



OFFICE OF INSPECTOR GENERAL
U.S. Agency for International Development

Audit of MCC's Fiscal Years 2018 and 2017 Financial Statements

AUDIT REPORT M-000-19-001-C
NOVEMBER 15, 2018

1300 Pennsylvania Avenue NW • Washington, DC 20523
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MEMORANDUM

DATE: November 15, 2018

TO: Millennium Challenge Corporation/Department of Administration and Finance,
Vice President and Chief Financial Officer, Cynthia Huger

FROM: Deputy Assistant Inspector General for Audit, Nathan Lokos /s/

SUBJECT: Audit of MCC's Fiscal Years 2018 and 2017 Financial Statements
(M-000-19-001-C)

Enclosed is the final audit report on Millennium Challenge Corporation's (MCC) financial statements as of September 30, 2018, and 2017. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA) to conduct the audit. The contract required the audit firm to perform the audit in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin No. 19-01, "Audit Requirements for Federal Financial Statements."

In carrying out its oversight responsibilities, OIG reviewed the audit firm's report and related audit documentation and inquired of its representatives. Our review, which was different from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on MCC's financial statements. The audit firm is responsible for the enclosed auditor's report and the conclusions expressed in it. We found no instances in which CLA did not comply, in all material respects, with applicable standards.

The audit objectives were to (1) express an opinion on whether the financial statements as of September 30, 2018, and 2017, were presented fairly, in all material respects; (2) evaluate MCC's internal controls; and (3) determine whether MCC complied with applicable laws and regulations. The purpose was not to provide an opinion on the effectiveness of the entity's internal control or compliance with provisions of applicable laws, regulations, contracts, and grant agreements. To answer the audit objectives, the audit firm reviewed MCC's financial statements, including the balance sheets as of September 30, 2018, and 2017, and the related statements of net cost, changes in net position, the combined statements of budgetary

resources for the years then ended, and the related notes to the financial statements. The net operating costs for this period were \$755,485,000.

The audit firm concluded that MCC's financial statements for the fiscal years ending September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles. The audit firm also found no instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements.

The auditors reported three significant deficiencies in internal control related to:

- Grant accrual estimates and validation (Modified repeat finding)
- Millennium Challenge Accounts' financial reporting (Modified repeat finding)
- Millennium Challenge Accounts' compliance (Modified repeat finding)

To address the deficiencies identified in the report, we recommend that MCC's Department of Administration and Finance and the Chief Financial Officer:

Recommendation 1. Update the "Expense Accruals Financial Management Division Procedure Manual" to reflect the current grant accrual methodology.

Recommendation 2. Provide Millennium Challenge Accounts with written guidance on developing grant accrual estimates to ensure validity of the grant accruals estimate. The guidance should include, but not be limited to, the following:

- Take into consideration the impact of contract advances and retentions for large works contracts in the accrual estimate.
- Ensure that accrual estimates do not include costs that will not be paid with compact funds.
- Consider historical questioned costs for contracts and grants that are significant in developing the accrual estimate.

Recommendation 3. Update the "Compact Grant Accrual Validation Data Call Desktop Manual" to include a time requirement for MCC to perform followup with Millennium Challenge Accounts so that errors in accrual estimates or validations are promptly identified and addressed.

Recommendation 4. Provide Millennium Challenge Accounts with written guidance to ensure that the Millennium Challenge Accounts perform grant accrual validation correctly to include, but not be limited to, validation of consultant contract costs.

Recommendation 5. Develop clear and complete written guidance for the Millennium Challenge Accounts' internal control over the data call process, provide effective training, and monitor the effectiveness of the internal control.

Recommendation 6. Develop, document, and implement a process to oversee and verify that the accountable Government entities conduct pre-Millennium Challenge Accounts compact

procurements in accordance with the compact agreement and the Program Procurement Guidelines.

Recommendation 7. Update MCC's Program Procurement Guidelines to require the Millennium Challenge Accounts to document alternative procurement procedures so that all parties are aware of what is required, who is accountable for what, and how the procurement will be documented.

Recommendation 8. Develop, document, and implement policies and procedures for MCC's management oversight of transfer and retention of pre-Millennium Challenge Accounts compact procurement and related documents to the Millennium Challenge Accounts.

Recommendation 9. Inform the Millennium Challenge Accounts that the U.S. State Department's Terrorist Exclusion List should be documented separately, for all currently active awards and future awards, and update MCC's vendor eligibility verification guidance provided to the Millennium Challenge Accounts for completeness and accuracy.

Recommendation 10. Identify the Millennium Challenge Accounts who are late with the vendor invoice payments, determine the reasons/causes for late payments, implement corrective actions, and monitor effectiveness of the corrective actions.

In finalizing the report, the audit firm evaluated MCC's responses to the recommendations. After reviewing that evaluation, we consider all recommendations open and unresolved due to the absence of a target date for final action. We ask that you provide written notification of actions planned or taken to reach management decisions, including the target dates for final action, on the recommendations.

We appreciate the assistance extended to our staff and the audit firm's employees during the engagement.

MILLENNIUM CHALLENGE CORPORATION

Independent Auditors' Report of Millennium Challenge Corporation's Financial Statements for the Periods Ending September 30, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

To the Inspector General
United States Agency for International Development

To the Board of Directors
Millennium Challenge Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the Millennium Challenge Corporation (MCC), which comprise the balance sheets as of September 30, 2018, and 2017, and the related statements of net cost, changes in net position, the combined statements of budgetary resources for the years then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

MCC management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S.; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 19-01). These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to MCC's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MCC's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MCC as of September 30, 2018, and 2017, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the U.S.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the U.S. require that the information in MCC's Management Discussion and Analysis (MD&A) and Required Supplementary Information (RSI) sections be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. All other information exclusive of the financial statements, MD&A, and RSI as listed in the table of contents of MCC's Agency Financial Report is presented for purposes of additional analysis and is not a required part of the financial statements. In addition, MCC management has included references to information on websites or other data outside of MCC's Agency Financial Report. This information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Report on Internal Control over Financial Reporting

In planning and performing our audits of the financial statements, we considered MCC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MCC's internal control or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of MCC's internal control or on management's assertion on internal control included in the MD&A.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of MCC's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we identified three deficiencies in internal control, summarized below and detailed in Exhibit I that we considered as significant deficiencies.

1. MCC's internal controls over grant accrual estimates and validation need to be strengthened (Modified Repeat Finding)
2. MCC's oversight and internal controls over Millennium Challenge Accounts' (MCAs') financial reporting needs to be strengthened (Modified Repeat Finding)
3. MCC's oversight and internal controls over MCAs' compliance needs to be strengthened (Modified Repeat Finding)

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

As part of obtaining reasonable assurance about whether MCC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards* or OMB Bulletin 19-01.

Management's Responsibility for Internal Control and Compliance

MCC management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under the Federal Managers' Financial Integrity Act (FMFIA), (2) providing a statement of assurance on the overall effectiveness on internal control over financial reporting, and (3) complying with other applicable laws, regulations, contracts, and grant agreements.

Auditors' Responsibilities

We are responsible for (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, and (2) testing compliance with certain provisions of laws, regulations, contracts, and grant agreements.

We did not evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting.

Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws, regulations, contracts and grant agreements applicable to MCC. We limited our tests to certain provisions of laws, regulations, contracts and grant agreements noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

Management's Response to Audit Findings

Management's response to the findings identified in our report is presented in Exhibit 2. We did not audit MCC's response and, accordingly, we express no opinion on it.

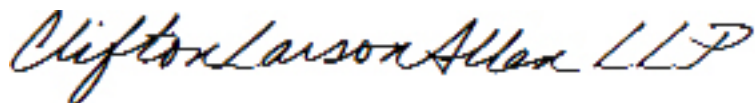
Status of Prior Year's Control Deficiencies

We have reviewed the status of MCC's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 13, 2017. The status of prior year findings is presented in Exhibit 3.

Purpose of the Report on Internal Control over Financial Reporting and on Compliance

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of MCC's internal control or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MCC's internal control and compliance. Accordingly, these reports are not suitable for any other purpose.

CliftonLarsonAllen LLP

A handwritten signature in black ink that reads "CliftonLarsonAllen LLP". The signature is written in a cursive, flowing style.

Arlington, Virginia
November 8, 2018

EXHIBIT 1
Significant Deficiencies in Internal Controls

**I. Controls over grant accrual estimates and validation need to be strengthened
(Modified Repeat Finding)**

In FY 2018, MCC changed its grant accrual methodology based on its evaluation of the validation data over the last four years to rely solely on MCC Compact Accountable Entities' (also known as Millennium Challenge Accounts or MCAs) grant accrual estimates submitted via data calls. MCAs were also responsible for assisting MCC in validating the estimated liability. MCC reported approximately \$536 million in compact grant related expenses and an accrued grant liability of \$108 million comprising retentions payable and expenses incurred but not yet reported by MCAs as of September 30, 2018. The compact grant activities are the core of MCC's financial and program operations.

We audited the grant accruals and validation for reasonableness and compliance with MCC's *Expense Accruals Financial Management Division Procedure Manual* (Manual) and interim grant accrual procedures that went into effect on October 1, 2017. During Fiscal Year (FY) 2018, MCC continued to refine its accrual methodology and collect supporting information in its data store¹ to help validate the methodology. However, we found the following conditions during our testing that impacted the quarterly grant accrual estimates. These issues increase the potential for the grant accrual estimate to be misstated and incorrectly reported in MCC's financial statements.

The Expense Accruals Financial Management Division Procedure Manual Does Not Reflect MCC's Actual Grant Accrual Methodology - MCC changed its grant accrual methodology via a memo effective October 1, 2017. MCC is no longer estimating the grant accrual amounts for MCAs, these are done by the MCAs, although MCC is still responsible for verifying these estimates. However, as of September 30, 2018, MCC's procedure manual has not been updated. Accounting policies that are not updated timely increase the risk of outdated policy and procedures not being followed by MCC's financial management personnel.

Issues with the Grant Accrual Estimates Versus Actual Validated Amounts - In our review of the quarterly grant accrual, we noted significant errors in the grant accrual estimates that raise concerns about MCC's process to ensure that its grant accrual methodology is valid and reliable. The actual costs incurred when compared to the estimates were materially not close. For example, for the fourth quarter of FY 2017, the material differences between the accrual estimates and actual payments showed that one MCA was \$6 million over the estimate and another MCA was \$6.5 million under the estimate. MCC explained that the differences were

¹ A data store is a repository for storing and managing collections of data which include not just repositories like databases, but also simpler store types such as simple files, email, etc.

EXHIBIT 1

Significant Deficiencies in Internal Controls

primarily caused by including paid advances and retentions, the foreign government contribution, and using unused spending authority in accordance with MCC's accrual policy at the time.

The grant accrual for the first quarter of FY 2018 showed a net difference of approximately \$22 million over the estimate. Two MCAs accounted for 90 percent or \$19.7 million of this difference. For this difference, one MCA provided reasonable explanation for \$6.5 million difference; however, the remaining differences were due to including the foreign government contributions in the cost estimates and weak and untimely validations.

Additionally, the grant accrual for the second quarter of FY 2018 showed a net difference of accrual being over the estimate by approximately \$9.5 million. One MCA accounted for 82 percent of this difference, or approximately \$7.8 million. For this difference, MCC attributed the overage in part to aggressive MCA oversight of final grantee and contractor payments for valid expenses and deliverables, therefore, payments were reduced; not made; and/or returned. However, MCC was unable to confirm if the MCA considered its historical questioned costs information in its accrual estimate as the compact closed-out and the MCA no longer exists.

The common factor that attributed to all noted differences was insufficient written guidance for MCAs in developing their accrual estimates. There is a high risk of material misstatement and potential for these errors to occur again if sufficient guidance is not provided.

MCC's Validation Controls Were Weak - MCC, as part of its internal control process, performs a validation of its accrual estimates as a key control to assess the reasonableness of the estimated amount recorded in the prior quarter. This validation process should provide MCC an indication of whether the estimation methodology continues to be sound. However, during our testing we found significant weaknesses that impacted the validation process. MCC did not follow-up on the significant accrual differences in a timely manner. MCC's Compact Grant Accrual Validation Data Call Desktop Manual does not provide deadlines for completing the validation or for MCC to complete its investigation. For the fourth quarter of FY 2017, MCC did not obtain a response for the difference until five months after the validation period for that quarter. Subsequently, for the first quarter of FY 2018, MCC did not obtain a response for the difference until three months after the validation period for that quarter. Delays in completing follow-ups can result in accrual estimate or validation errors being repeated in the following quarters before corrective action can be taken. Additionally, for the first quarter of FY 2018 MCA indicated that the difference of \$ 2.5 million was due to improper validation of consultancy contract costs following MCC's advice. MCA stated that MCC advised them to use the Consultant Deliverable Acceptance Dates for the period of performance which resulted in the understated validation costs. MCC does not have sufficient written guidance for MCAs on how to address grant accrual validations which resulted in significant variances in grant accruals.

EXHIBIT 1

Significant Deficiencies in Internal Controls

GAO *Standards for Internal Control in the Federal Government*, Section OV3.05 states that when evaluating implementation, management determines if the control exists and if the entity has placed the control into operation. A deficiency in implementation exists when a properly designed control is not implemented correctly in the internal control system. 12.03 states that management documents in policies for each unit its responsibility for an operational process's objectives and related risk, and control activity design, implementation, and operating effectiveness.

Federal Financial Accounting and Auditing Technical Release 12, *Accrual Estimates for Grant Programs, Federal Financial Accounting* (August 4, 2010), Paragraph 31, *Training and Monitoring of Grantees* states, "Since preparation of accrual estimates is dependent upon relevant and reliable data, accurate and timely reporting by grant recipients serves as the basis for historical data used in preparing future estimates and provides reliable actual data to which accrual estimates can be compared."

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer:

Recommendation 1. Update the "Expense Accruals Financial Management Division Procedure Manual" to reflect the current grant accrual methodology.

Recommendation 2. Provide Millennium Challenge Accounts with written guidance on developing grant accrual estimates to ensure validity of the grant accruals estimate. The guidance should include, but not be limited to, the following:

- Take into consideration the impact of contract advances and retentions for large works contracts in the accrual estimate.
- Ensure that accrual estimates do not include costs that will not be paid with compact funds.
- Consider historical questioned costs for contracts and grants that are significant in developing the accrual estimate.

Recommendation 3. Update the "Compact Grant Accrual Validation Data Call Desktop Manual" to include a time requirement for MCC to perform follow up with Millennium Challenge Accounts so that errors in accrual estimates or validations are promptly identified and addressed.

Recommendation 4. Provide Millennium Challenge Accounts with written guidance to ensure that the Millennium Challenge Accounts perform grant accrual validation correctly to include, but not be limited to, validation of consultant contract costs.

EXHIBIT 1
Significant Deficiencies in Internal Controls

2. MCC's oversight and internal controls over MCAs' financial reporting needs to be strengthened (Modified Repeat Finding)

The Department of Compact Operations, through collaboration with the Department of Administration and Finance, establishes operational oversight and financial reporting controls and procedures to govern the conduct and administration of MCC's Compact/Threshold portfolio by the MCA entities. The MCAs' financial operations, including their compliance with applicable laws, regulations, contracts, and grant agreements are crucial to MCC's financial statements as their financial activities are material and significant. During our site visits to four selected MCAs, we evaluated the MCAs' design and effectiveness of internal controls. As a result of procedures performed, we identified the following control deficiencies that collectively we considered a significant deficiency in controls over financial reporting. Some of the control deficiencies we identified this year were repeat deficiencies reported in prior years.

Oversight over MCA's Financial Reporting – Every quarter, MCC obtained financial data through the data calls from MCAs for its financial statement reporting. As in the past years, our audit disclosed that MCC continues to have challenges in ensuring that MCAs accurately, completely, and properly report financial activities and balances that are significant and relevant to MCC's financial statements. For example:

Advances and Contract Retentions reporting errors – For the first quarter of FY 2018, we found that an MCA understated the amount reported for advances made to one contract for approximately \$495,000, resulting in an overstatement of expenses, and an understatement of assets. Additionally, the same MCA overstated the contract retention amount for two contracts totaling approximately \$646,000. MCA submitted the data call information before ensuring that the retentions were paid, which occurred after the payment cutoff date for the quarter. MCC did not identify the retention reporting errors. Without written procedures for the MCAs to perform quality control verifications, MCC cannot gain assurance that the data reported is accurate.

In-House invoices reporting errors – Grant accrual estimates prepared by MCAs include vendor invoices received by the MCA (called in-house invoices) and goods and services received from vendors but not yet paid. For the first and second quarters of FY 2018, we found that selected MCAs disclosed reporting errors and incomplete data. For example, an MCA repeatedly overstated its in-house invoices by incorrectly reporting the value added tax (VAT) amounts which MCC funding is exempt from. In another instance, two MCAs understated their in-house invoices by incorrectly omitting the invoices in the data call. The reporting errors were due to MCAs not having sufficient internal controls for ensuring accuracy and completeness of the data reported, which resulted in misstatement of the expenses and accrued liabilities.

EXHIBIT 1 Significant Deficiencies in Internal Controls

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer:

Recommendation 5. Develop clear and complete written guidance for the Millennium Challenge Accounts' internal control over the data call process, provide effective training, and monitor the effectiveness of the internal control.

3. MCC's oversight and internal controls over MCAs' compliance needs to be strengthened (Modified Repeat Finding)

During the initial stage of the compact set up, the MCA compact agreements require assistance from the country government (the accountable government entity) to maintain all accounting books, records, documents and other evidence relating to the Program to adequately document the use of all MCC funding. The compact agreement requires the accountable government entity to ensure that the procurement of all goods, works, and services must be in accordance with MCC's Program Procurement Guidelines (PPG). The MCC PPG outlines MCAs' procurement functions. MCC is responsible for updating its PPGs and providing contractual guidance to MCAs. The MCAs' procurements operations, including their compliance with applicable laws, regulations, contracts, and grant agreements are crucial to MCC's financial statements as their financial activities are material and significant. During our site visits to four selected MCAs, we evaluated the MCAs' design and effectiveness of internal controls. As a result of procedures performed, we identified the following control deficiencies that collectively we considered a significant deficiency in controls over MCA compliance.

Procurement eligibility verification were not completed – MCC requires MCAs to verify vendors' eligibility from six U.S. Government databases. In May 2017, MCC provided the MCAs specific websites to comply with the mandated vendor eligibility requirements. During our audit we discovered that MCC did not include the mandatory site, the US State Department, Terrorist Exclusion List. MCC provided this guidance without verifying that the websites provided to MCAs included this mandatory site. During our testing, we noted that one MCA verified two vendors' eligibility against the sites provided by MCC. Accordingly, the two vendors were not checked against the U.S. State Department, Terrorist Exclusion List. Eligibility verification checks are in place to ensure that ineligible vendors are not allowed to participate in the compact program. Due to incomplete eligibility verification, MCA may process a procurement with a vendor that is on the terrorist exclusion list, which is unallowable under the compact agreement.

Weak oversight over pre-MCA compact procurements – During the initial stages of the compact, the pre-MCA compact procurements are initiated by the accountable government entity with the assistance of MCC prior to the establishment of the MCA or the hiring of the procurement agent. Specifically, MCC's PPG for MCAs requires various procurement documents and controls to support MCA's program procurements. During our audit we noted that two MCAs did not have the procurement documents for five major pre-MCA compact procurements (leases,

EXHIBIT 1
Significant Deficiencies in Internal Controls

procurement agent and fiscal agent contracts). MCC does not have sufficient procedures to ensure that pre-MCA compact procurements conducted on behalf of the MCA are properly documented and maintained. In the absence of documentation and the lack of properly documented procedures, MCAs are open to potential appeals, litigations, risk of fraud, waste and abuse.

MCA invoices were paid late – During our testing we found that certain MCAs did not make payments within thirty calendar days after receipt of valid invoices. Late payments ranged from 2 to 33 days. Moreover, one MCA did not date stamp invoices received for timely payment tracking purposes. The causes for these delays are not fully known by MCC, and MCC is investigating the deficiencies noted. Delay in payments may result in MCAs' expenses not being timely recognized and recorded by MCC.

GAO *Standards for Internal Control in the Federal Government*, Section OV3.05 states that when evaluating implementation, management determines if the control exists and if the entity has placed the control into operation. A deficiency in implementation exists when a properly designed control is not implemented correctly in the internal control system. 12.03 states that management documents in policies for each unit its responsibility for an operational process's objectives and related risk, and control activity design, implementation, and operating effectiveness.

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer:

Recommendation 6. Develop, document, and implement a process to oversee and verify that the accountable Government entities conduct pre-Millennium Challenge Accounts compact procurements in accordance with the compact agreement and the Program Procurement Guidelines.

Recommendation 7. Update MCC's Program Procurement Guidelines to require the Millennium Challenge Accounts to document alternative procurement procedures so that all parties are aware of what is required, who is accountable for what, and how the procurement will be documented.

Recommendation 8. Develop, document, and implement policies and procedures for MCC's management oversight of transfer and retention of pre-Millennium Challenge Accounts compact procurement and related documents to the Millennium Challenge Accounts.

Recommendation 9. Inform the Millennium Challenge Accounts that the U.S. State Department's Terrorist Exclusion List should be documented separately, for all currently active awards and future awards, and update MCC's vendor eligibility verification guidance provided to the Millennium Challenge Accounts for completeness and accuracy.

EXHIBIT 1
Significant Deficiencies in Internal Controls

Recommendation 10. Identify the Millennium Challenge Accounts who are late with the vendor invoice payments, determine the reasons/causes for late payments, implement corrective actions, and monitor effectiveness of the corrective actions.

EXHIBIT 2
Management's Response to Audit Findings



November 13, 2018

Ms. Mia Leswing
Principal
CliftonLarsonAllen, LLP
450 N. Fairfax Drive, Suite 1020
Arlington, VA 22203

Nathan Lokos
Deputy Assistant Inspector General for Audit
Office of Inspector General
United States Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20005

Dear Ms. Leswing and Mr. Lokos,

In response to the audit findings and recommendations cited in the “Audit of MCC’s Financial Statements, Internal Controls, and Compliance for the Fiscal Years Ending September 30, 2018 and 2017” report, MCC provides the following comments:

Significant Deficiencies: MCC’s internal controls over grant accrual estimates and validation need to be strengthened (Modified Repeat Finding)

Recommendation 1: Update the “Expense Accruals Financial Management Division Procedure Manual” to reflect the current grant accrual methodology.

Recommendation 2: Provide Millennium Challenge Accounts with written guidance on developing grant accrual estimates to ensure validity of the grant accruals estimate. The guidance should include, but not be limited to, the following:

- Take into consideration the impact of contract advances and retentions for large works contracts in the accrual estimate.
- Ensure that accrual estimates do not include costs that will not be paid with compact funds.
- Consider historical questioned costs for contracts and grants that are significant in developing the accrual estimate.

Recommendation 3: Update the “Compact Grant Accrual Validation Data Call Desktop Manual” to include a time requirement for MCC to perform follow up with Millennium

EXHIBIT 2 Management's Response to Audit Findings

Challenge Accounts so that errors in accrual estimates or validations are promptly identified and addressed.

Recommendation 4: Provide Millennium Challenge Accounts with written guidance to ensure that the Millennium Challenge Accounts perform grant accrual validation correctly to include, but not be limited to, validation of consultant contract costs.

MCC Response: MCC concurs with recommendations 1, 2, 3, and 4. A comprehensive corrective action plan will be developed to address the deficiency noted.

Significant Deficiencies: MCC's oversight and internal controls over MCAs' financial reporting needs to be strengthened (Modified Repeat Finding)

Recommendation 5: Develop clear and complete written guidance for the Millennium Challenge Accounts' internal control over the data call process, provide effective training, and monitor the effectiveness of the internal control.

MCC Response: MCC concurs with the recommendation. A comprehensive corrective action plan will be developed to address the deficiency noted.

Significant Deficiencies: MCC's oversight and internal controls over MCAs' compliance needs to be strengthened (Modified Repeat Finding)

Recommendation 6: Develop, document, and implement a process to oversee and verify that the accountable Government entities conduct pre-Millennium Challenge Accounts compact procurements in accordance with the compact agreement and the Program Procurement Guidelines.

Recommendation 7: Update MCC's Program Procurement Guidelines to require the Millennium Challenge Accounts to document alternative procurement procedures so that all parties are aware of what is required, who is accountable for what, and how the procurement will be documented.

Recommendation 8: Develop, document, and implement policies and procedures for MCC's management oversight of transfer and retention of pre-Millennium Challenge Accounts compact procurement and related documents to the Millennium Challenge Accounts.

Recommendation 9: Inform the Millennium Challenge Accounts that the U.S. State Department's Terrorist Exclusion List should be documented separately, for all currently active awards and future awards, and update MCC's vendor eligibility verification guidance provided to the Millennium Challenge Accounts for completeness and accuracy.

EXHIBIT 2
Management's Response to Audit Findings

Recommendation 10: Identify the Millennium Challenge Accounts who are late with the vendor invoice payments, determine the reasons/causes for late payments, implement corrective actions, and monitor effectiveness of the corrective actions.

MCC Response: MCC concurs with recommendations 6, 7, 8, 9 and 10. A comprehensive corrective action plan will be developed to address the deficiency noted.

Sincerely,



Cynthia Huger
Vice President and Chief Financial Officer
Department of Administration and Finance

EXHIBIT 3
Status of Prior Year Recommendations

Our assessment of the current status of the recommendations related to findings identified in the prior year audit is presented below:

<i>FY 2017 Recommendations</i>	<i>Type</i>	<i>Fiscal Year 2018 Status</i>
1. Evaluate whether its grant accrual methodology assumptions and calculations are effective. This evaluation should include an assessment of root causes for variances in estimated and actual accruals and take into consideration, experiences from at least the last 5 years.	Significant Deficiency (SD)	Open
2. Update the “ <i>Expense Accruals Financial Management Division Procedure Manual</i> ” to: a) Require supporting documentation, including rationale for deviating from MCC’s accrual policy and procedures. This documentation should also include MCC’s management approval for any deviations. b) Indicate in the guidance how reinstated unused spending authority and applicable subsequent disbursements are to be addressed in the grant accrual calculation.	SD	Open
3. Correct the accrual data for quarters three and four to reflect the actual spending authority and disbursements.	SD	Closed
4. Update the “ <i>Compact Grant Accrual Validation Data Call Desktop Manual</i> ” to include timeframes for validating Millennium Challenge Accounts’ grant accrual estimates and MCC’s follow-up on significant differences so errors are promptly identified and addressed.	SD	Open

EXHIBIT 3
Status of Prior Year Recommendations

<p>5. Provide Millennium Challenge Accounts with additional written instructions and training on evaluating the reasonableness of MCC's grant accrual estimates, and require each Millennium Challenge Account to submit documentation showing why it agrees with MCC's estimate.</p>	<p>SD</p>	<p>Open</p>
<p>6. Implement procedures for tracking and monitoring Millennium Challenge Accounts' compliance with grant management policies and procedures, including Millennium Challenge Accounts' grant oversight, procurement eligibility verification, and grant award processes.</p>	<p>SD</p>	<p>Open</p>
<p>7. Enforce the requirement for the Millennium Challenge Accounts to submit quarterly financial reports and financial information by the due dates.</p>	<p>SD</p>	<p>Closed</p>
<p>8. Establish procedures to ensure that Millennium Challenge Accounts' are providing accurate, complete, supportable, and valid financial information for data calls for contract retentions.</p>	<p>SD</p>	<p>Open</p>