



USAID
FROM THE AMERICAN PEOPLE

Office of Inspector General

December 1, 2008

The Honorable John J. Danilovich
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

Dear Mr. Ambassador:

The enclosed statement summarizes the Office of Inspector General's (OIG) conclusions on the most serious management and performance challenges facing the Millennium Challenge Corporation (MCC). Our decisions on which challenges to report were based primarily on audit, evaluation, or investigative work we have performed and additional analysis of MCC operations. More challenges may exist in areas that we have not yet reviewed, and other significant findings may result from further work.

The Reports Consolidation Act of 2000 (Public Law 106-531) requires that agency performance and accountability reports include a statement prepared by each agency's inspector general, summarizing the most serious management and performance challenges facing the agency and reporting the agency's progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2008 performance and accountability report.

We have discussed the management and performance challenges summarized in this statement with the responsible MCC officials. If you have any questions or wish to discuss this document further, I would be happy to meet with you.

Sincerely,

/s/

Donald A. Gambatesa
Inspector General

Enclosure

**Office of Inspector General's Statement on the
Millennium Challenge Corporation's
Most Serious Management and
Performance Challenges
Fiscal Year 2008**

The Office of Inspector General (OIG) has determined that the Millennium Challenge Corporation (MCC) faces management and performance challenges in the following areas:

- Financial management
- Information technology management
- Implementation of country compacts

Financial Management

For fiscal year (FY) 2008—the fifth consecutive year—OIG has issued unqualified opinions on MCC's fiscal year financial statements. Notwithstanding these unqualified opinions and the progress that MCC has made in establishing and maintaining financial management processes, MCC's quality control over quarterly and year-end financial reporting is not sufficient to enable the agency to detect errors and misstatements and to make corrections in a timely manner. MCC does not perform detailed quality control reviews over quarterly and year-end MCC trial balances and financial statements submitted for review and audit.

Specifically, MCC lacks sufficient oversight with its service providers—the National Business Center (NBC) and the U.S. Agency for International Development (USAID). NBC provides the majority of MCC's financial management services and all of its financial management systems, including the core financial systems and program feeder systems. USAID administers the Threshold Program on behalf of MCC. This issue was reported and recommendations were made in the OIG Audit Report on MCC's Fiscal Year 2008 Financial Statements.

MCC officials commented that the corporation has made painstaking efforts to mitigate the reporting difficulties with USAID in its capacity as a service provider. During the last fiscal year, MCC has met with USAID on four occasions to discuss, among other issues, the timing of conveyance of its deliverables. MCC will continue its efforts to work with USAID to eliminate this major source of errors and misstatements in financial statements.

In conclusion, MCC officials commented that the corporation will implement measures to improve quality control in accordance with OIG's recommendations.

Information Technology Management

MCC is not in compliance with the Federal Information Security Management Act of 2002 (FISMA). Enacted into law under Title III of Public Law 107-347 on December 17, 2002,

FISMA requires agencies to (1) develop, document, and implement agencywide information security programs to protect their information and information systems, including those provided or managed by another agency, contractor, or other source; (2) obtain an annual independent evaluation of information security programs and practices; and (3) assess compliance with the requirements of the act. MCC's information security program does not meet all of the FISMA requirements. Although MCC is making progress in complying with these requirements, weaknesses remain.

MCC noted that it has put into effect a comprehensive plan to address all of the FY 2008 FISMA audit findings by June 2009. Key components of this plan include:

- *Policy and Procedures.* Foundational information technology (IT) security policies will be completed in November 2008, and procedures associated with account review and control and inventory control will be completed by February 2009. The standard software approval list and procedures for change control are complete.
- *Technology.* MCC completed the transition to Computer Sciences Corporation (CSC) as its new IT service provider in September 2008. CSC has developed a technology refresh program that will deliver, by May 2009, desktops and laptops that are compliant with the Federal Desktop Core Configuration, as well as laptops and other mobile devices that require two-factor authentications and are fully encrypted.
- *General Support System.* MCC's systems security plan and certification and accreditation will be completed by May 2009.
- *IT Security Training Materials.* An IT security training plan, new security training materials, and a training repository will be completed by November 2008.

Implementation of Compacts

As a viable Government corporation, MCC identifies eligible countries and signs compacts and Threshold agreements. However, MCC is experiencing serious management challenges with compact implementation. Two of these challenges are the low rate of disbursements and the increasing costs associated with infrastructure projects.

Low Rate of Disbursements

MCC's actual disbursements lag behind planned disbursements for all 11 countries with compacts in force. In fiscal years (FY) 2005 and 2006, only \$61 million of the \$3 billion in signed compacts had been disbursed, merely 26 percent of the expected disbursements. In FY 2007, MCC almost doubled the amount of disbursements—\$137 million—but this represents only about a quarter of MCC's own disbursement projection. Unless the rates of disbursement increase, MCC may have large unexpended balances and uncompleted projects by the end of the compacts.

Within the precepts of the President's Management Agenda, as of September 30, 2007, MCC had not yet demonstrated significant progress in achieving its long-term performance goals. Because implementation of MCC compacts in developing countries is moving less rapidly than expected, funds are being expended slowly and initial outputs are limited. MCC expects more rapid progress in the near future.

MCC noted that the original compact disbursement projections, made when the compacts were signed and before feasibility studies were completed, have been significantly revised. Cumulative compact disbursements increased by 280 percent, to more than \$350 million in FY 2008, and MCC expects to disburse another \$450–\$550 million in FY 2009 for a cumulative total of \$800–\$900 million. MCC also expects to have 80 percent of the funds for its first five compacts under contract by the end of FY 2009. Only a small number of projects are expected to remain at risk of not being completed. MCC has committed to managing these projects aggressively and will revise projects when necessary or reallocate funds to where they can have greater impact on economic growth and poverty reduction.

MCC has refined the compact development process to provide a better chance of implementing planned compacts. Key components of this process include:

- Asking newly selected countries to develop concept papers for each project they wish to include in their compacts, so that economic returns, technical feasibility, sustainability, and implementation capacity can be analyzed early in the process. Such analysis will help MCC decide which projects to pursue. Conducting full feasibility studies, preliminary environmental and social impact assessments, and other key assessments before compact signature will reduce investment risks such as cost overruns and implementation delays. With the benefit of such preliminary studies, the rate of disbursements should increase once compacts enter into force.
- Working with partner countries to establish entities that will be accountable and to obtain fiscal and procurement agents before a compact is signed. These organizational improvements will facilitate project implementation.

Impact of Increasing Construction Costs on Infrastructure Projects

In its budget justification for 2009, MCC stated reasons for the increased costs related to infrastructure projects. The world is experiencing a construction boom that has caused a rise in costs for construction services and materials (such as oil and steel), and cost estimates are often revised during the project cycle, as project managers refine designs on the basis of technical studies, design upgrades, and enhanced environmental mitigation measures. These factors, combined with fluctuating currency exchange rates, cause MCC partner countries to face higher costs than initially projected for some infrastructure projects.

MCC is working with partner countries to meet these challenges. Specifically, MCC has:

- Revised the scope of some of the projects so that available resources are focused on those projects or project components that have the greatest economic rates of return and the most significant impact on poverty reduction.
- Reduced the scope of a few projects and focused resources on projects with the greatest likelihood of completion.
- Worked with partner countries to increase the amount of their contributions toward specific projects.
- Reached agreement with other donors to fund specific projects or project components that are attractive to other donors because they have completed feasibility studies and other necessary preparatory work.

MCC notes that it has also applied the lessons learned from these experiences to the development of new compacts. For example, by ensuring that as much work as possible on feasibility studies and other critical analyses is completed before compacts are signed, MCC will reduce the cost and timing uncertainties that have contributed to increased construction costs of MCC's current compacts.

Summary

Although MCC does have serious management challenges, as indicated in this statement, MCC has begun to take action in some areas and has plans for action in others to address these deficiencies. OIG will continue to examine the actions taken and report on their impact in addressing these serious management challenges.