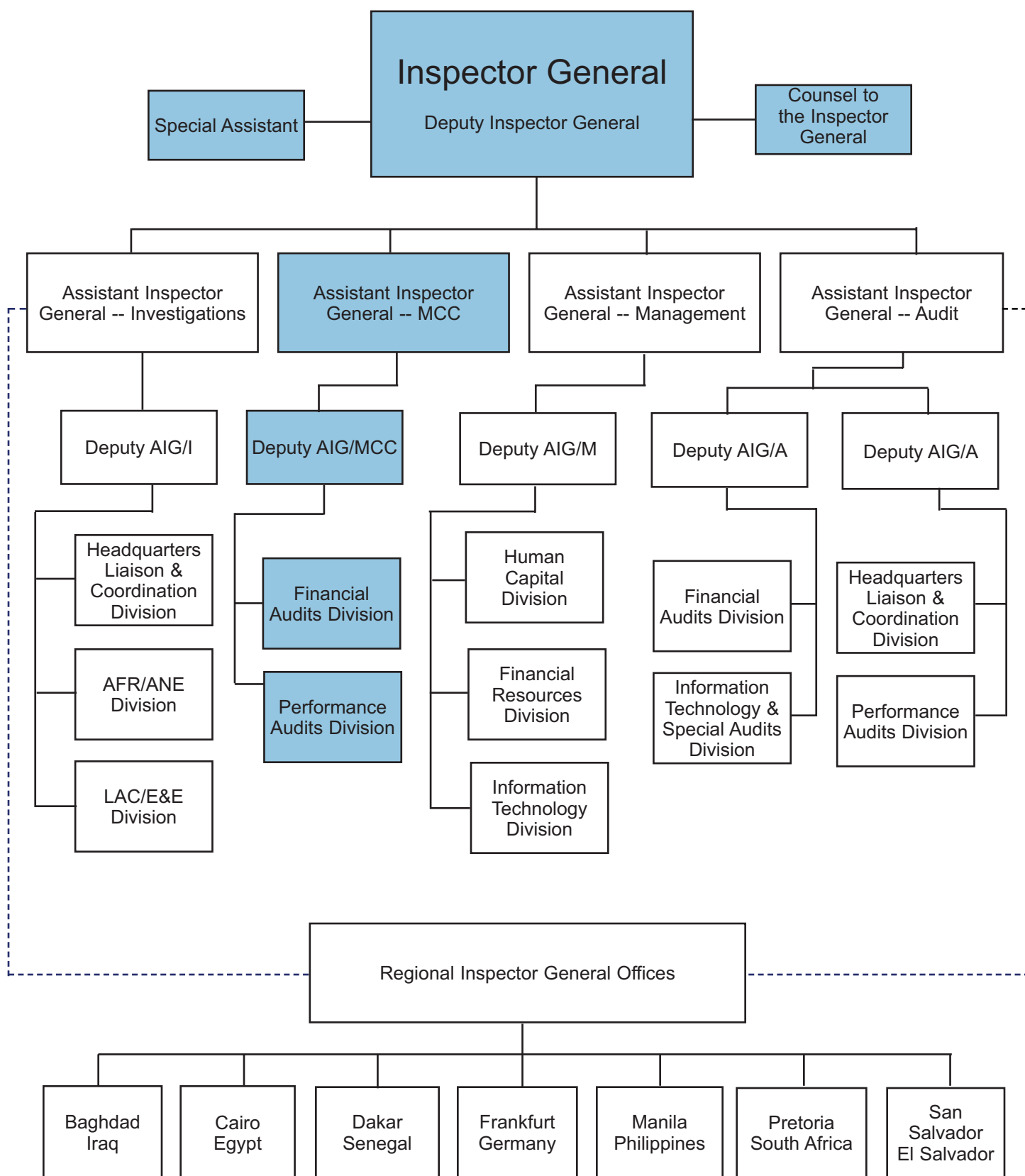
The Inspector General Act of 1978 (IG Act), as amended, established OIGs as independent and objective units created to (1) conduct and supervise audits and investigations relating to the programs and operations of their respective establishments; (2) provide leadership and coordination and recommend policies 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; Cairo, Egypt; Dakar, Senegal; Frankfurt, Germany; 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 MCC are led 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 Performance Audits Division. As MCC develops and expands its programs, the AIG/MCC will need to expand its staff to provide effective audit oversight of MCC's worldwide programs. The AIG/MCC is actively recruiting additional audit staff and 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 two audit reports issued this reporting period on MCC's compliance with provisions of the Federal Information Security Management Act of 2002, and its coordination with other donors, were accomplished with support from the OIG's Washington audit offices. Our audits of MCC's employee benefits program and the fiscal year 2005 financial statements, currently underway, are being done by a contracted certified public accounting firm. Our fraud-awareness briefing to MCC personnel included presenters from our OIG Investigations unit.

USAID Office of Inspector General



The Millennium Challenge Corporation - Highlights

The Millennium Challenge 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. MCC is located in Washington, D. C. with a staff of about 140 full-time employees.

MCC contracts with the Department of Interior's National Business Center in Denver, Colorado for its accounting, payroll and other administrative services.¹ MCC also has agreements with the Army Corp of Engineers, the Department of Agriculture, and the Treasury Department for technical services supporting Compact implementation.

Progress Since September 2004

MCC has made significant progress during the 12-month period ended September 30, 2005. For example, MCC:

- has built a skeleton staff of less than 60 to its current level of over 140 employees;
- developed operating policies and procedures for its operations;
- moved into permanent headquarters facilities;
- developed a system for managing final actions on OIG audit recommendations;
- signed a USAID-MCC Threshold agreement with Burkina Faso to assist that country to become eligible for a future Compact; and

- signed five development assistance Compacts.

MCC Signs Compacts with Five Countries

As of September 30, 2005, MCC has signed Compact agreements with:

- Madagascar for \$110 million to improve land titling, promote financial sector reform, and enhance investment opportunities in rural areas. The grant will support a program designed to raise incomes by bringing the rural population from subsistence agriculture to a market economy.
- Cape Verde for \$110 million to support the country's goal of poverty reduction and economic growth. The Compact will help transform Cape Verde by making sizeable investments in water resources, agricultural productivity, major port and road improvements, and initiatives to promote the private sector, including improving the investment climate and making financial sector reforms.
- Honduras for \$215 million to reduce poverty and spur economic growth by increasing the productivity of high-value crops and improving transportation links between producers and markets.
- Nicaragua for \$175 million to spur economic growth by funding projects aimed at reducing transportation costs and improving access to markets for rural communities, increasing wages and profits from farming and related enterprises in the region, and increasing investment by strengthening property rights.
- Georgia for \$295 million to reduce the poverty of some half million people by rehabilitating regional infrastructure, such as ensuring

¹ The National Business Center is an administrative and computer information service provider for the Department of Interior and other federal agencies.

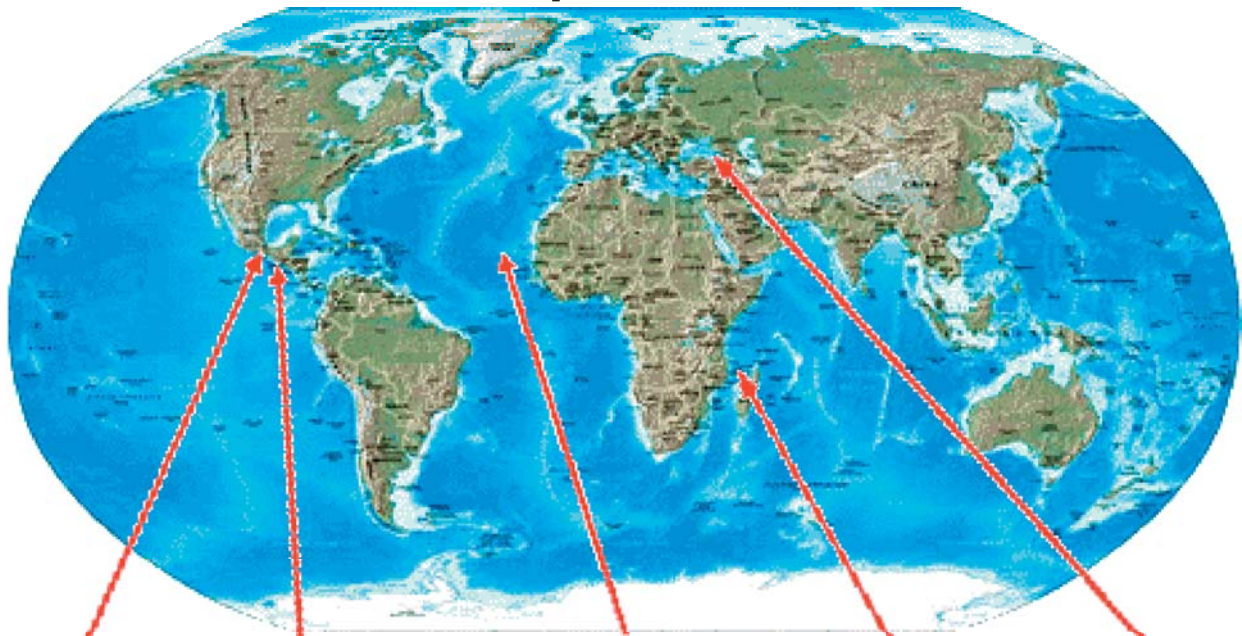
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reliable natural gas transmission and promoting private sector development.

As of September 30, 2005, Madagascar and Honduras have met the conditions precedent to funding, and Madagascar has requested \$2,500,924—the first request for Compact program funds—for project administrative costs. Also, MCC has signed grant agreements with the Governments of Senegal, Ghana and Mozambique to provide up to \$6.5, \$3.0 and \$6.0 million, respectively, to assist these countries in developing Compacts. Senegal's Compact

proposal contemplates the development of a large-scale industrial, commercial, and residential site to address one of Senegal's greatest barriers to poverty reduction and economic growth—the lack of suitable space for commercial and industrial expansion on the Dakar Peninsula. Ghana is proposing to become a world-class exporter of high-value fruit and vegetables by creating a strong investment climate. Mozambique plans to improve water, sanitation and business development services.

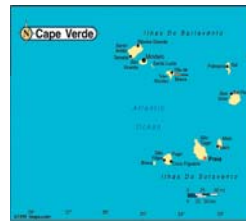
The Compact Countries



Honduras



Nicaragua



Cape Verde



Madagascar



Georgia

Applicability of Procurement Regulations to Millennium Challenge Corporation

Established in January 2004, the Millennium Challenge Corporation, until recently, was essentially in a start-up mode: hiring staff, securing a permanent office location, establishing its administrative procedures, selecting candidate countries for Compacts, and accomplishing other tasks related to establishing a new organization.

During its first year of operations, MCC's procurement function was primarily carried out by a series of temporary contractor employees under the direction of a contracting officer. However, by June 30, 2005, MCC had established an Acquisitions Office consisting of five full-time direct-hire contracting officers and specialists.

MCC's Acquisitions Office is responsible for the procurement of all supplies and services for the various program offices of MCC. From its inception until May 31, 2005, MCC made approximately 200 awards, including contracts, purchase orders, agreements with other Federal agencies, and blanket purchase orders. These awards were for purchases as small as a \$30 newspaper subscription but also included awards exceeding \$1 million.

Given the significant amount of contracting MCC has already done and is expected to do as it expands its operations, the AIG/MCC initiated an audit of MCC's contracting practices to determine whether MCC had complied with applicable laws and regulations in awarding its contracts.²

The most significant issue disclosed by the audit is the applicability of Federal procurement regulations—such as the Federal Acquisition Regulations (FAR) and Small Business Act—to MCC's domestic procurements. MCC officials had initially stated that these regulations did

not apply to MCC because the Corporation's enabling legislation (the Millennium Challenge Act of 2003) gave MCC flexibility in their applicability. Nevertheless, they have followed the FAR in the absence of any MCC procurement policies and procedures. The Office of Inspector General discussed the issue with officials in the Office of Federal Procurement Policy and Small Business Administration and found no support for MCC's position. Nor did the OIG find support for this position in MCC's enabling legislation. Furthermore, the Government Accountability Office's Principles of Federal Appropriations Law states that the procurement laws and regulations do apply to wholly owned government corporations such as MCC.

Subsequent to our audit field work, MCC officials determined that the FAR does apply to MCC, and MCC officials indicated they will disseminate clear guidance to its staff stating that the FAR does apply to MCC.

² Audit coverage did not extend to MCC's compacts with foreign governments or to purchases made overseas.

Safeguarding 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 Federal agencies. However, MCC is subject to many similar laws and regulations as Federal agencies, including the requirements for accountability and sound management. MCC is still in the process of identifying which laws and regulations to which it is subject.

As of September 30, 2005, MCC had signed five country Compacts with a total value of \$905 million and has made program-related disbursements of \$2.5 million under one of those Compacts.

Building a Foundation for Accountability

The overriding goal of the OIG is to help MCC become a viable, secure, and successful organization by conducting systemic reviews and, where warranted, recommending changes that will lead to improvements within MCC's programs and operations. Our activities are 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 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, USAID administers the MCC Threshold program.³ As of September 30, 2005, \$80 million has been allocated to USAID, and an additional \$105 million has been approved for future allocation to implement the Threshold program.

During this reporting period, we focused our efforts on ensuring effective use of MCC resources by directing our proactive and early involvement to the greatest vulnerabilities of MCC program and administrative activities. The OIG has taken and continues to take the approach that early involvement in MCC activities will help ensure good oversight. As MCC develops its program and operating concepts and procedures, we work closely with its executives and managers to enhance our knowledge of MCC'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 Compact programs are based on a solid foundation of effective controls.

We also presented our third fraud-awareness briefing to Corporation staff to enhance their understanding of fraud indicators and the potential for fraud occurring in MCC's program and administrative activities.

³ The Threshold program is a program to assist countries that are not quite eligible to apply for MCC assistance to become eligible.

Sound Accountability and Oversight of Compacts

The Millennium Challenge Corporation is still a relatively 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 been previously 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.

Given the inherent vulnerabilities of MCC's programs, the OIG has continued its proactive involvement to ensure that the programs are effectively managed and held to stringent accountability. During the past six-month period, we have expanded the process by reviewing and assessing the oversight capabilities of Compact-implementing entities and the auditing capabilities of potential auditing firms and government audit institutions in Madagascar and Honduras.

Madagascar

On April 18, 2005, the United States, through the Millennium Challenge Corporation, signed a four-year Compact with the Government of the Republic of Madagascar worth close to \$110 million. This first Millennium Challenge Compact is intended to reduce poverty and stimulate economic growth in Madagascar by focusing on three areas: property rights, the financial sector, and agricultural business investment.

To ensure management accountability of the U.S. assistance to Madagascar, an OIG team consisting of staff from our Washington headquarters and our regional office in Dakar, Senegal made a field visit to Madagascar to qualify local accounting firms to audit MCC assistance and to gain an

understanding of the Madagascar Compact implementation structure.

To understand the professional and regulatory environment in which audits are conducted in Madagascar, the team met with the Madagascar accounting standards body (**Le Conseil Superieur de la Comptabilite [CSC]**), the Supreme Audit Institution (**Chambre des Comptes de la Cour Supreme de Madagascar [SAI]**), and the professional association of accountants (**L'Ordre des Experts Comptables et Financiers de Madagascar [OECFM]**).

The CSC is a government body responsible for establishing the accounting standards for Madagascar. Our discussion included the standards-setting process, actual standards and related sanctions for non-compliance, and the OIG's role in ensuring the accountability of MCC assistance to Madagascar.

The SAI is headed by a President and is responsible for auditing all government and government corporations' funds and activities. In addition to gaining an understanding of the SAI's organizational structure and audit process, we discussed the OIG's need to ensure effective audit coverage of MCC activities and to assess the capabilities of firms conducting audits of MCC assistance.

The OECFM provides oversight for the accounting and auditing profession, which includes determining certification and practice requirements, as well as requirements to maintain certification. We also discussed the OIG's role in ensuring the accountability of MCC assistance to Madagascar.

The team then provided training on the audit requirements to 20 representatives from the interested CPA firms and the accounting and auditing authoritative bodies. That presentation covered audit standards, the reporting process and IG quality control procedures over audits of MCC assistance.

The team then visited the local offices of CPA firms interested in conducting audits of MCC assistance.

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This process included a review of eight audit firms over a 5-day period, each visit lasting about three hours. Prior to each visit, audit firms had completed questionnaires providing information on, among other things, their affiliations with international audit firms. At the conclusion of the field visit on July 29, 2005, the team had debated the scoring of each firm visited, documented the overall process so that it could be replicated in other MCC countries, and developed a CPA Firm Profile Matrix from which the OIG will make the final selection of approved firms. As a result of the meetings and evaluations of

the audit firms, we believe five audit firms have the capabilities to perform audits of MCC funds.

During the visit, we held discussions with the proposed MCA-Madagascar representatives to discuss program status and proposed accountability procedures to effectively account for program funds and other resources. We also conducted an audit-requirements presentation for the proposed MCA Madagascar staff, which included representatives of the proposed fiscal and procurement agent.

AIG/MCC Briefs MCA Madagascar Staff on Program Oversight and Accountability



Photograph of representatives from MCA Madagascar, OIG and the entity contracted as the Fiscal and Procurement Agent

While in Madagascar, we also met with the American Ambassador and the USAID Mission Director to brief them on our oversight responsibilities for the MCC Madagascar program. Also, staff from the OIG's Regional Inspector General's office in Dakar, Senegal provided valuable assistance during our review in Madagascar.

Honduras

On September 25, 2005, the United States, through the Millennium Challenge Corporation, signed a five-year Compact with the Government of the Republic of Honduras worth close to \$215 million. This Millennium Challenge Compact is intended reduce poverty and spur economic growth by increasing productivity of high-value crops and improving transportation links between producers and markets.

To ensure management accountability of the U.S. assistance to Honduras, an OIG team consisting of staff from our Washington headquarters and our regional office in San Salvador, El Salvador, made a field visit to Honduras to qualify local accounting firms to audit MCC assistance and to gain an understanding of the Honduras Compact implementation structure.

To understand the professional and regulatory environment in which audits are conducted in Honduras, the team met with the "Junta Técnica" for the "Ley sobre Normas de Contabilidad y de Auditoría", the Supreme Audit Institution "Tribunal Superior de Cuentas" [SAI], and the Board of Directors for the professional association of accountants, the Colegio Hondureño de Profesionales Universitarios de Contadores Públicos.

The "Junta Técnica" was established in February 2005 as a technical and specialized entity to follow up and disseminate the International Financial Information Norms and the Audit International Norms. The "Junta Técnica" is headed by the National Banking and Insurance Commission.

Audit firms are required to be a member of the "Colegio Hondureño de Profesionales Universitarios de Contadores Públicos" to perform audits in Honduras.

During our meeting with these entities we discussed: the requirements to become a Certified Public Accountant in Honduras, the standards-setting process, actual auditing standards and related sanctions for non-compliance, and the OIG's role in ensuring the accountability of MCC assistance to Honduras. We were informed that in Honduras, a high school graduate is qualified to perform bookkeeping services in both the public and private sectors. Additionally, an individual that completes the accounting studies at the local university is considered a Certified Public Accountant.

We were also informed that the SAI is headed by a President and is responsible for auditing all government and government corporations' funds and activities. In addition to gaining an understanding of the SAI organizational structure and audit process, we discussed the OIG's need to ensure effective audit coverage of MCC activities and to assess the capabilities of firms conducting audits of MCC assistance.

The team then provided training on the audit requirements to 18 representatives from the interested CPA firms and the accounting and auditing authoritative bodies. That presentation covered audit standards, the reporting process and IG quality control procedures over audits of MCC assistance.

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OIG Representatives Provide Training to Local Accounting Firms and SAI Staff in Honduras



Photograph of representatives from local audit firms SAI and OIG Staff.

The team then visited the local offices of CPA firms interested in conducting audits of MCC assistance. This process included a review of eight audit firms and the SAI over a 5-day period, with each visit lasting approximately two hours. Prior to each visit, audit firms had completed questionnaires providing information related to their firms including their affiliations with international audit firms. At the conclusion of the field visit on September 30, 2005,

the team had evaluated the scoring of each firm visited, documented the overall process so that it could be replicated in other MCC countries, and developed a CPA Firm Profile Matrix from which the OIG will make the final selection of approved audit firms. As a result of the meetings and evaluations of the audit firms, we believe five audit firms and the SAI have the capabilities to perform audits of MCC funds.

AIG/MCC Meets with SAI Honduras Staff on Program Oversight and Accountability

Photograph of representatives from SAI Honduras, and OIG.

During the visit, we held discussions with the proposed MCA-Honduras representatives to discuss program status and proposed accountability procedures to effectively account for program funds and other resources. We also conducted an audit-requirements presentation for the proposed MCA Honduras staff, which included representatives of the proposed fiscal and procurement agent.

While in Honduras, we also met with the American Ambassador and the USAID Mission Director to brief them on our oversight responsibilities for the MCC Honduras program.

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Ensuring Sound Oversight and Accountability through Coordination with Other Government Entities

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 with 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 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. Moreover, as part of our coordination efforts, the GAO participates in our annual planning conference.

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 MCC in keeping with its broad program flexibilities. Where there are areas that require debate, we initiate early dialogue to ensure compliance with important reporting time lines.

The Government Accountability Office

As the Congressional oversight agency, the GAO has the authority and responsibility to review Federal programs and to respond to special requests of the Congress. In September 2005,

at the request of the Senate Foreign Relations Committee, GAO initiated a second monitoring and oversight review of MCC.

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 and work plans to ensure that there is no duplication of effort and that all relevant areas are covered. We also discuss MCC management issues and the progress and results of our ongoing oversight work.

In a September 2005 meeting, we shared our FY 2006 audit plan with GAO representatives and discussed the areas where we plan to expend our resources. As a result of these activities, we are able to establish a reasonable degree of assurance that MCC’s risks and vulnerabilities are being addressed and reported to MCC and to the Congress.

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 they are consistent with Administration policies. OMB also oversees and coordinates the Administration’s procurement, financial management, information, and regulatory policies.

The OIG has established a working relationship with OMB in order to keep abreast of current OMB guidelines and expectations as they relate to MCC operations and to our audit work. This coordination and interaction help provide reasonable assurances that MCC 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. MCC has allocated \$80 million to USAID for this activity and has approved an additional \$105 million. 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 will be coordinating the oversight of agreement funds with them.

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 less than two years, 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. And within the past six months, MCC signed its first five Compacts and will soon face the daunting 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 MCC as well as soliciting feedback on the usefulness of our work. Participants in this planning process include congressional staff, representatives of USAID, OMB and GAO, and senior managers of MCC. In July of 2005, we presented our tentative fiscal year 2006 audit plan to MCC managers and obtained their comments and feedback, which will be assessed and considered as we finalize our plans.

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

- Keep Congress and MCC Management informed.
- Promote sound accounting and reporting.
- Promote economy, efficiency and effectiveness.

- Preserve and protect program and employee integrity.

Activities undertaken to meet these goals included a meeting with the Board Chair; ongoing dialogue with the General Accountability Office; conducting a fraud-awareness briefing in September 2005; working with MCC's Board of Directors to develop a charter for the Audit Committee; working with Corporation management to develop effective audit recommendation follow-up procedures; and issuing two audit reports with recommendations to improve MCC's operations.

Keeping Congress and the Head of MCC 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, the Board, and the Congress to keep them abreast of OIG activities relevant to MCC. Specifically, the OIG:

- Prepares and submits 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 performed during the reporting period. This is our third Semiannual Report to Congress and covers the period ending September 30, 2005.

- 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 May we met with the Board Chair to introduce OIG staff, brief her on OIG policies and operating preferences, and obtain her views and concerns vis-à-vis MCC and the OIG. We have regular frequent meetings with the CEO and continuing interactions with MCC senior management. In our meetings with the CEO, we discussed significant audits as well as the status of MCC's management controls, and program oversight and monitoring efforts.
- Continues 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.
- Conduct audits and distribute audit reports to MCC management and congressional staff in a timely manner. All nonclassified audit and review reports are transmitted to appropriate congressional committees.

Promoting Sound Accounting and Reporting on Financial Activities and Information Security

This strategic goal addresses MCC'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 three audits this period to address these challenges: an audit of the MCC's compliance with the Federal Information Security Management Act of 2002 (FISMA), an agreed-upon procedures audit covering MCC's employee benefits program, and a Financial Statement audit.

Audit of the Millennium Challenge Corporation's Compliance with the Provisions of the Federal Information Security Management Act of 2002

The Federal Information Security Management Act of 2002 (FISMA) requires agencies to develop, document, and implement an agency-wide information security program to protect its information and information systems, including those provided or managed by another agency, contractor, or other source.

This audit met the FISMA requirement for an annual evaluation of the Millennium Challenge Corporation's information security program. Its objective was to determine if MCC's information security program met the requirements of the FISMA.

MCC partially met the FISMA requirements. It reported on its security program in fiscal year 2004 and plans to do so in fiscal year 2005. However, it had not established and documented its information security program in eight key areas as required by FISMA. The information security program had not been documented because MCC had not applied the necessary resources to comply with the FISMA requirements. Consequently, MCC's operations and assets are at risk of fraud, misuse, and disruption.

The audit report includes eight recommendations to assist MCC in strengthening its information security program. MCC Management agreed with the audit findings and agreed to implement all eight recommendations. As a result, a management decision has been reached on each of the eight recommendations.

A prior audit report also contained a recommendation that MCC document an Agency-wide information system security program; MCC is still in

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the process of completing final action on that recommendation. (Appendix A, page 22)

(Report No. M-000-05-003-P)

Audit of Millennium Challenge Corporation's Consolidated Financial Statements, Internal Controls, and Compliance for the Fiscal Year 2005

The OIG and the MCC are working collaboratively so that the OIG can issue the fiscal year 2005 audit report on MCC's consolidated financial statements, internal controls, and compliance by November 15, 2005. This schedule, which was agreed to by the MCC and the OIG, has been adopted one year ahead of the Office of Management and Budget's (OMB) requirement for submitting audited financial statements within 45 days of the fiscal year-end. This audit was begun in July, under OIG oversight, by a non-Federal audit firm. The auditor will perform a full-scope financial statement audit of MCC's FY 2005 financial statements in accordance with OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

The auditor will determine whether the principal financial statements present fairly, in all material respects, the financial position of MCC as of September 30, 2005, in conformity with generally accepted accounting principles. The auditor will also obtain an understanding of the design of internal controls, determine whether they have been placed in operation, and assess the level of control risk relevant to management's assertion relative to the financial statement.

For fiscal year 2004, the OIG issued its audit report in January 2005 on the first set of financial statements prepared by MCC for the nine month period ended in September 2004. This audit was performed by a non-Federal accounting firm with OIG oversight. 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 has initiated corrective actions to remedy this reportable condition during fiscal year 2005.

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

This strategic goal addresses MCC'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 better understand management's response to these challenges and to provide management with recommendations to address the vulnerabilities associated with them.

Survey of Millennium Challenge Corporation's Coordination with Other Donors to Implement Its Assistance Program

This survey, conducted to determine what progress MCC has made in complying with and reporting on coordination with other donors, found that MCC has made progress in complying with and reporting on Millennium Challenge Act of 2003 requirements for other donor coordination, but needs to do so in a more substantive and timely manner. Although MCC has taken steps to implement and report on coordination assistance, it has not formally established a policy, issued guidelines, or made reporting requirements known.

Now that five compacts have been signed and more are imminent, MCC needs to move expeditiously in formalizing its draft policy and guidance concerning donor coordination requirements. This should help ensure continuity in how the transaction teams perform and report on their donor coordination efforts. MCC donor coordination efforts cross departmental areas within MCC. A single donor

coordination office that has direct control over MCC does not exist; therefore, an organization-wide policy and guidance concerning donor coordination is needed.

We recommended that MCC formally establish an organization-wide policy and guidance concerning donor coordination to comply with the Millennium Challenge Act and that the policy and guidance be approved at a sufficient level within MCC for proper implementation. This guidance should include information on, among other things, (1) how donor coordination efforts by transaction teams will be monitored and evaluated, (2) roles and responsibilities of the transaction teams and other responsible program offices, and (3) formal plans to comply with Millennium Challenge Act reporting requirements for coordinating with the U.S. Agency for International Development, other United States foreign assistance programs, and other donors. Further, the Compact document should contain information on where donor coordination efforts can be found in the compact or supplemental attachments.

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

Preserving and Protecting the Millennium Challenge Corporation's Program and Employee Integrity

This strategic goal is designed to foster the integrity of program and operational activities. Our 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, during this period we presented our third fraud-awareness briefing to MCC staff.

Investigations: Prevention and Fraud Awareness

OIG investigative priorities are twofold: first, to preserve and protect program and employee integrity within the Millennium Challenge Corporation; 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 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 such 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 in 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 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 have been distributed to the OIG's overseas offices and MCC headquarters. In an effort to expand our outreach efforts, these materials were produced in

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English, Spanish, French and Arabic. On September 14, 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 40 members of MCC.

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.

A P P E N D I C E S

REPORTS ISSUED*April 1, 2005 through September 30, 2005*

Report Number	Date of Report	Report Title	Amount of Findings (\$000)	Type of Findings
M-000-05-003-P	06/20/2005	Audit of the Millennium Challenge Corporation's Compliance with the Provisions of the Federal Information Security Management Act of 2002		
M-999-05-002-S	09/30/2005	Audit of Millennium Challenge Corporation's Compliance Coordination with Other Donors to Implement Its Assistance Program		

SIGNIFICANT AUDIT RECOMMENDATIONS DESCRIBED IN PREVIOUS SEMIANNUAL REPORT WITHOUT FINAL ACTION

As of September 30, 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	
M-0000-05-001-C	Require the Corporation's service provider – National Business Center – to conduct an internal control review of its Oracle Financial System	01/27/2005	1	01/27/2005	
M-000-05-002-P	Formalize and document the Corporation's administrative and program internal control system and establish a defined timetable for completing the process	03/31/2005	1	03/31/2005	
M-000-05-002-P	Conduct an evaluation of the Corporation's internal control system consistent the FMFIA and OMB implementing guidance	03/31/2005	1	03/31/2005	

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 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.

In our previous Semiannual Report, issued as of March 31, 2005, we reported that during our fiscal year 2004 financial statement audit, we determined that MCC'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.

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, it 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 was that management did not have a comprehensive understanding of the system's internal controls and the risks involved in conducting system transactions. According to MCC, they are the first organization to use the system, which is a new system for NBC.

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

MCC did request that NBC conduct the required internal control review and it was completed in September 2005. Our audit of MCC's fiscal year 2005 financial statements, currently underway, will determine if the review effectively remedies the deficiency.

OIG STATISTICAL SUMMARY*As of September 30, 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