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United States Government Accountability Office
Washington, DC 20548

April 11, 2008

The Honorable John J. Danilovich
Chief Executive Officer
Millennium Challenge Corporation
875 Fifteenth Street NW
Washington, D.C. 20005-2221

Subject: *Millennium Challenge Corporation: Analysis of Compact Development and Future Obligations and Current Disbursements of Compact Assistance*

Dear Mr. Ambassador:

The Millennium Challenge Corporation (MCC), now in its fourth year of operations, provides aid to developing countries that have demonstrated a commitment to ruling justly, encouraging economic freedom, and investing in people. MCC provides monetary assistance to eligible countries through multiyear compact agreements to fund specific programs targeted at reducing poverty and stimulating economic growth.¹ MCC has received appropriations for fiscal years 2004 to 2008² totaling more than \$7.5 billion, and has set aside about \$6.4 billion of this amount for compact assistance.³ The President has requested an additional \$2.225 billion for MCC for 2009, of which MCC plans to use \$1.88 billion for compact assistance with countries currently eligible for compacts.

MCC compact development is a four-phase process: (1) an eligible country submits a compact proposal; (2) MCC conducts a due diligence review of the proposed projects; (3) MCC and the country negotiate and sign the compact; (4) MCC and the country complete preparations, including developing disbursement plans, for the compact to enter into force. After the compact enters into force, compact implementation begins, and funds are obligated and disbursed. As of March 2008, MCC had selected 28 countries as eligible for compact assistance and had signed compacts with 16 of these countries.

¹The Millennium Challenge Act of 2003 (Public Law 108-199, Division D, Section 605) authorizes MCC to provide assistance to countries that enter into public compacts with the United States. MCC has negotiated compacts with countries that contain agreed upon assistance objectives, responsibilities, implementation schedules, expected results, and evaluation strategies. The act stipulates that a compact may not last longer than 5 years and that MCC may have only one compact with a country at a time.

²Unless otherwise noted in this report, all years refer to fiscal years.

³About \$1 billion has been set aside for MCC's threshold country program, administrative expenses, due diligence, monitoring and evaluation, and other costs. MCC's threshold program is designed to assist countries that have not yet qualified for compact assistance, but have demonstrated a significant commitment to improve their performance on MCC's eligibility criteria.

Eleven of these compacts have entered into force. Ten countries have not signed compacts and remain in the compact development process.⁴

We conducted this performance audit on the initiative of the Comptroller General. This report assesses

- the current status and pace of compact development;
- projected time frames for the commitment and obligation of MCC's existing (2004 to 2008) and requested (2009) appropriations; and
- MCC's progress in disbursing compact assistance.

To address these objectives, we analyzed MCC's budget presentations and other corporation records for 2004 to 2009 and obtained the views of MCC officials. We also compared MCC's actual and planned disbursements for compact assistance from July 2005 through December 2007 for 11 countries that have compacts in force. We conducted this performance audit from January to April 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform our work to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. (See enclosure I for additional information about our scope and methodology.)

Results in Brief

The 10 countries without signed compacts are in the first or second phase of compact development. Since MCC made its first eligibility selections, the length of time required for compact development has increased substantially. For example, the first 11 countries to sign compacts completed compact development an average of 25 months after being selected as eligible. Assuming the next 5 signed compacts enter into force as MCC projects, the average length of compact development for all 16 countries with signed compacts will increase to 32 months. MCC attributed the slowing pace of compact development to several factors, such as the increased size of more recent compacts, and estimates that future compact development will take an average of 36 months.

Assuming that MCC signs two additional compacts for \$858 million by the end of 2008, as planned, and that compact development continues at the pace observed to date (32 months), we project that MCC could obligate the balance of its existing (2004 to 2008) appropriations by the end of 2009. Similarly, at the observed pace of compact development, and assuming MCC funds four compacts with currently eligible countries, we project that MCC could commit and obligate its entire 2009 request for compact

⁴In addition to these 10 countries, MCC had previously selected The Gambia and Sri Lanka as eligible for compact assistance. However, MCC formally suspended The Gambia's eligibility on June 16, 2006, based on evidence of growing human rights abuses, increased restrictions on political rights, civil liberties and press freedom, as well as deteriorating economic policies and anticorruption efforts. In addition, the MCC Board of Directors did not re-select Sri Lanka as eligible for compact assistance for 2008.

assistance by the end of 2010. However, several factors could lengthen this projected time frame. For example, if the pace of compact development slows or MCC funds compacts with countries newly eligible in 2009, it would not commit and obligate all of its requested 2009 appropriation until 2011.

MCC's actual disbursements substantially lag behind planned disbursements for all 11 countries with compacts in force because initial compact disbursement plans underestimated the time required for compact countries to establish the structures, agreements, and capabilities to begin implementing compact projects. The slow rate of disbursements is most critical for Madagascar, Cape Verde, and Honduras, which are in the third year of compact implementation. For example, as of December 2007, MCC was 29 months (61 percent) into the 48-month Madagascar compact but had disbursed only \$22.7 million (21 percent) of the \$109.8 million compact. Unless disbursements for these countries increase significantly, MCC could have significant obligated, but undisbursed, balances when the compacts expire and may not be able to fully achieve compact goals for economic growth and poverty reduction. MCC reports that it is taking steps to increase disbursements of compact assistance.

In commenting on a draft of this report, MCC generally agreed with our factual analysis but disagreed with some of the report's emphasis and conclusions. MCC concurred with our analysis that the length of time required for compact development has increased, and attributed this increase to four primary factors. With regard to our analysis of MCC's commitment and obligation of funds, MCC commented that our report underemphasized the link between available appropriations and signing new compacts and that it planned to commit the President's entire request by the end of 2009, slightly earlier than we projected. We believe that our report clearly projects the timing of both the commitment and obligation of funds, as illustrated in figures 4 and 5. Finally, MCC concurred with our analysis that actual disbursements lag behind original disbursement projections.

Background

A country that has been selected as eligible for assistance may begin the four-phase compact development process that can lead to a compact's entry into force:

- **Country proposal development.** After the MCC Board of Directors selects a country as eligible for assistance, MCC invites the country to submit a compact proposal. The proposal must be developed in consultation with members of civil society, including the private sector and nongovernmental organizations. On receiving a proposal, MCC conducts a preliminary assessment and reports its findings in an internal "opportunity memo" to the MCC investment committee. The opportunity memo signifies the end of the proposal development phase and the beginning of due diligence review.
- **MCC due diligence review.** In conducting due diligence, MCC evaluates the eligible country's proposal against MCC criteria to ensure that proposed projects will be effective and funds will be well used. For example, MCC analyzes the projects' costs and economic, environmental, and social impact. MCC also assesses the level of civil society participation in proposal development. Based on its assessment of the

proposal, MCC makes recommendations in an investment memo to the MCC investment committee.

- **Compact negotiation and MCC approval.** Following the issuance of an investment memo, MCC enters into formal compact negotiations with the eligible country. If the negotiations are successful, the MCC Board of Directors may approve the compact, and MCC and the eligible country sign it. MCC commits funds for the compact at signing but does not obligate these funds until the compact enters into force. Each signed compact includes a multiyear financial plan that summarizes MCC's planned projects and disbursements by project in each fiscal year.
- **MCC and compact country complete entry-into-force requirements.** MCC and the country's accountable entity must complete supplemental agreements, including a disbursement agreement and a procurement agreement, before the compact enters into force and the funds are disbursed.⁵

At the successful conclusion of these four phases, the compact enters into force, and MCC obligates the full amount of the compact and starts disbursing assistance as the country starts implementing projects.

Actual and Requested Appropriations, 2004 to 2009

MCC has received appropriations for fiscal years 2004 to 2008 totaling more than \$7.5 billion and has set aside about \$6.4 billion of this amount for compact assistance. As of March 2008, MCC had obligated \$2.98 billion for 11 compacts that had entered into force and had committed an additional \$2.55 billion for 5 signed compacts, leaving a balance of about \$858 million available for compact assistance (see table 1). The President has requested \$2.225 billion for MCC in 2009, of which the corporation plans to use \$1.88 billion for compact assistance.

⁵The disbursement agreement sets out the conditions for disbursements from MCC and reimbursements by the country's accountable entity to any person or entity. These conditions include performance targets for the projects outlined in the compact. Procurement agreements set forth guidelines for all procurements of goods, works, and services financed with MCC funding.

Table 1: Actual and Requested MCC Funding, 2004 to 2009, as of March 2008

Dollars in millions	2004 to 2008 (actual)	2009 (requested)	Total
Appropriations	\$7,529	\$2,225	\$9,754
Less threshold program ^a	(601)	(150)	(751)
Less administrative	(288)	(100)	(388)
Less due diligence	(138)	(55)	(193)
Less 609 (g) ^b	(100)	(35)	(135)
Less USAID IG ^c	(11)	(5)	(16)
Total available for compact assistance	\$6,391	\$1,880	\$8,271
Obligations for compact assistance (11 compacts)	(2,983)	--	(2,983)
Committed for compact assistance (5 compacts)	(2,550)	--	(2,550)
Balance available for compact assistance	\$858	\$1,880	\$2,738

Source: GAO analysis of MCC data.

^a The MCC threshold program is designed to assist countries that have not yet qualified for compact assistance but have demonstrated a significant commitment to improve their performance on MCC's eligibility criteria.

^b 609(g) refers to funds paid by MCC under the authority given it by section 609(g) of the Millennium Challenge Act of 2003 to make grants to facilitate the development and implementation of compacts. If certain conditions are met, MCC may fund an eligible country's request for "management support payments" for salaries, rent, and equipment for the country's technical team prior to compact signature.

^c USAID IG refers to the U.S. Agency for International Development Office of Inspector General.

Currently Eligible Countries Are in the Early Phases of Compact Development, and the Average Pace of Compact Development Has Slowed

All 10 currently eligible countries without signed compacts are in the initial phases of compact development. The average pace of compact development has slowed as the 16 countries with signed compacts have progressed through the process, and it may slow further as the remaining eligible countries complete compact development.

Eligible Countries Are in the Initial Phases of Compact Development

Of the 10 currently eligible countries without signed compacts, 8 are under active consideration⁶ and all 8 are in the first two phases of compact development.

- Five countries—Jordan, Malawi, Moldova, the Philippines, and Ukraine—are in the first (proposal development) phase of the compact development process. Of these countries, only Moldova has submitted a proposal for compact assistance to MCC.⁷
- Senegal had previously submitted compact proposals and progressed to the second (due diligence) phase, but MCC officials expect the country to submit a new proposal; thus, it will return to the first (proposal development) phase.
- The remaining two countries—Burkina Faso and Namibia—have submitted proposals and are currently in the second (due diligence) phase.⁸

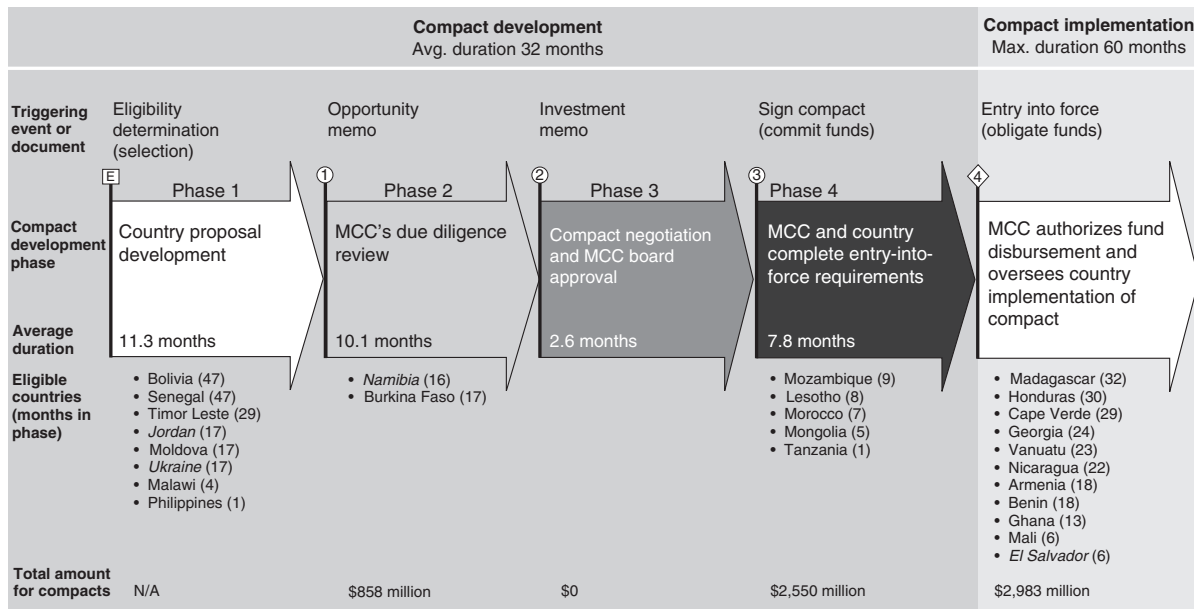
⁶MCC is monitoring political developments in Bolivia and Timor-Leste.

⁷Moldova submitted a proposal for \$518 million in compact assistance on February 28, 2008.

⁸MCC projects that Burkina Faso and Namibia will advance to the third phase of compact development (compact negotiation and MCC board approval) by the end of April 2008.

Figure 1 summarizes the status of compact development for the countries selected as eligible for compact assistance.

Figure 1: MCC Compact Development and Implementation, as of March 31, 2008



Source: GAO analysis of MCC data.

Notes:

Average duration reflects the months that the 16 countries with signed compacts spent in each phase of compact development.

The opportunity memo is MCC's preliminary assessment of the country's proposal and is submitted to the MCC investment committee. If the memo is approved, MCC launches into a detailed due diligence review of the proposal.

The investment memo contains MCC's findings from its due diligence review of the country's proposal and recommendations to the MCC investment committee on compact funding.

Italicized countries were selected as low-middle-income countries (based on per capita income). Armenia, Cape Verde, and Morocco were selected as low-income countries but are now classified as low-middle-income countries.

MCC is monitoring political developments in Bolivia and Timor-Leste.

Average Time Required for Compact Development Has Increased

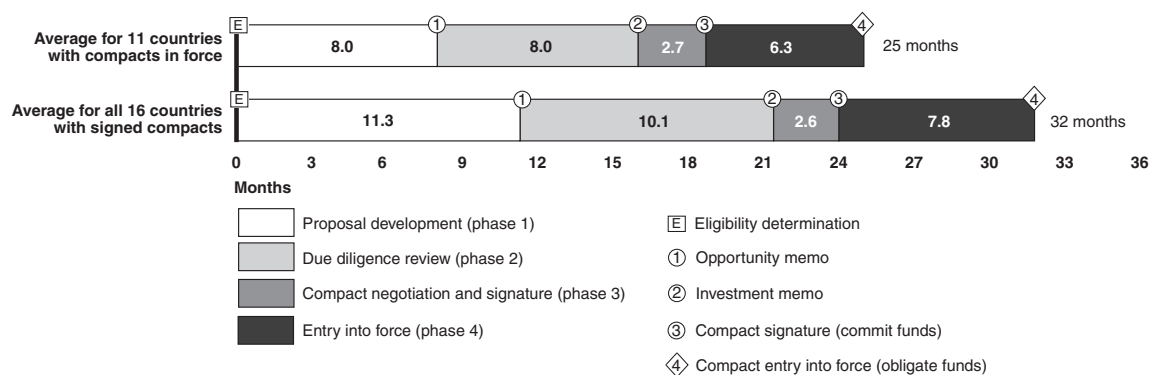
The average pace of compact development—the length of time from a country's selection as eligible to its compact's entry into force—has slowed substantially since MCC selected the first countries in 2004.

- The first 11 countries to sign compacts took an average of 19 months to complete the first three phases of compact development. In contrast, the next 5 countries to sign compacts took an average of 36 months to complete the first three phases.

- The first 11 countries to sign compacts took an average of about 6 months to complete phase 4 of compact development. Assuming the next 5 countries' compacts enter into force by the end of 2008, as MCC now projects,⁹ these countries will complete phase 4 in an average of about 11 months.
- The first 11 countries to sign compacts completed the four phases of compact development in an average of 25 months. Assuming the next 5 countries' compacts enter into force as MCC projects, the average length of time required for all 16 countries with signed compacts to complete compact development would be about 32 months.

Figure 2 compares the average pace of compact development for the first 11 countries to sign compacts with the estimated average pace for all 16 countries with signed compacts (assuming the last 5 compacts enter into force as MCC projects).

Figure 2: Average Number of Months to Complete Compact Development



Source: GAO analysis of MCC data.

Pace of Compact Development Could Slow Further

The average pace of compact development could slow further as the 10 countries without signed compacts move through the four phases. First, as figure 1 shows, 8 of these countries have remained in the first two phases of compact development substantially longer than the average for the 16 countries with signed compacts.¹⁰ Second, the average time required to complete the final phase of compact development likely will continue to increase. For example, whereas the first 11 compacts entered into force an average of 6 months after signature, MCC estimates that subsequent compacts will enter into force 6 to 18 months after signature. MCC officials plan to use these additional months to better prepare for project implementation and disbursement of

⁹In February 2008, the MCC Chief Executive Officer told the House Appropriations Subcommittee on State, Foreign Operations, and Related Programs that the corporation expected the five compacts would enter into force in autumn 2008. MCC's 2009 budget justification had projected these compacts would enter into force during the spring and summer of 2008.

¹⁰The MCC Board selected Malawi and the Philippines as newly eligible in December 2007 and March 2008, respectively.

compact assistance. To support these efforts, MCC plans to increase the use of compact implementation funding during the period between compact signature and entry into force.¹¹ MCC estimates that future compact development will take an average of 36 months from eligibility selection to entry into force.

MCC officials attribute the slowing pace of compact development to four primary factors:

- **Number of countries selected.** MCC's Board of Directors selected 16 countries as eligible for compact assistance in the corporation's first year of operations. MCC officials focused the corporation's resources on countries most prepared to move through compact development.
- **Increased compact size.** Compact development for larger, recent compacts has required more time and effort, particularly in phases 1 and 2. The average compact size for the first 11 compacts is \$271 million; the average size for the most recent 5 compacts is \$510 million.
- **Country capacity constraints.** MCC reports that country capacity affects the length of compact development, particularly in phase 1, and those countries with lower capacity generally have taken considerably longer to complete proposals that support opportunity memos. In this regard, MCC noted that the overall pace of compact development is more heavily dependent on the country's capacity and the quality of its proposal than on MCC.
- **Expanded compact development.** Reflecting lessons learned from the first 11 compacts, MCC plans to engage countries earlier and invest more time and effort in compact development to improve countries' implementation capacity before compacts enter into force.

MCC Could Fully Obligate Its Existing Appropriations by the End of 2009 and Its Requested Appropriations by Late 2010, at the Earliest

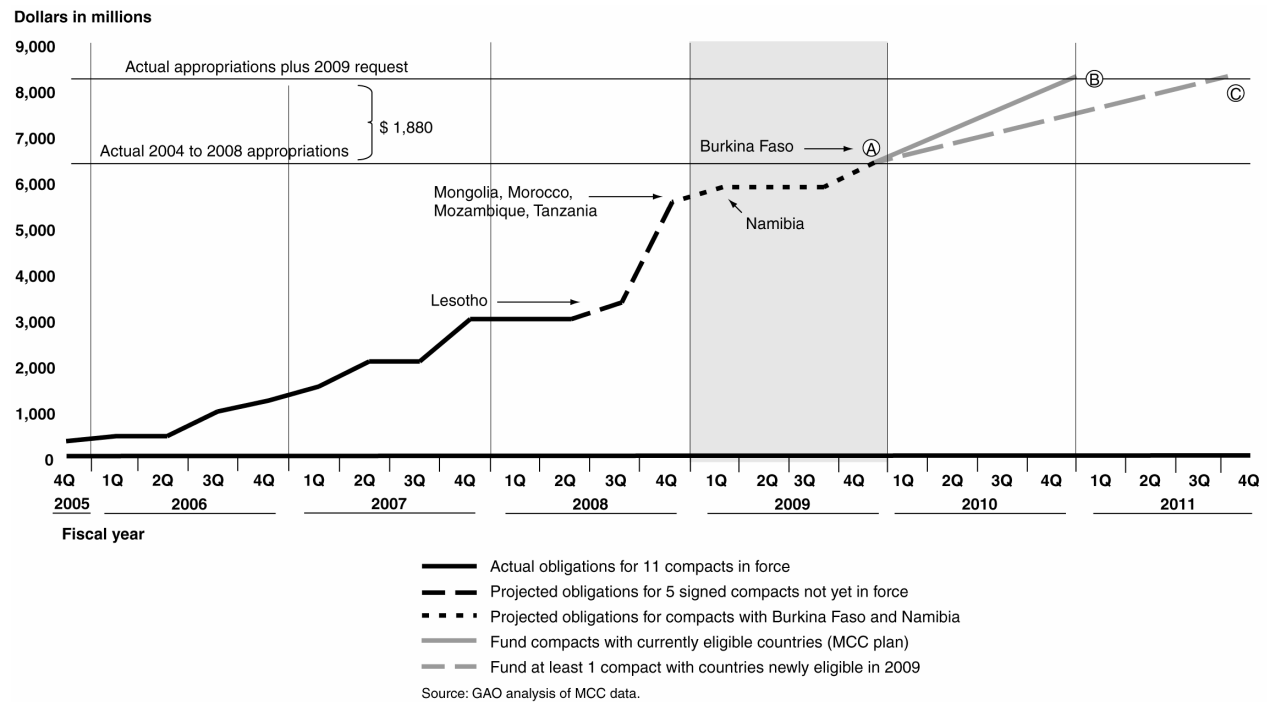
Based on MCC projections, the corporation could commit the balance of its remaining 2004 to 2008 appropriations by the end of 2008 and obligate these funds by the fourth quarter of 2009. Similarly, given MCC's projected amount and observed pace of compact awards, and assuming that MCC funds compacts with only the currently eligible countries, we estimate that MCC could commit and obligate the President's entire \$1.88 billion 2009 request for compact assistance during 2010. However, if the pace of compact development slows or MCC funds compacts with countries newly eligible in 2009, we project that it would not obligate all of the requested 2009 appropriation until late 2011.

¹¹MCC employs these funds under the authority granted in the Millennium Challenge Act for compact development funds and includes the funds in the stated compact amount. Section 609(g) of the Act provides that MCC may enter into contracts or make grants to eligible countries for the purpose of facilitating the development and implementation of compacts. The 2008 House Appropriations Committee Report (110-197) expressed some concerns that eligible countries may be misinterpreting MCC's authority under section 609(g) and directed MCC to provide guidance to countries on that authority.

MCC Could Obligate the Balance of Existing 2004 to 2008 Appropriations by the End of 2009

At MCC’s projected amount and observed pace of compact awards, we estimate that MCC could commit the balance of its remaining 2004 to 2008 appropriations by the end of 2008 and obligate these funds by the fourth quarter of 2009. Figure 3 shows MCC’s obligations for compact assistance to date and summarizes the results of our assessment of how quickly MCC could obligate the balance of its remaining 2004 to 2008 appropriations and requested 2009 appropriations.

Figure 3: Actual and Estimated MCC Obligations for Compact Assistance, 2004 to 2009



Notes:

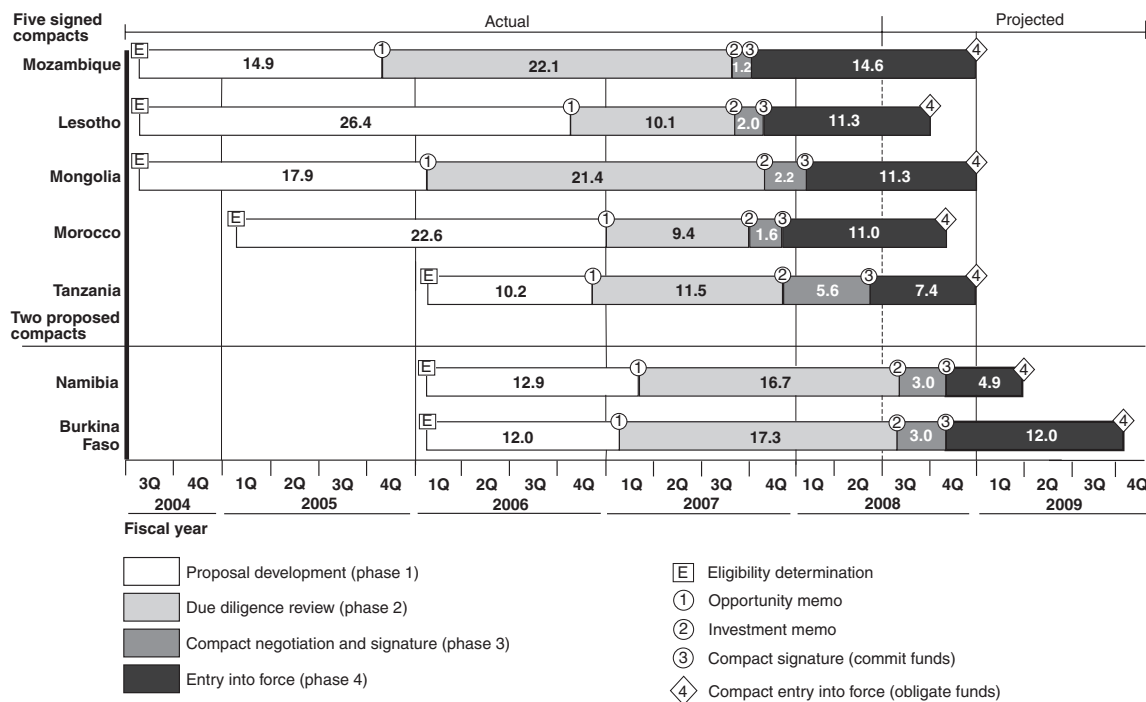
- (A) MCC obligates the balance of its 2004 to 2008 appropriations, assuming compacts with Lesotho, Mongolia, Morocco, Mozambique, Tanzania, Namibia, and Burkina Faso enter into force by the end of 2009 as projected.
- (B) MCC obligates all of its requested 2009 appropriations (\$1.88 billion), assuming the corporation funds compacts with currently eligible countries and compact development proceeds at an average pace.
- (C) MCC obligates all of its requested 2009 appropriations (\$1.88 billion), assuming the corporation funds at least one compact with a country newly eligible in 2009 and compact development proceeds at an average pace.

- As figure 3 shows, MCC plans to obligate the \$2.55 billion it has committed for the five signed compacts with Lesotho, Mongolia, Morocco, Mozambique, and Tanzania when these compacts enter into force by the end of 2008.
- MCC plans to use the \$858 million balance available for compact assistance to fund new compacts with Burkina Faso and Namibia. MCC plans to sign compacts with these two countries and commit the balance of its existing appropriations by the end

of 2008.¹² Assuming that these countries proceed to entry into force as MCC projects, it could obligate these funds by the fourth quarter of 2009.

Figure 4 shows the actual and projected pace of compact development—and the actual and projected commitment and obligation dates—for the five countries with signed compacts not yet in force and for the two projected new compacts with Burkina Faso and Namibia.

Figure 4: Actual and Projected Compact Development for 2004 to 2008 Appropriations



Source: GAO analysis of MCC data.

MCC Could Obligate All of Its Requested 2009 Appropriations by Late 2010, at the Earliest

The President requested \$2.225 billion for MCC in 2009, of which MCC plans to use \$1.88 billion to fund compacts with up to five of the countries that are currently eligible for MCC assistance. At MCC’s projected amount and observed pace of compact awards, and assuming MCC funds compacts with only the currently eligible countries, we estimate that MCC could commit all of its 2009 request for compact assistance by the first quarter of 2010 and obligate all of these funds by the fourth quarter of 2010, at the earliest. Our projection assumes that MCC signs compacts with four countries currently

¹²MCC’s plans to sign compacts with Burkina Faso and Namibia by the end of 2008 are consistent with projections based on the current pace of compact development.

in phase 1 of compact development—Jordan, Malawi, Moldova, and Senegal.¹³ Signing compacts with four countries implies an average compact size of \$470 million.

Several Factors Could Lengthen Projected Time Frames to Obligate Entire 2009 Request

Several factors could lengthen the projected time frames for MCC to obligate the President's entire 2009 request:

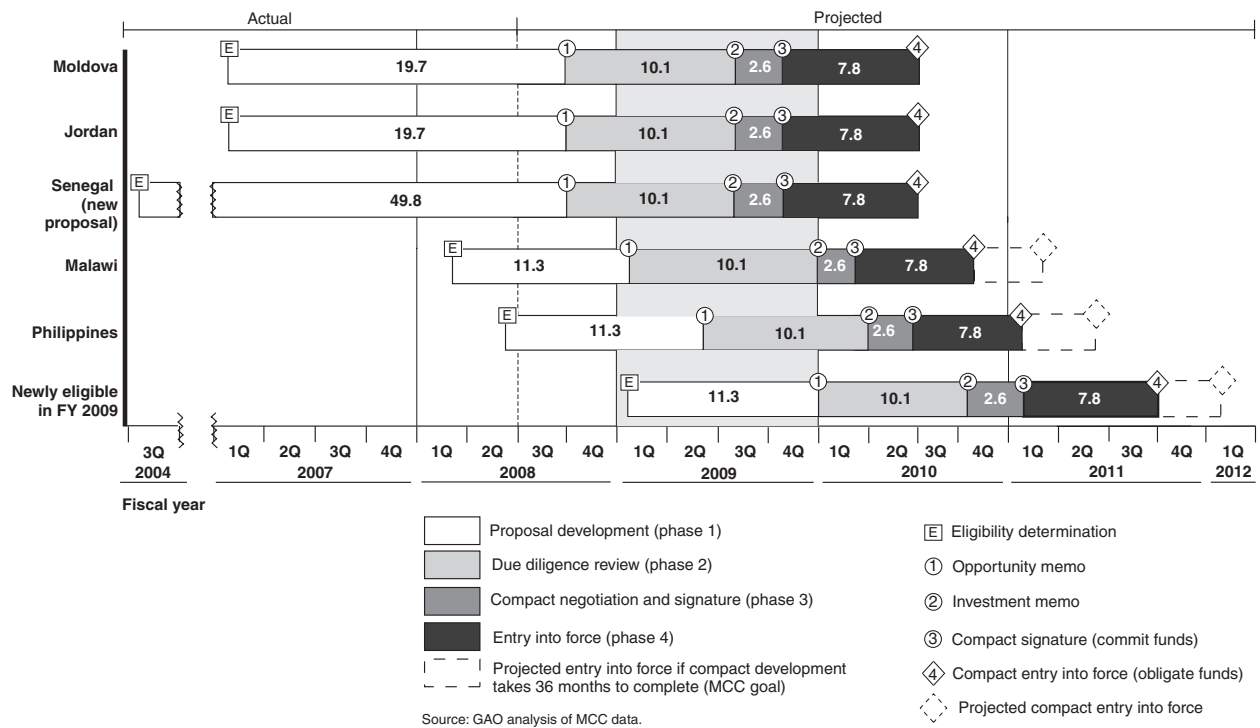
- First, as of the end of March 2008, only one of the countries currently in phase 1 of compact development had submitted a compact proposal.¹⁴ Our estimate that MCC will fully commit and obligate its 2009 request during 2010 assumes that an additional three countries will submit proposals by November 2008, and proceed through each phase at the average pace for the remainder of compact development. Delays in submitting proposals would extend the time frames.
- Second, at the current pace of compact development, if MCC uses its 2009 appropriations to fund a compact with the Philippines, we project that the corporation could commit all of its funds by the second quarter of 2010 and obligate all of its funds by the first quarter of 2011. MCC's Board of Directors selected the Philippines as newly eligible for compact assistance in March 2008.
- Third, at the current pace of compact development, if MCC uses its 2009 appropriations to fund at least one compact with a country newly eligible in 2009, we project that the corporation could commit all of its 2009 request in the first quarter of 2011 and obligate all of these funds by the end of the third quarter of 2011. MCC plans to select eligible countries for 2009 in November or December 2008.
- Fourth, all of these estimates assume that countries complete compact development at the average pace observed to date (32 months). However, if countries take an average of 36 months to complete compact development (as MCC currently projects), MCC would obligate all of its 2009 request about one fiscal quarter later.

Figure 5 shows the actual and projected pace of compact development—and the projected commitment and obligation dates—for five currently eligible countries and a country newly eligible for compact assistance for 2009.

¹³Because Jordan and Ukraine are low-middle-income countries and, therefore, limited by the Millennium Challenge Act to no more than 25 percent of total available compact assistance, MCC is more likely to sign a compact using 2009 funds with only one of these countries. According to MCC officials, Jordan is more actively engaged in proposal development. As previously discussed, MCC is monitoring political developments in Bolivia and Timor-Leste.

¹⁴As previously discussed, Moldova submitted a proposal for \$518 million in compact assistance on February 28, 2008.

Figure 5: Actual and Projected Compact Development for 2009 Appropriations



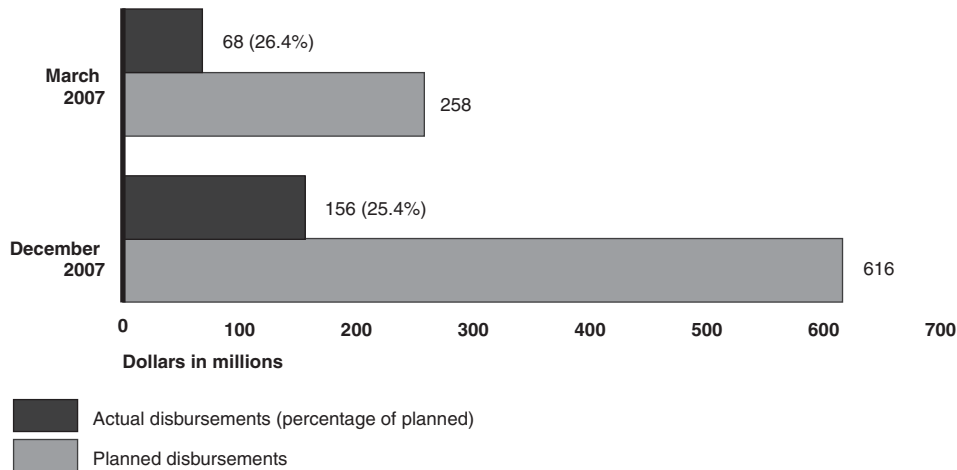
Actual Disbursements Substantially Lag Behind Planned Disbursements

MCC’s actual disbursements (outlays) substantially lag behind planned disbursements for all 11 countries with compacts in force. The slow rate of disbursements is most critical for Madagascar, Cape Verde, and Honduras, which are in the third year of compact implementation. Unless the pace of disbursements for these countries increases significantly, MCC could have significant obligated, but undisbursed, balances when the compacts expire and may not be able to fully achieve compact goals for economic growth and poverty reduction.

Overall, as of December 2007, MCC’s actual disbursements are about 25 percent of planned disbursements.¹⁵ As figure 6 shows, over the last 9 months, MCC’s disbursements have risen from \$68 million to \$156 million. However, actual disbursements as a percentage of planned disbursements remain essentially unchanged.

¹⁵Planned disbursements refer to the disbursement schedule published in the signed compacts. MCC develops these schedules prior to the signing of each compact. As such, its estimates are based either on the project’s prefeasibility study, feasibility study, or design documents, depending on the status of project development at the time the compact is signed.

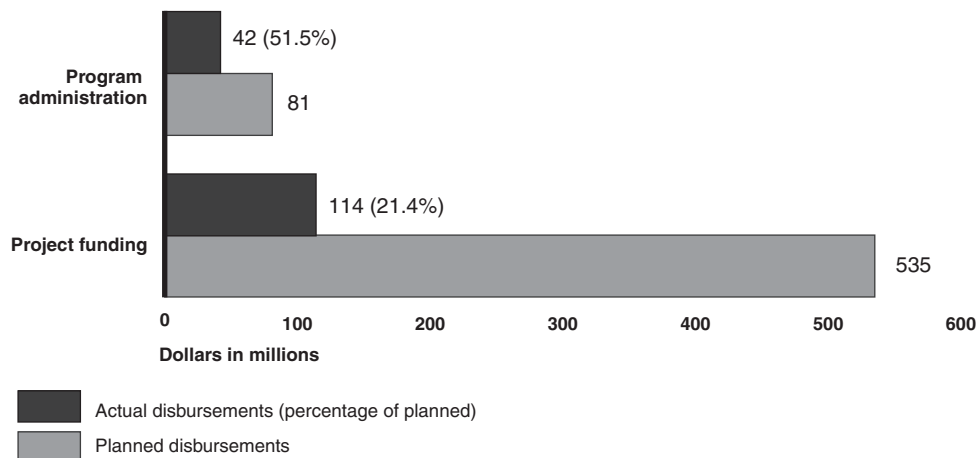
Figure 6: Comparison of MCC's Total Actual and Planned Disbursements for Compact Assistance, as of March 31 and December 31, 2007



Source: GAO analysis of MCC disbursement data.

Figure 7 illustrates that actual disbursements for program administration, monitoring, and evaluation are roughly half of planned disbursements, whereas actual disbursements for project funding are about 21 percent of planned disbursements.

Figure 7: Actual and Planned Disbursements by Program Administration and Projects, as of December 31, 2007

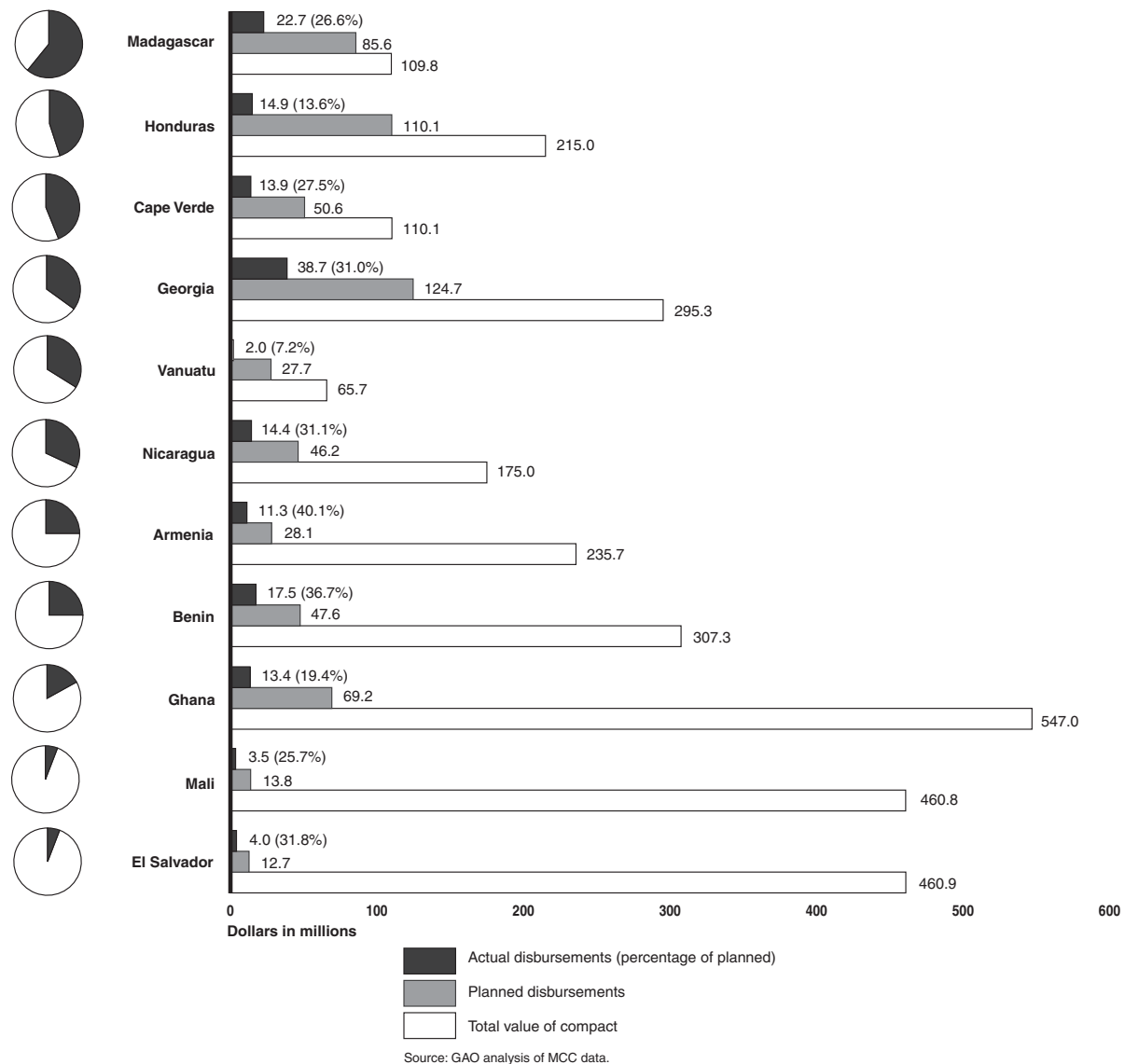


Source: GAO analysis of MCC disbursement data.

Further, MCC has not met its planned rate of compact disbursements for any of the 11 compacts currently in force (see fig. 8). The lag is of greatest concern for Madagascar, Honduras, and Cape Verde, which are in the third year of compact implementation. Given the shorter amount of time left in the compacts with these three countries, actual disbursements as a percentage of total and planned disbursements are critical. For

example, as of December 2007, MCC was 29 months (61 percent) into the 48-month Madagascar compact but had disbursed only \$22.7 million (21 percent) of the \$109.8 million compact. MCC planned to have disbursed \$85.6 million by this date. MCC's signed compacts contain language providing that when a compact expires or is terminated, any funding not disbursed by MCC is automatically released from an obligation in connection with that compact.

Figure 8: Elapsed Time, Actual and Planned Compact Disbursements, and Total Compact Size for the 11 MCC Compacts in Force, as of December 31, 2007



According to MCC officials, actual disbursements are significantly less than what MCC had projected at the time of compact signing because initial compact disbursement plans underestimated the time required for compact countries to establish the structures, agreements, and capabilities to begin implementing compact projects. As a result,

compact implementation has proceeded at a slower pace than MCC anticipated, and actual disbursements lag behind initial disbursement projections.

MCC has set a goal to improve its overall rate of actual disbursements to about 42 percent of planned disbursements by the end of 2008¹⁶ and reports that it has taken several steps to meet this goal. First, the corporation's 2009 budget justification states that it restructured in late 2007 to enhance its ability to monitor and support compact implementation. As part of this restructuring, MCC officials told us that they had established an internal team to review each compact project and identify the steps that need to be taken to complete the project by the end of the compact term. Second, in an effort to identify potential delays and problems in project implementation early on, MCC officials told us that the corporation now requires compact countries to submit quarterly reports that project detailed disbursements over the next four quarters. Finally, as previously discussed, MCC officials told us that they plan to lengthen phase 4 (the period between compact signature and entry into force) to give countries more time to establish the structures and agreements needed to begin implementing compact projects.

Agency Comments and Our Evaluation

MCC provided written and oral comments on a draft of this report; the corporation's written comments and our evaluation are reprinted in enclosure II. MCC also provided additional information on the compact development process, commitment and obligation of existing and requested compact assistance, and disbursement rates for compact assistance, which we have incorporated, as appropriate. In its comments, MCC generally agreed with our factual analysis but disagreed with some of our report's emphasis and conclusions.

- **Compact development.** MCC concurred with our analysis that the length of time required for compact development has increased and attributed this increase to four primary factors. We have incorporated a discussion of these factors in the report, as appropriate. MCC also said that the statutory restriction that MCC have no more than one compact with a country at a time contributes to the length of the compact development process. In addition, MCC noted that it has adopted a goal of completing the compact development process in an average of 36 months and reported that it is implementing several changes to the process to achieve this objective.
- **Commitment and obligations.** In its comments, MCC does not disagree with our factual analysis but states that "by focusing primarily on obligations, this report underemphasizes the essential link between available appropriations and signing new compacts." We disagree with MCC's assertion. Our report projects the timing of both the commitment and obligation of funds. For example, figures 4 and 5, which present our projections for individual countries, clearly show both the projected timing of compact signature (commitment of funds) and compact entry into force (obligation of funds). MCC also stated that it plans to sign four compacts in 2009, committing all \$1.88 billion requested for compact assistance for 2009 by the end of that fiscal year.

¹⁶MCC reports that it plans to disburse \$450 million by the end of 2008, which is about 42 percent of the disbursements it had planned to make by that time. See Millennium Challenge Corporation, *Budget Justification 2009* (Washington, D.C., February 2008), page 12.

This is earlier than our analysis suggests, based on the average pace of compact development. To achieve MCC's objective, at least one country will have to progress from eligibility to compact signature in less time than the current average of about 24 months.

MCC also characterized one scenario in our analysis (under which the corporation used its 2009 appropriation to fund at least one compact with a country newly eligible in 2009) as "worst case." We maintain it is reasonable to consider an alternative scenario where MCC is unable to complete compact development with up to five of the countries that are currently eligible, as stated in its 2009 budget justification. As MCC officials have noted, the overall pace of compact development is more heavily dependent on a country's capacity and the quality of its proposal than on MCC.

- **Disbursements.** MCC concurred with our analysis that actual disbursements lag behind original disbursement projections. MCC reported that it revised its disbursement projections based on updated cost and schedule information and is taking several steps to improve disbursement rates in order to fully expend all obligations in the compact time remaining.

We are sending copies of this report to interested congressional committees. We will also make copies available to others upon request. In addition the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions or wish to discuss this material further, please contact me at (202) 512-3149 or gootnickd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Emil Friberg, Jr., Michael Rohrback, Jordan Holt, and Jeremy Sebest made significant contributions to this report.



David Gootnick
Director, International Affairs and Trade

Enclosures (2)

Enclosure I: Objectives, Scope, and Methodology

This report assesses (1) the current status and pace of compact development, (2) projected time frames for the commitment and obligation of the Millennium Challenge Corporation's existing (2004 to 2008) and requested (2009) appropriations, and (3) MCC's progress in disbursing compact assistance. To address these objectives, we analyzed MCC's budget justifications and other corporation records for 2004 to 2009 and obtained the views of MCC officials.

- Status and pace of compact development.** We reviewed MCC budget justifications, country status reports, and other agency records to identify the current status of eligible countries and the dates that they reached the following key compact development milestones: first notification of eligibility, issuance of the opportunity memo, issuance of the investment memo, compact signature, and compact entry into force. To determine the average pace for each phase of compact development, we calculated the time elapsed between the relevant milestones for the 16 countries with signed compacts (see table 2).

Table 2: Months to Complete Compact Development Phases for the 16 Countries with Signed Compacts

Eligible country^a	Months to complete proposal development Time elapsed between selection as eligible and opportunity memo	Months to complete due diligence review Time elapsed between opportunity and investment memos	Months to complete compact negotiation and signature Time elapsed between investment memo and compact signature	Months to complete entry into force Time elapsed between compact signature and entry into force	Total months to complete compact development Time elapsed between selection as eligible and compact entry into force
Madagascar	5.1	2.3	4	3.3	14.7
Honduras	3.8	7.5	1.9	3.5	16.8
Cape Verde	5.4	7.2	1.3	3.4	17.4
Georgia	5.7	8.1	2.4	6.8	23
Vanuatu	12.6	5.3	3.9	1.9	23.7
Nicaragua	5.7	6.9	1.6	10.4	24.6
Armenia	12.4	6	4.3	6.1	28.8
Benin	8.7	9.7	3.2	7.4	29
Ghana	8	17.5	1.3	6.5	33.4
Mali	14	13.8	2.4	10.1	40.4
El Salvador	6.3	3.4	3	9.7	22.4
Average for 11 countries with compacts in force	8	8	2.7	6.3	24.9

Lesotho	26.4	10.1	2	11.3 ^b	49.8
Morocco	22.6	9.4	1.6	11 ^b	44.7
Mongolia	17.9	21.4	2.2	11.3 ^b	52.8
Mozambique	14.9	22.1	1.2	14.6 ^b	52.8
Tanzania	10.2	11.5	5.6	7.4 ^b	34.7
Average for 16 countries with signed compacts	11.3	10.1	2.6	7.8	31.8

Source: GAO analysis of MCC data.

^a Countries are listed by the dates that their compacts entered into force.

^b MCC projects the Lesotho, Mongolia, Morocco, Mozambique, and Tanzania compacts will enter into force by the end of 2008.

- Commitment and obligation of existing and requested appropriations.** We reviewed and analyzed MCC's 2009 and prior budget justifications and interviewed agency officials to identify MCC's plans for committing and obligating existing and requested appropriations. For the five countries with signed compacts that have not entered into force, we used MCC's most recent projected entry-into-force dates. MCC's plans to sign compacts with Burkina Faso and Namibia by the end of 2008 are consistent with our projections based on the average time it has taken countries to complete compact negotiation to date. The projections we present for Burkina Faso and Namibia are provided by MCC and assume that both countries enter the compact negotiation phase by the end of April 2008. We projected when MCC could commit and obligate requested 2009 appropriations under two scenarios: (1) MCC uses the monies to fund compacts with currently eligible countries according to the plan stated in its 2009 budget presentation, which was confirmed during interviews; or (2) MCC uses the monies to fund compacts with at least one country that it selects as newly eligible in 2009. We assumed that both the currently eligible countries and those that would be newly eligible in 2009 would complete compact development phases at the average pace for the 16 countries with signed compacts. For the three countries that had already been in the proposal development phase for longer than average (Moldova, Jordan, and Senegal), we assumed that they entered the second phase of compact development (due diligence) by November 2008 and proceeded through the remaining phases of compact development at the average pace to date.
- Progress in disbursing compact assistance.** To determine the extent to which MCC met its planned disbursement schedule, we compared MCC's actual and planned disbursements from July 2005 through December 2007 for the 11 countries with compacts in force. For data on planned disbursements, we used the disbursement schedules published in the compact documents. For data on actual disbursements, we used MCC's disbursement data, as of March 31 and December 31, 2007. We determined that MCC's disbursement data were sufficiently reliable for our purposes based on discussions with MCC officials and our review of U.S. Agency for International Development Inspector General audits of MCC's internal controls and 2007 financial statements. In our analysis of planned and actual expenditures, we used MCC's assumption that compact funds are disbursed evenly throughout the

compact implementation year. In practice, however, MCC approves disbursements on a quarterly basis and disburses compact funds in monthly payments according to the terms of the quarterly approval.¹⁷ Because the 11 compacts are at different points in their implementation, we prorated planned disbursements on an annual basis for each country based on the date the compact entered into force. In developing our estimates, we included actual disbursed amounts classified by MCC as “pending subsequent report” as project funding. We discussed the pace of compact assistance disbursements with MCC officials; however, we did not assess MCC’s plans for improving compact assistance disbursement rates.

We conducted this performance audit from January to April 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform our work to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

¹⁷According to agency officials, MCC is in the process of shifting to the Department of the Treasury’s international payment system, whereby vendors submit invoices directly to the Treasury for payment. Once MCC has fully implemented this new system, it will no longer disburse monthly payments of compact funds directly to MCC country entities.

Enclosure II: Comments from the Millennium Challenge Corporation



**MILLENNIUM
CHALLENGE
CORPORATION**
REDUCING POVERTY THROUGH GROWTH

April 7, 2008

Mr. David B. Gootnick
Director, International Affairs and Trade
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Gootnick:

Thank you for the opportunity to provide comments on the GAO report entitled “Millennium Challenge Corporation: Analysis of Compact Development and Future Obligations and Current Disbursements of Compact Assistance.” MCC appreciates GAO’s inclusion of key factors affecting compact development, but we disagree with some of the report’s emphases and conclusions. In particular, MCC would highlight the essential link between available appropriations and signing new compacts. We address report issues below.

Statutory Background

MCC’s statute requires that a country have no more than one compact at a time. This requirement contributes to the length of the compact development process analyzed by GAO in this report. Removing this statutory restriction would expedite compact development because typical country proposals include multiple projects at different stages of preparedness. Thus, amending current law to permit MCC to enter into more than one compact at a time with a single country would help MCC’s planning, programming, and disbursements.

See
comment 1.

Time Required for Compact Development

As GAO has pointed out, the time required for compact development, the period from eligibility notification to a compact’s entry into force (EIF), has lengthened from the earliest 11 compacts to the most recent five compacts. There are four primary drivers of this lengthening:

See
comment 2.

Number of Countries Initially Selected: MCC’s Board of Directors selected 16 countries as eligible for compact assistance in May 2004, and a 17th country in November of that year. MCC focused our limited resources on the ten countries from that group most prepared to move quickly on compact development. As we now complete the final phase of compact development for an additional four of those original 17 selectees (Lesotho, Mongolia, Morocco, and Mozambique), we know they are not representative of the time required for the four phases of developing a compact.

See
comment 3.

Country Capacity Constraints: Country capacity constraints directly affect the length of the first phase for country proposal development. After being selected as eligible, a country develops and submits its proposal with the guidance and support of MCC staff. MCC provides comprehensive guidance and offers assistance to countries, but we do not impose deadlines. Countries with lower capacity generally take considerably more time to complete proposals meeting the standards to support opportunity memos. MCC's adherence to the principle of country ownership means that we will not rush our country counterparts in developing compacts and will only sign compacts that meet the required standards.

Larger Compacts: More recently, MCC has intentionally signed larger compacts, which require more effort at each phase, particularly for phases 1 and 2. The average compact size for the first 11 compacts was \$270 million. The average for the most recent five exceeds \$500 million. MCC projects the average compact size for upcoming compacts will exceed \$400 million.

Incorporation of Lessons Learned: MCC has incorporated lessons learned from the first 11 compacts to engage countries earlier and invest more time and effort to improve compact development and ensure implementation capacity before EIF.

MCC Commitments and Obligations

A critical MCC requirement for new compact development is having sufficient appropriations at the point of compact signature to commit the full compact amount.

GAO notes that MCC commits the entire amount for each compact at signing, but by focusing primarily on obligations, this report underemphasizes the essential link between available appropriations and signing new compacts. Congress deliberately instituted the requirement for the up-front commitment of the entire amount of MCC funding for the full compact term, a key reform of U.S. development assistance meant to provide certainty for countries that make considerable efforts in policy reform and compact implementation. Failure to provide full funding at signing may lead to shorter-term, less effective projects and result in higher costs as contractors increase bids to reflect new levels of uncertainty about MCC's ability to fund long-term contracts.

MCC is confident we will commit the balance of FY 2004 – 2008 appropriations in FY 2008 and the FY 2009 appropriations by the end of FY 2009. GAO's analysis points out that compacts with Burkina Faso and Namibia, expected to be signed in FY 2008, will consume all appropriations now available for compact assistance. MCC will not have any remaining appropriations with which to sign additional compacts until FY 2009.

MCC obligates a portion of the amount committed at compact signing, called "compact implementation funding," which we disburse during the period between compact signing and EIF. When a compact enters into force, MCC obligates and disburses the remaining amount over the five years of the compact. Again, GAO's analysis considers the timeframe in which MCC may obligate its funding but does not sufficiently emphasize that MCC must have the appropriations available at the time of signing for commitment.

See
comment 4.

See
comment 5.

MCC strongly disagrees with GAO's estimate that MCC will not commit FY 2009 appropriations until FY 2010. MCC plans to commit, and begin obligating, 2009 appropriations in 2009.

We expect to sign four compacts in FY 2009, which will commit the entire \$1.8 billion of the President's request for compacts, with an average compact size exceeding \$450 million. MCC expects these compacts to enter into force by FY 2010, thereby obligating all remaining FY 2009 funds. The GAO assertion that MCC might not commit our FY 2009 requested funding until the first quarter of FY 2011 is a worst-case scenario that does not reflect the compact development work already underway. MCC is already working with four eligible countries on developing compacts for FY 2009 funding (Jordan, Moldova, Senegal and Malawi) and has already launched planning work with two others (Philippines and East Timor). Any four of these six countries would fully utilize the requested level of FY 2009 funding. Moreover, in some of these, we would expect to begin obligating compact implementation funding *during* FY 2009. Reductions in appropriations below the President's request would lengthen the compact development process by forcing MCC to postpone signing a portion of these compacts.

MCC Disbursement Rates

MCC concurs that actual compact disbursements are behind the original projected disbursements included in the multi-year financial plans for the first 11 compacts. As GAO's analysis notes, it took longer than initially projected to create host country entities and establish the necessary capabilities to begin full implementation. These structures are essential to performing MCC's fiduciary responsibilities and ensuring results and accountability for compact funds. MCC now begins these processes earlier and invests more effort in the compact development process at each of the four phases. These efforts will lengthen the compact development timeline as compared with the original 11 compacts, but they should yield more predictable disbursement rates for subsequent compacts and help ensure U.S. taxpayer funds are well spent.

A multi-year financial plan included in a compact is a preliminary budget based upon the due diligence work done by MCC in the compact development process. As additional information becomes available regarding project cost and timelines leading up to EIF and beyond, MCC revises its disbursement projections. MCC recently completed an internal review of disbursement projections for FY 2008 that was reviewed with MCC's Board of Directors, and submitted to Congress on January 25th. These revisions update the multi-year financial plans and reflect the on-the-ground reality in our existing countries. MCC will continue to update disbursement projections routinely as part of MCC's regular reviews of portfolio work plans and contract schedules.

MCC's internal review reveals lower disbursements in the early years and increased disbursements in later years, yielding an S curve rather than a bell curve. This is consistent with the industry standard for infrastructure projects. MCC implementation teams are committed to full expenditure of all compact dollars in the time remaining under each of our compacts.

Changes in MCC's Compact Development Process

Based on experience to date, MCC is modifying its compact development process to achieve *three objectives*:

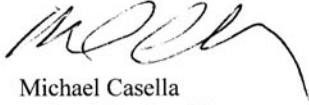
- 1) *Target an overall timeframe* from eligibility selection to EIF of 36 months;
- 2) *Enhance the quality* of compact proposals, in terms of the technical and economic soundness, while ensuring greater cost certainty; and
- 3) *Accelerate compact implementation by completing more preparatory work earlier.*

Specific process changes include:

- MCC now provides partner countries clear guidance during initial high-level consultations, based on MCC's experience and requirements, to encourage a sharper focus on a limited number of interventions that can be designed and implemented in reasonable timeframes.
- Once eligible, partner countries now lead a series of analyses to identify the most significant barriers to economic growth in key economic sectors, to guide their internal consultative process and proposal development.
- Partner countries are now developing project concept papers as the basis for early discussions with MCC. These project concepts will provide both an early screening mechanism and an opportunity for MCC to help partners plan for detailed project development.
- MCC will mobilize financial and technical resources to help partner countries develop feasibility studies, environmental impact assessments, framework resettlement plans, preliminary technical designs, and procurement packages, and to recruit fiscal and procurement agents before compact signing. This will ensure greater cost certainty and strengthen overall design, thereby reducing the time between compact signing and EIF.
- Finally, MCC will ensure the partner countries have compact implementation funding after signing to enable commencement of detailed technical designs for the most complex infrastructure projects prior to EIF. MCC will work with the government to: develop implementing entity agreements; finalize detailed implementation plans; develop initial annual budgets; draft terms of reference for procurement; and pre-qualify consultants and contractors for early procurement actions. These early actions will permit smoother implementation upon EIF.

The overall timeframe from eligibility to signing and EIF depends heavily on the capacity of the host country and the quality of its proposal. Efforts to reduce this timeline should be guided by the need to complete environmental and social compliance work, economic and technical feasibility, design, and implementation planning to ensure predictable costs and disbursements. The nature of the proposed investments in a compact also will affect the time needed to complete these preparatory steps.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Casella', with a long, sweeping underline that extends to the right.

Michael Casella
Acting Vice President
Administration and Finance
Millennium Challenge Corporation

Our Evaluation

The following notes provide our evaluation of the specific comments in the Millennium Challenge Corporation's letter.

1. Our analysis reflects MCC's statutory requirement that it have no more than one compact with a country at a time. It was beyond the scope of this report to evaluate this statutory requirement.
2. Our report discusses the factors affecting the length of compact development on page 8.
3. We disagree with MCC's assertion that our report underemphasizes the link between available appropriations and signing new compacts. Our report projects the timing of both the commitment and obligation of funds. For example, figures 4 and 5, which present our projections for individual countries, clearly show both the projected timing of compact signature (commitment of funds) and compact entry into force (obligation of funds). In addition, our report discusses MCC's use of compact implementation funding during the period between compact signature and entry into force on page 8. MCC employs these funds under the authority granted in section 609(g) of the Millennium Challenge Act and includes these funds in the stated compact amount.
4. MCC plans to sign four compacts and commit the entire \$1.88 billion requested for compact assistance for 2009 by the end of that fiscal year. This is earlier than our analysis based on the average pace of compact development suggests. To achieve MCC's objective, at least one country will have to progress from eligibility to compact signature in less time than the current average of about 24 months. Although MCC states that it expects to begin obligating its requested funds during fiscal year 2009, our report projects when MCC would fully obligate *all* of its requested appropriations. MCC states that it expects to obligate all 2009 funds by 2010, as our analysis projects.
5. We maintain it is reasonable to consider a scenario where MCC is unable to complete compact development with four or five of the countries that are currently eligible and uses its 2009 appropriation to fund at least one compact with a country newly eligible in 2009. As MCC officials have noted, the overall pace of compact development is more heavily dependent on a country's capacity and the quality of its proposal than on MCC. In this regard, six of the eight countries have been in the first phase of compact development substantially longer than average, particularly Senegal and Timor-Leste (47 and 29 months, respectively), and only one of the countries in the first phase (Moldova) had submitted a proposal as of the end of March 2008. Moreover, as previously discussed, MCC is monitoring political developments in Bolivia and Timor-Leste, which has recently experienced civil unrest and did not pass MCC's eligibility indicators for 2008, including the control of corruption. Additionally, two of the countries (Malawi and Philippines) are at the very beginning of compact development (they were selected in December 2007 and March 2008, respectively).

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