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MILLENNIUM
CHALLENGE
CORPORATION

MCC Has Addressed
a Number of
Implementation
Challenges, but Needs
to Improve Financial
Controls and
Infrastructure
Planning



GAO

Accountability * Integrity * Reliability



Highlights of [GAO-10-52](#), a report to congressional committees

Why GAO Did This Study

Established in January 2004 with a mission to reduce poverty through economic growth, the Millennium Challenge Corporation (MCC) has committed \$6.9 billion for compacts with 19 developing countries. MCC vests compact management with accountable entities in recipient countries, called Millennium Challenge Accounts (MCA). MCAs, with guidance from MCC, allocate resources, oversee and implement a financial plan, approve expenditures and procurements, and implement compact projects.

This report, directed by the fiscal year 2008 Consolidated Appropriations Act, assesses MCC and MCA (1) financial controls; (2) procurement practices; and (3) development, implementation, and oversight of contracts and projects. GAO focused on financial and procurement transactions and projects at MCAs in Honduras, Georgia, and Cape Verde, countries with high disbursement totals as of the end of fiscal year 2008.

What GAO Recommends

GAO recommends that the Chief Executive Officer of MCC (1) improve FAPs and ensure comprehensive policies for all MCA expenses, (2) reinforce MCC's price reasonableness analysis guidance, and (3) improve project design reviews and cost estimates prior to issuing contract solicitations. MCC accepted the recommendations.

View [GAO-10-52](#) or key components. For more information, contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov.

MILLENNIUM CHALLENGE CORPORATION

MCC Has Addressed a Number of Implementation Challenges, but Needs to Improve Financial Controls and Infrastructure Planning

What GAO Found

As required by MCC guidelines, each of the three MCAs GAO reviewed had developed a Fiscal Accountability Plan (FAP) that documented policies and procedures related to internal control, such as funds control, documentation, and segregation of duties. However, each of the FAPs GAO reviewed, in place as of the end of fiscal year 2008, had gaps in certain areas, such as incomplete policies and procedures for some expenses. Although MCC agreements require that each country prepare a FAP, the initial guidance MCC provided to the three MCAs was general and did not contain sufficient information to help the countries develop sound internal control structures. For example, guidance stated that records must support transactions and that procedures must incorporate segregation of duties. However, specific guidance on payroll, travel, and inventory controls would have helped the MCAs develop comprehensive policies. To address this, MCC developed a FAP template in November 2008, but MCC allows the MCAs flexibility and does not require them to implement the template's policies and procedures. In addition, GAO identified a significant number of the transactions tested that lacked adequate supporting documentation or were not properly approved by management. These deficiencies increase the risk of fraud, waste, and abuse of MCC program funding.

MCC has increased standardization of the MCA procurement guidelines, which were initially developed on a country-by-country basis. The MCAs GAO assessed generally adhered to MCC's procurement guidelines. GAO found that, in some cases, MCAs did not document a price reasonableness analysis of winning bids. GAO also found that when MCAs delegated procurement responsibility to outside entities, the procedures used by these entities were generally consistent with MCC's procurement framework.

MCC conducts oversight of MCA infrastructure contracts and projects, but insufficient planning of projects during compact development and cost escalation has undermined project implementation. As a result of insufficient planning, designs had to be revised, and project scopes have been reduced. Significant delays to project schedules—the result of undertaking additional planning and design—further compounded the escalation in construction costs experienced on projects and contributed to the restructuring of projects. For example, two of five planned roads in Cape Verde were eliminated, in part due to insufficient design and cost increases. In addition, the schedule for construction of the remaining three roads was extended by 11 months. MCC has worked with the MCAs to significantly restructure projects to keep them within their budgets and 5-year compact time frames. MCC also has taken steps to provide increased assistance to MCAs to help them conduct better planning for projects. However, these changes alone will not address the problems projects encountered with design development and cost escalation. Industry best practices and past GAO work have shown that conducting design reviews and updating cost estimates prior to contract solicitation help to ensure that projects can be successfully bid and constructed.

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Abbreviations

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| CNFA | Citizens Network for Foreign Affairs |
| DCI | data collection instrument |
| FAP | Fiscal Accountability Plan |
| GRDF | Georgia Regional Development Fund |
| IAR | interim activity review |
| IST | Implementation Support Team |
| MCA | Millennium Challenge Account |
| MCC | Millennium Challenge Corporation |
| MDF | Municipal Development Fund (of Georgia) |
| MIT | Ministry of Industry and Transport (of Cape Verde) |
| PPR | Procurement Performance Report |
| RCD | resident county director |

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United States Government Accountability Office
Washington, DC 20548

November 6, 2009

The Honorable Patrick Leahy
Chairman
The Honorable Judd Gregg
Ranking Member
Subcommittee on State, Foreign Operations,
and Related Programs
Committee on Appropriations
United States Senate

The Honorable Nita M. Lowey
Chair
The Honorable Kay Granger
Ranking Member
Subcommittee on State, Foreign Operations,
and Related Programs
Committee on Appropriations
House of Representatives

Established in January 2004 with the mission of reducing poverty through economic growth, the Millennium Challenge Corporation (MCC) has committed approximately \$6.9 billion from the Millennium Challenge Account (MCA) for compacts with 19 developing countries as of August 2009.¹ MCC compacts are limited by U.S. law to extend for no more than 5 years.² During the 5-year compact implementation period, MCC vests responsibility for day-to-day management—including financial controls, procurement functions, and contract management—to accountable entities in recipient countries, commonly called “MCA-[country name],” in keeping with the MCC principle of country ownership. MCC provides the frameworks and guidance for financial controls, procurement, and contract management that MCAs are to use in implementing compact projects. The statute establishing MCC requires that each compact include (1) a plan to ensure fiscal accountability for the use of compact funds and (2) a requirement for open, fair, and competitive procedures in the

¹As of August 2009, MCC had signed compacts with Madagascar, Honduras, Cape Verde, Nicaragua, Georgia, Benin, Vanuatu, Armenia, Ghana, Mali, El Salvador, Mozambique, Lesotho, Morocco, Mongolia, Tanzania, Burkina Faso, Namibia, and Senegal.

²22 U.S.C. § 7708(j).

administration of grants or cooperative agreements or the procurement of goods and services for the accomplishment of compact objectives.³

In the fiscal year 2008 Consolidated Appropriations Act, Congress directed GAO to review the financial controls and procurement practices of MCC and its accountable entities.⁴ For this report, we examined MCC's (1) financial controls; (2) procurement practices; and (3) development, implementation, and oversight of contracts and projects.⁵ Our previous analysis found that the MCA pace in implementing compacts within the required 5-year time frame consistently lagged behind MCC's initial projections, placing the MCAs and MCC at risk of not achieving compact goals within the time limit.⁶

We focused our analysis on MCC's compacts with Honduras,⁷ Georgia, and Cape Verde, which, as of September 30, 2008, accounted for approximately

³22 U.S.C. 7708(b)(1)(G) and (I).

⁴Consolidated Appropriations Act, 2008, Pub. L. No. 110-161 § 668(d)(1)(A). The act also required us to examine the results achieved by MCC's compacts. We will respond to this requirement separately.

⁵We first reported on the fiscal accountability, procurement structures, and implementation of early MCC compacts—including those with Honduras and Cape Verde—in *Millennium Challenge Corporation: Compact Implementation Structures Are Being Established; Framework for Measuring Results Needs Improvement*, [GAO-06-805](#) (Washington, D.C.: July 28, 2006).

⁶According to GAO analysis, as of the end of the first quarter of fiscal year 2009, MCC had disbursed \$437 million in compact assistance—32 percent of initially planned disbursements—for the 16 compacts that had entered-into-force. The 16 compacts have a total value of approximately \$5.7 billion. Although MCC began reestimating planned project disbursements quarterly in January 2008, MCAs have generally not met these reduced projections.

⁷On June 28, 2009, Honduras experienced a coup and the elected president was forcibly exiled. In September 2009, MCC terminated \$11 million of its assistance under the compact and placed a hold on an additional \$4 million.

39 percent of MCC's total disbursements.⁸ For objective 1, we assessed MCA policies and procedures and reviewed in-country file documentation that focused on 689 financial transactions completed during fiscal year 2007 or 2008. For objective 2, we reviewed MCC's framework and assessed compliance by reviewing in-country file documentation for a statistically selected sample of 138 procurements conducted in fiscal year 2008. For both objectives, if we identified missing or incomplete documentation, we brought it to the attention of MCA staff and gave them an opportunity to provide the missing documentation. For objective 3, we focused on the three largest infrastructure construction contracts in each country and the largest consultant services contract associated with construction services, including a review of contractor reporting and site visits to projects in Honduras and Georgia. See appendix I for a complete description of our objectives, scope, and methodology.

We conducted this performance audit from June 2008 to October 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

Each of the three MCAs we reviewed had developed a Fiscal Accountability Plan (FAP) that documented its operational policies and procedures, including funds controls. However, our review of these policies and procedures showed that, at all three MCAs, the FAPs had gaps in certain areas, such as incomplete policies and procedures for some

⁸Our findings are not projectable to other countries. We initially planned to examine Georgia, Madagascar, and Honduras, the compacts with the first-, second-, and third-highest total disbursements as of the end of fiscal year 2008. Together, these three compacts accounted for approximately 46 percent of MCC's total disbursements. However, our audit in Madagascar in January 2009 was interrupted by protests and instability in the country that ultimately led to the forced resignation of the country's elected president. On March 20, 2009, MCC announced that it was placing a hold on its operations in Madagascar, and it terminated the program on May 19, 2009, because of the undemocratic change of government. We eliminated Nicaragua, the country with the fourth-highest disbursement total, from our consideration because MCC partially suspended the compact in December 2008 due to concerns about the conduct of elections in the country. In June 2009, the MCC Board of Directors terminated the suspended portions of the Nicaragua compact. After removing Nicaragua from our consideration, we included Cape Verde, the country with the fifth-highest disbursements.

operational expenses. MCC compact agreements require that each country prepare a FAP, which must clearly document policies and procedures related to internal control, such as funds control, documentation, and segregation of duties. However, financial guidance MCC provided to the three MCAs did not contain sufficiently detailed information to enable the countries to develop sound internal control structures that would help ensure adequate control over funds. For example, the guidance stated that procedures must be in place to ensure that disbursements are executed in accordance with the compact, records must be maintained to provide clear support of transactions, and procedures must incorporate segregation of duties and internal control. However, this guidance did not contain examples of the policies and procedures that the MCAs could implement to ensure an adequate fiscal accountability structure. For example, more specific or detailed guidance in payroll, travel, and inventory controls would have assisted the MCAs in developing comprehensive policies and procedures. To help address the FAPs' shortcomings, MCC developed a FAP template in November 2008. However, MCC allows the MCAs flexibility and does not require compact countries to implement the policies and procedures included in the template. Additionally, our review of the implementation of established financial controls at three MCAs found that these MCAs did not consistently comply with established controls. During our testing, we identified a significant number of transactions that lacked adequate supporting documentation or were not properly approved by management officials. These internal control deficiencies increase the risk of fraud, waste, and abuse of MCC program funding.

All three MCAs generally adhered to MCC's evolving framework for ensuring open, fair, and competitive procurements. MCC has increased the specificity of its procurement guidance over time. MCC initially allowed countries to develop their own guidelines, but now requires standard MCC guidelines applied across all countries. Conversely, MCC has decreased its level of review of compliance with its guidance over time by reducing the number of required MCC reviews of country procurements. MCC now relies more heavily on post-reviews and independent audits to identify procurement problems. On the basis of our detailed review of stratified random samples of procurements at three MCAs, we estimated that these MCAs complied with most MCC requirements. However, the MCAs we reviewed did not consistently document their evaluation of the reasonableness of winning bid prices. When the MCAs delegated procurement responsibility to implementing entities outside of the MCA, those entities generally adhered to MCC's procurement framework.

MCC conducts oversight of MCA infrastructure contracts and projects, but insufficient planning of projects during compact development and cost escalation has undermined project implementation. During compact implementation, MCC conducts oversight of MCA projects by monitoring projects, establishing performance incentives and accountability structures, and using cross-functional teams. However, MCC-funded infrastructure projects have experienced delays, project scopes have been reduced, and contract costs have increased. As a result of insufficient planning, the MCAs have had to contract for and conduct additional engineering surveys, designs have had to be revised, and project scopes have been reduced. Significant delays to project schedules—the result of undertaking additional planning and design—further compounded the escalation in construction costs experienced on projects and contributed to the restructuring of projects. MCC has taken action to work with the MCAs to significantly restructure projects to keep them within their budgets and the 5-year compact time frames. MCC also has taken steps to revise the compact development process to provide increased MCC assistance to the MCAs to help them conduct better planning for projects. However, these changes alone will not address the problems that the projects have encountered with design development and cost escalation. Industry best practices and GAO past work have shown that conducting design reviews and updating cost estimates—to include assessing risks—prior to contract solicitation help to ensure that projects can be successfully bid and constructed.

We are recommending that the Chief Executive Officer of the Millennium Challenge Corporation (1) revise MCC guidance to require that MCA FAPs include comprehensive policies and procedures that are in accordance with best practices, (2) revise MCC guidance to require that FAPs incorporate policies and procedures related to monitoring and evaluating implementing entities' compliance with contract agreements, (3) reinforce existing guidance to MCAs on conducting and documenting price reasonableness analyses, (4) establish a programmatic goal that MCAs conclude all project planning efforts prior to the point at which MCAs issue contract solicitations, and (5) require MCAs to obtain detailed reviews of project cost estimates and project designs before contract solicitation for large construction projects.

We received written comments on a draft of this report from MCC. MCC accepted our recommendations and outlined steps it had taken to address them, but also commented on some of GAO's specific findings. We have reprinted MCC's comments, with our responses, in appendix IV. We also

incorporated technical comments from MCC in our report where appropriate.

Background

MCC Compact Development and Implementation

MCC undertakes a process each fiscal year to identify countries as candidates for MCA assistance. MCC uses per capita income data to identify two pools of countries as eligible candidates: low-income countries and lower-middle-income countries. Candidate countries also must not be statutorily barred from receiving U.S. assistance. MCC's Board of Directors then uses quantitative indicators to assess a candidate country's policy performance. To be eligible for MCA assistance, a country must pass the indicator for control of corruption and at least one-half of the indicators in each of the following three categories: ruling justly, investing in people, and encouraging economic freedom. To pass an indicator test, a country must score better than at least one-half of the other candidates (above the median) in its income group. If the policy performance of a country implementing a compact declines, the board can suspend or terminate the compact.

Eligible countries may develop and propose projects, with guidance from MCC, with the goal of achieving economic growth and poverty reduction. MCC conducts an initial peer review of the country's proposal, including an examination of proposed accountability and procurement structures, project scope, preliminary cost estimates, and the feasibility of implementing projects within the 5-year compact period.⁹ MCC also may provide 609(g) funds¹⁰ to the country to assist in compact development. If MCC accepts the proposal, it negotiates and signs a compact with the eligible country, committing the full amount of the compact. After compact signature, the MCA completes additional agreements, budgets,

⁹MCC also reviews, among other things, the economic analysis of project benefits, the consultative process used to develop the compact, monitoring and evaluation plans, donor coordination, and environmental and social safeguards.

¹⁰Section 609(g) of the Millennium Challenge Act of 2003 gives MCC the authority 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.

and plans prior to entry-into-force. At entry-into-force, MCC obligates and begins disbursing compact funds, and compact implementation begins.

Following MCC's internal reorganization in October 2007, MCC revamped its compact development process to include greater up-front engagement with eligible countries and assistance in conducting needed studies and establishing management structures.¹¹ MCC's 2010 Congressional Budget Justification notes that it revised the phases of compact development in an effort to address the challenges and problems it encountered with current compacts.¹²

MCC Compacts in Honduras, Georgia, and Cape Verde

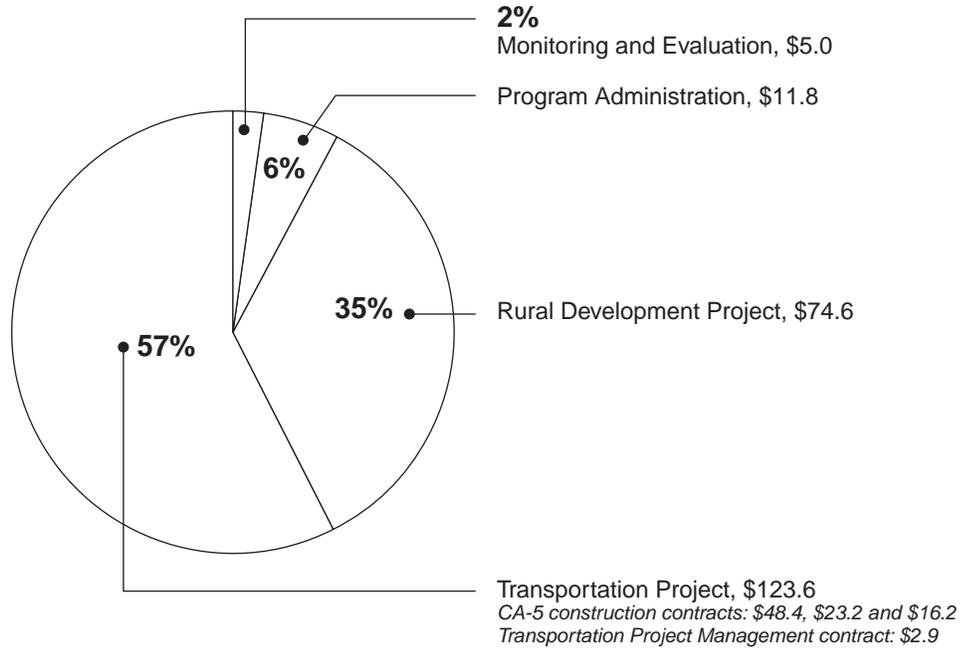
The three compacts we selected for review vary in the type and size of projects funded, but each devotes more than one-half of compact funds to infrastructure projects, such as roadways, bridges, and ports. Figures 1, 2, and 3 provide compact obligations by country. As of August 2009, these three compacts were in their 4th year of 5 years of compact implementation.

¹¹MCC used its previous compact development process for compacts with the three countries in which we performed fieldwork.

¹²Previous GAO reports assessed various aspects of MCC's compact development, including eligibility determinations, due diligence, and economic analyses. See GAO, *Millennium Challenge Corporation: Independent Reviews and Consistent Approaches Will Strengthen Projections of Program Impact*, [GAO-08-730](#) (Washington, D.C.: June 17, 2008); *Millennium Challenge Corporation: Vanuatu Compact Overstates Projected Program Impact*, [GAO-07-909](#) (Washington, D.C.: July 11, 2007); *Millennium Challenge Corporation: Compact Implementation Structures Are Being Established; Framework for Measuring Results Needs Improvement*, [GAO-06-805](#) (Washington, D.C.: July 28, 2006); and *Millennium Challenge Corporation: Progress Made on Key Challenges in First Year of Operations*, [GAO-05-455T](#) (Washington, D.C.: Apr. 26, 2005).

Figure 1: Honduras Compact Obligations, as of April 2009

Dollars in millions



Total: **\$215.0**

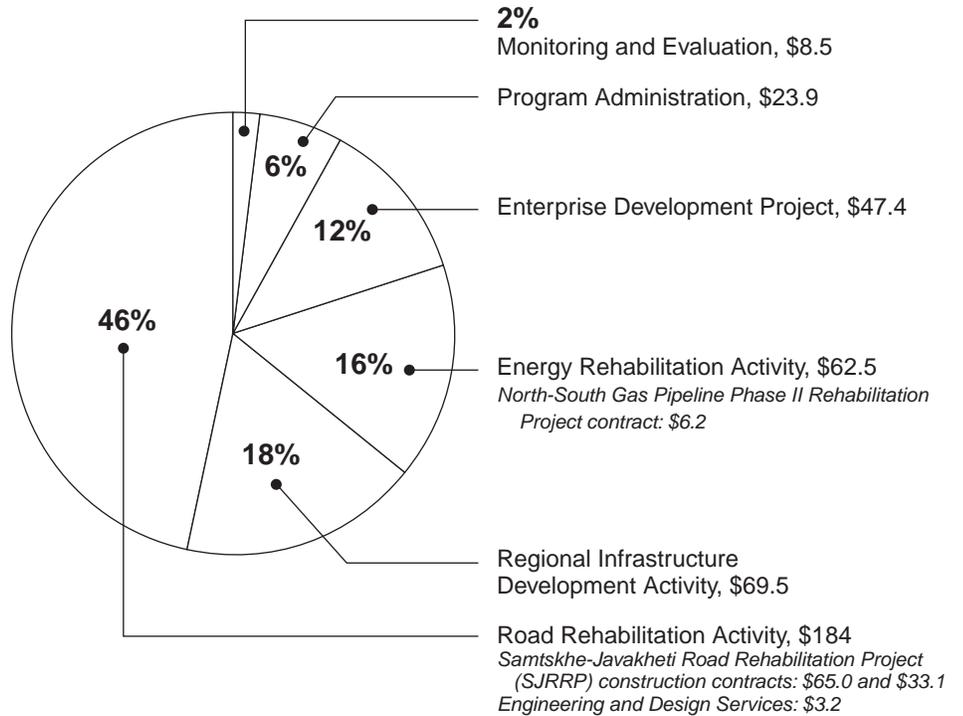
Entry-into-Force: **September 29, 2005**

Source: GAO analysis of MCC data.

Note: Contract values (shown in italics) are initial values and do not include subsequent change orders.

Figure 2: Georgia Compact Obligations, as of April 2009

Dollars in millions



Total: **\$395.3**
Entry-into-Force: **April 7, 2006**

Source: GAO analysis of MCC data.

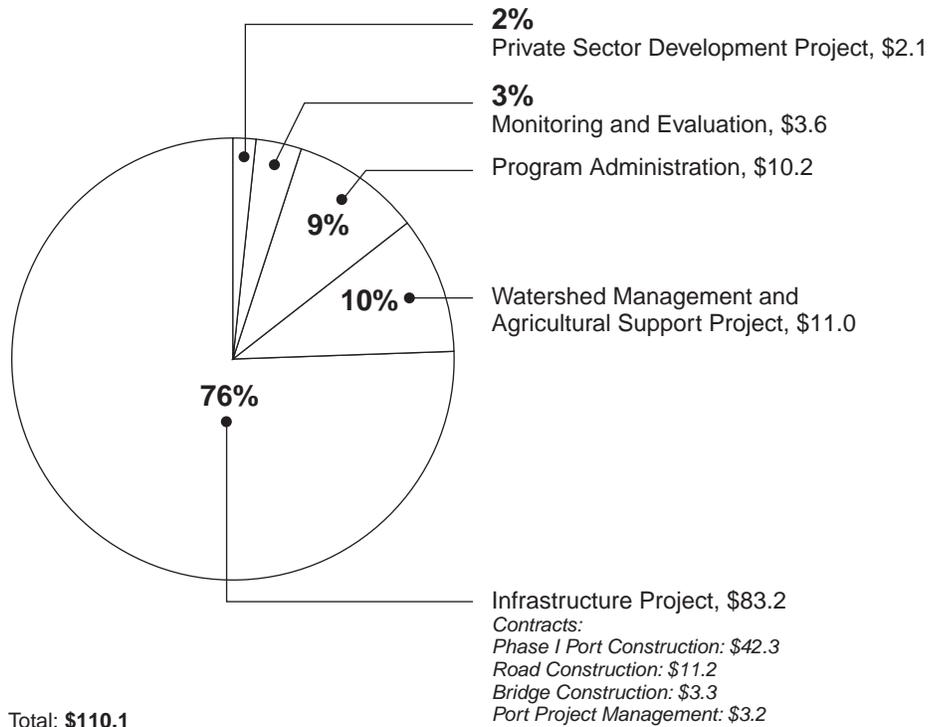
Notes:

After conflict erupted between Russia and Georgia in August 2008, the United States announced a \$1.0 billion aid package to Georgia in September 2008. As part of this assistance, MCC provided \$100.0 million in additional compact funding on November 20, 2008, increasing the compact to its current value of \$395.3 million.

Contract values (shown in italics) are initial values and do not include subsequent change orders.

Figure 3: Cape Verde Compact Obligations, as of April 2009

Dollars in millions



Total: **\$110.1**
Entry-into-Force: **October 17, 2005**

Source: GAO analysis of MCC data.

Note: Contract values (shown in italics) are initial values and do not include subsequent change orders.

MCC Financial Controls, Compact Procurement Structure, and Contract and Project Implementation Oversight

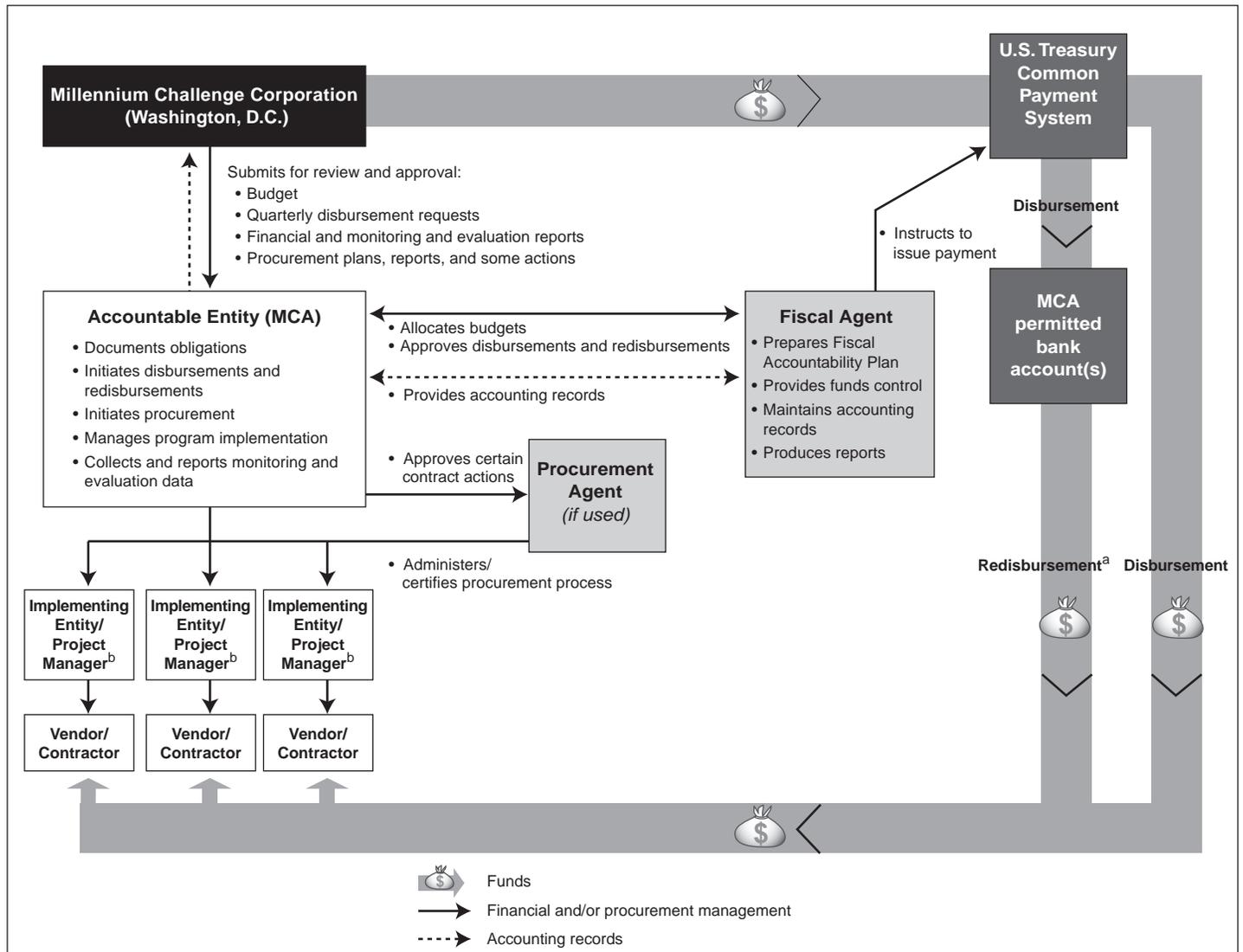
Financial Controls

MCC has developed management and control guidance and structures to implement the statutory requirements for fiscal accountability and for open, fair, and competitive procurements. MCC and MCAs have established processes for controls over compact funds; the procurement of required goods, works, and services; and the development and management of contracts after award.

MCC compacts and related documents include sections on fiscal accountability that describe the agreement between MCC and the recipient country in areas such as financial management and procurement practices. According to MCC's *Fiscal Year 2007 Guidance for Compact-Eligible Countries*,¹³ two key entities are generally involved in fiscal accountability. First, the country must authorize an accountable entity to oversee the MCC program and its components, allocate resources, oversee and implement a financial plan, approve expenditures and procurements, and be accountable for MCC program results. Second, the compact typically will require a fiscal agent for MCC-funded activities that is responsible for certain aspects of fiscal accountability, such as funds controls and, in some cases, procurement management. The MCC fiscal accountability framework is depicted in figure 4.

¹³Millennium Challenge Corporation, *Fiscal Year 2007 Guidance for Compact-Eligible Countries*, Chapter 30, Fiscal Accountability Guidelines.

Figure 4: MCC Fiscal Accountability Framework



Source: GAO analysis of MCC data.

Note: Audits and MCC reviews can occur anywhere within the framework.

^aMCC can directly disburse compact funds through the Department of the Treasury's system to MCA-contracted parties, such as vendors, suppliers, or project managers, upon the MCA's approval. Alternatively, MCC can disburse funds to the MCA's permitted accounts from which the MCA can reimburse funds to its contractors.

^bImplementing entities or project managers are contracted by the MCA to perform oversight functions. An implementing entity is a government agency or nongovernmental agency or other public- or private-sector entity or persons to which an MCA may provide MCC funding, directly or indirectly, through an outside project manager, to implement and carry out the projects or any other activities to be carried out in furtherance of a compact.

To address financial management, MCC requires each MCA to adopt a FAP that clearly documents the policies and procedures, including internal controls, that will help ensure appropriate fiscal accountability over the use of MCC-provided funds. In its *Fiscal Year 2007 Guidance for Compact-Eligible Countries*, MCC provided the MCAs with information that the MCAs should consider when developing their policies and procedures. For example, the MCAs should ensure that, in developing procedures for their disbursements, they consider funds control and documentation (i.e., procedures for authorizing, verifying, and recording a transaction); separation of duties and other internal controls (i.e., procedures for segregating approval and processing duties); and procedures related to the reconciliation of funds. MCC, as a component of this framework, is responsible for reviewing and approving certain policy documents and for ensuring that financial controls are adequately structured and implemented for each country.

MCC assesses the status of financial management at the compact country through the review of reports, in particular annual financial audits of the MCA financial statements and Quarterly Disbursement Reports. MCC requires annual financial audits of the resources managed by the MCAs to assess whether funds received and costs incurred are recorded in conformity with the terms of the compact agreement and generally accepted accounting principles. MCC also requires Quarterly Disbursement Requests and Reports from the MCAs, which describe the funds used in the past quarter and the estimated expenses requiring MCC funding for the next quarter and beyond. After reviewing and approving the quarterly disbursement requests, MCC authorizes disbursement of the funds for the next quarter.

Prior to fiscal year 2008, MCC requested that the Department of the Treasury (Treasury) transfer compact funds into the MCA bank accounts (e.g., permitted bank accounts) for redisbursement by the MCAs to their contractors. According to MCC officials, in September 2008, MCC started using the Treasury's Common Payment System to make direct payments to the MCA contractors. However, as shown in figure 4, countries still maintain permitted bank accounts that are used to redisburse funds received from MCC. Thus, the MCAs may continue to internally process and manage project or program payments through the use of the country's

Compact Procurement
Structure

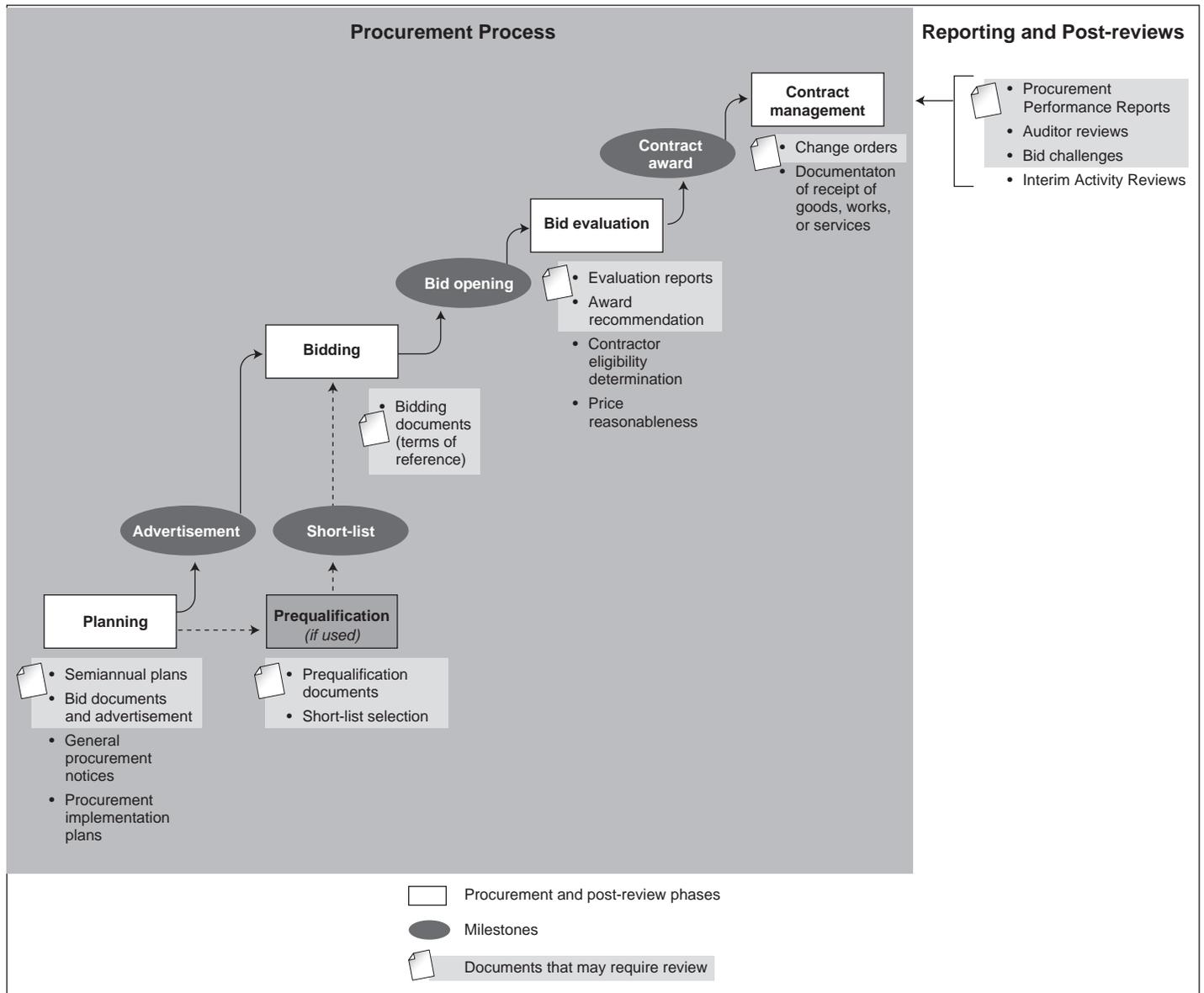
permitted bank account, which receives funds during MCC's quarterly disbursements.

As part of the country's proposal for compact funding, the MCAs identify their approach to procurement. Prior to May 2007, the guidelines used by the MCAs were negotiated and documented in a procurement agreement—a supplemental agreement to the compact. MCC currently uses standard procurement guidelines, based on World Bank guidelines, and requires their use in compacts, unless it specifically permits alternative procedures. MCC also has developed several guidance papers that assist countries in implementing the standard procurement guidelines.¹⁴ The MCAs may contract with a procurement agent to perform key procurement functions.¹⁵ Figure 5 summarizes MCC's compact procurement process.

¹⁴Examples of MCC-developed guidance include procedures for verifying excluded parties, technical evaluation panels, procurement performance reports, procurement implementation plans, the bid challenge system, and price reasonableness analyses.

¹⁵According to MCA officials, MCAs in Honduras and Georgia originally used procurement agents as part of their compact management systems. However, both MCAs have since chosen to discontinue this practice and use MCA employees to conduct procurements. MCA-Cape Verde has never used a procurement agent.

Figure 5: Compact Procurement Process Established by MCC Guidelines



Source: GAO analysis of MCC data.

Note: This graphic illustrates some key documents and terms and will not apply to every procurement. For example, prequalification is usually used only for large or complex procurements. Noncompetitive procurements will omit portions of this process; sole source procurements will not be advertised or competed; and shopping and limited bidding procurements are directed to a preselected list of potential bidders, rather than openly advertised.

Contract and Project
Implementation Oversight

The MCAs manage compact procurements, but MCC retains review authority at points in the process, including procurement planning, prequalification, bid evaluation, and proposed contract award. MCC's guidelines require both MCA and MCC approvals at up to three levels: (1) the MCA procurement director, (2) the MCA governing body, and (3) MCC. The level of review depends on the value and method of the procurement. Higher-value procurements and those using less-competitive methods generally require more second- and third-level reviews and approvals. Before MCC published standardized guidelines, the Honduras, Georgia, and Cape Verde procurement agreements required the first approval to be by the MCA management, and the second approval to be by the MCC governing body, or in the case of Cape Verde, by a special Procurement Review Commission consisting of Cape Verde government officials.

To conduct oversight of large infrastructure projects managed by the MCAs, MCC reviews key documents, such as bidding packages, contract documents, technical project requirements, and work plans. In general, MCC's implementation process for infrastructure contracts and projects requires that the MCAs have individual project directors—for example, a roads director—who oversee outside implementing entities and project management consultants. MCC also requires the MCAs to engage the services of a project management firm or an implementing entity to help manage compact projects before receiving project funding. MCA independent construction supervisors conduct oversight of day-to-day construction and the activities of the construction contractors to ensure compliance with contract requirements. MCC's Implementation Support Team (IST) and resident country director, aided by MCC's own independent engineers, monitor progress of the construction works as managed by the MCAs and executed by their contractors. To report progress, the MCAs prepare quarterly reports to MCC. MCC's deputy vice presidents hold quarterly country portfolio reviews during which the IST reports on implementation progress as well as issues and concerns. Figure 6 depicts the oversight, management, and contractual relationships between MCC, the MCA, and their contractors for infrastructure projects.

MCC's Accountability Framework Does Not Always Help Ensure Adequate Funds Controls in Compact Countries

The MCAs have made progress in implementing policies and procedures for managing their administrative and operating expenses. However, our review of these policies and procedures, as documented in each country's FAP, found gaps in the design of the policies and procedures, which prevented the establishment of an adequate internal control structure. In addition, our tests of transactions at the three MCAs showed that processed financial transactions did not consistently comply with the MCAs' established controls, resulting in transactions that lacked proper approvals and adequate documentation.

MCA Fiscal Accountability Plans Had Gaps and Did Not Address Certain Key Controls

During our review of the three MCAs we visited, we found that each entity had documented policies and procedures in their FAPs as required by MCC. However, travel and payroll policies in two of the three countries we visited were incomplete or did not address key procedures or controls. In addition, the FAPs in all three countries lacked policies and procedures related to disbursements for each MCA's main project or program expenses. The lack of adequate and comprehensive policies contributes to internal control structures that increase the risk of fraud, waste, and abuse in MCC-funded projects. For example:

- Travel policies in Honduras and Cape Verde lacked key requirements for supporting documentation. For example, in Honduras, travel policy allowed employees to be paid for lodging and per diem for local or international travel prior to the trip but did not require staff to submit detailed documentation related to hotel or airline flight receipts upon return to document the completion of travel. In addition, the policy did not address certain key issues, such as a business class airfare policy. Similarly, Cape Verde's travel policies and procedures did not require staff to submit documentation related to hotel expenditures.¹⁶ Furthermore, Cape Verde's FAP authorized business class airfare for travel of 9 hours or more, regardless of whether stops were made overnight for business or personal reasons.
- Payroll policies in Honduras and Cape Verde did not include a requirement for staff to prepare individual time sheets or other documentation that

¹⁶According to our *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999), internal control and other significant events should be clearly documented in management directives and other policies. Clear and complete policies should help ensure that transactions are properly documented and substantiated.

could be used by direct supervisors to verify actual hours worked before payroll was processed. Although payroll at these countries is based on contracted salaries, we could not determine from the documentation available whether staff members had actually worked the compensated hours.¹⁷

- The FAPs in all three countries lacked policies and procedures for authorizing and paying major program expenses, such as payment for road resettlement, investments, grants, and credit line transactions. These program expenses are often managed by an implementing entity and comprised some of the largest disbursements for the MCAs we reviewed. For example, in Honduras the credit line and grant disbursements totaled \$9.9 million, or 29 percent of the total disbursement amount of \$33.8 million for the period we reviewed. Specific program or project requirements could be found through extensive reviews of various agreements between the MCAs and their implementing entity or other external guidance. However, key controls related to the disbursement approval process and documentation requirements for these transactions were not documented in the countries' FAPs.¹⁸ It is important to include the relevant controls for these activities in the FAP to ensure that the MCAs have an adequate structure in place to efficiently manage their projects and provide a central point of reference for all documentation and approval requirements.

The lack of comprehensive policies and procedures at the MCAs is the result of limitations in the initial guidance that MCC provided to the three MCAs. MCC's initial *Guidance for Compact-Eligible Countries* consisted primarily of outlining the responsibilities of MCC and the recipient government in matters related to financial management and provided general guidance about the foundation of the policies and procedures to be developed. For example, the guidance stated that (1) procedures must be in place to ensure that disbursements are executed in accordance with

¹⁷GAO, *Maintaining Effective Control over Employee Time and Attendance Reporting*, [GAO-03-352G](#) (Washington, D.C.: January 2003), states that effective controls over payroll information should provide reasonable assurance that time and attendance information reflects actual work performed and is sufficiently detailed to allow for verification. In addition, supervisory authorization and approval is a key part of ensuring the propriety of time and attendance information.

¹⁸GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001), describes best practices for adequate documentation of internal controls and states that internal control activities should appear in administrative policies or accounting manuals.

the compact or related documents, (2) records must be maintained that provide clear support of a transaction, and (3) procedures must incorporate the principle of segregation of duties and internal controls. However, this guidance did not contain examples of the policies and procedures that the MCAs could implement to ensure an adequate fiscal accountability structure. For example, more specific or detailed guidance in payroll, travel, and inventory controls would have assisted the MCAs in developing comprehensive policies and procedures. According to MCC, to help the MCAs comply with their responsibility for developing their FAPs, MCC's fiscal accountability directors often worked hand-in-hand with the MCAs and fiscal agents while drafting their initial guidance. The directors also collaborated with colleagues who worked on other countries' FAPs to help ensure that the major internal controls and critical FAP elements were addressed.

To help address shortcomings in the FAPs, in November 2008, MCC developed a FAP template with suggested policies and procedures to help compact countries strengthen their FAPs. The FAP template provides suggested policies and procedures regarding segregation of duties and asset management, as well as examples of financial controls in areas such as travel and payroll. According to MCC officials, the template is designed to be a guidance document that provides examples of how controls could be structured for different expense types. For example, the template requires employees to submit time sheets for supervisory approval and travelers to submit hotel receipts for travel expenses. MCC management does not require compact countries to model their policies and procedures on the guidance provided in this template FAP or adopt its provisions because MCC delegates responsibility for implementing internal control to the countries' accountable entity, which can tailor their FAPs to meet their needs. Rather, the MCC-developed FAP template serves as a reference point that can be used by compact countries when drafting their FAPs.

MCA's Did Not Consistently Apply Internal Controls Established in the FAPs and Other Documents

For controls provided in the FAP and other MCA documents to be effective in preventing unauthorized or improper disbursements, the MCA management must ensure that control activities established in its policies and procedures are properly applied. However, our review of the MCA's compliance with established control activities in operational areas—such as travel, payroll, program- or project-related expenses,¹⁹ and inventory—identified instances where the MCA's did not consistently comply with established controls. These control deficiencies and inadequate monitoring of the MCA's implementing entities, increase the risk of fraud, waste, and abuse of MCC program funding.

Travel Expenses

A random sample of travel disbursement transactions for each of the three MCA's we reviewed showed instances in which management failed to consistently comply with the controls described in the FAP's travel policies and procedures, which resulted in improperly documented or approved travel disbursements. For example, trip reports, which the MCA management requires as evidence of travel completion, were not always provided in Honduras and Cape Verde. Specifically, all of the 33 prepaid travel disbursements we tested in Honduras lacked such supporting documentation. In Cape Verde—which also requires other supporting documentation, such as boarding passes—we found that 19 of the 30 travel transactions we tested lacked documentation to support trip completion. Therefore, we could not determine whether the trips were completed or complied with the applicable authorization for these transactions.²⁰

Travel policies for MCA-Honduras and MCA-Georgia require employees to obtain travel authorizations and provide receipts upon completion of travel for reimbursement transactions.²¹ In Honduras, for 9 of the 22 travel reimbursements we tested, the supporting documentation lacked certain required documents, such as boarding passes and hotel receipts. Three of the 22 travel reimbursements were made even though the travel

¹⁹Program- and project-related expenses include disbursements for construction resettlements, grant expenses, investments, technical and construction services, and other miscellaneous expenses.

²⁰According to our *Standards for Internal Control in the Federal Government*, documentation for transactions and other significant events should be complete and accurate and facilitate tracing transactions and related information from authorization through processing.

²¹In Honduras, travel reimbursements are made to employees if the trip is not planned enough in advance to process the advance payment. In Georgia, all travel disbursements are reimbursements because MCA-Georgia policies do not allow advance payments.

authorizations did not have all of the required information.²² For these 3 transactions, documentation showed management approval, even though all required trip details were not properly documented. For MCA-Georgia, 8 of the 35 travel reimbursements we tested did not have certain documentation, such as hotel receipts or boarding passes, as evidence that the trips had taken place.

Our MCA-Georgia sample also included one travel disbursement for a board member of the Georgia Regional Development Fund (GRDF), which did not reflect a reasonable effort to minimize costs charged to the investment fund.²³ According to the GRDF travel guidelines, board members can travel in business class if the total length of the flights—including layovers, but excluding stopovers—exceeds 14 hours. According to the policy, a board member may add the time of a flight before a stopover to the time of a flight after a stopover to determine the flight's total length. During our testing, we identified a transaction in which a board member booked two round-trip tickets for a board meeting in Tbilisi—one from his residence in Washington, D.C., to London, where he also has a residence, and one from London to Tbilisi. The trip included a 36-day stopover in London after the board meeting, but before the board member traveled back to Washington, D.C. The ticket from London to Tbilisi, a 5-hour flight, was booked in premium class, and the total cost of the ticket was \$3,640, justified by the 14-hour exception. However, a 36-day stopover in London should make the traveler ineligible for business class travel under the 14-hour rule. Although this travel was made in accordance with the GRDF guidelines that we have previously mentioned, it did not reflect a reasonable effort to minimize anticipated costs to the investment fund.²⁴

²²MCA-Honduras's FAP requires that all travel authorizations contain the origin and destination of the trip, the trip duration, and estimated cost. For these two sample items, the authorizations were approved and funds were disbursed, even though the authorizations did not contain travel dates or origin and destination information.

²³The Georgia Regional Development Fund, LLP, was established by and capitalized by the Millennium Challenge Georgia Fund. The GRDF is a \$30-million risk capital investment fund that focuses on long-term growth-oriented investments in growing and dynamic small- and medium-size enterprises. The fund focuses particularly on businesses operating in the regions beyond Tbilisi and those operating in agribusiness and tourism.

²⁴MCC officials stated that this practice has already been identified as problematic, and GRDF travel guidelines require flight costs with significant variations above coach class due to stopovers to be borne by the individual traveler.

Payroll Expenses

Our review of the implementation of payroll controls, using a random sample of disbursements, identified several instances in which payroll disbursements were made without adequate documentation or approvals as required in the FAPs. Our testing in Georgia determined that 4 of the 62 payroll transactions we tested lacked direct supervisor approval on the time sheets, and 59 of 62 transactions lacked the approval and certification of the human resources manager, as required by MCA-Georgia's FAP. For Cape Verde, we were unable to trace disbursements to the contracted salary amount for 4 of our 15 sample items because employee files were not always updated to reflect annual cost-of-living increases.

Program- and Project-Related Expenses

Program- and project-related expenses include payments disbursed by the MCAs for grant expenses, resettlement expenses, investment funds, and other operating expenses.²⁵ Many program- and project-related expenses are often managed by an implementing entity hired by the MCAs to oversee project implementation. During our testing, we identified issues related to incomplete documentation and a lack of management approval of these expenses. The lack of adequate management reviews and a poor control environment in these areas resulted in unsupported and questionable costs related to disbursements at the three countries we tested.

Grant expenses. During our testing of grants made by the MCAs, we observed payments to beneficiaries that lacked adequate evidence that certain prerequisites were met. We also identified inconsistencies in the documentation provided as support for the transactions.²⁶ During our testing in Honduras, we identified 20 instances from a random sample of 53 grant disbursements where the forms provided to the MCA as evidence of receipt by the beneficiary of the agricultural equipment items were not signed by the beneficiary or were signed by the contractor responsible for delivering the goods to the beneficiary.²⁷ Thus, we could not determine

²⁵Other operating expenses include disbursements for technical assistance, construction services, and office-related expenses.

²⁶MCA grant programs in the three countries we visited aim to reduce poverty in rural regions of the country by stimulating economic growth in the agricultural sector. A contractor for the MCA often manages these grant programs. Grant funds in these programs can be used to purchase agricultural equipment or provide technical training to farmers.

²⁷The delivery of goods receipt provides evidence that the grant items were provided and should be signed by the recipients. MCA-Honduras officials stated that the contractor may have signed for the grant recipients if they were not present when the equipment was delivered. However, we could not substantiate this explanation.

whether the beneficiary had received the goods. In Georgia, our testing identified 7 instances from a random sample of 54 grant disbursements in which beneficiaries did not certify, as required by the grant agreements, that certain milestones were met before they received funds. Furthermore, several of the samples we tested had different beneficiary signatures on the payment request form and the grant agreement documents. The most recent audit of MCA-Georgia, performed by their independent audit firm, also identified significant shortcomings in the supporting documentation for grant disbursements.²⁸

Resettlement expenses. Resettlement payments compensate landowners for property used for the MCA projects, such as road and pipeline construction.²⁹ During our testing of resettlement disbursements in Honduras, we identified transactions that lacked the documentation required to support the disbursement amount and the recipient's eligibility to receive the funds. In 6 of the 25 transactions we selected in Honduras, the files had inadequate documentation to provide evidence that the beneficiary had received funds and did not include the beneficiary's signature. In some cases, the beneficiary's signature was not the same as that on other documents in the file. Several files had different signatures on documents that (1) evidenced acceptance of the resettlement offer by the beneficiary and (2) acknowledged that the beneficiary received the funds from MCA-Honduras. These control deficiencies occurred due to the absence of an MCA policy requiring confirmation of these signatures. According to MCA-Honduras officials, in some cases the officials were familiar with the beneficiaries and with those who had signed for them.

Investment funds. MCA-Georgia established a fund that made investments in businesses that met certain criteria to further their development. The GRDF management agreement describes processes, such as board authorizations, investment fund goals, and documentation

²⁸U.S. Agency for International Development, Office of Inspector General, *Audit of the Millennium Challenge Corporation (MCC) Resources Managed by Millennium Challenge Fund Georgia (MCG), Under the Compact Agreement Between the MCC and the Government of Georgia From June 30, 2008 to December 31, 2008*, Audit Report No. M-000-09-018-N (Washington, D.C.: June 2009).

²⁹A resettlement is the result of an economic or physical displacement of individuals and may involve land or other property acquisition. Compensation for resettlement is provided to families or individuals affected by a project who lose land, assets, or access to resources due to the project. Compensation can be monetary, in kind, or replacement of the lost asset.

requirements, that should be met before investment payments are requested and approved.³⁰ Our review of 5 investment transfers, totaling \$3.7 million, showed that 2 transactions were processed without adequate documentation of the required board approvals. Also, 3 of the 5 investments did not have fully completed investment proposals before approval by the GRDF Board of Directors.³¹ Furthermore, two of the five payment requests made to the MCA fiscal agent lacked supporting documentation and required follow-up to ensure that GRDF personnel had provided the required documentation. In its semiannual audit covering the last 6 months of 2008, the MCA-Georgia auditor also reported that transactions related to the GRDF investment fund lacked adequate documentation.

Other operating expenses. Other operating expenses include MCA disbursements for technical services, construction services, and office-related expenses. During our testing of these expenses, we found instances of inadequate documentation and approvals. For example, in Honduras, we identified 23 of 58 operating expense transactions that did not have the required supporting documentation, such as a Certificate of Delivery of Goods Report.³² As a result, for these items, there was no evidence that the goods or services were provided before the invoices were processed and payments were made to the contractors. We were able to verify the existence of 17 of the 23 items that did not have a certificate in the financial files. However, we were unable to verify the existence of the remaining 6 items.³³

³⁰SEAF Management, LLC, a global investment firm, is the contractor charged with managing the fund. The GRDF Board of Directors approves the investments before funds are made available to the recipient.

³¹During our review of the GRDF disbursement transactions, we found inconsistencies between the initial investments in businesses and the program goals. For example, we noted that all 5 initial investments were made to two businesses where the main place of business was inside the Tbilisi area, contrary to the program goal of providing 80 percent of investment funds to businesses outside the city. In addition, because of the calculation method used by the fund manager to calculate revenue, we noted it was difficult to determine whether one of the businesses complied with the investment guidelines.

³²According to MCA-Honduras's FAP, project directors and the relevant executing units are responsible for certifying that goods and services are provided and received according to the terms and conditions of the applicable contract. A certification of the delivery of goods is submitted along with the invoice for payment processing.

³³These 6 items were primarily services rendered by MCA contractors; without the certificates, there was no evidence that the services were provided to MCA-Honduras.

In Georgia, MCA procurement officials had not properly approved 3 of the 58 transactions we tested.³⁴ In addition, 8 of the 58 transactions were not supported by adequate documentation. For these 8 transactions, we could not determine whether payments were made in accordance with the applicable contracts because the invoices were insufficiently detailed. For example, one invoice requested payment for “fourth quarter . . . under services agreement,” with no additional information provided. In addition, in its June 2009 report, the MCA-Georgia auditor reported \$1.2 million in questioned costs due to a similar lack of supporting documentation for one road construction project. The auditor also noted significant shortcomings in the supporting documentation for interim payment applications of the civil works performed by the contractor.³⁵

In Cape Verde, we found that, in 4 of the 37 technical services transactions tested, amounts disbursed to a contractor did not agree with the provisions of the applicable contract. For these transactions, 4 payments were made on one contract that did not have a payment schedule that listed the deliverables to be provided for MCA-Cape Verde to initiate payment. As a result, we could not determine whether the correct amounts were paid for services rendered for the invoices we examined.

Inventory

Our testing of a random selection of assets included in inventory identified several instances where documentation was not in compliance with inventory policy and procedures, as required in the FAPs. As a result, we could not always determine whether the items provided were the same as the items in the asset listing. For example, of the 39 inventory items we tested in Georgia, we were unable to determine whether 15 of these items were the same as the items described in the inventory list due to poor

³⁴In Georgia, the procurement department is responsible for certifying that goods and services are provided in accordance with the applicable contract. Certification by the procurement department is a key control and serves as evidence that the goods and services were received before payment is made to the contractor. As a result, payments should not be processed by the finance department unless the procurement department’s certification is received. The failure of the finance department to comply with this provision of the FAP increases the possibility that MCA-Georgia will make payments to contractors without evidence that the goods and services were delivered in accordance with the contract, resulting in an increased risk of improper payments.

³⁵Interim payments are submitted to the supervising consultant for approval and subsequently billed to MCA-Georgia. However, the auditor also noted significant shortcomings in the procedures performed by the supervising consultant to verify volumes and other measures of civil works that the contractor claims as performed and bills the MCA. The auditor stated that documents were either missing or lacked sufficient detail.

recordkeeping, such as incomplete asset information, lack of asset tags, and inadequate serial number tracking. These 15 items included 7 computers and 1 cell phone. MCA-Georgia auditors also reported that inventory and asset management was a problem in their semiannual financial audits citing shortcomings in recordkeeping, tagging of assets, and inaccurate or incomplete recording of asset movements and changes in custody.³⁶ Auditors recommended that the MCA fully implement the asset management procedures described in MCA-Georgia's Asset Management Manual. In addition, MCA-Georgia and MCA-Cape Verde reported instances of lost or stolen inventory items, such as laptops or other electronic equipment, indicating the need for improved property safeguarding controls.³⁷ The MCA-Georgia fiscal agent stated it could not identify 16 items in its last MCA-wide inventory process in December 2008. Among the 16 items were 4 computers and 4 cell phones.³⁸ Subsequent to our visit, the MCA fiscal agent performed another inventory count in May 2009 and located some of missing items. Furthermore, MCA-Cape Verde officials stated that after-hours thefts had resulted in a number of missing laptops and a projector, which were still missing at the time of our fieldwork in May 2009.³⁹

³⁶ *Audit of the Millennium Challenge Corporation (MCC) Resources Managed by Millennium Challenge Fund Georgia (MCG).*

³⁷ According to our *Standards of Internal Control in the Federal Government*, an agency must establish physical control to secure and safeguard vulnerable assets. Assets that are particularly vulnerable to loss, theft, damage, or unauthorized use—such as inventory or equipment—should be physically secured and access-controlled. Assets also should be periodically counted and compared with control records.

³⁸ Our population of inventory items excluded the 16 items that were missing as a result of the fiscal agent's last annual inventory count.

³⁹ According to MCC, MCA-Cape Verde officials informed the local police of the thefts and filed insurance claims for the stolen items.

MCC Has Decreased Its Level of Procurement Review; Countries Generally Adhered to MCC Requirements

MCC has increased standardization of the MCA procurement guidelines, which were initially determined on a country-by-country basis. In the most recent version of its procurement guidelines, released in July 2008, MCC reduced the number of approvals required from MCC and the MCA while at the same time requiring postprocurement reviews to supplement MCC oversight. The MCAs we assessed generally adhered to MCC's procurement guidelines, although they did not fully comply with some requirements, such as contractor eligibility and price reasonableness determinations. In addition, we found that when the MCAs delegated procurement responsibility to outside entities, the procedures used by these entities were generally consistent with MCC's procurement framework.

MCC Has Increased Standardization of Procurement Guidelines and Reduced Its Level of Review

MCC has increased standardization of the MCA procurement guidelines. In its initial compact country procurement agreements, MCC permitted countries to select their own procurement guidelines but reviewed them to determine whether they met MCC requirements for open, fair, and competitive procurement. In May 2007, MCC issued standardized procurement guidelines to simplify country processes, according to MCC officials. MCC reviews and now requires their use in all new compacts.⁴⁰ MCC officials also said that using a standardized procurement framework encourages more firms to bid on MCA procurements, because they become familiar with MCC requirements and do not have to adjust to new ones for different MCAs.

MCAs in each of the three countries we examined have modified the procurement framework they used while implementing compacts. The MCAs in Honduras, Georgia, and Cape Verde all began their compacts using country-specific procurement guidelines. MCC officials told us that Honduras and Georgia switched to MCC's standard guidelines in May 2007 and August 2008, respectively. MCA-Cape Verde has continued to use its own procurement guidelines because most of their large procurements were complete, according to MCC and MCA-Cape Verde officials.⁴¹

⁴⁰MCC based these guidelines on the same World Bank guidelines that many countries had previously used. See World Bank, *Guidelines: Procurement under IBRD Loans and IDA Credits* (May 2004, revised Oct. 1, 2006).

⁴¹Of all compact countries, the MCAs in Madagascar, Cape Verde, and Vanuatu continued to use country-specific procurement systems.

MCC Has Reduced Its Involvement in Approving Procurements

According to MCC officials, MCC's initial level of involvement in procurement development and review was unsustainable, especially as MCC's compact portfolio grew. According to MCC officials, they were getting "bogged down" looking at smaller procurements, and they concluded that the MCAs' governing bodies were likewise required to review too much detail within individual procurements. MCA country officials with whom we spoke also stated that the initial review process delayed procurement and thus the project schedule. For example, as early as 2006, MCA-Cape Verde was concerned about the mismatch between the number of reviews required of the Procurement Review Commission and the time frame of projects.

In the most recent version of its procurement guidelines, released in July 2008, MCC introduced the "Implementation Model Framework" as the standard procurement model for all compact countries and reduced the number of required approvals by MCC. This model formalizes the extent to which MCC is involved in procurements and further reduces the number of points at which MCC approvals are required. Although the MCAs' procurement procedures do not change, for those countries transitioning to this model, MCC plays more of an oversight role. MCC's July 2008 version of the procurement guidelines also establishes a 2-tier system of approvals that allows for even fewer reviews of procurement actions for those countries with a good procurement record.⁴² Schedule A of the 2-tier system represents the initial level of review for most countries, which is referred to as implementation support.⁴³ As countries gain experience and MCC gains confidence that they are implementing MCC procurement guidelines, MCC permits the country to transition to Schedule B, which is referred to as oversight.⁴⁴

⁴²In addition to procurement experience, other factors that determine the level of MCC oversight include the likelihood of corruption and fraud, the degree of project completion risk, and the maturity of the compact.

⁴³Schedule A in the July 2008 procurement guidelines reduced the level of MCC approvals in 20 of 61 potential procurement actions for different procurement methods. Of these 20 cases, 9 no longer require any advance approval from MCC; in the remaining 11 cases, the threshold for MCC approval has been increased to procurements of more than \$500,000.

⁴⁴As of October 2008, five countries have transitioned to Schedule B. In 13 of 61 potential procurement actions, Schedule B reduces the level of MCC review below that of Schedule A—in all 13 cases by removing MCC review altogether.

MCC Conducts
Postprocurement Reviews and
Requires Procurement Audits

See appendix II for a discussion of the oversight model and a comparison of the review required under Schedule A and Schedule B to the review required in previous procurement guidelines.

When it reduced the number of required pre-approvals, MCC also formalized a separate postprocurement review process to supplement its oversight of the MCA procurements. In July 2008, MCC began to conduct yearly interim activity reviews (IAR) of compact countries. The IARs assess a nongeneralizable random sample of procurements from each country for compliance with procurement and contract administration processes. As of August 2009, MCC had conducted IARs of eight compact countries. In the three IARs for the countries we examined, MCC officials reported that the procurement files were in “excellent,” “good,” and “acceptable” condition. These three IARs reviewed a total of 29 procurements.⁴⁵ In the case of Cape Verde, critical issues identified by the IARs included failure to create a Procurement Implementation Plan and to conduct price reasonableness analyses. During our fieldwork, we discussed the IAR findings with the procurement director in Cape Verde, who reported that the MCA was addressing the issues identified in the IAR and provided documentation of additional processes.

MCC guidelines for audits of accountable entities require that the MCA auditors assess and report on procurement compliance. According to the guidelines, the audit’s specific objectives should include testing compliance with the procurement agreement, procurement guidelines, and the FAP. We reviewed 7 audit reports for Georgia, Honduras, and Cape Verde and found no reporting of material procurement-related findings, although some audit reports did not clearly state that they included procurement within the scope of the audit. In all, we reviewed 24 audit reports for MCA countries—3 reports had procurement-related findings. One of these 3 audit reports had seven findings, another had five, and the last had one. The other 21 audit reports did not contain any reporting related to procurement.

⁴⁵One procurement reviewed in Georgia included multiple shopping purchases.

MCA We Assessed Generally Adhered to MCC Procurement Guidelines

MCAs we assessed generally adhered to MCC Procurement Guidelines but have not documented that they fully complied with some requirements. On the basis of our review of a stratified random sample of 138 procurement files,⁴⁶ we estimate that the three MCAs we reviewed obtained almost all of the required approvals from MCC in the procurement process, and that they obtained approvals from the MCA governing body in most cases. We also estimate a high rate of MCA compliance with MCC procurement requirements for

- advertising prequalification;
- using a competitive bidding process to conduct procurements;
- advertising procurements and preparing bid documents;
- using MCC procedures for opening bid documents, documenting the reasons for disqualified bids, and selecting the winning bidder; and
- documenting receipt of the good or service procured.

Table 1 provides additional details on the procurement requirements we tested and our estimated results. Appendix III provides more information on the specific findings for the procurement criteria we tested.

Table 1: Estimated Percentage of Country Procurements Meeting MCC Procurement Criteria

| Procurement criteria | Percentage of country procurements, by MCA | | |
|---|--|----------------------|-----------------------|
| | Cape Verde ^a | Georgia ^b | Honduras ^a |
| Documentation of overall approvals | | | |
| Obtained all required MCC approvals ^c | 100% | 96% | 100% |
| Obtained all required MCA governing body approvals ^d | 100 | 86 | 92 |
| Documentation of prequalification | | | |
| Advertised prequalification for procurement in English | 100 | 100 | 100 |
| Advertised prequalification in required locations | 94 | 96 | 100 |

⁴⁶We reviewed stratified random samples of 47 procurement files in Cape Verde, 63 procurement files in Honduras, and 28 procurement files in Georgia. All percentage estimates from the samples presented in this report have a margin of error of plus or minus 10 percentage points or less, unless otherwise noted. The number of procurement files we reviewed in each country was based upon the number of procurements completed in that country in fiscal year 2008. Appendix I contains a complete discussion of our scope and methodology.

| Procurement criteria | Percentage of country procurements, by MCA | | |
|--|--|----------------------|-----------------------|
| | Cape Verde ^a | Georgia ^b | Honduras ^a |
| Documentation of invitation for bid | | | |
| Justified use of another procurement method if the MCA did not use competitive bidding | 100 | 100 | 97 |
| Advertised procurement in English | 100 | 100 | 100 |
| Published bidding documents in English | 99 | 100 | 93 |
| Circulated procurement advertisement in required locations | 99 | 82 | 98 |
| Documentation of bid evaluation | | | |
| Documented bid opening | 100 | 100 | 100 |
| Provided a detailed report on evaluation and comparison of bids in procurement file | 100 | 100 | 100 |
| Documented reason for disqualification when bids were disqualified | 100 | 100 | 100 |
| Documented contractor eligibility | 98 | 25 | 74 |
| Documented impartiality of the evaluation panel | 74 | 86 | 80 |
| Documentation of contract management | | | |
| Had procured item or record of receipt of item | 100 | 100 | 99 |
| Items matched contract specifications | 100 | 100 | 99 |

Source: GAO analysis of MCA procurement files.

Note: MCC's requirements vary by the size and type of procurement; therefore, not all procurements we examined had to meet each requirement we tested. For more information on these procurements, see appendix III.

^aThe percentages listed for Cape Verde and Honduras are estimates based on our review of a stratified random sample of procurements. These estimates have a margin of error of less than plus or minus 9 percentage points at the 95 percent confidence level.

^bIn Georgia, we reviewed all 24 procurements conducted by the MCA and 4 procurements by the Georgian Municipal Development Fund during fiscal year 2008; thus, the percentages reflect actual procurements reviewed, rather than estimates.

^cThis variable represents a summation of all instances where MCC approvals might be required (eight approval steps).

^dThis variable represents a summation of all instances where MCA governing body approvals might be required (seven approval steps).

Despite general compliance with MCC procurement guidelines, the MCAs did not document contractor eligibility and evaluation panel impartiality in all cases, as follows:

-
- *Contractor eligibility:* In Georgia, 25 percent of procurements in fiscal year 2008 documented contractor eligibility.⁴⁷ In addition, we estimate that MCA-Honduras documented contractor eligibility in about 74 percent of the procurements it conducted in fiscal year 2008. MCC requires that the MCAs conduct contractor eligibility reviews for all procurements. Parties to be excluded from MCC contracts include firms declared ineligible under World Bank anticorruption policies and U.S. antiterrorist policies.⁴⁸ MCC has taken steps to improve eligibility verification and documentation by issuing guidance for contractor eligibility in February 2008. MCC's guidance was prompted by a U.S. Agency for International Development, Office of Inspector General, assessment of procurement that found that MCAs had not fully complied with guidance on determining contractor eligibility.⁴⁹
 - *Impartiality of the evaluation panel:* We found that all three MCAs we reviewed documented the impartiality of the bid evaluation review panel less than 90 percent of the time. For example, we estimate that MCA-Cape Verde documented the impartiality of the technical evaluation panel for 74 percent of all procurements in fiscal year 2008, and that MCA-Honduras documented technical evaluation panel impartiality for 80 percent of procurements. Our review of all procurements in Georgia in fiscal year 2008 found that MCA-Georgia documented impartiality of the technical evaluation panel 86 percent of the time. Although MCA compliance was below 90 percent for evaluation panel impartiality, the margin of error on our estimates for MCA-Honduras and MCA-Cape Verde may bring them close to 90 percent compliance.

Additionally, we found that the MCAs we reviewed did not consistently document their evaluation of the reasonableness of prices contained in the winning bid. MCC guidance states that the MCAs should conduct and document price reasonableness analysis for all procurements to ensure that no more than a commercially reasonable price is paid to procure

⁴⁷In a number of cases, the MCA procurement director or another document in the file stated that the MCA had assessed contractor eligibility, but this was not documented in the file.

⁴⁸More information on firms that are excluded from MCA entity program procurements can be found in the following document: MCC, *Millennium Challenge Corporation Program Procurement Guidance: Guidance on Excluded Parties Verification Procedures in MCA Entity Program Procurements* (Feb. 15, 2008).

⁴⁹U.S. Agency for International Development, Office of Inspector General, *Audit of Compliance with Procurement Requirements by the Millennium Challenge Corporation and its Compact Countries* (Mar. 3, 2008).

When MCAs Delegated Procurement Responsibility, the Procedures Used Were Generally Consistent with MCC's Procurement Framework

goods, works, and services. While MCC guidance states that competitive bids or bids close to the budget, among other criteria, may be used to identify a price as reasonable, MCC's procurement directors generally did not document this determination in their files or the evaluation reports. MCA procurement directors believed that they did not need to document price reasonableness if they received multiple competitive bids for a procurement or if bids were within the planned budget. An MCC review of an MCA-Cape Verde procurement, conducted in February 2009, also found that the MCA had not conducted a price reasonableness analysis.

When the MCAs delegated procurement responsibility, procurement procedures used by the outside entities were generally consistent with MCC procurement principles and guidance. For all three MCAs we visited, procurements were generally conducted by the MCA procurement staff or its contracted procurement agent. We found examples of instances where the MCA had used alternate guidelines or delegated procurement responsibility to an outside entity.

For procurement of small works, MCA-Cape Verde used procurement guidelines developed by the Cape Verde Ministry of Industry and Transport (MIT) that did not use the same standard for price reasonableness as MCC. These differing standards led MIT to automatically discard bids that it considered "unreasonably low" but that would have been evaluated under MCC guidelines. In Cape Verde, procurements for road and bridge construction began before the compact entered-into-force. Although MCC reviewed and accepted the results of these MIT procurements, the MCA file did not contain a full record of the procurement procedure for the \$3.4-million bridge procurement.

MCA-Georgia used two outside entities to conduct procurements. Procurement responsibility for Regional Infrastructure Development projects was delegated to the Municipal Development Fund (MDF) of Georgia, and procurement responsibility for most procurements conducted for Agricultural Development Activity grant programs was given to the Citizens Network for Foreign Affairs (CNFA), the nonprofit organization managing the grant program.

- In the case of MDF, a March 2006 collaboration agreement between MDF and MCC lays out the procurement procedures that MDF is required to follow in conducting procurements financed entirely or in part by MCC. These procurement guidelines have the same requirements as the March 2006 MCA-Georgia procurement guidelines. However, MCC issued updated procurement guidance in 2007 and 2008 and did not modify the

collaboration agreement to encompass these new requirements. For example, we found that MDF procurements did not meet the requirements for advertising and contractor eligibility that MCC issued in 2007 and 2008.

- In the case of grants administered by CNFA, we found that MCA-Georgia has created a separate procurement process. CNFA relies on grantees to identify suppliers for goods and to provide price quotes from multiple suppliers showing that their chosen supplier has the lowest price. According to CNFA officials, CNFA staff check with the identified suppliers to verify that the prices provided by grantees to CNFA are accurately reported. However, CNFA staff do not conduct independent market research to ensure that the price estimates provided by grantees are reasonable and comparable with market prices. According to MCA-Georgia, grant recipients often live in rural areas and need to procure secondhand equipment, and thus they are often best equipped to identify existing suppliers.

MCC Conducts Oversight, but Insufficient Planning of Projects during Compact Development Has Undermined Project Implementation

Project status reports of MCC and MCA consultants indicate that the MCA projects have encountered problems, which include delays, scope reductions, and cost increases. These problems are due, in part, to insufficient planning, escalation of construction costs, and insufficient MCC review. MCC is conducting oversight during implementation by monitoring project performance, establishing incentives for accountability, and using cross-functional teams to oversee and support the projects.

MCA Projects We Assessed Have Encountered Problems Due to Insufficient Planning of Projects

On the basis of our review of contractor reports in the three countries we assessed, we found that MCC-funded infrastructure projects were substantially delayed. For example:

- After receiving initial contractor bids in excess of the planned budget, MCA-Georgia restructured what it had planned to award as three large contracts for the road projects into six smaller planned contract lots, leading to a delay of at least 6 months to rebid and award the contracts. Under the second procurement, MCA-Georgia was able to award contract lots 2, 3, and 4 and parts of lots 5 and 6—rather than six full lots—within the available project budget. At the time of our site visit in March 2009, the road construction contractors were behind 3 to 4 months on a schedule of

24 to 30 months in part due to contractor delays in getting labor, equipment, and field offices operational. One contractor also experienced delays due to issues related to the need to revise the designs, delayed preparation of construction working drawings, and slow coordination of the utility relocations. In July 2009, subsequent to our visit to Georgia, MCA-Georgia removed one roadway lot from one of the contractor's contracts and awarded it to another contractor. The action was taken following MCA-Georgia's assessment that one contractor's performance was unacceptable based on the contractor's failure to make sufficient progress on the road. MCA-Georgia awarded that roadway lot to another contractor in an attempt to complete the road projects within the compact time frame.⁵⁰

- Delays of up to 9 months occurred in constructing approximately 100 kilometers of the CA-5 highway project in Honduras. The delays were in part due to the MCA having to contract for additional topographic surveys that were needed to update the designs, revising designs to add additional travel lanes and road intersections, realigning the road to minimize property resettlement requirements, and addressing contractor performance issues. At the time of our visit in December 2008, the construction contractor for two sections of the road was about 3 months behind schedule on contracts of 24 months in duration due to slow progress during the rainy season.
- In Cape Verde, phase I of the port project was delayed 9 months. In addition, the construction contractor for the roads project was granted an 11-month extension on a 30-month contract. The Cape Verde bridges project was extended from 12 to 30 months. The reasons for delays varied across the three projects and included in some instances procurement delays, the inability of the MCA to provide site access for the contractor to begin work, and having to improve designs that were not ready for implementation.

Our review of contractor reports indicated that these MCAs reduced the scope of projects, including the following:

⁵⁰U.S. Agency for International Development, Office of Inspector General, *Audit of the Millennium Challenge Corporation's Regional Infrastructure Rehabilitation Project in Georgia*, Audit Report No. M-000-09-007-P (Washington, D.C.: Sept. 30, 2009).

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- MCA-Georgia reduced the original compact scope for the award of 245 kilometers of road construction contracts to just over 170 kilometers because the full scope of the contracts could not be awarded within the initial compact budget.⁵¹
 - In Honduras, MCC was no longer exclusively funding the construction of the CA-5 highway project as planned under the compact. One of the four road sections of the CA-5 highway could not be awarded within the funding available through the compact, nor could construction be completed within the 5-year window.⁵² As a result, the scope of the roadwork as funded by MCC was reduced and, at the time of our review, compact funding covered the cost of approximately 65 kilometers along portions of three sections of road. The section not funded by MCC was being funded through a loan from the Central American Bank for Economic Integration to the government of Honduras.
 - Two of five roads in Cape Verde were eliminated from the contractor's project scope due to increased costs. In addition, the construction of phase II of the MCA-Cape Verde port project could no longer be funded under the available compact budget and, at the time of our review, was on hold until outside donor assistance could be used.⁵³

Examples of MCA contract cost increases in the three countries we reviewed include the following:

- In MCA-Georgia, the independent construction supervisor estimated that the final contract price for one road contract, originally awarded at \$65.0 million, would rise by 15 percent, or nearly \$10.0 million; another contract, originally awarded at \$33.1 million, would rise by nearly 18 percent or about \$6.0 million.

⁵¹In November 2008, an additional \$100 million in compact assistance was made available to Georgia. Of this amount, \$60 million was programmed for the award of additional road contracts under a third procurement that funds much of the original scope that had to be cut.

⁵²MCC funded the preparation of the final design documents, the environmental impact assessment, and the development and implementation of resettlement action plans for the entire 110-kilometer CA-5 highway project. MCC also continues to fund MCA-Honduras management resources.

⁵³MCA-Cape Verde reported that funding for phase II was secured from the government of Portugal, and that phase II was expected to start this year.

Insufficient Planning, Cost Escalation, and MCC's Insufficient Design Review Have Contributed to the Need to Restructure Projects

- Changes in contract costs totaling about \$2.0 million—an approximately 17 percent increase—were approved on the Cape Verde roads project, which was originally awarded at about \$11.0 million.⁵⁴
- Contract cost changes on the Cape Verde bridges contract have been approved for a total of about \$750,000—approximately 23 percent—on a contract initially awarded at \$3.3 million.

Our review of the three MCAs found that projects had to be redesigned and restructured due to insufficient planning before implementation, which led to delays in implementation. Our past work found that it is critical to set appropriate time frames to conduct planning, design, and construction activities.⁵⁵

Insufficient planning. Insufficiently developed project designs led to redesign and delays in contract award and implementation in each of the three compact countries. For example, in five of the six projects we reviewed (six contracts for roads projects in each of the three countries, and two contracts for the port and bridges projects in Cape Verde), we found that insufficient planning—principally due to poor topographic surveys—led to inadequate designs. The redesign of projects delayed the bid process while designs were revised and, in other cases, resulted in significant modification of designs after contract award. Industry experts have found that actual costs for projects with limited planning can range from 20 to 30 percent higher than estimated.⁵⁶ The following examples highlight some of the problems our review found that were reported by MCC, the MCAs, and their consultants:⁵⁷

⁵⁴The roads and bridges are currently being redesigned to a higher standard than originally planned, and this redesign is one of the reasons for the cost increases.

⁵⁵Our work also indicates that a number of factors influence the time needed to complete road construction projects. See GAO, *Highway Infrastructure: Preliminary Information on the Timely Completion of Highway Construction Projects*, GAO-02-1067T (Washington, D.C.: Sept. 19, 2002).

⁵⁶GAO, *Afghanistan Reconstruction: Progress Made in Constructing Roads, but Assessments for Determining Impact and a Sustainable Maintenance Program Are Needed*, GAO-08-689 (Washington, D.C.: July 8, 2008).

⁵⁷We did not assess the topographic surveys and project designs but are reporting on the problems that MCC, the MCAs, and their consultants identified that have led to the issuance of contract variation orders.

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- MCA-Georgia issued contract variation orders to address identified shortcomings in the project design. After beginning construction, the contractor found discrepancies between the design and the existing roadway conditions. This discrepancy required additional topographic engineering surveys, more-developed designs, and additional construction work. In addition, trees between 8.0 and 15.9 centimeters are legally required under Georgian law to be cut rather than uprooted with heavy equipment, but this requirement was not identified as a payable item in contract documents. Furthermore, the extent of the work required to relocate utilities was not sufficiently addressed in the design, according to the contractor. MCC officials noted that MCA-Georgia had contracted separately for a utility relocation survey that proved to be deficient.
 - MCA-Honduras had to undertake additional topographic engineering surveys because earlier surveys were not sufficiently detailed or were unavailable. This issue contributed to a 4½-month delay in awarding contracts. In addition, fundamental planning decisions, such as adding travel lanes, interchanges, and safety features, were still under review during the design stage, which took time to resolve and resulted in significant changes in scope.
 - MCA-Cape Verde, after construction award, found that road designs, accepted by the government of Cape Verde, were of poor quality and inadequate as a basis for construction.⁵⁸ The topographic information in the design was inadequate, and thus the designs inaccurately represented the extent of the work required.⁵⁹
 - MCA-Cape Verde found that bridge designs had to be revised after the award of the construction contract because the initial designs were not sufficiently adequate for construction.
 - MCA-Cape Verde's port project faced potential delays due to differences between the actual topographic and seafloor conditions and the conditions represented in the design drawings for required shore protection and the coastal road serving the port.

⁵⁸The Cape Verde roads and bridges were originally designed under a World Bank-funded road program that predated the compact.

⁵⁹U.S. Agency for International Development, Office of Inspector General, *Audit of the Millennium Challenge Corporation Programs in Cape Verde*, Audit Report No. M-000-09-002-P (Washington, D.C.: Mar. 31, 2009). The Office of Inspector General for MCC noted that the problems with roadway designs were the result of an unclear compact development policy governing the conduct of prefeasibility studies.

Cost escalation. We found that cost escalation of construction materials and schedule delays associated with project redesigns also contributed to the need to restructure projects.⁶⁰ For example, three road projects (six contracts) and the port project experienced cost escalation of construction material prices—especially oil, which heavily affects roadway construction costs. In its oversight role, MCC is not directly responsible for the development of cost estimates. However, our review of MCC Standards of Clearance⁶¹ indicated that MCC has a role in ensuring that the MCAs properly update—to include adjusting for the escalation of construction costs—and revalidate cost estimates before contract solicitation and throughout the project life cycle.

Although MCC officials stated that the MCC project teams are knowledgeable about the MCA cost estimates and schedules, MCC does not have a formal policy governing their development and review and does not centrally track updates over a project’s life cycle. In addition, MCC does not issue guidance to the MCAs on assessing the extent to which cost escalation should be considered a risk factor and assessing its potential impact on planning, design, and construction schedules. MCC requires the MCAs to include an “owner’s contingency” in project cost estimates to cover unforeseen conditions and risks, such as cost escalation. MCC also reviews cost estimates of MCA projects quarterly as part of the disbursement request review process.

Evidence we reviewed suggested that the MCAs’ initial cost estimates were not realigned when project scopes were revised or as prevailing market conditions changed. For example, the budget and cost estimates supporting the first MCA-Georgia road procurement—canceled because bids exceeded available project funding—were largely based on planning

⁶⁰Industry experts note that cost escalation is a major concern on construction projects and has the potential to affect scope and schedule. The National Academies has reported that many state transportation agencies do not focus on management of cost estimates, failed to understand the risk of cost escalation posed by market conditions, and did not track changes in market conditions on their project estimates and budgets. See National Academies, *Transportation Research Board, Guidance for Cost Estimation and Management for Highway Projects During Planning, Programming, and Preconstruction* (Washington, D.C.: 2007).

⁶¹MCC Standards of Clearance govern MCC approvals of compact development and implementation documents, such as work plans, contract bidding documents, and engineering documents. The standards state that MCC should review these documents to ensure that estimates are current (e.g., time, conditions, applicable standards, and guidance).

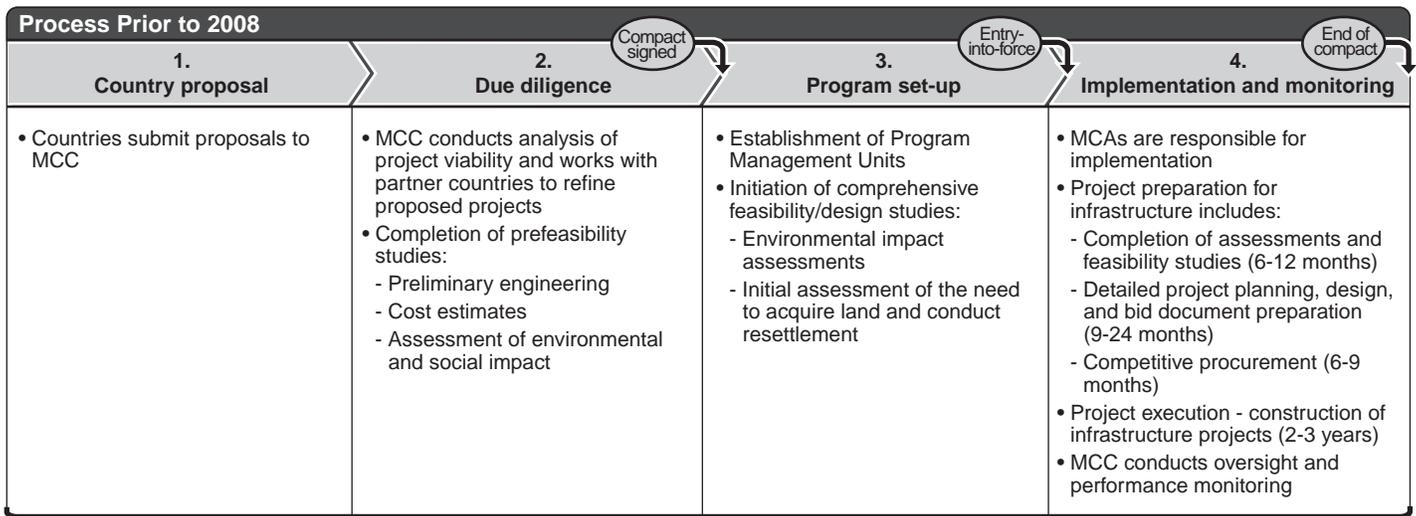
estimates that were 2 years old. In addition, the estimates did not sufficiently account for (1) cost escalation, (2) changes in scope and standards that occurred after the feasibility study, (3) weakening of the U.S. dollar, and (4) an increase in construction work worldwide that resulted in less competition.⁶²

Design review. We found that MCC consultants' reviews of designs before award of contract were insufficient. For example, one of MCC's consultants characterized its design review as "big picture in nature" and "not to be considered a detailed review," stating specifically that "building drawings were not completed and not reviewed," and that "the cost estimate was not reviewed." In contrast, our review of industry leading practices indicates that a well-organized, detailed review can ensure that design plans and specifications are sufficient for construction and will provide the contractor with sufficient information to prepare a competitive and cost-effective bid.⁶³ MCC has taken some steps to modify its compact development process by increasing its assistance to support MCA planning for projects before implementation. Previously, final feasibility studies, environmental assessments, and detailed project planning were typically not completed until after entry-into-force. Under the new process, that type of planning is more likely to be completed before entry-into-force. See figures 7 and 8, which show MCC's prior and current compact development and implementation processes.

⁶²GAO's *Cost Estimating and Assessment Guide* notes that updating cost estimates throughout a project life cycle results in higher quality estimates to support various phases of a project. The guide also notes that estimates, actual costs, and associated schedule data should be tracked centrally to inform lessons learned that can be applied to future project schedules and cost estimates. See GAO, *Cost Estimating and Assessment Guide*, [GAO-09-3SP](#) (Washington, D.C.: Mar. 2, 2009).

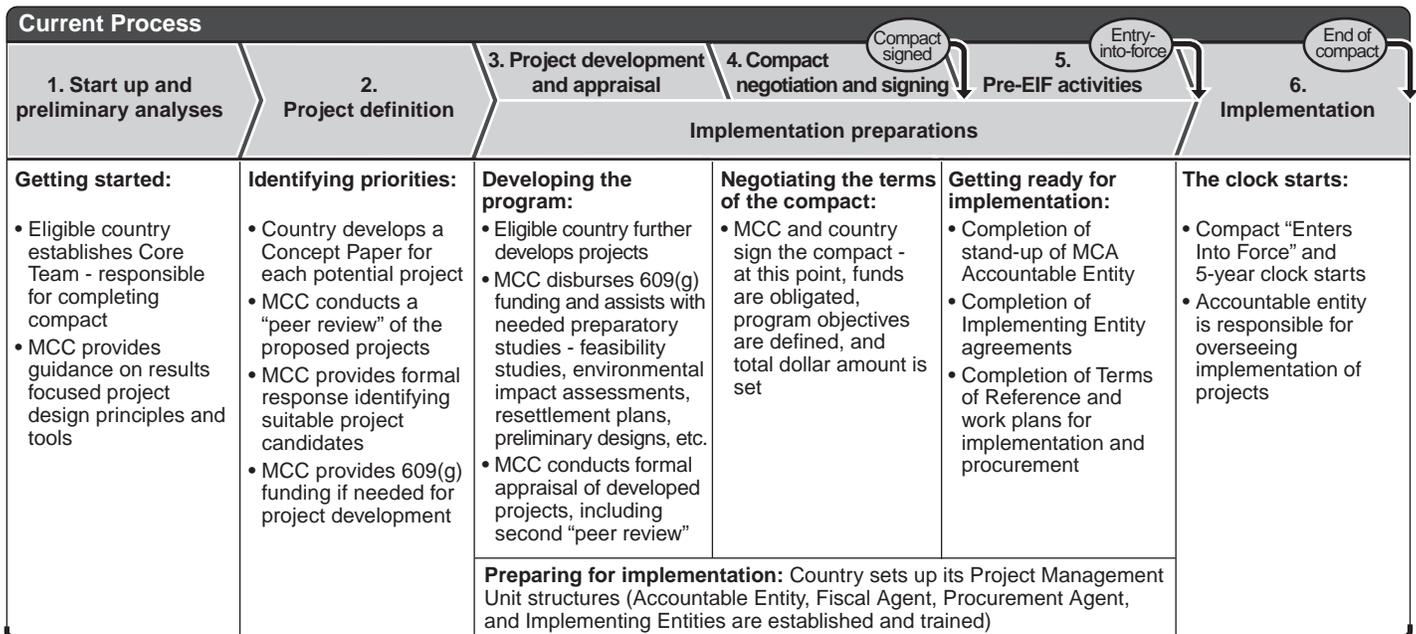
⁶³American Association of State Highway and Transportation Officials, *Constructability Review Best Practices Guide* (Washington, D.C.: August 2000).

Figure 7: MCC Compact Development and Implementation before 2008



Source: GAO summary of MCC publications.

Figure 8: MCC Compact Development and Implementation Process as of 2008



Source: GAO summary of MCC publications.

MCC officials stated that they are making greater use of MCC 609(g) funding authority and Compact Implementation Funds⁶⁴ to support these activities earlier in the process for more recent compacts. MCC also noted that it expects to make greater use of Compact Implementation Funds to assist the countries in preparing their procurement processes and begin final project design in cases when planning feasibility studies are completed.

MCC Conducts Oversight during Implementation

In all nine contracts that we examined—the three road projects (six contracts), the port project, the bridges project, and the pipeline project—we found that MCC’s Implementation Support Team (IST) conducts oversight and monitors project performance during compact implementation. We also found that MCC has a resident country director (RCD) in each compact country. The RCD monitors MCA management and project implementation as MCC’s representative to the government in the compact country and at the board meetings of accountable entities. The RCD is not a voting member, but provides oversight over MCA decisions about contract awards and contract changes affecting cost, schedule, and scope.

MCC requires the MCAs to prepare implementation plans that include program and project work plans and uses independent consultants to monitor MCA reporting status against those plans. MCC also reviews key documents, such as bidding packages, contract documents, and technical project requirements. We found that MCC staff in-country and in Washington, D.C., visit projects firsthand to confirm MCA reporting and assessment of status of projects. MCC officials stated that, to integrate oversight efforts, they schedule consultant site visits to coincide with those of headquarters staff, to the extent possible.

According to MCC officials, communication occurs daily between the RCD, the deputy RCD, their counterparts in the MCAs, and the MCAs’ individual project directors. The MCAs prepare quarterly progress reports for MCC. The RCDs discuss project performance—usually weekly—with the MCAs, including discussions about scope, cost, schedule, and other project-related issues. The RCD’s monitoring is reported informally to

⁶⁴Compact Implementation Funds represent a portion of the funds agreed to in a compact and are made available at the time of compact signing for the purposes of speeding implementation between compact signing and entry-into-force.

MCC headquarters on an ongoing basis and formally in quarterly country portfolio reviews with MCC's deputy vice presidents. During those reviews, the IST also reports on implementation progress.

Under the compact model of country ownership, MCC does not have the authority to direct MCA contractors that implement MCA projects but works with the MCAs, which direct contractors to take corrective actions. MCC, through provisions in the compacts and MCC Program Procurement Guidelines—and outlined in MCC Standards of Clearance—has the right to review and approve MCA projects and contract documents and may direct the MCAs to ensure that (1) appropriate design standards and specifications are used, (2) schedules and cost estimates are prepared, (3) environmental and social assessments are made and incorporated into projects' scopes, and (4) changes to contracts that increase the value by 10 percent or more are justified. In Georgia, MCC's engineers raised significant design and environmental concerns about the Naniani landslide site and potential risk to the pipeline project at the site. MCC's engineers reported that the existing pipeline ruptured in December 2006 due to a landslide, and that a reoccurrence could damage the MCC-funded repairs. MCC's consultant reviewed the geotechnical information and recommended rerouting the pipeline and that it be included in the project scope of the Georgian Oil and Gas Corporation.⁶⁵ The recommendation was accepted and incorporated, and MCC and its consultant continued to monitor the project, conducting a follow-up inspection of the site in July 2008. MCC's consultant reported that the pipeline was completed and at a location far better than the original location. The rerouting of the pipeline is shown in figure 9.

⁶⁵The Georgian Oil and Gas Corporation is a limited liability company that is under the full state ownership of the government of Georgia.

Figure 9: Rerouting of Pipeline at the Naniani Landslide Site in Georgia



Source: MCA-Georgia.

New pipeline being laid and rerouted to avoid steep hillside areas that are susceptible to landslides.



Source: GAO.

The new pipeline route runs down and under the small hill shown and is less susceptible to landslides.

MCC Conditions the Disbursement of Funds on the MCAs Meeting Certain Requirements

MCC's compact framework sets out conditions that the MCAs must meet before receiving funds that act as incentives for establishing accountable organizational structures to implement country compacts. We found that, in all nine projects in the three countries in our review, MCC required that the MCAs engage the services of a project manager or an implementing entity to help the MCAs manage the infrastructure projects outlined in their compacts before they received project funding. In some instances, the MCAs contracted with a commercial project management consultant to act as a project manager on the MCAs' behalf. In other instances, the MCA entered into a formal agreement with another government entity that acted as the implementing entity. For example, for its road construction projects, MCA-Georgia contracted with an international project management firm.

MCC also ensures that the MCAs have accountable individuals, to meet another condition for receiving project funding, to oversee the management of large infrastructure projects. MCC requires the MCAs to assign "project directors," such as a roads director, to monitor implementing entities and outside project management contractors. In Georgia and Cape Verde—where the infrastructure projects reviewed included roads and bridges, a pipeline, and a port project—we found that MCC required the MCAs to have project directors for the different types of projects. In addition, we found that MCC required the MCAs to use independent construction supervisors to conduct oversight of day-to-day construction, including overseeing construction progress and the actions of the construction contractor to ensure compliance with contract requirements. In the case of the pipeline project in Georgia, the implementing entity acted as both the project manager and the independent construction supervisor.

MCC also requires the MCAs to conduct oversight of their project management units and projects through an MCA supervisory board generally comprising high-level government officials and representatives of the business sector and civil society. The board places additional high-level oversight and accountability on the performance of the project management units, the projects, and MCA contractors. The supervisory board must be briefed on challenges that require changes to the project scope, contract cost, schedule, or contractor. MCC also works with the MCAs' supervisory boards to restructure projects when needed to keep them within their budgets and compact time frames. The board is required to approve changes that the MCA project management unit proposes and decisions about hiring or replacing staff when performance and accountability issues warrant a change. In one of the three countries we

MCC Uses Cross-Functional Teams to Oversee Projects

reviewed, MCC took action when it had concerns about the effectiveness of the MCA's top-level management officer and worked with the supervisory board to see that the compact country changed the leadership of the MCA's project management unit.

We found that MCC uses integrated cross-functional project teams—comprising headquarters' IST and its independent engineering consultants—to provide technical expertise and operational support to MCC's oversight and to the MCAs in implementing infrastructure projects. MCC headquarters personnel who support oversight include contracting, financial, legal, environmental, and engineering staff. MCC also has about 24 engineering and environmental consultants that it uses to support MCC project oversight reviews.

On the basis of evidence contained in MCC's independent engineers' reports, MCC conducts reviews of project scope, cost, schedule, design and specifications, contractor performance, and environmental and safety issues. In cases where individuals must be moved and property acquired to accommodate projects, MCC also conducts reviews to ensure that the MCAs comply with MCC resettlement policies. In addition to conducting technical reviews of projects, MCC independent consultants also report on the performance of MCA project management consultants and construction supervisors in conducting effective project and construction management.

Conclusions

MCC works in challenging and resource-poor countries and has provided them with ownership and flexibility in the ways they can meet MCC's statutorily mandated requirement to ensure fiscal accountability and open, fair, and competitive procurements. While the MCAs we examined have made progress in implementing policies and procedures for financial management, some gaps remain. Without additional specificity from MCC in its financial guidance, the MCAs may continue to use inadequate policies and procedures that do not reflect best practices in their internal financial management and in monitoring the financial control activities of their implementing entities. In addition, although the MCAs generally adhered to MCC procurement requirements, absent their consistent adherence to guidance on conducting and documenting price reasonableness analysis, MCC will not be able to ensure that it receives the best value in procurements. Finally, MCC is conducting oversight and has taken steps to advance planning for infrastructure projects. However, the process changes MCC has made will not address problems caused by shortcomings in the designs that were not discovered until after contract

award and by cost estimates that did not sufficiently account for cost escalation associated with project delays and construction prices. Planning should be completed earlier so that the MCAs have more time to conduct effective design reviews and independent cost reviews. Otherwise, MCC risks funding MCA projects that cannot be completed within the 5-year compact time frame and within the allotted compact budgets. Earlier project planning and design and cost reviews will likely add to the cost and time required for planning and design, but should result in better designs, help to control costs, and reduce the challenges encountered during implementation.

Recommendations for Executive Action

To improve MCC's financial controls, procurement practices, and contract management, we recommend that the Chief Executive Officer of the Millennium Challenge Corporation take the following five actions:

1. Revise MCC guidance to MCAs to require that MCA FAPs include comprehensive policies and procedures related to the MCAs' financial transactions that are in accordance with best practices covering procedures such as authorizations, approvals, and key documentation of all transaction types.
2. Revise MCC guidance to MCAs to require that MCA FAPs incorporate policies and procedures related to disbursements of the MCAs' primary project- or program-related expenses, including oversight procedures and responsibilities for MCA personnel in charge of monitoring and evaluating the implementing entities' compliance with contract agreements.
3. Reinforce existing MCC guidance to MCAs on conducting and documenting price reasonableness analyses.
4. Establish a programmatic goal that MCAs conclude all project planning efforts—to include MCC final approvals of the MCAs' final feasibility surveys, engineering surveys, environmental surveys, and resettlement studies—prior to entry-into-force, but not later than the point at which the MCAs issue contract solicitations.
5. Require MCAs to obtain detailed reviews of project cost estimates—to include the extent that risks to projects, such as cost escalation, schedule delays, and other issues, have been considered—and of project designs before contract solicitation for large construction projects to better ensure that projects can be successfully bid and built.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from MCC. In commenting on the draft, MCC accepted GAO's recommendations and provided additional comments on some of our findings.

Regarding MCA financial controls, MCC accepted our recommendations and commented that some MCA travel and payroll policies did not require the documentation we looked for to verify expenses. However, without such documentation, we could not verify that travel actually occurred for the travel transactions or that employees worked the necessary number of hours for the payments made. Finally, MCC clarified certain aspects of the GRDF investment guidelines; accordingly, we have adjusted the report to reflect this clarification.

Regarding procurement, MCC accepted our recommendation and stated that it had now incorporated its existing guidance on price reasonableness analyses and contractor eligibility into MCC Procurement Guidelines so that they carry the weight of MCC policy. Furthermore, MCC procurement directors have been directed to reject any evaluation reports received from an MCA that do not include these determinations.

Regarding infrastructure planning and oversight, MCC stated that it accepted our recommendation that they conclude planning efforts prior to contract solicitation—ideally, prior to entry-into-force of the compact—and modified its processes beginning in fiscal year 2008 to require completion of feasibility studies and environmental assessments before compact signing. We are in the process of assessing the specific actions MCC has taken that address our findings.

MCC also accepted our recommendation that they obtain detailed reviews of project designs and cost estimates but stated that it conducts a number of reviews in due diligence and prior to the release of design and bidding documents. While MCC conducts reviews, our assessment of the compacts we examined, all of which had significant design, cost, and schedule issues, indicates that the project review process can still be improved. For example, MCC could expand its reviews by soliciting specialized project management experience in risk analysis and scheduling.

We have reprinted MCC's comments, with our responses, in appendix IV. We also incorporated technical comments from MCC in our report where appropriate.

We are sending copies of this report to interested congressional committees, the Chief Executive Officer of the Millennium Challenge Corporation, and other parties. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact David Gootnick 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. GAO staff who made major contributions to this report are listed in appendix V.



David Gootnick
Director, International Affairs and Trade Issues



Kay Daly
Director, Financial Management and Assurance Issues



Terrell G. Dorn
Director, Physical Infrastructure Issues

Appendix I: Objectives, Scope, and Methodology

The fiscal year 2008 Consolidated Appropriations Act, Public Law 110-161, mandated that GAO review the financial controls and procurement practices of the Millennium Challenge Corporation (MCC) and its accountable entities and the results achieved by its compacts. For the purpose of this initial engagement, we focused on financial controls and procurement practices for MCC compacts and on the development, implementation, and oversight of contracts and projects at MCC and its accountable entities.

We assessed MCC's overall framework for financial controls, procurement practices, and contract management through a detailed review of these areas at three MCC compact countries: Honduras, Georgia, and Cape Verde. While we cannot statistically project our findings to other countries on the basis of these three countries, we chose these countries because they totaled approximately 39 percent of MCC's disbursements at the end of fiscal year 2008. Intervening political events in other MCC countries also affected the selection of countries.¹

To determine whether MCC's financial controls help ensure accountability over compact country funding, we obtained an understanding of MCC financial requirements imposed on the country when compact agreements were signed. MCC delegates much of the development and implementation of internal control procedures and the fiscal oversight of its federal funding to the country's Millennium Challenge Account (MCA) accountable entity. As a result, we focused our work on policies and procedures at the three selected MCAs, including internal controls related to their financial transactions and on MCC's oversight of this process.

¹We initially planned to examine Georgia, Madagascar, and Honduras, the compacts with the first-, second- and third-highest total disbursements as of the end of fiscal year 2008. Together, these three compacts accounted for approximately 46 percent of MCC's total disbursements. However, our audit in Madagascar in January 2009 was interrupted by protests and instability in the country that ultimately led to the forced resignation of the country's elected president. On March 20, 2009, MCC announced that it was placing a hold on its operations in Madagascar, and it terminated the program on May 19, 2009, because of the undemocratic change of government. We eliminated Nicaragua, the country with the fourth-highest disbursement total, from our consideration because MCC partially suspended the compact in December 2008 due to concerns about the conduct of elections in the country. In June 2009, the MCC Board of Directors terminated the suspended portions of the Nicaragua compact. After removing Nicaragua from our consideration, we included Cape Verde, the country with the fifth-highest disbursements. In June 2009, Honduras experienced a coup, and the elected president was forcibly exiled. In September 2009, MCC terminated \$11 million of its assistance under the compact and placed a hold on an additional \$4 million.

To assess the extent to which the MCAs had adequate policies and procedures for managing their operations effectively, we used MCC's financial guidance and our *Standards for Internal Control in the Federal Government*.² Specifically, we (1) obtained relevant policies and procedures as documented in the country Fiscal Accountability Plan (FAP) and determined whether the policies were comprehensive; (2) interviewed each MCA's financial management staff to discuss additional control procedures not documented in the country FAP or other agreements; and (3) obtained additional documents, such as compact agreements or service contracts, to determine whether additional internal control information was included in these agreements. While our internal control standards for the federal government are not binding for the MCAs, they are a statement of best practices, and adherence to these standards provides reasonable assurance that fraud, waste, abuse, and mismanagement will be prevented or promptly detected.³

To determine the extent to which the MCAs were effectively implementing their internal controls as described in their FAPs' policies and procedures or other agreements, we gained an understanding of each MCA's overall financial management structure, and policies and processes by interviewing MCA officials. Specifically, we:

- Conducted walk-throughs and interviews with each MCA's financial management officials to identify relevant policies and procedures, including key internal control activities for its financial transactions.
- Performed tests of those control activities that we considered key in providing reasonable assurance that transactions were correct and proper, including
 - *segregation of duties related to the approval and authorization of payments*: dividing key duties and responsibilities among different people to reduce the risk of error or fraud,

²GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

³Internal control standards give management the responsibility and discretion to develop and implement the mechanisms for internal control necessary for providing reasonable assurance that the objectives of the agency are achieved with regard to effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

- *adequate supporting documentation*: supporting the disbursements through documentation to provide a basis for reconciling payment amounts and authorizations to disbursement of funds,
- *proper execution of transactions and events*: authorizing and executing transactions by persons acting within the scope of their authority to ensure that only valid transactions are initiated and approved, and
- *physical control over assets*: securing assets and periodically counting and comparing totals with control records.

We tested MCA transactions using data collection instruments (DCI) and criteria described in the MCA’s policies and procedures as documented in the MCA’s FAP or other documentation, such as project- or program-related contracts or agreements with third parties hired to manage or oversee implementation of the project activities. If transactions were not properly supported, we queried MCA officials to determine whether the required documentation could be located.

To perform tests of internal controls included in the MCA’s policies and procedures, we selected stratified random samples of disbursement transactions for fiscal years 2007 and 2008. Given the variation in the programs and projects conducted by the three countries selected, we divided our work into strata that included operational expenses such as travel; payroll; and project-related expenses, such as credit lines, resettlements, grants, and investments. See table 2 for additional details on the number and dollar value of transactions tested.

Table 2: Sample of Disbursements Tested and Dollar Value for Each MCA

| MCA | Number of strata | Sample size | Total number of transactions in the population | Total dollar value of sampled transactions | Total dollar value of transactions in the population |
|------------|------------------|-------------|--|--|--|
| Cape Verde | 7 | 166 | 1,789 | \$2,273,420 | \$22,529,469 |
| Georgia | 7 | 283 | 2,507 | 4,694,281 | 55,416,097 |
| Honduras | 6 | 240 | 2,318 | 10,092,713 | 33,799,980 |

Source: GAO analysis of MCC data.

The MCAs often contract out the management or oversight of some program- or project-related activities to implementing entities that have more specialized knowledge or needed skills. For some of these implementing entities, we selected additional transactions and tested controls at their site to determine whether transactions were properly

documented and to assess the MCAs' oversight of those activities. We selected items from the country's inventory list to test whether the MCA had established an adequate system to ensure physical control over assets. Disbursements for each country were randomly selected within each stratum to ensure an objective selection.

Our initial methodology for transaction testing included the selection of a statistical sample of transactions at each MCA; however, as our countries changed, we found that inconsistencies between the countries' financial management reporting systems did not always allow us to select an individual transaction to trace. For example, certain MCA systems processed transactions, such as payroll, in a batch process, and a payment selected from the database could be an entire monthly payroll, rather than a payment involving an individual. In addition, for some credit line and resettlement programs, the MCAs transferred large balances to credit institutions that would be divided and paid to specific recipients. In these cases, we selected additional transactions to test other key controls that could not be tested with the large transfers. Because of this limitation, we decided to use a random sample selection and to present results for the selected samples, rather than projecting to the entire population.

We assessed the reliability of the financial data provided by the three countries we reviewed by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

To describe MCC's procurement framework and its evolution, we reviewed MCC compact agreements, current and previous editions of MCC's procurement guidelines, procurement agreements, procurement guidance papers, and implementation letters. We did not independently assess the adequacy of the World Bank procurement guidelines upon which MCC procurement guidelines are based. We assumed after discussion with internal GAO procurement experts that fully implementing World Bank/MCC guidelines would constitute open, fair, and competitive procurement.

We also interviewed MCC officials in Washington, D.C., and compact countries, and MCA procurement officers and procurement agents in compact countries, to further our understanding of how MCC and the MCAs have managed and overseen procurement activities and to identify any issues with implementing MCC's framework in practice. We analyzed

current and previous editions of MCC guidance and agreements to identify how MCC's requirements and procedures have evolved. We further reviewed MCC interim activity reviews and audits of the MCAs to document MCC's post-review and audit processes.

To assess the adherence of MCA compact countries to MCC's procurement framework, we examined a stratified random sample of completed fiscal year 2008 MCA entity procurements for our three focus countries. As shown in table 3, we divided these procurements into the following four strata: (1) sole source procurements, (2) the five largest dollar value procurements, (3) procurements requiring MCC review, and (4) procurements that did not require MCC review. We identified the universe of procurements in each country using MCC's Procurement Performance Report (PPR) for each country. To ensure that the PPR sufficiently reflected the procurements in each country, we interviewed staff at the MCAs and checked reported procurement dates and descriptions in the files against those reported in the PPRs. We found a high degree of accuracy in the data reported in the PPRs, which provided us with reasonable assurance that the PPRs were sufficiently reliable for the purposes of our analysis.

Table 3: MCA Procurements by Population and Sample Sizes

| MCA | Procurement, by stratum | | | | Total |
|-------------------|-------------------------|------------------------------|-----------------|--------------------|------------|
| | Sole source | Five-largest non-sole source | With MCC review | Without MCC review | |
| Honduras | | | | | |
| Population size | 7 | 5 | 10 | 83 | 105 |
| Sample size | 7 | 5 | 10 | 41 | 63 |
| Cape Verde | | | | | |
| Population size | 2 | 5 | 1 | 64 | 72 |
| Sample size | 2 | 5 | 1 | 39 | 47 |
| Georgia | | | | | |
| Population size | 5 | 5 | 2 | 16 | 28 |
| Sample size | 5 | 5 | 2 | 16 | 28 |

Source: GAO analysis of MCA Procurement Performance Reports.

We reviewed all sole source procurements in each country during fiscal year 2008 because of their high risk for abuse, as outlined in the U.S. Agency for International Development, Office of Inspector General's Fraud Indicators. We also reviewed the five largest dollar value procurements in each country because of the dollars involved and their importance for compact implementation. We divided the remaining procurements into those with and without MCC review to determine whether MCC involvement in procurement changed the level of compliance with MCC's guidelines. Because of the small number of procurements with MCC review in each country, we selected all of these procurements in our sample. In addition, because the number of procurements with MCC review was so small relative to those without MCC review in each country, we could not make a valid comparison between the two strata. In Cape Verde and Honduras, we selected a stratified random probability sample for each country large enough to generate percentage estimates with a margin of error of at most plus or minus 10 percentage points at the 95 percent confidence level. We selected 63 of the 105 procurements from Honduras and 47 of the 72 procurements from Cape Verde. With this probability sample, each procurement in the population had a known, nonzero probability of being included in the sample. Each procurement in the sample was subsequently weighted in the analysis to account statistically for all procurements in the population, including those that were not selected. All percentage estimates from these samples presented in this report have a margin of error of plus or minus 10 percent or less, unless otherwise noted.

In Georgia, we reviewed all 28 procurements conducted in fiscal year 2008 because the relatively small number of procurements conducted in the country over that time period made sampling unnecessary.

We examined the selected procurements using a DCI to determine whether procurements were conducted according to MCC's procurement criteria.⁴ We assessed the MCA procurement process on compliance with MCC procurement guidelines, as outlined in table 4.

⁴MCC's procurement criteria are outlined in the MCC Procurement Guidelines and the Procurement Agreements between MCC and each compact country. For each procurement we reviewed, we ascertained compliance with guidelines outlined in the MCA Procurement Agreement and the MCC Procurement Guidelines that were in place at the time of the procurement.

Table 4: Measures of Compliance with MCC Procurement Guidelines

| MCC requirements | Compliance elements assessed |
|--|--|
| MCC oversight or approval of a procurement action | MCC approvals, when required, at up to eight points in the procurement process, including approval of procurement method, prequalification and bidding documents, short-listed contractors, the technical evaluation report, the proposed award, the final contract, and any modifications to the contract after it has been signed. |
| MCA governing body oversight or approval of a procurement action | MCA approvals, when required, at up to seven points in the procurement process, including approval of prequalification and bidding documents, short-listed contractors, the technical evaluation report, the proposed award, the final contract, and any modifications to the contract after it has been signed. |
| Choice of procurement process | Whether the MCA used a competitive bidding process to secure the contract. In cases where the MCA used a noncompetitive procedure, we assessed whether the MCA provided appropriate justification to do so. |
| Prequalification procedures | Whether the MCAs followed MCC guidelines for advertising for prequalification. |
| Advertising procedures | Whether the MCAs followed MCC guidelines for advertising procurements and preparing bidding documents. |
| Bid evaluation procedures | MCA compliance with nine bid evaluation requirements, including documenting the independence of the technical evaluation panel, preparation of the technical evaluation report, selection of the winning bidder, vetting of contractors to comply with MCC requirements, and determination of price reasonableness. |
| Documentation of receipt of goods, works, or services contracted under the procurement | Whether the MCAs had received goods, works, or services and whether the received goods matched specifications outlined in the contract. |

Source: GAO analysis of MCC requirements.

We reviewed each file to assess whether it contained documentation that the MCA had followed the required procedures. If required documentation was not present in the file, we queried MCA officials to determine whether the required document could be located elsewhere. We did not, however, assess the quality of these required documents. In addition, our review included only a limited number of procurements that were completed following the introduction of MCC’s implementation model and Schedule B approvals matrix. Therefore, our findings do not assess the effectiveness of the implementation model.

In addition to the statistical selection of the procurements for review using our DCI, we also judgmentally selected procurements whose reporting in the PPR exhibited potential indicators of fraud, such as multiple contract awards to a single entity, contracts awarded in multiple lots where awarding as one lot would have required additional reviews, and contracts awarded on a sole source basis. Some of these procurements were selected for inclusion in our DCI analysis; the remainder were assessed through interviews or document review to determine whether these potential fraud indicators could be explained by other circumstances. In

addition, because canceled procurements represent lost time and effort spent in developing the procurement or contract, we identified canceled procurements in each country in fiscal year 2008. Although we did not do a formal review of these procurements using the DCI, we interviewed the MCA staff about these procurements to understand the reasons for cancellation.

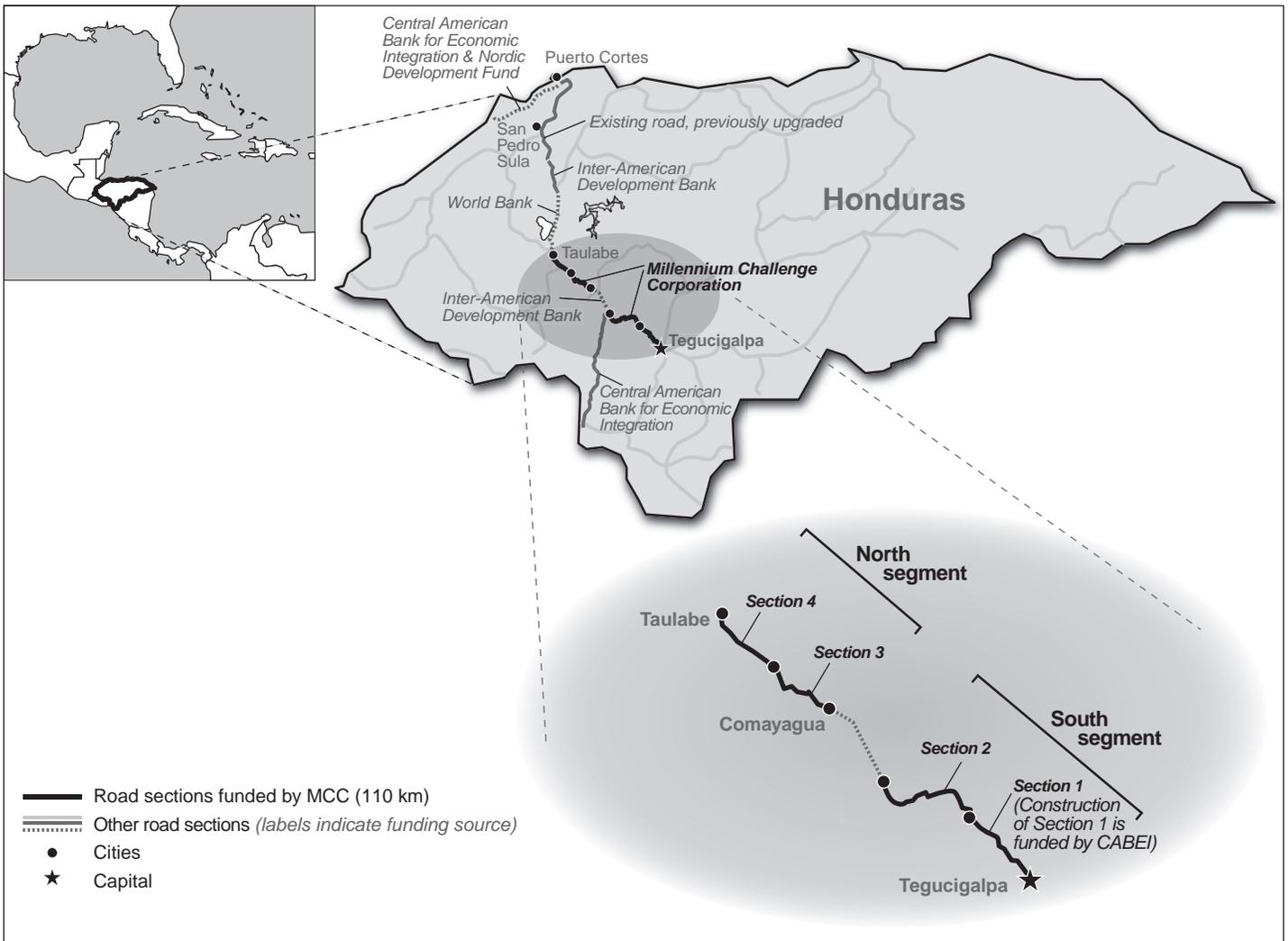
To assess the time frames required for MCC procurements, we identified key procurements in each of our three focus countries. We defined key procurements as those with a contract award amount greater than or equal to \$1 million for goods, works, or consultant services. We then reviewed Procurement Implementation Plans for those procurements, where available, and compared the time frames anticipated in those plans with the actual procurement time frames provided to MCC in the PPR to determine the difference between planned and actual time frames. We further reviewed associated reporting documents and discussed these key procurements with the MCA procurement directors to determine the causes for any delays in these key procurements.

To assess MCC's development, implementation, and oversight of contracts, we examined the three infrastructure construction contracts with the largest dollar value and the largest consultant services contract associated with construction services in each of our three sample countries.

We reviewed the following MCAs:

- *Honduras*: The Honduras compact called for the improvement of approximately 110 kilometers of the CA-5 highway comprising the "North Segment" (sections 3 and 4) and a "South Segment" (sections 1 and 2), both of which are located north of Tegucigalpa. We reviewed three MCC-funded road construction contracts associated with the CA-5 highway project in Honduras. The contracts are identified as roadway sections 2, 3, and 4, with contract awards of \$48.4 million, \$16.2 million, and \$23.2 million, respectively. Other roadway sections of the highway are being improved by other funding sources. (See fig. 10.)

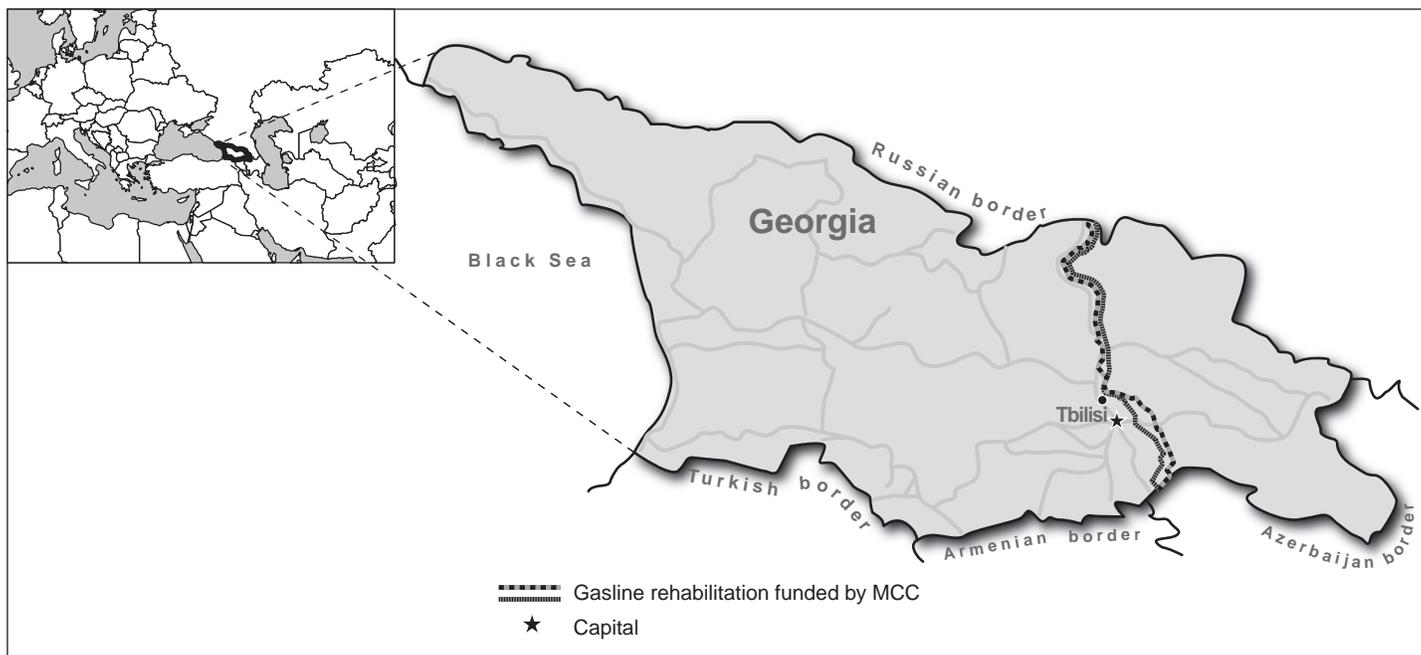
Figure 10: Honduras CA-5 Highway Project



Sources: GAO synthesis of MCA-furnished project maps; Map Resources (base map).

- Georgia:* We reviewed one MCC-funded construction contract, awarded for 8.7 million Georgian Lari—valued at more than \$6.2 million at the time—for phase II of the North-South Gas Pipeline Rehabilitation Project at nine sites along the pipeline. (See fig. 11.)

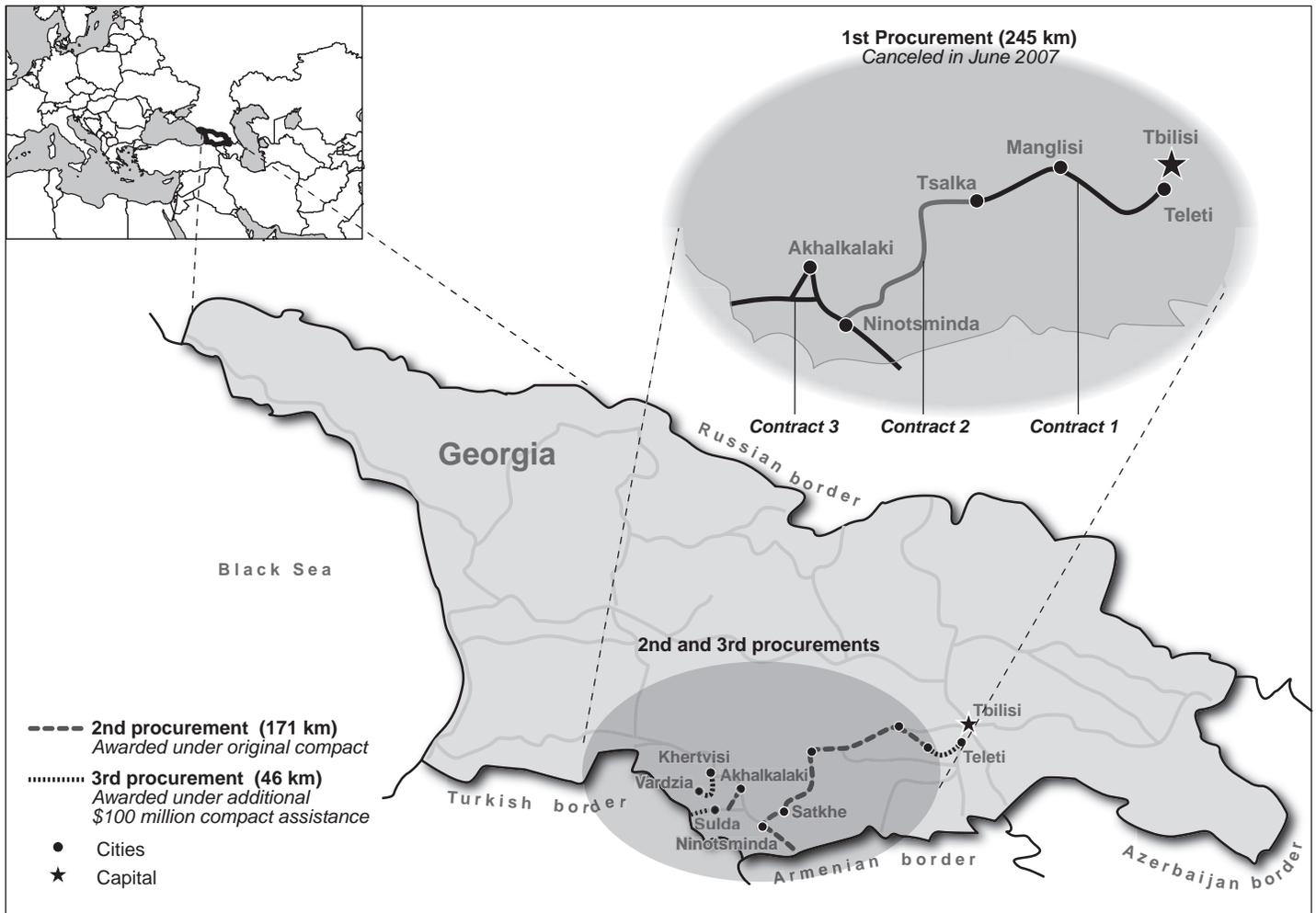
Figure 11: Georgia North-South Gas Pipeline Rehabilitation Project



Sources: GAO synthesis of MCA-furnished project maps; Map Resources (base map).

- We also reviewed two road construction contracts associated with the Samtskhe-Javakheti Roads Rehabilitation Project—for rehabilitation of approximately 171 kilometers of roads in the Samtskhe and Javakheti regions—that were awarded under what is identified as the “2nd procurement.” The first contract under that procurement was awarded in March 2008 for \$65.0 million; the second was awarded in May 2008 for \$33.1 million. An earlier procurement effort—identified as the “1st Procurement”—intended to award three contracts to rehabilitate 245 kilometers was canceled in June 2007 after contractor bids exceeded the available budget. When Georgia received an additional \$100 million in compact funding, it allowed for a “3rd procurement” that enabled MCA-Georgia to award three additional road contracts, two in April 2009 and the third in June 2009, totaling about 46 kilometers. (See fig. 12.)

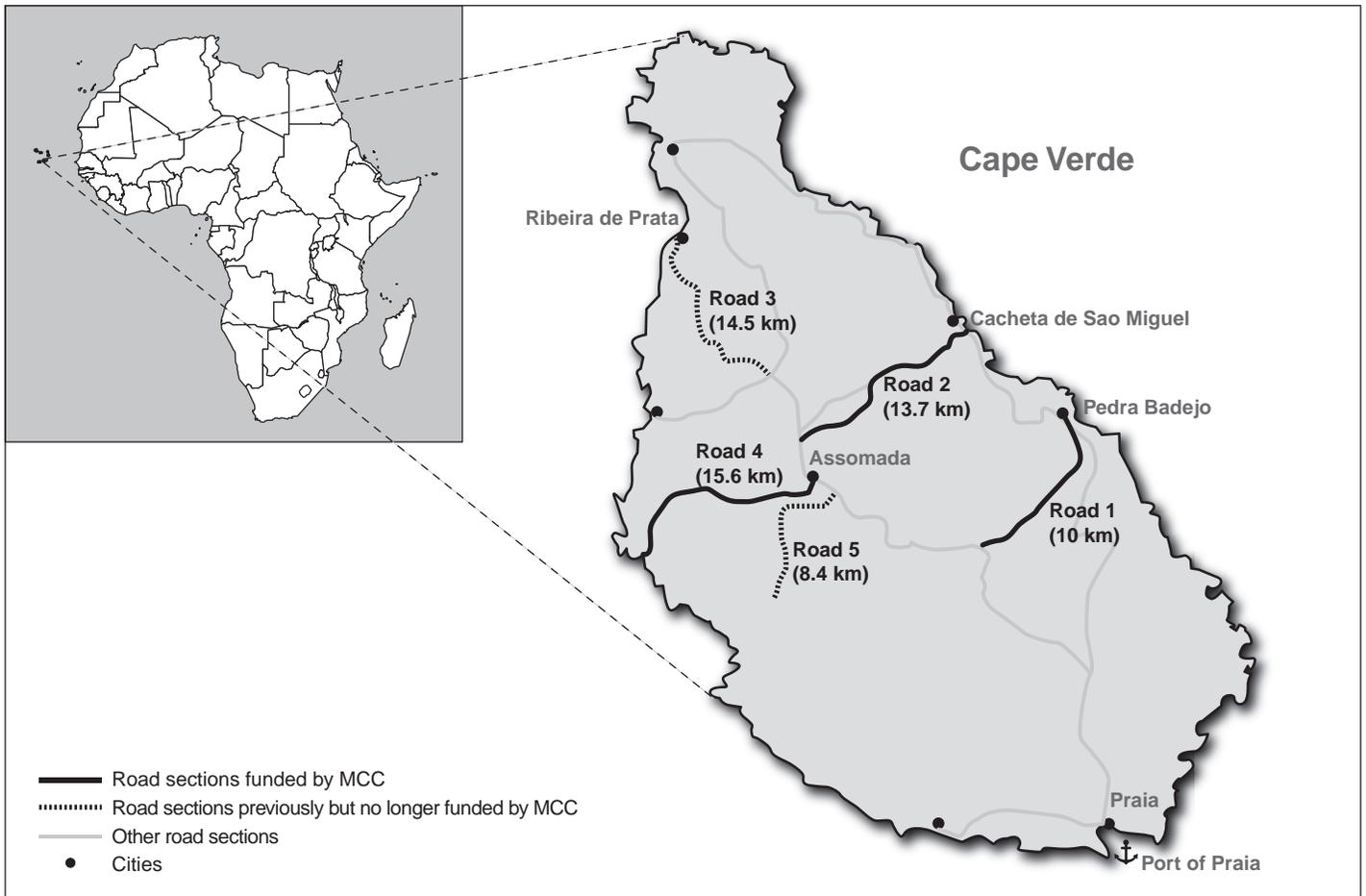
Figure 12: Samtskhe-Javakheti Roads Rehabilitation Project Procurements



Sources: GAO synthesis of MCA-furnished project maps; Map Resources (base map).

- Cape Verde:* In the case of Cape Verde—which consists of 10 separate islands—we reviewed three contracts valued at more than \$56.6 million to improve Cape Verde’s port, roads, and bridges. The contract for the phase I port project, to upgrade and expand the port of Praia on Santiago Island, was awarded for \$42.3 million. The roads contract, to rehabilitate five roads on Santiago Island, was awarded for more than \$11.0 million. Two of five roads were eliminated (identified as roads 3 and 5) from the contract scope due to cost increases. The contract for reconstruction of four bridges, on Santo Antão Island (not shown), was awarded for roughly \$3.3 million. (See fig. 13.)

Figure 13: MCC-Funded Roads Project and Port of Praia Project on Santiago Island, Cape Verde



Sources: GAO synthesis of MCA-furnished project maps; Map Resources (base map).

We also examined MCC’s use of its independent engineers in supporting MCC’s oversight efforts related to the previously discussed infrastructure contracts and projects. To conduct our work, we reviewed project reports prepared by (1) the MCAs, (2) MCA implementing entities, (3) MCA project management consultants, (4) MCA independent construction supervisors, (5) MCA construction contractors, (6) MCC independent engineers, and (7) MCC. Those project reports generally report on project status, including scope, cost, schedule, engineering, environmental, and health and safety issues. To further understand and corroborate these reports, we interviewed MCC officials in Washington, D.C., and MCC resident country directors working in the compact countries. We also interviewed MCA management in the compact countries, MCA project

management consultants, MCA independent construction supervisors, MCA design engineers, and MCA construction contractors.

We compared MCC's oversight with GAO's *Executive Guide: Leading Practices in Capital Decision-Making*⁵ to assess MCC's activities against best practices. Our assessment of planning, design, schedule, and cost status of projects was informed by our review of MCC and MCA reports and those of their contractors. Our evaluation of the sufficiency of MCC's oversight documents was guided by lessons learned from past GAO work on infrastructure projects and industry best practices. Lastly, we made field visits to select projects in Honduras and Georgia to confirm some of the information reported within contractor progress reports. Because a recent U.S. Agency for International Development, Office of Inspector General, audit of Cape Verde compact implementation included field visits to projects, our findings for this objective did not rely on a site visit in Cape Verde.

We conducted this performance audit from June 2008 to October 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁵GAO, *Executive Guide: Leading Practices in Capital Decision-Making*, [AIMD-99-32](#) (Washington, D.C.: Dec. 1, 1998).

Appendix II: Reductions in MCC Procurement Review Thresholds

MCC's most recent version of its procurement guidelines, released in July 2008, established a 2-tier system of approvals that allows for less MCC review of procurement actions. Schedule A under these guidelines represents the initial level of review for most countries and is a reduction in review from all previous versions of the procurement guidelines. As countries gain experience and MCC gains confidence that they are implementing MCC procurement guidelines, MCC permits the country to transition to Schedule B.

Figure 14: MCC Approval Requirements from the Program Procurement Guidelines of July 21, 2008 (Goods, Works, and Nonconsultant Services)

| I. Goods, works and non-consultant services | | May 2007 – June 2008 versions | July 2008 version | |
|---|---|--|--------------------|---|
| | | | Schedule A | Schedule B (for MCC-approved compacts) |
| Procurement procedure or method | Decision | MCC procurement review thresholds | | |
| Pre-qualification | Pre-qualification documents and advertising procedures | Above \$1,000,000 | — | No review required |
| | Report with proposed list of entities qualified | Above \$500,000 | — | No review required |
| | Record of bid challenges | Review all | — | — |
| Competitive bidding | Bidding documents | Goods > \$1,000,000 Works above \$5,000,000 | — | — |
| | Technical evaluation or review report with proposed award | Above \$250,000 | Above \$500,000 | Above \$500,000 |
| | Final contract | Above \$250,000 | No review required | No review required |
| | Record of bid challenges | Review all | — | — |
| Limited bidding | Short list report | Above \$100,000 | — | No review required |
| | Bidding documents | Above \$500,000 | — | — |
| | Technical evaluation or review report with proposed award | Above \$1,000,000 | — | — |
| | Final contract | Above \$1,000,000 | No review required | No review required |
| Shopping | Record of bid challenges | Review all | — | — |
| | Short list report | No review required | — | — |
| | Record of purchases | No review required | — | — |
| Direct contracting | Record of bid challenges | Quarterly record of decisions | — | — |
| | Proposed award | Above \$50,000 | — | — |
| | Final contract | Above \$50,000 | — | — |
| Force account | Record of bid challenges | Review all | — | — |
| | Selection of using equipment owned by or employees of Government for performing works | Review all | — | — |
| | Proposed contract | Review all | — | — |
| All procurement actions | Final contract | Review all | — | — |
| | Contract modifications and change orders | If increases value of contract by 10% or more | — | — |

 Reductions in MCC review thresholds from previous versions
 — Indicates no change

Source: GAO analysis of MCC data.

Appendix II: Reductions in MCC Procurement Review Thresholds

Figure 15: MCC Approval Requirements from the Program Procurement Guidelines of July 21, 2008 (Consultant Services)

| II. Consultant services | | May 2007 – June 2008 versions | July 2008 version | |
|---|--|--|--------------------------|---|
| Procurement procedure or method | Decision | MCC procurement review thresholds | Schedule A | Schedule B (for MCC-approved compacts) |
| Quality and cost based selection | Request for expression of interest | Above \$500,000 | No review required | No review required |
| | Technical evaluation panel | Above \$500,000 | No review required | No review required |
| | Short list report | Above \$100,000 | Above \$500,000 | No review required |
| | Proposal documents | Above \$500,000 | — | — |
| | Technical evaluation report | Above \$100,000 | Above \$500,000 | Above \$500,000 |
| | Proposed award | Above \$100,000 | Above \$500,000 | No review required |
| | Final contract | Above \$100,000 | No review required | No review required |
| | Record of bid challenges | Review all | — | — |
| Quality based selection and selection under fixed budget | Request for expression of interest | Above \$500,000 | No review required | No review required |
| | Technical evaluation panel | Above \$500,000 | No review required | No review required |
| | Short list report | Above \$100,000 | No review required | No review required |
| | Proposal documents | Above \$500,000 | — | — |
| | Technical evaluation report for QBS only | Above \$100,000 | Above \$500,000 | Above \$500,000 |
| | Proposed award | Above \$100,000 | Above \$500,000 | No review required |
| | Final contract | Above \$100,000 | Above \$500,000 | No review required |
| | Record of bid challenges | Review all | — | — |
| Least-cost selection | Request for expression of interest | No review required | — | — |
| | Technical evaluation panel | No review required | — | — |
| | Short list report | Above \$100,000 | Above \$500,000 | No review required |
| | Proposal documents | No review required | — | — |
| | Proposed award | Above \$100,000 | Above \$500,000 | No review required |
| | Final contract | No review required | — | — |
| | Record of bid challenges | Review all | — | — |
| Selection based on consultant's qualifications | Request for expression of interest | No review required | — | — |
| | Technical evaluation panel | No review required | — | — |
| | Short list report | Above \$50,000 | Above \$500,000 | No review required |
| | Standard solicitation documents | No review required | — | — |
| | Technical evaluation report | No review required | — | — |
| | Proposed award | No review required | — | — |
| | Final contract | Above \$50,000 | Above \$500,000 | No review required |
| Sole-source selection | Record of bid challenges | Review all | — | — |
| | Proposed award | Above \$50,000 | — | — |
| | Final contract | Above \$50,000 | — | — |
| Selection of individual consultants | Record of bid challenges | Review all | — | — |
| | Short list report | Above \$50,000 | — | No review required |
| | Technical evaluation panel | Above \$50,000 | No review required | No review required |
| | Technical evaluation report | No review required | — | — |
| | Proposed award | No review required | — | — |
| | Final contract | Above \$50,000 | — | No review required |

Reductions in MCC review thresholds from previous versions
 Indicates no change

Source: GAO analysis of MCC data.

MCC uses professional judgment and its implementation model framework to identify countries that may graduate from Schedule A to Schedule B. Among other things, the framework addresses the MCA's (1) capability and experience, (2) successful execution of previous procurements, (3) appropriate and qualified procurement advisors, and (4) maturity of the compact.

Schedule A reduced the level of MCC approvals in 20 of 61 potential procurement actions, entirely eliminating MCC review in 9 cases. In 13 of 61 potential procurement actions, Schedule B reduced the level of MCC review below that of Schedule A—in all 13 cases by removing MCC review altogether. As of October 2008, five countries have transitioned to Schedule B.

Appendix III: Documentation of Compliance with MCC Procurement Criteria

This appendix provides a more detailed breakout of the results of our procurement requirement testing contained in table 1 of this report.

Table 5: Detailed Estimated Percentage of Country Procurements Meeting MCC Procurement Criteria

| Procurement criteria | Percentage (number of reviewed procurements) | | |
|---|--|----------------------|-----------------------|
| | Cape Verde ^a | Georgia ^b | Honduras ^a |
| Overall approvals | | | |
| Obtained all required MCC approvals^c | 100% (47) | 96% (28) | 100% (63) |
| Obtained all required approvals | 23 | 32 | 15 |
| Approvals not required | 77 | 64 | 85 |
| One or more approval missing | 0 | 4 | 0 |
| Obtained all required MCA governing body approvals^d | 100% (47) | 86% (28) | 92% (63) |
| Obtained all required approvals | 17 | 29 | 10 |
| Approvals not required | 83 | 57 | 82 |
| One or more approval missing | 0 | 14 | 8 |
| Prequalification | | | |
| Advertised prequalification for procurement in English | 100% (47) | 100% (27) | 100% (63) |
| Met requirement to advertise prequalification in English | 9 | 11 | 7 |
| Not required to advertise prequalification in English | 91 | 89 | 93 |
| Did not meet requirement to advertise prequalification in English | 0 | 0 | 0 |
| Advertised prequalification in required locations | 94% (47) | 96% (28) | 100% (63) |
| Met requirement to advertise prequalification in required locations | 4 | 11 | 7 |
| Not required to advertise prequalification in required locations | 90 | 86 | 93 |
| Did not meet requirement to advertise prequalification in required locations | 6 | 4 | 0 |
| Invitation for bid | | | |
| Justified use of another procurement method if the MCA did not use competitive bidding | 100% (47) | 100% (28) | 97% (63) |
| Justified use of another procurement method | 5 | 21 | 5 |
| Justification not required | 95 | 79 | 92 |
| Did not justify use of another procurement method | 0 | 0 | 3 |
| Advertised procurement in English | 100% (47) | 100% (28) | 100% (63) |
| Met requirement to advertise procurement in English | 13 | 39 | 13 |
| Not required to advertise procurement in English | 87 | 61 | 87 |
| Did not meet requirement to advertise procurement in English | 0 | 0 | 0 |
| Published bidding documents in English | 99% (47) | 100% (28) | 93% (63) |
| Met requirement to publish bidding documents in English | 13 | 36 | 7 |
| Not required to publish bidding documents in English | 86 | 64 | 87 |

**Appendix III: Documentation of Compliance
with MCC Procurement Criteria**

| Procurement criteria | Percentage (number of reviewed procurements) | | |
|--|--|----------------------|-----------------------|
| | Cape Verde ^a | Georgia ^b | Honduras ^a |
| Did not meet requirement to publish bidding documents in English | 1 | 0 | 7 |
| Circulated procurement advertisement in required locations | 99% (47) | 82% (28) | 98% (63) |
| Met requirement to circulate procurement advertisement in specified publications | 68 | 7 | 5 |
| Not required to circulate procurement advertisement in specified publications | 30 | 75 | 93 |
| Did not meet requirement to circulate procurement advertisement in specified publications | 1 | 18 | 2 |
| Bid evaluation | | | |
| Documented bid opening | 100% (47) | 100% (28) | 100% (63) |
| Met requirement to document bid opening | 70 | 39 | 15 |
| Not required to document bid opening ^e | 30 | 61 | 85 |
| Did not meet requirement to document bid opening | 0 | 0 | 0 |
| Procurement file contained a detailed report on evaluation and comparison of bids | 100% (47) | 100% (28) | 100% (63) |
| Met requirement to have a detailed report on evaluation and comparison of bids | 97 | 86 | 94 |
| Not required to have a detailed report on evaluation and comparison of bids ^f | 3 | 14 | 6 |
| Did not meet requirement to have a detailed report on evaluation and comparison of bids | 0 | 0 | 0 |
| Documented reason for disqualification when bids were disqualified | 100% (47) | 100% (28) | 100% (63) |
| Met requirement to document reason for disqualification when bids were disqualified | 54 | 21 | 10 |
| Not required to document because no bids were disqualified | 46 | 79 | 90 |
| Did not meet requirement to document reason for disqualification when bids were disqualified | 0 | 0 | 0 |
| Documented contractor eligibility | 98% (47) | 25% (28) | 74% (63) |
| Met requirements to verify and document contractor eligibility | 98 | 25 | 74 |
| Not required to verify and document contractor eligibility | 0 | 0 | 0 |
| Did not meet requirements to verify and document contractor eligibility | 2 | 75 | 26 |
| Documented impartiality of the evaluation panel | 74% (47) | 86% (28) | 80% (63) |
| Met requirements to document impartiality of the evaluation panel | 71 | 71 | 72 |
| Not required to document impartiality of the evaluation panel ^g | 3 | 14 | 8 |
| Did not meet requirements to document impartiality of the evaluation panel | 26 | 14 | 20 |

**Appendix III: Documentation of Compliance
with MCC Procurement Criteria**

| Procurement criteria | Percentage (number of reviewed procurements) | | |
|---|--|----------------------|-----------------------|
| | Cape Verde ^a | Georgia ^b | Honduras ^a |
| Contract management | | | |
| Had procured item or record of receipt of item | 100% (46) | 100% (27) | 99% (62) |
| Met requirement to have procured item or record of receipt of item | 93 | 78 | 87 |
| Not required to have item or record of receipt of item ^g | 7 | 22 | 13 |
| Did not meet requirement to have item or record of receipt of item | 0 | 0 | 1 |
| Procured items matched contract specifications | 100% (47) | 100% (27) | 99% (63) |
| Procured items matched contract specifications | 73 | 74 | 85 |
| Not required ^h | 27 | 26 | 14 |
| Procured items did not match contract specifications | 0 | 0 | 1 |

Source: GAO analysis of MCA procurement files.

Note: MCC's requirements vary by the size and method of the procurement; therefore, not all procurements we examined had to meet each requirement we tested. For more information on these procurement methods, see appendix II.

^aThe percentages listed for Cape Verde and Honduras are estimates based on our review of a stratified random sample of procurements. These estimates have a margin of error of less than plus or minus 9 percentage points at the 95 percent confidence level.

^bIn Georgia, we reviewed all 24 procurements conducted by the MCA and 4 by the Georgian Municipal Development Fund during fiscal year 2008; thus, the percentages reflect actual procurements reviewed, rather than estimates.

^cThis variable represents a summation of all instances where MCC approvals might be required (8 approval steps).

^dThis variable represents a summation of all instances where MCA governing body approvals might be required (7 approval steps).

^eWe did not check for a record of bid openings for sole source contracts and shopping procurements.

^fWe did not check for an evaluation and comparison of bids for sole source contracts.

^gWe did not check for the item or record of receipt of item for contracts that were ongoing at the time of our review.

^hWe did not check if procured items matched contract specifications in cases where the contract was ongoing.

Appendix IV: Comments from the Millennium Challenge Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Darius Mans
Acting Chief Executive Officer

October 23, 2009

Mr. Emil Friberg
Assistant Director
Government Accountability Office
441 G Street N.W.
Washington D.C. 20548

Dear Mr. Friberg:

This letter is in response to the Government Accountability Office's (GAO) request for comments on GAO's draft report (GAO-10-52) titled *MCC Has Addressed a Number of Implementation Challenges but Needs to Improve Financial Controls and Infrastructure Planning*, dated October 2009. I appreciate GAO's recognition of the Millennium Challenge Corporation's (MCC) operational challenges with partner countries and of the steps that MCC has already taken to strengthen financial controls and implementation oversight, which includes standardizing a fiscal accountability plan (FAP) template, standardizing MCC Program Procurement Guidelines, and improving the development of infrastructure projects in new compacts.

Please find below MCC's comments on the recommendations for executive action and certain other findings as set forth in the draft report:

GAO Recommendation #1: Revise MCC guidance to Millennium Challenge Accounts (MCAs) to require that MCA fiscal accountability plans include comprehensive policies and procedures related to its financial transactions that are in accordance with best practices covering procedures such as authorization, approvals, and key documentation of all transaction types.

MCC Response: MCC accepts the recommendation. Documented policies and procedures are in place for project and program expenses in FAPs, program implementation agreements, and implementing entity agreements. MCC agrees that it would be useful to have all policies and procedures in one source document and will work with the MCAs to incorporate separate internal control documents as annexes to the FAP. Based on the findings in the draft report, MCC will work with the MCAs to tighten up policies and procedures related to travel, payroll, and authorization of major program expenditures where deficiencies were noted.

875 Fifteenth Street NW | Washington, DC | 20005-2221 | p: (202) 521-3570 | f: (202) 521-3572 | www.mcc.gov

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Comments on specific GAO findings:

- *Travel policies in Honduras and Cape Verde lacked key requirements for supporting documentation.*

See comment 1.

Honduras: Honduras uses a modified version of the United Nations travel policy that, in most cases, does not require submission of receipts for lodging, meals, and incidental expenses. Transportation costs are generally paid in advance by MCAs on behalf of the traveler. The Honduras FAP sets forth this policy and also states per diem amounts for all destinations. In some cases, however, travelers may claim actual expenses for travel and, in those cases, receipts are required for expenses exceeding \$35.00. The Honduras FAP does not expressly prohibit business class air travel, nor does it make allowances for it. All travel must be approved by the general director of MCA-Honduras, who assesses the request based on the need and purpose of travel.

See comment 1.

Cape Verde: The Cape Verde FAP provides that, for purposes of travel outside and inside Cape Verde, MCA-Cape Verde will pay its travelers a daily subsistence allowance for each day of the mission outside the main office to cover travelers' expenses related to meals, hotel accommodations, and communication. The allowance is calculated using rates provided by the United Nations Funds and Programs Office in Cape Verde.

Further, within ten business days after returning from the mission the traveler must submit:

- i. A mission report containing the principal findings of the mission, the deliverables accomplished, the actions to be taken, and the entity responsible for these actions.
- ii. A financial report showing the actual cost of the mission against the planned cost, accompanied by the following documents:
 - a. Original travel voucher/document;
 - b. Boarding pass stub or valid receipt for hotel stays; and
 - c. Receipts for other expenses not foreseen and supported by the traveler.

Also, in the event that the mission duration was shorter than originally planned, the traveler must refund the corresponding portion of the daily subsistence allowance.

MCC agrees with the finding concerning Cape Verde business class travel and the FAP language in this area will be improved.

- *Payroll policies in Honduras and Cape Verde did not include a requirement for staff to prepare individual timesheets or other documentation that could be used by direct supervisors to verify actual hours worked before payroll was processed.*

Honduras: The Honduras FAP states that, "The MCA-Honduras Administration and Finance Director shall receive from Executing Units a monthly payroll sheet properly prepared and

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See comment 2.

authorized, and invoices for all required payments of staff.” This “monthly payroll sheet” would be considered either a timesheet or other documentation. MCC’s fiscal accountability directors will affirm adherence to these procedures as part of their next site visit and, if necessary, recommend an improvement to the FAP.

Cape Verde: MCC acknowledges the finding and agrees that Cape Verde FAP language in this area needs to be improved.

GAO Recommendation #2: Revise MCC guidance to MCAs to require that MCA FAPs incorporate policies and procedures related to disbursements of the MCA’s primary project or program-related expenses, including oversight procedures and responsibilities for MCA personnel in charge of monitoring and evaluating the implementing entities’ compliance with contractual agreements.

MCC Response: MCC has not examined the samples cited by GAO as a basis for their findings and therefore has no comments on the specific deficiencies noted in the draft report. MCC accepts the recommendation, and will work with the MCAs to strengthen compliance with documentation requirements where needed as part of a review of the FAPs (see MCC’s response to recommendation #1).

Comment on specific GAO finding:

- *During our review of the GRDF disbursement transactions, we found inconsistencies between the initial investments and the program goals, as defined by the GRDF operating guidelines. (Footnote #31)*

See comment 3.

The draft report states that the Georgia Regional Development Fund (GRDF) has invested in two businesses located in Tbilisi. In fact, GRDF has invested in only one such entity (a furniture retailer located in Tbilisi). Moreover, GRDF’s investment guidelines permit (i) up to 20 percent of GRDF’s invested capital to be invested in businesses within Tbilisi, and (ii) a fraction of the investments to go to businesses not engaged in agriculture or tourism. This investment is therefore consistent with the investment guidelines.

GAO also notes that one GRDF investee was a subsidiary of a company whose revenues exceeded the \$5 million limit for investment eligibility. In fact, the investee is not a subsidiary of this company and the investee had revenues of less than \$5 million. Therefore this investment is also consistent with the investment guidelines.

GAO Recommendation #3: Reinforce existing guidance to MCAs on conducting and documenting price reasonableness analyses.

MCC Response: MCC accepts the recommendation and has already undertaken efforts to address this concern. MCC is pleased by the GAO finding that the three MCAs reviewed obtained nearly all required approvals for procurement actions and that each MCA showed a high rate of compliance with MCC’s procurement requirements.

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Prior to GAO's visits, MCC's interim activity reviews identified that for some procurements MCAs may have had difficulty finding price reasonableness information, or, alternatively, the MCAs may have misunderstood the requirement. MCC takes price reasonableness of all contract awards seriously and, based on the interim activity reviews, has implemented corrective actions in the countries where issues were identified. The lessons learned from the interim activity reviews have also been disseminated to other MCAs as a guide for "best practices." MCC's existing guidance paper, *Guidance on the Price-Reasonableness Analysis*, describes in detail the methods for conducting the price reasonableness analysis. The guidance has been incorporated into the MCC Program Procurement Guidelines to ensure that the price reasonableness determination requirement carries the weight of being part of MCC policy rather than solely as guidance. All MCC procurement directors have been directed to reject any evaluation report received from an MCA that does not include a price reasonableness determination. In addition, MCC procurement directors have provided training to several MCAs on this subject. MCC will ensure that MCA and MCC compact implementation staffs have training in this specific area and in procurement practices generally to ensure uniformity of procurement training at the MCAs and MCC.

Comment on specific GAO finding:

- *Despite general compliance with MCC procurement guidelines, MCAs did not document contractor eligibility and evaluation panel impartiality in all cases.*

Documentation of both contractor eligibility and evaluation panel impartiality is required in the evaluation reports. Upon receipt, MCC procurement staff ordinarily review an evaluation panel report for approval. It is clear from the draft report that evidence of such a review was missing from some evaluation reports. MCC will reinforce in a letter to all staff and MCAs that both eligibility checks and evidence of evaluation panel impartiality must be completed, and that results of the review must be included in the evaluation reports. All MCC procurement directors have been directed to reject any evaluation report received from an MCA that does not include a contractor eligibility determination and/or documentation of the impartiality of the evaluation panels. MCC's existing guidance paper, *Guidance on Excluded Parties Verification Procedures in MCA Entity Program Procurements*, describes in detail the methods for conducting the contractor eligibility determination. This guidance has been incorporated into the MCC Program Procurement Guidelines to ensure that the contractor eligibility determination requirement carries the weight of being part of MCC policy rather than solely as guidance. In addition to the contractor eligibility determination guidance, MCC procurement directors have provided training to the MCAs on this subject. MCC will ensure that all MCAs and MCC compact implementation staff have training in this specific area and in procurement practices generally to ensure uniformity of procurement training at the MCAs and MCC.

GAO Recommendation #4: Establish a programmatic goal that MCAs conclude all project planning efforts -- to include MCC final approvals of MCAs final feasibility surveys, engineering surveys, environmental surveys, and resettlement studies -- prior to entry into force, but not later than the point at which MCAs issue contract solicitations.

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See comment 4.

MCC Response: MCC accepts the recommendation, and has already implemented changes to address the concern. In early compacts, infrastructure projects were approved, for the most part, based on studies and designs that were at a relatively early stage -- pre-feasibility studies and preliminary designs. Full feasibility studies, environmental impact assessments, resettlement action plans, final designs, and design reviews were undertaken following compact signing, either using 609(g) grant funds or compact funds. Project costs and scope often changed as a result of that process, with the consequences noted in the draft report. Recognizing the implications of this early approach, beginning in fiscal year 2008, MCC modified its internal processes to require completion of full feasibility studies and environmental impact assessments (including resettlement plans) prior to compact signing.

GAO Recommendation #5: Require MCAs to obtain detailed reviews of project cost estimates - - to include the extent risks to projects such as cost escalation, schedule delays, and other issues have been considered -- and project designs before contract solicitation for large construction projects to better ensure that projects can be successfully bid and built.

MCC Response: MCC accepts this recommendation and has already undertaken efforts to address the concern. Under MCC's revised compact development process, full feasibility studies and environment impact assessments are completed prior to compact signing. MCC conducts independent due diligence on this work and then cost contingencies are included based on industry standards; this additional up-front work will help ensure that projects can be successfully completed within five years and within budget. In all cases of design-bid-build infrastructure projects, full engineering designs are completed before construction bidding is initiated.

Through internationally competitive procurements, MCAs procure the services of design firms that prepare the detailed designs and bidding documents for infrastructure projects (including engineering drawings, specifications, bills of quantity, and contractual documents). In addition, it is standard practice for the same design firms to prepare confidential cost estimates following completion of the design process and prior to the release of the bidding documents for these projects. These confidential cost estimates serve to update the earlier, feasibility-level cost estimates prepared by the same or another firm and are based on the detailed bill of quantities for the contract.

See comment 5.

In addition, there are numerous parties that typically review designs and bidding documents prior to their release, including MCA staff, representatives of the implementing entity and/or beneficiary organization, the MCA project management consultant and/or construction supervisor, government design review commissions, environmental permitting agencies, MCC staff, and MCC's independent engineer.

The revised process cannot, however, guard against all unforeseen site conditions and unanticipated price spikes. For example, cost increases experienced by the Cape Verde, Georgia, and Honduras projects resulted from a number of factors, including design changes and quality changes, coupled with the unprecedented worldwide run-up in material and construction costs that hit this group of countries and projects particularly hard prior to the global financial crisis.

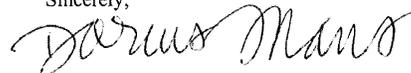
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Therefore, project budgets must, and now do, incorporate appropriate contingencies to address these physical risks as well as price adjustments.

I appreciate the opportunity to comment on the draft report.

Sincerely,



Darius Mans
Acting Chief Executive Officer

cc: Mr. David Gootnick, GAO

Following are GAO's comments on the Millennium Challenge Corporation's letter dated October 23, 2009.

GAO Comments

1. In its comments, MCC pointed out that for the purposes of travel, MCA-Honduras and MCA-Cape Verde generally pay travelers a daily subsistence allowance for each day of the travel to cover travelers' expenses related to lodging, meals, and incidental expenses. The allowance is calculated using specified per diem rates. As MCC stated, not every country requires the submission of receipts for such expenses. However, if the MCA does not receive such supporting documentation for travel expenses, the MCA has no proof that the travel actually occurred. As a case in point, even though Cape Verde's FAP lists a number of supporting documents that travelers should provide after returning from a trip, we found that 19 of the 30 travel transactions we tested lacked such documentation. Therefore, we could not confirm that travel was completed. Furthermore, the required trip reports were not always provided in Honduras and Cape Verde to substantiate that the travel occurred.
2. MCC noted that the FAP for MCA-Honduras calls for a monthly payroll sheet to confirm payments to staff. However, we found that the information on the monthly payroll sheet only included personnel information, such as names and payment amounts. Without individual time sheets, we were unable to verify that employees worked the necessary number of hours for the payments made. We view this as a key control in the payroll process. Additionally, MCC developed a FAP template in November 2008 that provides examples of how controls could be structured. For example, the template requires employees to submit time sheets for supervisory approval. Taking actions to adopt these procedures would help ensure the propriety of these transactions.
3. MCC pointed out that the Georgia Regional Development Fund investments met guidelines that permit such investments. MCC also stated that one investee was not a subsidiary of a larger company that fell outside of the investment guidelines. Based on MCC's comments, we reevaluated the evidence previously provided and agree with MCC regarding the subsidiary, but reconfirmed the principal place of business for the two companies as Tbilisi. We modified footnote 31 to reflect this information. Also, as stated in footnote 31, the fund manager used calculation methods that made it difficult to determine whether one of the businesses complied with the investment guidelines. Having clear supporting documentation and guidance are

critical to ensuring that these investments, and the other areas we had concerns with, adhere to the guidelines. We appreciate that MCC stated it plans to work with the MCAs to strengthen compliance with documentation requirements where needed as part of a review of the FAPs.

4. MCC reports that, as of fiscal year 2008, it requires the completion of full feasibility and environmental assessments, including resettlement plans, before compact signature. We support MCC's efforts to take action to finalize those project planning activities prior to compact signing and are in the process of assessing the specific actions MCC has taken to implement the recommendation. According to MCC, while it instituted the process change in fiscal year 2008, the revised process has thus far only been applied to the Senegal compact, signed in September 2009, and to due diligence for a proposed compact with Moldova.
5. We recognize that MCC is using its independent engineers, the MCA's project consultants, and the compact country's project stakeholders to review designs. However, our assessment of the compacts we reviewed, all of which had significant design issues, cost growth, and schedule delays, indicates that the project review process can still be improved before contract solicitation. For example, MCC could expand its review of final designs, cost estimates, and risk assumptions by soliciting services of a technical specialist with project management experience in project risk analysis and project scheduling. Based on the projects we reviewed and the problems we found, we believe that outside expertise would benefit the project review process and avoid the expense of addressing issues related to the lack of planning.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

David B. Gootnick, 202-512-3149 or gootnickd@gao.gov

Staff Acknowledgments

In addition to the person named above, Emil Friberg, Jr. (Assistant Director), Mike Armes, John Bauckman, Lynn Cothorn, Lucia DeMaio, Tim DiNapoli, Mattias Fenton, Jordan Hamory Holt, Elizabeth Martinez, Heather Rasmussen, Donell Ries, Michael Simon, Susan Tieh, Patrick Tobo, and Matt Wood made key contributions to this report. Also, Jehan Abdel-Gawad, Jim Ashley, C. Etana Finkler, Ernie Jackson, Amanda Miller, Charlotte Moore, Josh Ormond, and Jena Sinkfield provided technical assistance.

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