



# Millennium Challenge Corporation

Reducing Poverty Through Growth

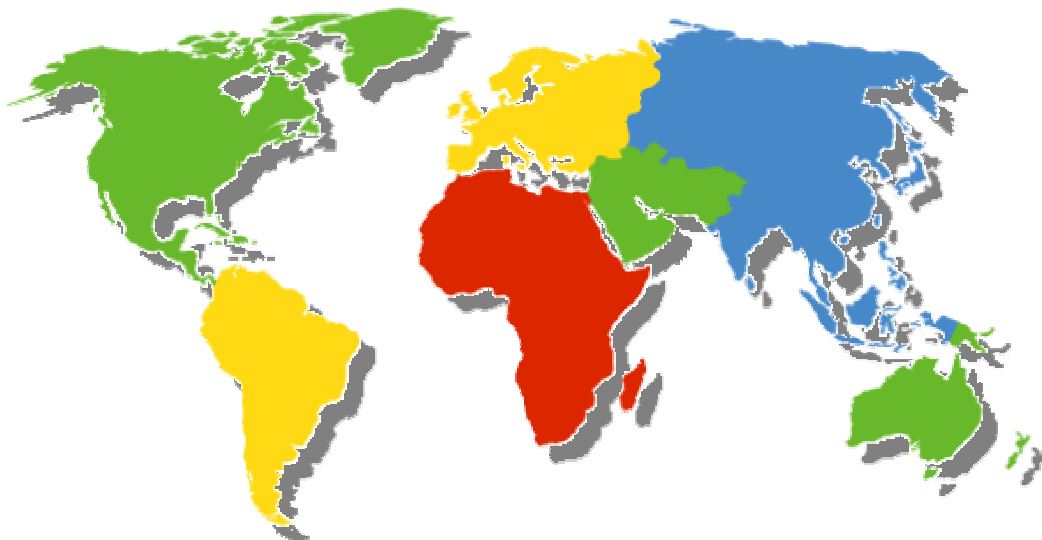
## OFFICE OF INSPECTOR GENERAL

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

Report No. M-000-05-001-S

March 31, 2005



Washington, D.C.





# Millennium Challenge Corporation

Reducing Poverty Through Growth

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*Office of Inspector General*

March 31, 2005

## **MEMORANDUM**

**FOR:** Chief Executive Officer, Millennium Challenge Corporation,  
Paul V. Applegarth

**FROM:** Assistant Inspector General for the Millennium Challenge  
Corporation, Henry L. Barrett /s/

**SUBJECT:** Review of the Millennium Challenge Corporation's Progress in  
Achieving Its Planned Organizational Structure and Beginning Its  
Assistance Programs As of February 28, 2005 (Report No. M-000-  
05-001-S)

This memorandum transmits our final report on the subject review. In finalizing the report, we considered your comments on our draft report and have included them in their entirety as Appendix II.

The report contains one recommendation for corrective action. Based on your written comments to our draft report, we consider that final action has been taken on this recommendation.

I appreciate the cooperation and courtesy extended to my staff during the review.

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## Background

On January 23, 2004, the Millennium Challenge Corporation (MCC) was established by the Millennium Challenge Act of 2003 (Act)<sup>1</sup> to administer the Millennium Challenge Account (MCA). The MCC is a new government corporation designed to provide assistance to selected developing countries that rule justly, invest in their people and encourage economic freedom.

Countries eligible to receive MCA assistance are selected from a group of candidate countries. Candidate countries for fiscal years 2004 and 2005 were lower income countries (per capita income of less than \$1415 in fiscal year 2004 and \$1465 in fiscal year 2005) that were not otherwise prohibited from receiving assistance under U.S. law. Eligible countries are selected by MCC's Board of Directors based on the candidate countries' relative rankings against each other using objective indicators of the countries' past and current policy performance in the areas of governing justly, investing in people, and encouraging economic freedom.

On May 6, 2004, the MCC Board selected 16 countries as eligible to submit proposals for assistance under fiscal year 2004 funding. On November 8, 2004, the MCC Board selected 16 eligible countries for fiscal year 2005 funding which included 15 of the countries that were eligible to apply for fiscal year 2004 funding, with one additional country.

In addition to the eligible countries, MCC has established a Threshold Program designed to assist countries that are on the "threshold" and committed to undertaking the reforms necessary to improve policy performance and eventually qualify for MCA assistance as an eligible country. Up to ten percent of available funding may be used for this program. The MCC Board selected 7 countries for fiscal year 2004 and 12 countries for fiscal year 2005 (which included 6 countries from fiscal year 2004) to participate in this program.<sup>2</sup>

For its initial year of operations, MCC received an appropriation of \$994 million and \$1.488 billion for fiscal year 2005. For fiscal year 2006, the President's budget has requested \$3 billion for MCC.

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<sup>1</sup> The Millennium Challenge Act of 2003 is Part D, Title VI of Public Law 108-199—The Consolidated Appropriations Act of 2004.

<sup>2</sup>MCC's website ([www.mcc.gov](http://www.mcc.gov)) identifies the eligible and Threshold Program countries for fiscal years 2004 and 2005.

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## Review Objectives

This review is a follow up of our August 2004 review, which we reported on in Report No. M-000-04-001-S dated September 30, 2004.<sup>3</sup> As in the previous review, we directed our objectives to assess and report on the current status of the MCC in terms of achieving its planned organizational structure, developing its compact development process, and complying with the Millennium Challenge Act of 2003 and other applicable laws and regulations.

Appendix I contains a discussion on the review's scope and methodology.

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## Review Findings

### What progress has the Millennium Challenge Corporation made in achieving its planned organizational structure?

The Millennium Challenge Corporation (MCC) made significant progress in achieving its planned organizational structure. At the time of our review, MCC had reached about 55 percent of its planned staffing level of 200 positions with 110 employees on board (95 direct hires, 3 personal service contractors, 8 institutional contractors and 4 detailees). MCC still plans a target full staffing level of 200 positions—176 positions that have already been programmed for specific offices and the remaining 24 positions currently being reserved for eventual allocation to the various offices as its staffing requirements become better known.

The table below shows MCC's staffing by office at the end of August 2004 and February 2005, as well as its full staffing target for December 2005.

**Table 1: MCC's Staffing by Office Projected through December 2005**

Office	Staffing as of August 31, 2004	Staffing as of February 28, 2005	Full Staffing Target December 2005
Chief Executive's Office	5	6	8
General Counsel	6	7	11
Administration and Finance	14	22	18
Country Relations	15	32	65
Markets and Sectoral Assessments	6	19	33
Domestic Relations	5	7	12
Monitoring and Evaluation	3	12	16
Development Policy	2	3	7
International Relations	1	2	6
<b>Reserved Positions for Future Allocation</b>			<b>24</b>
<b>Totals</b>	<b>57</b>	<b>110</b>	<b>200</b>

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<sup>3</sup> Review of the Millennium Challenge Corporation's Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs As of August 31, 2004, Report No. M-000-04-001-S, dated September 30, 2004.



To enhance its technical expertise in selected areas, MCC entered into interagency agreements with other U.S. Government agencies and may enter into more as the need arises. At the time of our review, MCC had entered or planned to enter into interagency agreements with: (1) the Department of the Treasury to provide resources in the area of fiscal accountability and financial systems, (2) the Department of Agriculture to provide resources to assist with agriculture projects and environmental issues, including tapping into resources from land grant universities, and (3) the Army Corps of Engineers to provide assistance on infrastructure projects.

MCC also plans to send country resident representatives overseas to provide an on-the-ground presence to oversee activities in the compact countries. An unspecified number of locally employed staff (LES)<sup>4</sup> personal service contractors will be hired to assist the representatives. The LES staff will be in addition to the 200 U.S. positions it is anticipating by December 2005.

As MCC continues to build its staffing levels, one of the challenges it faces is developing a diverse workforce that will meet its needs for both its administrative operations and its overseas assistance programs. According to one MCC official, MCC employees are coming from the international development field, the private sector and the Federal government. In creating such a diverse workforce, MCC has to ensure that those employees not coming from a government background become familiar with Federal government regulations and standards. MCC also recognizes that it will be a challenge to monitor the activities in the field with its limited staff where the risks have not been specifically defined. MCC will need to be very rigorous in its monitoring efforts to protect MCC-financed programs from fraud, waste and abuse.

### **What is the status of the Millennium Challenge Corporation's compact development process?**

MCC has made progress in developing and negotiating compacts with several eligible countries and has taken the initial steps in establishing its Threshold Program. The status of these programs is described below.

#### **Eligible Country Program**

Although MCC had not signed a compact with any of its eligible countries as of the end of February 2005, MCC officials indicated that they had made considerable progress toward finalizing as many as five compacts in the next few months. Equally important, MCC had established a foundation for the future by substantially creating the procedures and documents it will use in developing and negotiating compacts with its eligible countries. MCC

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<sup>4</sup> Locally employed staff is the general term used for Foreign Service Nationals and locally employed American citizens who are employed by a U.S. Government agency overseas.

records indicate that by the end of February 2005, 15 of the 16 countries eligible for fiscal year 2004 funding had submitted at least an initial draft MCC program proposal and most of these countries have submitted more refined draft proposals with assistance from MCC.

MCC continues to refine its procedures in developing compacts with the eligible countries and additional adjustments and changes can be expected as MCC gains more experience and a track record with the implementation of its first country programs. MCC has invested extensive time and resources in developing its “due diligence” process—the appraisal process where MCC supports the development of a country’s proposal and identifies potential fiscal and procurement agents and issues of concern to be addressed before signing a compact to ensure sound investment of U.S. funding. This effort involves not only MCC personnel but also contracted outside technical assistance when necessary. These efforts are documented within MCC’s “due diligence plan” for each country and summarized—with a detailed description of the country’s proposal—in an investment memo which must be approved by MCC’s “investment committee” comprised of MCC’s CEO and Vice Presidents.<sup>5</sup>

MCC officials expected the first compact would be signed with Madagascar in April 2005<sup>6</sup> with the initial disbursements to be made within two months of compact signing. Depending on the completion of MCC’s due diligence efforts in the countries and approval by the Board, MCC estimates that up to an additional three or four compacts may be signed during the remainder of fiscal year 2005. MCC also anticipates notifying Congress that negotiations will begin with an additional four to five eligible countries during the remainder of fiscal year 2005.

MCC officials report that the preparation and negotiation of the Madagascar compact has served as a prototype for future compacts and subsequent compacts are expected to proceed more quickly. The remaining country proposals are in various stages of development and it is difficult to project when a compact might be signed since progress is primarily dependent on the eligible countries. Some of these proposals are only rough initial drafts while others have received initial MCC approval and are being actively developed with substantial MCC assistance.

### **Threshold Program**

In addition to progress in developing and negotiating compacts with eligible countries, MCC has moved forward in establishing its Threshold Program to assist selected countries that are committed to undertaking necessary

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<sup>5</sup> MCC did not have a completed due diligence plan at the time of our review. As of March 21, 2005, we were informed that they had substantially completed its first due diligence plan (for Madagascar) but it was not finalized.

<sup>6</sup> Subsequent to our review cutoff date, on March 14, 2005, MCC’s Board of Directors approved MCC’s first Millennium Challenge compact with the country of Madagascar.

reforms to improve policy performance so that they might eventually qualify for assistance as an eligible country. The Act allows up to ten percent of available funding to be used for this program and the MCC Board selected 7 countries in fiscal year 2004 and 12 countries in fiscal year 2005 (which included 6 countries from fiscal year 2004) to participate in the program.

In October 2004, MCC signed a memorandum of agreement with the U.S. Agency for International Development (USAID) to allocate up to \$40 million for USAID to administer the program. MCC has posted guidance on its website to assist Threshold Program countries in developing and preparing concept papers—the first step toward possibly receiving MCC funding. MCC and USAID personnel have worked closely in explaining and promoting the program with officials of the selected countries. MCC reports that concept papers were evaluated with close collaboration and input from USAID, the Department of State, and other Federal agencies.

As of February 28, 2005, MCC had received concept papers from each of the seven fiscal year 2004 Threshold Program countries. Subsequent to our review cutoff date, MCC’s investment committee approved four of the concept papers allowing those countries to proceed toward preparing program plans for possible MCC approval and funding before the end of fiscal year 2005. The other three countries were given an additional 60 days to clarify and make necessary changes to their concept papers before they might be approved.

**What progress has the Millennium Challenge Corporation made in complying with the Millennium Challenge Act of 2003 and other applicable Federal laws and regulations?**

During the latest six month period, the Millennium Challenge Corporation (MCC) continued to make progress in complying with the provisions of the Millennium Challenge Act of 2003 (Act) and continued to assess the applicability of other Federal laws and regulations to its operations. However, while MCC officials reported that the MCC has followed the Federal Acquisition Regulation (FAR) since its inception, MCC recently issued an internal memorandum stating that language in the Act constitutes “character and necessity”<sup>7</sup> language per applicable legal precedents and that such language exempts MCC from the general statutory and regulatory provisions governing Federal procurement when developing its own procurement policies and procedures. We question MCC’s rationale that “character and necessity” language gives MCC the authority to deviate from Federal procurement laws and regulations.

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<sup>7</sup> “Character and necessity” language refers to a provision in a government corporation’s authorizing legislation that is interpreted by GAO as providing the government corporation fiscal autonomy. Fiscal autonomy allows government corporations to use its funds for expenses otherwise unallowable by Federal agencies.

Below we first discuss our review observations regarding the MCC's compliance with the Act, and subsequently discuss its compliance with other laws and regulations.

### **Compliance with the Act**

The Act has a number of authorities and requirements which instruct the MCC on how to organize itself, identify countries that are candidates for assistance, select countries eligible to submit assistance proposals, enter into agreements with the countries, administer assistance to the countries, as well as other provisions and requirements on reporting and coordination with U.S. Government entities.

As reported in our prior review report, during its first eight months of operations, MCC had made progress in complying with the Act.

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

The above actions were in accordance with the requirements of the Act.

### **Complying with other laws and regulations**

As reported in our prior review report, MCC officials identified a number of laws and regulations that they believed that MCC is wholly or partially exempt from because it is a government corporation. During this latest six month period, MCC wrote an internal memorandum concluding that it is not obligated in the future to follow the general statutory and regulatory provisions governing Federal procurement, including the Federal Acquisition Regulation. As explained below, we question MCC's opinion and believe it would be prudent for MCC to obtain a second opinion on its position.

## **Applicability of Federal Procurement Rules to MCC Needs to be Determined**

In an internal memorandum, dated December 8, 2004, MCC's Office of General Counsel presented an opinion on the applicability of the Federal procurement rules to MCC. The opinion states that Congress included "character and necessity" language in the Act<sup>8</sup> that provides MCC with fiscal autonomy and permits it to exercise broad authority and discretion to handle expenditures. Citing its interpretation of the Government Accountability Office's (GAO) *Principles of Federal Appropriation Law*, the opinion states that the "character and necessity" language of the Act permits MCC to prescribe the manner in which it will procure goods and services, and that MCC is not obligated to follow the general statutory and regulatory provisions governing Federal procurement, including the Federal Acquisition Regulation (FAR). Further, the opinion stated, "This means that as the MCC moves forward and establishes its own procurement policy, it should refer to, and incorporate into its procurement policy, portions of the Federal procurement statutory and regulatory scheme that is best suited to the MCC." This policy was addressing MCC's options for future procurement practices. MCC officials report that MCC has followed the FAR since MCC's inception.

Our interpretation of the same GAO *Principles of Federal Appropriation Law* cited in MCC's opinion is that "character and necessity" language is intended to apply to laws of a fiscal nature and not to procurement laws and regulations. GAO's guidance specifically states that Federal procurement laws and regulations are expressly applicable to wholly-owned government corporations. Hence, there was some question whether MCC's opinion regarding MCC being exempt from the FAR and general procurement statutes was soundly based.

We believe that it would be in MCC's best interest to seek a "second opinion" on MCC's interpretation that the Act's "character and necessity" language exempts MCC from general statutory and regulatory provisions governing Federal procurement, including the Federal Acquisition Regulation. GAO officials suggested that the appropriate organizations from which MCC might obtain an opinion of these matters might be the Office of Management and Budget's Office of Federal Procurement Policy or the General Services Administration. By getting a second opinion on the flexibilities that the Act provides to deviate from the FAR and general procurement statutes, MCC will have a firmer basis upon which to build an MCC-specific procurement policy. Hence, we are making the following recommendation:

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<sup>8</sup> MCC cited Section 614(a)(4) of the Act which states that the Corporation: "May determine and prescribe the manner in which its obligations shall be incurred and its expenses allowed and paid, including expenses for representation."

**Recommendation No. 1 – We recommend that the Millennium Challenge Corporation (MCC) request the advice of appropriate authorities on the issue whether the “character and necessity” language in the Millennium Challenge Act exempts MCC from general statutory and regulatory provisions governing Federal procurement.**

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**Evaluation of  
Management  
Comments**

In its management comments, MCC requested that the report mention only the number of compacts MCC estimates may be signed during the remainder of fiscal year 2005, rather than identifying the countries. Additionally, it requested that we add a further sentence that MCC expects to notify Congress of its intent to begin negotiations with several more countries during the remainder of fiscal year 2005. This final report includes the changes requested by MCC.

Regarding Recommendation No. 1, MCC stated that the language in the Millennium Challenge Act (Act) is precisely that same language as is contained in the Federal Deposit Insurance Corporation (FDIC) statute which the Government Accountability Office (GAO) interpreted for FDIC to be the “functional equivalent” of “character and necessity” language. Therefore, MCC believed that the GAO has already answered the question whether the language in the Act constitutes “character and necessity” language. We reviewed the reference cited by MCC in its comments and agree that the language in the Act is nearly the same as the language for the FDIC as cited in the GAO reference. Hence, this final report does not reflect that there is a question that the Act includes “character and necessity” language.

MCC indicated it will take under advisement our recommendation that it obtain a second opinion of whether “character and necessity” language permits MCC to deviate from general procurement statutes. While its comments did not state that it would seek a second opinion regarding deviating from the Federal Acquisition Regulation (FAR), MCC stated that it intends to continue following the requirements of the FAR as it has in the past.

Given that MCC intends to continue following the FAR and the fact that this review report puts MCC on notice of the OIG’s position that “character and necessity” language would not give authority to deviate from general procurement statutes or the FAR, we consider MCC’s comments to be generally responsive to Recommendation No. 1 and consider that final action has been taken on the recommendation.

MCC’s management comments are included in their entirety in Appendix II of this report.

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**Scope and  
Methodology****Scope**

The Millennium Challenge Corporation's Office of Inspector General conducted this review to gain an understanding of the progress that MCC has made in establishing its organizational structure, beginning its assistance program and assessing MCC's compliance with applicable laws and regulations. Our review was not an audit and therefore was not designed to fully comply with generally accepted government auditing standards. The review was conducted at the MCC office located in Arlington, Virginia from January 31 through March 4, 2005.

**Methodology**

In planning and performing this review, we interviewed MCC management officials and examined documentation relating to MCC's organization, staffing, budget, relevant laws and regulations and its progress in developing country compacts.

To determine the progress MCC has made in achieving its planned organizational structure, we interviewed MCC officials to determine the current status of its organizational structure in terms of where they are now versus where they expect to be when fully staffed and operational, the anticipated staffing needs of each office, and hiring plans. We also reviewed documentation such as organizational charts and staffing plans.

To determine the status of MCC's compact development process, we interviewed key MCC personnel involved with proposal development, addressing due diligence issues and compact negotiation. We also interviewed key personnel who are developing MCC's program to assist selected "threshold" countries. In addition, we reviewed:

- MCC guidance to countries for developing proposals for MCC assistance,
- MCC criteria and methodology for determining candidate and eligible countries,
- summary reports of the status of proposal and compact development for the 16 countries eligible for fiscal year 2004 funding, and
- file documentation for selected eligible countries.

To determine whether the MCC complied with the Millennium Challenge Act of 2003 (Act) and other applicable Federal laws and regulations, we met with and obtained documentation from MCC staff. We discussed with the MCC staff their interpretation of parts of the Act and whether the MCC complied with its terms. In reviewing compliance issues, we determined the minimum level of action necessary to meet the requirements of selected provisions of the Act and other Federal laws and regulations' requirements but did not attempt to fully evaluate the thoroughness, effectiveness or impact of the actions MCC has taken.

**Management  
Comments**



**Millennium Challenge Corporation**

Reducing Poverty Through Growth

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Paul V. Applegarth  
Chief Executive Officer

MEMO TO: Henry L. Barrett, Assistant Inspector General, MCC

March 31, 2005

FROM: Paul V. Applegarth /s/

SUBJECT: Management Comments – Review of Millennium Challenge Corporation’s Progress in Achieving Its Planned Organizational Structure and Beginning Its Assistance Programs As of February 28, 2005 (Report No. M-000-5-00X-S)

Please find below the Millennium Challenge Corporation (MCC) management’s comments to the Inspector General’s (IG) draft report of the review of MCC’s progress in achieving its organizational structure and beginning its assistance programs. MCC management appreciates the opportunity to comment on the draft report. We have reviewed the draft report, discussed it with the appropriate members of MCC’s staff, and offer the following comments, which we trust you will consider as you prepare the final report.

General Comment

MCC requests that you revise the second sentence in the second full paragraph on page 8 of the draft report, as follows: “Depending on the completion of MCC’s due diligence efforts in the countries and approval by the Board, MCC estimates that up to an additional 3 to 4 compacts may be signed during the remainder of fiscal year 2005.” Also, MCC requests that immediately following the previous sentence you add the following sentence: “MCC also anticipates notifying Congress that negotiations will begin with an additional 4 to 5 eligible countries during the remainder of fiscal year 2005.”

Response to Recommendation 1

The report recommends that MCC request a second opinion as to whether the statutory language in Section 614(a) (4) of the Millennium Challenge Act (the “Act”) constitutes “character” and “necessity” authority as recognized by the Government Accountability Office (GAO) because

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## Appendix II

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Section 614(a)(4) of the Act does not contain the words “character” and “necessity.” The GAO guidance makes it clear, however, that the language in Section 614(a)(4) does in fact provide MCC “character and necessity” authority, and that it is not necessary for a government corporation’s enabling legislation to use the words “character” and “necessity” in order to provide such authority. In *Principles of Federal Appropriations Law*, Volume IV, Chapter 17, page 17-141, the GAO noted that the FDIC’s statute, which contains precisely the same language as Section 614(a)(4) of the Act, is the “functional equivalent” of “character and necessity” language in other statutes. Since we believe GAO precedent has already unambiguously answered this question, MCC does not feel it is necessary to seek a second opinion.

We will take under advisement your recommendation to seek a second opinion on the application of this “character and necessity” authority with respect to any particular statutory provisions MCC may seek to depart from in the future. We note, however, that notwithstanding any potential argument that provisions of the Act could be read to provide relief from the Federal Acquisition Regulations (FAR), MCC in fact intends to continue following the requirements of the FAR in conducting its procurement activities, as it has in the past.

If you have any questions about these comments please contact Jonathan O. Bloom, MCC’s Senior Advisor to the CEO, at 202-521-3894 or bloomjo@mcc.gov. Thank you and your staff for assisting us in this important endeavor and for providing MCC management the opportunity to comment on the draft report.

