OFFICE OF INSPECTOR GENERAL
for the Millennium Challenge Corporation

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION'S FINANCIAL STATEMENTS, INTERNAL CONTROLS, AND COMPLIANCE FOR THE PERIOD ENDING SEPTEMBER 30, 2006 AND 2005

AUDIT REPORT NO. M-000-07-001-F
November 14, 2006

WASHINGTON, DC

Office of Inspector General
for the
Millennium Challenge Corporation

November 14, 2006

The Honorable John J. Danilovich
Chief Executive Officer
Millennium Challenge Corporation
875 15TH Street, NW
Washington, DC 20005-2203

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2006 and 2005 Report No. M-000-07-001-F

Dear Mr. Ambassador:

Enclosed is the final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Williams, Adley & Company, LLP to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2006. The contract required that the audit be performed in accordance with generally accepted government auditing standards (GAGAS), Office of Management and Budget (OMB) Bulletin 06-03, *Audit Requirements for Federal Financial Statements,* and the GAO/PCIE *Financial Audit Manual.*

In its audit of the MCC's financial statements for the period ending September 30, 2006 the auditors found:

- that the financial statements were fairly presented in conformity with generally accepted accounting principals (GAAP),

- six reportable conditions in the internal controls over financial reporting and its operation. Five of the six reportable conditions are material weaknesses, and

- three instances of material noncompliance with laws, regulations, contracts, and agreements.

The material weaknesses identified in MCC's internal controls process increases the need for MCC to develop written policies and procedures to streamline its financial operations. Under current operating procedures, the material weaknesses, increases the risk of improper recording, unauthorized transactions, omissions, potential funds control violations and noncompliance with laws, regulations, contracts and grant agreements. Williams Adley & Company LLP reported the following internal control weaknesses:

1. MCC's policies and procedures were not always complete and consistent. (material weaknesses)

2. MCC's policies for disbursing advances to grantees do not accommodate effective cash management. (material weakness and noncompliance)

3. MCC does not have a property management system. (material weakness)

4. MCC did not properly record compact expenses during the fiscal year. (material weakness)

5. MCC's Chief Financial Officer was not an integral part of the compact/grant processes. (material weakness).

6. MCC's travel disbursement controls and procedures do not permit effective and efficient management of travel.

Williams, Adley & Company, LLP also reported instances of noncompliance with laws, regulations, contracts, and grant agreements, inclusive of those referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) and disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards, issued by the Comptroller General of the United States, and OMB Bulletin 06-03, *Audit Requirements for Federal Financial Statements.* The instances of noncompliance are:

1. MCC did not fully comply with FFMIA and the Government Performance Results Act (GPRA). (material noncompliance)

2. MCC did not fully comply with Federal Information Security Management Act (FISMA). (material noncompliance)

3. MCC's policies for disbursing advances to grantees do not accommodate effective cash management. (material noncompliance)

In carrying out its oversight responsibilities, the OIG reviewed Williams, Adley & Company, LLP's report and related audit documentation. This review, as differentiated from an audit in accordance with GAGAS was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements, or internal control; on whether MCC's financial management systems substantially complied with FFMIA; or on MCC's compliance with other laws and regulations. Williams, Adley & Company, LLP is responsible for the attached auditor's report, dated November 14, 2006, and the conclusions expressed in the report. However, our review disclosed no instances on where Williams, Adley & Company, LLP did not comply, in all material respects, with applicable standards.

To address the internal control weaknesses and the noncompliance findings reported by Williams Adley & Company, LLP, we are making the following recommendations to MCC's management:

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation:

2.1 Develop and implement policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the U. S. Treasury requirements concerning advances and immediate cash advances.

2.2 Develop and implement policies and procedures to ensure that disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.

2.3 Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.

2.4 Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's management:

4.1 Require that the final quarterly disbursement requests received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.

4.2 Develop and implement policies and procedures that require compact expenses are properly and accurately recorded and reported on a quarterly basis.

4.3 Implement written procedures requiring that appropriate and timely follow-up measures are performed and recorded on late and/or outstanding fund disbursements and/or advances requests.

4.4 Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's management revise their policies and procedures to invest the Office of the Chief Financial Officer with the level of responsibility, including role and all levels of authority established by the Chief Financial Officer Act.

Recommendation No. 6: We recommend that Millennium Challenge Corporation management develop and implement internal controls to reject travel expense reimbursement requests that exceed the allowable country per diem limits unless additional electronic authorization is provided.

Recommendation No. 7: We recommend that the Millennium Challenge Corporation's management:

7.1 Develop performance goal templates and follow-up training to ensure that Government Performance Results Act (GPRA) requirements are adequately addressed and consistent. We also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.

7.2 Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions and decrease the risk of errors.

In finalizing the report, we have received and considered MCC's response to the draft report and the recommendations included therein.

In its comments, MCC accepted all of the report's recommendations except for 2.1.

At the time of this report, MCC had not accepted recommendation 2.1 and no management decision has been made. Essential elements of a management decision include specific actions, estimated completion dates for implementation, or an explanation and justification regarding why a recommendation is not considered valid by MCC management officials. For recommendation 2.1, MCC has not clearly stated why the recommendation is not valid.

MCC has agreed with recommendations 4 and 6 and has taken actions that implement the recommendation. Accordingly, we are closing these two recommendations upon issuance of the report.

Based on MCC's response to the remaining recommendations, we consider that a management decision has been reached on recommendation no. 1. However, we believe a management decision has not been reached on recommendations nos. 2.2, 2.3, 2.4, 3, 5, 7.1 and 7.2 because the decisions did not specifically identify the activities that MCC plans to conduct to implement the recommendation and/or the decision did not specify a target implementation date by which the recommendation will be implemented. Specifically:

Recommendation: 2.2 --not specific and no target implementation date
Recommendation: 2.3 --no target implementation date
Recommendation: 2.4 --not specific and no target implementation date
Recommendation: 3 --no target implementation date
Recommendation: 5 --no target implementation date
Recommendation: 7.1 --not specific and no target implementation date
Recommendation: 7.2.--no target implementation date

We discussed the lack of specificity and target dates in the management decisions with the MCC staff and they stated that they will study these decisions and revise them accordingly.

Please forward to us within 30 days your revised management decisions for the above recommendations.

Please inform us when you have taken final action on the recommendations.

The OIG appreciates the cooperation and courtesies extended to our staff and the staff of Williams, Adley & Company, LLP during the audit. Please contact me or Mr. Manuel S. Avila, IG/MCC/FA at (202) 712-1897, if you have any questions concerning this report.

Sincerely,

/s/

John M. Phee
Assistant Inspector General/MCC

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Williams Adley & Company, LLP
Certified Public Accountants/Financial Management Consultants

Independent Auditors' Report

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the accompanying Statements of Financial Position of the Millennium Challenge Corporation (MCC or Corporation) as of September 30, 2006 with summary totals for September 30, 2005, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2006 with summary totals for September 30, 2005. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

In connection with our audit, we also considered the MCC's internal control over financial reporting and tested the MCC's compliance with certain provisions of applicable laws, regulations, contracts and grant agreements that could have a direct and material effect on the financial statements.

SUMMARY

As stated in our opinion, we concluded that the MCC's financial statements as of and for the year ended September 30, 2006 with summary totals for September 30, 2005 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting and its operation resulted in six matters that we consider to be reportable conditions. We believe that five of the six reportable conditions are material weaknesses.

1 MCC's Policies and Procedures Were Not Always Complete and Consistent (material weakness)

2. MCC Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management (material weakness and noncompliance)

3. MCC Does Not Have a Property Management System (material weakness)

4. MCC Did Not Properly Record Compact Expenses During the Fiscal Year (material weakness)

5. MCC's Chief Financial Officer Was Not an Integral Part of the Compact/Grant Processes (material weakness)

6. MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel (reportable condition)

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, inclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed three instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*:

1. MCC did not fully comply with FFMIA and Government Performance and Results Act (GPRA) (material noncompliance)

2. MCC did not fully comply with Federal Information Security Management Act (material noncompliance)

3. MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management (material weakness and noncompliance)

The following sections discuss our opinion on the MCC's financial statements, our consideration of the MCC's internal control over financial reporting, our tests of the MCC's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and the distribution of our report. The status of prior year findings is included as Appendix A. Management's response to the findings and our evaluation of said response is included as Appendix C and Appendix B, respectively.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying Statements of Financial Position of the Corporation as of September 30, 2006 with summary totals for September 30, 2005, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2006 with summary totals for September 30, 2005. These financial statements are the responsibility of Corporation management. 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 United States of America and standards applicable to financial statement audits contained in

Government Auditing Standards, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Corporation as of September 30, 2006 with summary totals for September 30, 2005, and changes in net position, cash flows and budgetary resources for the year ended September 30, 2006 with summary totals for September 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements of the Corporation taken as a whole. The information contained in the Management's Discussion and Analysis and Performance Section is not a required part of the financial statements, but is supplementary information required by the Federal Accounting Standards Advisory Board guidance. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and do not express an opinion thereon.

The accompanying Statements of Functional Expenses for the year ended September 30, 2006, and as summarized for year ended September 30, 2005, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This statement is the responsibility of the management of the Corporation. The information in this statement has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our fiscal year 2006 audit, we considered MCC's internal control over financial reporting by obtaining an understanding of MCC's internal control, determined whether internal controls had been placed into operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control; accordingly, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MCC's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses or noncompliance may occur and not be detected.

We noted six matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that five reportable conditions are material weaknesses. All material weakness and the reportable condition are described on pages 4-15.

MATERIAL WEAKNESSES

MCC's Policies and Procedures Were Not Always Complete and Consistent (material weakness)

Condition:

During fiscal year (FY) 2006, the Millennium Challenge Corporation (MCC) used various processes to address the financial aspects of its operations. These processes evolved during the year as the organization grew in both number of personnel and span of operations. However, during this growth, the development and implementation of final written policies and procedures to guide MCC's streamlined operational structure was not adequately addressed. During the fiscal year, MCC lacked final written policies and procedures. Written policies and procedures must be in place to ensure operational efficiencies, risk reduction, and consistent application. Several policies and procedures, i.e. advances, budget, and accruals, remained in draft form, throughout the year. Additionally, several procedures do not address the responsible positions at the various control levels for the processing of data/data entry functions, or submission and approval levels and procedures in the areas of fixed assets and the open obligations review required revision.

While the current Department of Administration and Finance (A&F) management team has emphasized the preparation and issuance of a comprehensive financial management policies and procedures (FMPP) manual, as of the end of the FY, such a manual was being drafted.

MCC has hired contractors to assist in the production of the FMPP manual by December 31, 2006.

Criteria:

The GAO "*Standards for Internal Control in the Federal Government*" states that internal control and all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. Also, information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.

Additionally, management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management. A positive control environment is the foundation for all other standards. It provides discipline and structure as well as the climate which influences the quality of internal controls.

Cause:

Division of Finance (within the Department of A&F) management stated that they have not had the available personnel to sufficiently dedicate to the development and issuance of final policies and procedures during the year.

Effect:

The lack of sufficient detail and accountability in the procedures produced inconsistent application of controls and processes, and increased the risk of errors, improper recording, unauthorized transactions, omissions and potential funds control violations. Furthermore, the lack of formal procedures can result in noncompliance with laws and regulations. Also, the effective and efficient processing of financial transactions is diminished. Examples of the effect of the lack of final MCC policies and procedures include:

- The policy established for the proper recording of fixed assets was not followed during the year, thereby resulting in potentially incorrect posting of asset transactions.
- Employees travel claims were greater than the approved per diem rates.
- Compact expenses were not reported in the third quarter financial statements.

Recommendation #06-01:

We recommend that Millennium Challenge Corporation's Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Management Response:

MCC accepts the recommendation and is currently implementing relevant corrective action. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

MCC Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management (material weakness and noncompliance)

Condition:

MCC entered into various compacts and provided several advances during fiscal year 2006. MCC personnel indicated that monthly disbursements were made based upon the quarterly request. However, we noted that for most Millennium Challenge Authorities (MCAs), MCC disbursed funds on a quarterly basis based upon the disbursement request, rather than monthly. We noted that several disbursements were not used within 30 days nor the quarter.

Madagascar	July 28, 2005	$ 2,500,924	-	March 30, 2006
	December 13, 2005	$ 1,755,506	-	June 30, 2006
	May 31, 2006	$ 5,391,665	$2,311,342	Not expected to be expended by September 30, 2006
Georgia	May 2, 2006	$ 3,603,404	$221,594	Not expected to be expended by September 30, 2006
	September 15, 2006	$6,509,706	6,509,706	
Honduras	February 28, 2006	$ 1,646,545	$138,840	Not expected to be expended by September 30, 2006
	September 29, 2006	$1,369,849	$1,369,849	
Cape Verde	February 1, 2006	$ 7,526,864	$3,913,663	Not expected to be expended by September 30, 2006
Vanuatu	June 30, 2006	$ 1,127,055	$1,023,658	Not expected to be expended by September 30, 2006
	August 9, 2006	$ 219,504	$219,504	
	September 6, 2006	$ 111,688	$111,688	

Country	Date of Disbursement	Amount of Disbursement	Projected Cash Balance at September 30, 2006	Date when disbursement was completely expended
	September 18, 2006	$ 116,377	$116,377	
Nicaragua	June 30, 2006	$ 1,483,399	433,889	Not expected to be expended by September 30, 2006
	August 28, 2006	$ 378,550	378,550	
	August 31, 2006	$ 289,110	289,110	

The Department of the Treasury's Financial Management Service publications did not envision the inclusion of sovereign governments; however, in the analysis of cash management, we used the Treasury Financial Manual (TFM) as a valuable source of sound business practices. The TFM is the Department of the Treasury's official publication for financial accounting and reporting of all receipts and disbursements of the Federal Government. The purpose of the TFM is to provide policies, procedures, and instructions for Federal departments and agencies to follow in carrying out their fiscal responsibilities.

Also, through various OMB Circulars, OMB has attempted to address the need for advances to cover immediate cash needs or timely disbursements of an entity for direct program costs for carrying out the purpose of the approved program or project. Thus, funds paid to a grantee are not to be held, but are to be promptly applied to the grant purpose. Although the timeframe for immediate cash needs has not been clearly defined by OMB, the general rules employed by various Federal agencies are 30 days for non-governmental entities as outlined in the TFM. Based upon this definition, MCC has provided Federal funds in excess of immediate cash needs.

Criteria:

Per the Appropriations Law Volume II, advances under an assistance program are intended to accomplish the program purposes and not to profit the recipient other than in the manner and extent specified in the program. Section 2025 of the Treasury Financial Manual –Volume 1, Part 6-Chapter 2000, states that advances to a recipient organization will be limited to the minimum amounts necessary for immediate disbursement needs and will be timed to be in accordance with the actual immediate cash requirements of the recipient organization in carrying out the purpose of an approved program or project. The timing and amount of cash advances will be as close as is administratively feasible to actual disbursements by the recipient organization.

Best business practice defines immediate cash needs as money used for the purpose of carrying out the Compact's approved programs within a thirty day period. Also, when funds are drawn from Treasury before it is needed, or in excess of current needs, the government loses the use of the funds.

Cause:

The approved agreements entered into by MCC with MCA Madagascar and other compact grantees indicate that quarterly advances will be provided based upon their estimated costs. Although, MCC's management has changed the policy, it has not been effectively implemented and monitored to ensure that it occurs.

Effect:

MCC received a total of $304,000 in interest from compact countries during the first three quarters of FY 2006 and remitted this amount to Treasury. As of the end of FY 2006 the additional $174,402 of interest is due to MCC. MCC has not adopted an approach that provides funds only for a grantee's immediate cash needs and reduces the risk of misappropriation.

Recommendation # 06-02:

We recommend that Millennium Challenge Corporation:

(1) Develop and implement policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the U.S. Treasury requirements concerning advances and immediate cash needs.
(2) Develop and implement policies and procedures to ensure that all disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.
(3) Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.
(4) Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.

Management Response:

MCC Management accepts recommendations 2.2, 2.3, and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with the GAO policy based upon what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

MCC Does Not Have a Property Management System (material weakness)

Condition:

We noted that MCC reported $5,656,567 in property as of June 30, 2006; however, they were unable to provide detailed records to support the amount reported. The MCC does not have a property management system that provides detail information on original cost, date of purchase, location, useful life, depreciation, and accumulated depreciation.

For the year end financial statements, sufficient analysis was performed to ensure consistent application of the capitalization policy and to determine an appropriate measure of depreciation expense to ensure that fixed assets would be fairly stated.

Criteria:

OMB Circular A-127 "*Policies and Standards for Financial Management Systems*" states that financial management in the Federal government requires accountability of financial and program managers for financial results of actions taken, control over the Federal government's financial resources and protection of Federal assets. To enable these requirements to be met, financial management systems must be in place to process and record financial events effectively and efficiently, and to provide complete, timely, reliable and consistent information for decision makers and the public.

The Joint Financial Management Improvement Program (JFMIP) standards require that property management systems assist managers in collecting and maintaining information for financial reporting in accordance with generally accepted accounting principles and managing the various types of property. Additionally, they should assist managers in ensuring that assets are safeguarded against improper use or disposition.

Cause:

MCC did not create a property management system to support its property financial policy nor did management ensure that an accountable employee was assigned to ensure its implementation.

Effect:

The quarterly financial statements may be misstated due to the inaccurate recording and reporting of property and depreciation expense. In the June 30, 2006 financial statements, no depreciation expense was recorded. Lack of sufficient controls over property can result in loss, waste and abuse of federal resources.

Recommendation #06-03:

We recommend that Millennium Challenge Corporation develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Management Response:

MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

MCC Did Not Properly Record Compact Expenses During the Fiscal Year (material weakness)

Condition:

As a result of our review of the third quarter financial statements, we noted that MCC did not report any compact program costs. Although MCC had received disbursement requests that can be used to post the expenses incurred, nothing was recorded. According to the compact and disbursement agreement, each MCA is required to submit quarterly disbursement requests that include the expenses incurred to date. These requests are due regardless of the need for funding. The requests should provide the following:

- Previous quarter advances;
- Previous quarter disbursements;
- Estimated expenses; and
- Next quarter's advance request.

For the year end financial statements, MCC recorded compact expenses of $8,493,394. Additional analysis was performed utilizing the disbursement requests to increase expenses recorded and to ensure that advances and compact expenses were fairly stated.

Criteria:

OMB Circular A-136 "*Financial Reporting Requirements*", Section II.4.4.3, Program Costs, states that the reporting entity should report the full cost of each program's output, which consists of (a) direct cost and indirect costs of the output, and (b) the costs of identifiable supporting services provided by other segments within the reporting entity and by other reporting entities. The reporting entity should accumulate and assign costs in accordance with the costing methodology in Statement of Federal Financial Accounting Standard (SFFAS) No. 4.

In Section 3.2 of the disbursement agreements, it states that the MCA shall deliver to MCC a completed MCC disbursement request in the form attached hereto as Exhibit A, and otherwise satisfactory to MCC in content. Exhibit A section E, commitment and expenditure report provides for the reporting of cumulative actual redisbursements and projected redisbursements.

Cause:

The Fiscal Accountability Office is responsible for the collection of the required quarterly expense/disbursement requests, and they have encountered many problems recovering the reports from the various MCAs. The requests are not sent directly to the Division of Finance and must be provided by the Fiscal Accountability Office. Additionally, MCC is not enforcing the requirement and the compact and disbursement agreements appear to lack sufficient strictures for noncompliance.

MCC did not perform a sufficient review of the financial statements to address the omission of the compact expenses.

Effect:

As a result of the nonrecording of compact expense, the MCC quarterly financial statements were inaccurate and MCC management's ability to rely on the financial statements to make informed decisions was impaired.

Recommendation #06-04:

We recommend that Millennium Challenge Corporation's management:

(1) Require that the final quarterly request received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.

(2) Develop and implement policies and procedures that ensure compact expenses are properly and accurately recorded and reported on a quarterly basis

(3) Implement written procedures requiring that appropriate and timely follow-up measures are performed and are recorded for historical reference on incomplete, outstanding, or late disbursement requests.

(4) Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.

Management Response:

MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

MCC's Chief Financial Officer Was Not an Integral Part of the Compact/Grant Processes (material weakness)

Condition:

Based on interviews and observations, we noted that MCC's Division of Finance was not integrally involved in the compact/grant processes to ensure that the financial aspects are addressed, recorded and reported in their proper sequence and appropriate timing. The Chief Financial Officer or his designees should be integrally involved in all MCC operations that result in a financial transaction. The CFO should be integrally involved in the:

1. establishment of the compact amount to ensure that there is sufficient appropriations available,
2. development of grant policies and procedures to ensure that they are in compliance with Federal government laws and regulations and to ensure that sufficient financial information is provided to MCC to accomplish its responsibilities,
3. review of compacts in order to initiate accounting transactions in the system and budget transactions with OMB, and
4. establishment of the reporting structure to ensure that financial information is provided timely and in the format necessary for required financial reporting.

Criteria:

According to the CFO Act of 1990, "An agency Chief Financial Officer shall oversee all financial management activities relating to the programs and operations of the agency." Under the Act, an agency CFO's responsibility will extend to every aspect of financial management related to operating agency programs. Government wide organizational change is needed to vest the CFOs with authority related to accounting, budget execution, and other financial management operations. This will ensure that one person, who is part of top management, has overall responsibility for establishing and implementing effective financial management policies, internal controls, and financial management systems.

Cause:

During fiscal year 2005, MCC management developed the selected compacts based on informal procedures. Therefore, the Chief Financial Officer's involvement was based on an informal basis, and was not included in the official procedures that were developed during fiscal year 2006.

Effect:

This condition can result in the lack of (1) control over pertinent financial management activities, (2) sufficient information to accurately report on compact expenses and advances, and (3) control over disbursement to ensure compliance with Treasury cash management requirements. Additionally, it can result in confusion over the financial reporting required and the timeframe required.

Recommendation #06-05:

We recommend that Millennium Challenge Corporation's management revise their policies and procedures to invest the Office of the Chief Financial Officer with the level of responsibility, role, and all levels of authority established by the Chief Financial Officer Act.

Management Response:

MCC management accepts the recommendation and will take necessary steps to establish and implement required policies, procedures, and organizational protocol to ensure that the Corporation's CFO is appropriately involved with the financial management operations entity-wide.

REPORTABLE CONDITION

MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel (reportable condition)

Condition:

MCC follows the Federal Travel Regulations and has an overall policy related to travel. However, prior to February 2006, MCC was using blanket travel authorizations (TA) to serve as an approval for employee travel. Once MCC approved the blanket TA, it was submitted to National Business Center (NBC) to post an obligation within Oracle. After February, MCC modified the travel policy that instituted the individual TA's that outlined the specific purpose of the employee's travel. NBC no longer posts travel obligations in advance in Oracle but obligates and pays the travel vouchers, simultaneously.

Similar to FY 2005, MCC requires all employees to post their travel expenses online in E-Travel. Although the travel voucher process is electronic, E-Travel does not interface with Oracle Federal Financials. Therefore, an NBC accounting technician must manually enter each voucher. During our travel testing, we noted twenty-six instances totaling $97,802 for which employees' receipts were not available. We also noted the following:

1. Eleven of 115 (10%) travel vouchers totaling $869 exceeded per diem rates;
2. Six of 115 (5%) vouchers equaling $557 consisted of expenses in excess of $75 and were not supported; and
3. Four of 115 (3%) vouchers totaling $35,663 were not approved by the travel manager within E-Travel.

MCC enhanced its travel policy in August 2006. MCC management changed the Corporation's supporting documentation requirements to require travelers to scan into the E-travel system and electronically attach to the pertinent travel vouchers receipts for claimed expenses of $75 or more. Division of Finance personnel are responsible for reviewing submitted vouchers to ascertain that required receipts are electronically attached to travelers' vouchers. Travelers who do not scan and attach their required receipts to vouchers are contacted by Division of Finance staff to obtain "missing" receipts.

Criteria:

U.S. General Services Administration (GSA) Federal Travel Regulations Chapter 301 "Temporary Duty (TDY) Travel Allowances" states that traveler is responsible for expenses over the reimbursement limits established in this chapter. The traveler's agency will not pay for excess costs resulting from circuitous routes, delays, or luxury accommodations or services unnecessary or unjustified in the performance of official business. Also, receipts shall be required to support all lodging costs for which an allowance is claimed under the lodgings-plus per diem system except that a statement instead of a receipt may be accepted for the fee or service charge incurred for the use of Government quarters.

Federal Travel Regulations Chapter 301-7.2 states that it is the responsibility of the head of each agency, or his/her designee, to authorize or approve only those per diem allowances that are justified by the circumstances affecting the travel and are allowable under the specific rules in this part.

Additionally, the "*Standards for Internal Control in the Federal Government*" states that internal controls and all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. Also, information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.

Cause:

Prior to the finalized procedures distributed in August 2006, management worked from incomplete draft travel procedures. Additionally, the travel manager did not approve the online vouchers in E-travel consistently. Employees are required to retain all receipts that are $75 or greater and thus, are not required to submit their receipts to the agency. Therefore, for employees on travel during the time of testing, their receipts were unavailable for audit.

Effect:

The lack of sufficient detail and accountability in the procedures can produce inconsistent application of the travel policies and increase the risk of errors, improper recording, unauthorized transactions, omissions, potential funds control violations due to the lack of obligations and noncompliance with laws and regulations. This also diminished the effectiveness and efficiency with which the financial transactions were being processed.

Recommendation #06-06:

We recommend that Millennium Challenge Corporation's management develop and implement controls to reject travel expense reimbursement requests that exceed the allowable country per diem unless additional electronic authorization is provided.

Management Response:

MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manger/supervisor be apprised of claimed expenses that are not in compliance with the FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

The status of prior years findings is provided in Appendix A. Management's response in its entirety is included in Appendix C.

As required by OMB Bulletin No. 06-03, with respect to internal controls related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

COMPLIANCE WITH LAWS AND REGULATIONS

MCC's management is responsible for complying with laws and regulations applicable to MCC. As part of obtaining reasonable assurance that MCC's balance sheet is free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 06-03, including the requirements referred to in the FFMIA. We limited our tests of compliance to these provisions and we did not test compliance with all laws, regulations, contracts, and agreements applicable to MCC. Providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 and FFMIA, we are required to report whether MCC's financial management systems substantially comply with: (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we relied on the results of a SAS 70 review of the Department of Interior's Oracle Federal Financial System performed by an Independent Audit Firm. The results of that review have been presented to MCC in a separate report. Providing an opinion on compliance with those provisions was not, however, an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed that the Corporation did not fully comply with the FFMIA, which is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03.

Under FFMIA, we are required to report whether the Corporation's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed three instances of noncompliance with laws and regulations.

MATERIAL NONCOMPLIANCE

MCC Did Not Fully Comply with FFMIA and GPRA

Condition:

Millennium Challenge Corporation has not fully complied with the following laws and regulations:

- Government Performance and Results Act (GPRA)
- Federal Financial Management Improvement Act (FFMIA)

We noted that the agency performance plans provided to us did not fully comply with GPRA requirements, for example: human, capital and other resources needed to achieve performance goals were not quantified as required. Also, agency performance goals were not written in a manner that could be quantified in several instances and milestones were not included. Therefore, we could not directly link measurement of agency performance goals with the overall strategic plan. In addition, baseline data to be used as performance indicator measurement thresholds were not provided for some indicators.

The FFMIA requires an integrated financial management system. MCC does not have an integrated financial management system. When MCC decided to outsource its accounting operations, MCC selected NBC from the available Federal Centers of Excellence as the best choice to meet its needs. In order to address the needs of MCC, multiple systems, i.e. E-

Travel, procurement, and Federal Personnel and Payroll System (FPPS), are used, but these systems cannot exchange data electronically. The entry of the travel expenses and disbursements must be done manually. The entry of obligations and commitments requires a process of emails, scanning and manual entry into Oracle Federal Financial (OFF) System application. The payroll expenses and disbursements must be uploaded into OFF from FPPS.

Additionally, we obtained and reviewed the Financial Management Controls and Assertion letter and noted the following assertion, "During FY 2006, NBC's sytems were not in substantial compliance with FFMIA requirements. In its assurance statement as of June 30, 2006, NBC asserted that 'were in substantial non-compliance with FFMIA requirements'." Subsequently, NBC instituted several corrective actions to address the issues raised and were in substantial compliance by September 30, 2006, per their representation.

Criteria:

The GPRA under United States Code Title 5, Chapter 3, section 306(a)(3) states that strategic plans shall contain, "a description of how the goals and objectives are to be achieved, including a description of the operational processes, skills and technology, and the human, capital, information, and other resources required to meet those goals and objectives." In addition, under section 306(a)(4), it also requires "a description of how the performance goals included in the plan required by section 1115(a) of Title 31 shall be related to the general goals and objectives in the strategic plan." Under section 4(b), "Annual Performance Plans and Reports," it amends section 1115 of Title 31 to, "express such goals in an objective, quantifiable, and measurable form unless authorized to be in an alternative form under subsection (b)." Also, the performance report should evaluate the performance plan for the current fiscal year relative to the performance achieved toward the performance goals in the fiscal year covered by the report.

The FFMIA requires MCC to implement and maintain a financial management system that complies substantially with Federal requirements for an integrated financial management system.

Cause:

MCC is still developing the GPRA process and has not developed system-wide strategic plan implementation standards, formats or procedures at the departmental level. Also, performance measures baseline data is incomplete and as such, in some instances there are no indicators available to measure progress made.

The MCC does not have its own financial system. The Corporation has contracted with NBC to provide accounting and IT services including usage of its OFF application. The MCC is required by government regulations to use Federal Centers of Excellence, of which NBC is one. According to MCC officials, the Corporation has been directed to use the systems available through NBC. MCC believes that in fiscal year 2006, it used the only options available. NBC is working with MCC to provide enhancement to the system to accommodate MCC's needs within the context of the OMB requirements for Centers of Excellence.

Effect:

Without a performance plan that meets key GPRA requirements MCC management may not have meaningful performance data linked to the strategic objectives and goals of the MCC. The reader of the financial statements is not provided with a clear picture of the accountability and achievements of the Corporation.

Furthermore, because MCC does not have an integrated financial management system, the users may not receive complete, accurate, and timely financial information needed for decision-making purposes because of the inefficiencies caused by the manual processes.

Recommendation #06-07:

We recommend that MCC management:

1. Develop performance goal templates and follow-up training to ensure that Government Performance and Results Act (GPRA) requirements are adequately addressed and consistent. We also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.

2 Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Management Decision:

MCC accepts the recommendations. Relative to GPRA, the Department of Administration and Finance management is working with various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regards to system integration, the Department of Administration and Finance is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness, and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

MCC Does Not Fully Comply With The Federal Information Security Management Act (FISMA)

An OIG audit identified significant non-compliance with FISMA requirements. Also, MCC engaged an outside expert to perform an independent security audit. MCC acknowledged that it had not met the majority of the FISMA requirements and proposed a timetable for compliance.

We are reporting this deficiency as required by the guidance issued by the Office of Management and Budget. However, because this deficiency was addressed in a prior OIG audit report, we are not making any recommendation in this report.

MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management

The internal control finding "MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management" is also a noncompliance with laws and regulations.

The complete finding and recommendation for this finding is presented in the internal control section of this report. We are not making any recommendations for this finding because we reported and made recommendations for corrective actions in the internal control section.

DISTRIBUTION

This audit was performed pursuant to the Government Corporation Control Act, and is intended solely for the information and use of the United States Congress, the President, the Director of the Office of Management and Budget, Comptroller General of the United States, the Corporation and its Inspector General, and is not intended to be, and should not be, used by anyone other than these specific parties.

Williams, Adley & Company, LLP

October 25, 2006
Washington, D.C.

STATUS OF PRIOR YEAR FINDINGS

Review of Oracle Federal Financial System

The Millennium Challenge Corporation (Corporation) does not have its own financial system. The Corporation contracted with the Department of Interior, National Business Center (NBC) to provide accounting and IT services including usage of its Oracle Federal Financial (OFF) System application. The NBC has not conducted an internal control review, such as a Statement of Auditing Standards (SAS) 70 review of the Oracle Federal Financials System nor has MCC directed NBC as its third-party servicer to have a review conducted in accordance with the federal system requirements.

Recommendation
We recommend that MCC direct the National Business Center to conduct an internal control review, such as a SAS 70 review to assess the control environment of the Oracle Federal Financial System.

Status
The NBC performed a SAS 70 review of the Oracle Federal Financial System for the period March 1, 2005 to July 31, 2005. The independent auditors reported that the relevant aspects of the NBC's controls that had been placed in operation are suitably designed to provide reasonable assurance that the specified control objectives would be achieved, except for the following two items:

- OFF requires transactions exceeding a dollar threshold to be approved by certifying officers. The electronic workflow in OFF currently does not require the approval by certifying officers of all such transactions.
- NBC is responsible for monitoring budgetary accounts for MCC. However, OFF limit edits are not designed to prevent obligations from exceeding the allotment.

NBC provided a self-certification asserting no change in the system controls from August 1 to September 30, 2005. No system review was performed for the period October 1, 2004 to February28, 2005 to assess operational efficiency, effectiveness and transparency

In fiscal year 2006, NBC performed a SAS 70 review for the period October 1, 2005 to July 31, 2006. The independent auditors reported that the relevant aspects of the NBC's controls that had been placed in operation are suitably designed to provide reasonable assurance that the specified control objectives would be achieved, except for the following item:

- OFF requires transactions exceeding a dollar threshold to be approved by certifying officers. The electronic workflow in OFF currently does not require the approval by certifying officers of all such transactions.

MCC's Policies and Procedures Were Not Always Complete and Consistent

During the fiscal year, the Millennium Challenge Corporation (MCC) has used various processes to address the financial aspects of their operations. These processes have evolved during the year as the organization has grown in personnel and operations. In this growth, however, the development of written policies and procedures to guide MCC's streamlined operational structure has not been a high priority for MCC in several areas. However, written policies and procedures must be in place to ensure operational efficiencies, risk reduction, and consistent application.

Recommendation 05-1:

We recommend that MCC's Office of Finance and Administration revise and reissue written policies and procedures that provide additional specificity in the areas noted above including the Fund Balance with Treasury, financial reporting, payroll processing, accrual generation and reporting, interagency reporting, fixed assets, travel, monitoring and internal grant processes. These policies and procedures should provide the following information at a minimum:

- Position accountable for each step in the process,
- Position responsible for approving/reviewing the information,
- The acceptable internal and external timelines for each step in the process, and
- The specific documentation required determining the authorization, timeliness and review of transaction.

Status

MCC had not issued final policies and procedures in several areas. Therefore, the finding is repeated but revised as finding # 06-1.

MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel

According to MCC's management, MCC has adopted the Federal Travel Regulations as its overall policy related to travel. MCC's internal travel policies and procedures do not permit the effective and efficient management of travel. These procedures do not ensure that travel is adequately planned and managed. Because a blanket travel authorization is used, there is no record that individual travel has taken place and that accounting has occurred for each instance. Additionally, the policy does not require that appropriate coordination include the Office of Finance. For example, the Office of Finance should have knowledge of planned trips, the timing, exceptions to the standard travel policy, and the estimated costs in order to ensure that sufficient obligations have been recorded to cover expenses incurred by MCC travelers. Currently, an initial estimate is prepared annually to fund the blanket travel authorization and the estimate is adjusted quarterly by the controller based upon expense patterns. There are, however, no automated processes in place to ensure that the estimate is sufficient to cover the travel expenses incurred. This problem is compounded by the untimely filing of travel vouchers thereby increasing the difficulty and reducing the accuracy of the estimation process performed by the controller.

Recommendation #05-2:

We recommend that MCC management:

(1) Develop and disseminate explicit policies to ensure that employees are aware of and follow the Federal Travel Regulations. Any exception should be documented and approved by a manager/supervisor in writing.
(2) Institute policies and procedures to ensure proper authorizations and approvals are obtained and coordination with the Office of Finance has occurred for each planned trip prior to travel to ensure that the information is properly captured in the financial management system.
(3) Develop and institute controls to reject those expenses claimed that exceed the allowable country per diem unless explicit written authorization is provided prior to travel.

Status:
MCC issued a revised policies and procedures in fiscal year 2006. However, we found additional exceptions in fiscal year 2006 related to travel expenses that exceed per diem, and lacked documentation. Also, we noted that no obligations are recorded prior to processing the travel voucher for reimbursement. The finding has been revised. Recommendations 2 and 3 were retained and a new recommendation was added. See recommendation #06-06

MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable

MCC entered into a compact with Madagascar in April 2005. The Compact became effective in July 2005, and an immediate advance was provided to MCA Madagascar amounting to $2,500,924. Based upon information obtained at year-end, MCA Madagascar has expended $650,000 of the initial advance.

Through various OMB Circulars, OMB has attempted to address the need for advances to cover immediate cash needs or timely disbursements of an entity for direct program costs for carrying out the purpose of the approved program or project. Thus, funds paid to a grantee are not to be held but are to be promptly applied to the grant purpose. Although the timeframe for immediate cash needs has not been clearly defined by OMB, the general rules employed by various Federal agencies are 30 days for non-governmental entities. Based upon this definition, MCC has provided Federal funds in excess of immediate cash needs.

Recommendation #05-3:

We recommend that management:

(1) Develop policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the Treasury requirements concerning advances and immediate cash needs.
(2) Establish policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.

Status:

MCC's policies and procedures have not changed in this area. In fiscal year 2006 more funds have been provided to various MCAs and the timelines between requesting the funds and their use has not improved but worsened. The finding was revised with additional data and recommendations. See recommendation #06-02.

MCC's Human Resources Responsible for Managing Its Financial Operations are Inadequate

During our internal control and substantive testing, we noted that the MCC relies solely on the Controller, with contract assistance, to perform the substantial duties of the Office of Financial Management (OFM). The current range of Controller responsibilities include, but are not limited to, the approval of miscellaneous obligations; monthly, quarterly and yearly financial information review; development of financial policies and procedures; financial statement review; audit coordination; coordination with other agencies including OMB, USAID/OIG, and NBC; and approval of funds availability.

Recommendation #05-4:

We recommend that MCC evaluate and document the need for additional employees in OFM to ensure that proper internal controls are in place to meet the agency's objective and thus, providing the Controller with adequate delegation of authority. Additionally, the roles and responsibilities of the current Controller position and the new positions in OFM should be clearly delineated and communicated.

Status:

MCC took significant steps to improve their human resources in the Office of Finance. They hired an additional five employees including a Chief Financial Officer, Deputy Chief Financial Officers and several accountants. The delineation of their roles and responsibilities will be outlined clearly in the newly revised policies and procedures.

MCC Did Not Fully Comply with FFMIA and GPRA

Millennium Challenge Corporation has not complied with the following laws and regulations:

- Government Performance and Results Act (GPRA)
- Federal Financial Management Improvement Act (FFMIA)

MCC has not developed performance goals and objectives that comply with the requirements of the GPRA. Although MCC has several guiding objectives, they do not meet the requirements of GPRA. The information in Management's Discussion and Analysis are not sufficient to meet GPRA requirements and the goals presented are on a calendar year basis rather than a fiscal year.

The FFMIA requires an integrated financial management system. MCC does not have an integrated financial management system. When MCC decided to outsource its accounting operations, MCC selected NBC from the available Federal Centers of Excellence as the best choice to meet its needs. In order to address the needs of MCC, multiple systems, i.e. E-Travel, procurement, and FPPS, are used but these systems cannot exchange data electronically. The entry of the travel expenses and disbursements must be done manually. The entry of obligations and commitments requires a process of emails, scanning and manual entry into OFF. The payroll expenses and disbursements must be uploaded into OFF from FPPS.

Recommendation #05-5:

We recommend that MCC management:

(1) Implement their intended corrective actions for preparation of a GPRA based performance goals and objectives by March 2006, as specified in its FMFIA assessment, specifically:
- Complete the development of a strategic plan for the next six fiscal years that meets OMB requirements.
- Involve MCC staff in the determination of corporate performance goals.
- Articulate operational performance goals for FY 2006, that align with the defined strategic goals and submit to the Board and OMB.

(2) Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Status:

MCC has made improvements in these areas. However, there are remaining issues and thus the finding has been repeated with a revision to the finding for GPRA. See recommendation # 06-07.

MCC Does Not Fully Comply with The Federal Information Security Management Act (FISMA)

In a report issued June 2005, an OIG audit identified significant non-compliance with FISMA requirements. Subsequently, MCC completed its FISMA report to OMB as of September 30, 2005, where it acknowledged that it had not met the majority of the FISMA requirements and proposed a timetable for compliance.

We are reporting this deficiency, as required by the guidance issued by the Office of Management and Budget. However, because this deficiency was addressed in a prior OIG audit report, we are not making any recommendation in this report.

The OIG continues the report significant noncompliances with FISMA requirements in fiscal year 2006.

Management Comments and Our Evaluation

We received and evaluated MCC's management comments to the recommendations made in this report. We considered their comments to be generally responsive except for specific exceptions detailed below. Management comments have been included in their entirety in Appendix C.

In its response MCC's management stated that it recognizes the importance of accountability, effective stewardship, and public disclosure related to the resources entrusted to it, and that their goal is to achieve and maintain excellence in financial management, financial reporting and internal control systems. Further, MCC's management commented that it will implement the recommendations as soon as possible to strengthen their systems of internal controls and lend further credibility to their financial statements and overall financial operations. MCC's management went on to address each recommendation. MCC's management also recognized and thanked both the OIG and Williams, Adley & Company, LLP for working closely with them during the audit process and providing counseling and support throughout the year.

Based on MCC's comments, we consider that a management decision has been reached on recommendations 1, 4, and 6 provided in this report but not on recommendations 2, 3, 5, and 7. These recommendations do not provide defined timelines for the corrective action implementation. Also, the corrective actions for recommendation 2.4 and 7.1 require additional details to ensure that the recommendations are appropriately addressed. On recommendation 2.1, management agreed to "the spirit" of the recommendation but has not agreed to the usage of the US Treasury requirements. MCC should report to the OIG when management decision has been reached on the four recommendations and when final action has been taken on the recommendations. The following is a brief summary of MCC's management comments on the seven recommendations included in this report and our evaluation on those comments.

Recommendation No. 1

MCC accepts the recommendation and is currently implementing relevant corrective action. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

Auditor Evaluation: We conclude that management has adequately addressed this issue.

Recommendation No. 2

MCC Management accepts recommendations 2.2, 2.3, and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with the GAO policy based upon what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because the response does not address recommendation 2.4; and does not discuss the implementation of recommendation 2.2. Also, the management response does not specify an implementation date for any of the subparts of recommendation 2.

Recommendation No. 3

MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action.

Recommendation No. 4

MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

Auditor Evaluation: We conclude that management has adequately addressed this issue.

Recommendation No. 5

MCC management accepts the recommendation and will take necessary steps to establish and implement required policies, procedures, and organizational protocol to ensure that the Corporation's CFO is appropriately involved with the financial management operations entity-wide.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action.

Recommendation No. 6

MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manger/supervisor be apprised of claimed expenses that are not in compliance with the FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

Auditor Evaluation: We conclude that management has adequately addressed this issue.

Recommendation No. 7

MCC accepts the recommendations. Relative to GPRA, the Department of Administration and Finance management is working with various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regards to system integration, the Department of Administration and Finance is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness, and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action. Also, the response to recommendation 7.1 does not provide enough detail information to conclude that the finalization of baseline data, review of performance indicators, the development of templates, or performance of follow-up training is part of the corrective action plan.

MILLENNIUM CHALLENGE CORPORATION
REDUCING POVERTY THROUGH GROWTH

November 6, 2006

TO: John Phee
Assistant Inspector General

FROM: Michael Ryan /s/
Vice President, Administration & Finance

SUBJECT: Management Response to Draft Independent Auditor's Report on MCC's Financial Statements for Fiscal Years Ended September 30, 2006 and 2005, Respectively

We have received the subject draft report and are pleased to note that the independent auditors, Williams, Adley & Company, LLP, are issuing an unqualified opinion on our principal financial statements, namely the Statements of:

- Financial Position;
- Operations and Changes in Net Position;
- Cash flows;
- Functional Expenses; and
- Budgetary Resources.

The auditor's unqualified opinion is being issued despite material internal control weaknesses and noncompliance with selected laws and regulations that have been identified.

The Millennium Challenge Corporation's (MCC) management recognizes the importance of accountability, effective stewardship and public disclosure related to the resources entrusted to it. Our goal is to achieve and maintain excellence in our financial management, financial reporting and internal control systems. Accordingly, we will implement the recommendations as soon as possible to strengthen our systems of internal control and lend further credibility to our financial statements and overall financial operations.

We wish to recognize and thank you, your team and Williams, Adley & Company for working closely with us during the audit process. We look forward to working with you and your staff on the fiscal year (FY) 2007 financial audit. Any questions may be addressed to Mr. Gerald Thomas, Deputy Chief Financial Officer, or to me.

Following are our management decisions and responses to Williams Adley's audit recommendations.

Material Weakness 1: MCC's policies and procedures were not always complete and consistent.

Recommendation 1: Williams, Adley & Company recommends that MCC's Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Management Decision: MCC management accepts the recommendation and is currently implementing relevant corrective actions. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer, 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

* * * * *

Material Weakness 2: MCC policies for disbursing advances to grantees do not accommodate effective cash management.

Recommendations: Williams, Adley & Company recommends that MCC management:

2.1: Develop and implement policies and procedures to ensure that payment schedules and other agreements entered into with grantees are reflective of U.S. Treasury requirements concerning advances and immediate cash needs.

2.2: Develop and implement policies and procedures to ensure that all disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.

2.3: Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.

2.4: Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. Government resulting from the grantee advances, are properly recorded.

Management Decision: MCC management accepts recommendations 2.2, 2.3 and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with GAO policy based on an evaluation of what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

* * * * *

Material Weakness 3: MCC does not have a property management system.

Recommendation 3: Williams, Adley & Company recommends that MCC develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Management Decision: MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

* * * * *

Material Weakness 4: MCC did not properly record compact expenses during the fiscal year.

Recommendations: Williams, Adley & Company recommends that MCC management:

4.1: Require that the final quarterly disbursement requests received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.

4.2: Develop and implement policies and procedures that require compact expenses are properly and accurately recorded and reported on a quarterly basis.

4.3: Implement written procedures requiring that appropriate and timely follow-up actions are performed and documented on late and/or outstanding fund disbursements and/or advance requests.

4.4: Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.

Management Decision: MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

* * * * *

Material Weakness 5: MCC's Chief Financial Officer was not an integral part of the compact/grant processes.

Recommendation 5: Williams, Adley & Company recommends that MCC management revise its policies and procedures to invest the Office of the Chief Financial Officer (CFO) with the level of responsibility, including role and all levels of authority established by the Chief Financial Officers Act.

Management Decision: MCC management accepts the recommendation and will take the necessary steps to establish and implement required policies, procedures and organizational protocol to ensure that the Corporation's CFO is appropriately involved with financial management operations entity-wide.

* * * * *

Reportable Condition 1: MCC's travel disbursement controls and procedures do not permit the effective and efficient management of travel.

Recommendation 6: Williams, Adley & Company recommends that MCC management develop and implement controls to reject travel expense reimbursement requests that exceed the allowable country per diem limits unless additional electronic authorization is provided.

Management Decision: MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manager/supervisor be apprised of claimed expenses that are not in compliance with FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

* * * * *

Material Noncompliance 1: MCC did not fully comply with the Federal Financial Management Improvement Act (FFMIA) and the Government Performance and Results Act (GPRA).

Recommendations: Williams, Adley & Company recommends that MCC management:

7.1: Develop performance goal templates and follow-up training to ensure that Government Performance and Results Act (GPRA) requirements are adequately addressed and consistent. Williams, Adley & Company and the OIG also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.

7.2: Assess the automated options available to handle MCC operations and develop short-range and long-range plans for implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Management Decision: MCC accepts the recommendations. Relative to GPRA, Department of Administration and Finance management is working with the various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regard to systems electronic integration, Department of Administration and Finance management is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential automation opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

* * * * *

Material Noncompliance 2: MCC does not comply with the Federal Information Security Management Act (FISMA). Williams, Adley & Company makes no recommendation(s) relative to this material noncompliance since the deficiency was identified by the Office of Inspector General in a prior audit and MCC management has:

- acknowledged that it has not fully met FISMA requirements;
- hired an outside expert to perform an independent security audit; and
- proposed a timetable for compliance.

Millennium Challenge Corporation
Statements of Financial Position
As of September 30, 2006 With Summary Totals for 2005

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Assets								
Current Assets								
Fund Balance with Treasury *(Note 2)*	$ 3,931,404,752	$ 3,610,671,774	$ 55,951,660	$ 193,230,000	$ 32,200,504	$ 37,567,478	$ 1,783,336	$ 2,358,547,000
Receivables/Advances/Prepayments *(Note 3)*	18,893,478	16,587,951	511,426	-	1,731,899	62,202	-	4,338,698
Fixed Assets								
Leasehold Improvements and Capital Equipment *(Note 4)*	4,632,785	-	-	-	-	4,632,785	-	4,244,059
Total Assets	$ 3,954,931,015	$ 3,627,259,725	$ 56,463,086	$ 193,230,000	$ 33,932,403	$ 42,262,465	$ 1,783,336	$ 2,367,129,757
Liabilities								
Accounts Payable	2,552,277	-	774,246	-	731,258	1,046,773	-	1,319,467
Other Liabilities *(Note 5)*	2,516,786	-	-	-	(461,774)	2,978,560	-	2,522,803
Accrued Funded Annual Leave	2,698,070	-	-	-	-	2,698,070	-	1,386,644
Total Liabilities	$ 7,767,133	$ -	$ 774,246	$ -	$ 269,484	$ 6,723,403	$ -	$ 5,228,914
Net Position								
Unexpended Appropriations								
Obligated	1,283,003,458	1,187,867,694	43,098,943	0	23,298,780	26,954,705	1,783,336	349,153,392
Commitments	856,804,162	842,399,600	5,052,595	0	8,495,391	856,576	0	606,634,745
Allotments - Realized Resources	1,802,661,275	1,596,992,431	7,537,302	193,230,000	1,868,748	3,032,794	-	1,401,835,873
Cumulative Results of Operations	4,694,987	-	-	-	-	4,694,987	-	4,276,833
Total Net Position *(Note 6)*	$ 3,947,163,882	$ 3,627,259,725	$ 55,688,840	$ 193,230,000	$ 33,662,919	$ 35,539,062	$ 1,783,336	$ 2,361,900,843
Total Liabilities and Net Position	$ 3,954,931,015	$ 3,627,259,725	$ 56,463,086	$ 193,230,000	$ 33,932,403	$ 42,262,465	$ 1,783,336	$ 2,367,129,757

The notes are an integral part of these financial statements

Millennium Challenge Corporation
Statements of Operations and Changes in Net Position
For the Year Ended September 30, 2006 With Summary Totals for 2005

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Financing Sources								
Appropriations Used	$ 92,455,115	$ 16,747,194	$ 5,895,167	$ -	$ 15,137,340	$ 54,055,700	$ 619,714	$ 39,312,758
Expenses	92,036,960	16,747,194	5,895,167	-	15,137,340	53,637,545	619,714	35,035,926
Excess of Financing Sources over Expenses	$ 418,155	$ -	$ (0)	$ -	$ 0	$ 418,155	$ -	$ 4,276,832
Net Position								
Excess of Financing Sources over Expenses	418,155	-	(0)	-	0	418,155	-	4,276,832
Increase in Unexpended Appropriations								
Appropriated	-							-
Obligated	933,850,067	863,789,695	36,954,637	-	14,498,520	17,054,929	1,552,286	346,388,202
Commitments	856,804,162	842,399,600	5,052,595	0	8,495,391	856,576	0	626,634,744
Allotments - Realized Resources	(168,109,344)	(358,233,833)	(8,007,053)	193,230,000	1,868,748	3,032,794	-	407,664,296
Transfers In/(Out)	(20,000,000)	-	-	(20,000,000)	-	-	-	-
Permanent Recission	(17,700,000)	(17,700,000)	-	-	-	-	-	(12,000,000)
Total Increase in Unexpended Appropriations	1,585,263,040	1,330,255,462	34,000,179	173,230,000	24,862,659	21,362,454	1,552,286	1,372,964,074
Beginning Net Position	2,361,900,842	2,297,004,263	21,688,661	20,000,000	8,800,260	14,176,608	231,050	988,936,768
Ending Net Position	$ 3,947,163,882	$ 3,627,259,725	$ 55,688,840	$ 193,230,000	$ 33,662,919	$ 35,539,062	$ 1,783,336	$ 2,361,900,842

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statements of Functional Expenses
For the Year Ended September 30, 2006 With Summary Totals for 2005

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Salary and Benefits	$27,587,426	$ -	$ -	$ -	$ -	$ 27,587,426	$ -	$ 13,343,440
Travel	6,362,880	-	-	-	317,509	6,045,371	-	3,980,087
Rent/Lease	4,404,013	-	-	-	-	4,404,013	-	718,546
Utilities	766,206	-	-	-	-	766,206	-	207,704
Information Technology Services	2,562,575	-	-	-	-	2,562,575	-	2,065,657
Accounting Services	4,244,677	-	-	-	-	3,624,963	619,714	3,186,484
Interagency Agreements	4,636,977	-	-	-	4,636,977	-	-	564,654
Other Services	13,563,769	-	-	-	9,755,703	3,808,066	-	6,082,697
Supplies and Equipment	2,211,918	-	-	-	-	2,211,918	-	2,671,882
Grants	22,642,361	16,747,194	5,895,167	-	-	-	-	1,024,133
Miscellaneous	3,054,158	-	-	-	427,151	2,627,007	-	1,190,642
Total Expenses	$ 92,036,960	$ 16,747,194	$ 5,895,167	$ -	$ 15,137,340	$ 53,637,545	$ 619,714	$ 35,035,926

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statements of Cash Flows
For the Year Ended September 30, 2006 With Summary Totals for 2005

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Cash Flows from Operating Activities								
Excess of Financing Sources over Expenses	$ 418,155	$ -	$ -	$ -	$ -	$ 418,155	$ -	$ 4,276,832
Adjustments Affecting Cash Flow:								
Depreciation Expense	483,000					483,000		$ -
Changes in Assets and Liabilities:								
Appropriated Capital Used	(92,455,115)	(16,747,194)	(5,895,167)	-	(15,137,340)	(54,055,700)	(619,714)	(39,312,758)
Increase in Advances/Receivables/Prepayments	(14,554,780)	(14,782,027)	(511,426)		768,101	(29,428)	-	(4,170,099)
Increase in Accounts Payable	1,232,809	-	774,246	-	659,128	(200,565)	-	1,295,584
Decrease in Other Liabilities	(6,017)	-	(154,526)	-	(1,459,696)	2,059,014	(450,809)	1,668,178
Increase in Annual funded Leave Liabilities	1,311,427	-	-	-	-	1,311,427	-	1,216,743
Total Adjustments	(103,988,676)	(31,529,221)	(5,786,873)	-	(15,169,807)	(50,432,252)	(1,070,523)	(39,302,352)
Net Cash Used in Operating Activities	$ (103,570,521)	$ (31,529,221)	$ (5,786,873)	$ -	$ (15,169,807)	$ (50,014,097)	$ (1,070,523)	$ (35,025,520)
Cash Flows from Investing Activities								
Purchase of Property	$ (871,727)	$ -	$ -	$ -	$ -	$ (871,727)	$ -	$ (4,244,059)
Net Cash Used in Investing Activities	$ (871,727)	$ -	$ -	$ -	$ -	$ (871,727)	$ -	$ (4,244,059)
Cash Flows from Financing Activities								
Appropriations received net of recissions	$ 1,752,300,000	$ 1,347,002,655	$ 39,895,345	$ 248,230,000	$ 40,000,000	$ 75,000,000	$ 2,172,000	$ 1,488,000,000
Transfers Out	(75,000,000)			(75,000,000)				(80,000,000)
Net Cash Provided by Financing Activities	1,677,300,000	1,347,002,655	39,895,345	173,230,000	40,000,000	75,000,000	2,172,000	1,408,000,000
Net Increase in Cash	1,572,857,752	1,315,473,434	34,108,472	173,230,000	24,830,193	24,114,176	1,101,477	1,368,730,421
Fund Balance with Treasury, Beginning	2,358,547,000	2,295,198,340	21,843,188	20,000,000	7,370,311	13,453,302	681,859	989,816,579
Fund Balance with Treasury, Ending	$ 3,931,404,752	$ 3,610,671,774	$ 55,951,660	$ 193,230,000	$ 32,200,504	$ 37,567,478	$ 1,783,336	$ 2,358,547,000

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statements of Budgetary Resources
For the Year Ended September 30, 2006 With Summary Totals for 2005

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Budgetary Resources:								
Budget Authority:								
Appropriations	1,770,000,000	1,364,702,655	39,895,345	248,230,000	40,000,000	75,000,000	2,172,000	1,500,000,000
Net Transfer, Current Year Authority								
Unobligated Balance - Beginning of Period	2,053,722,184	1,972,926,264	15,544,354	65,251,566				986,171,577
Unobligated Balance - Transferred								
Spending Authority from Offsetting Collections	-							
Advances Received	-							
Adjustments:								
Recoveries of Prior Years Obligations	-							
Permanently Not Available *(Note 7)*	(17,700,000)	(17,700,000)	-	-	-	-	-	(12,000,000)
Total Budgetary Resources	$ 3,806,022,184	$ 3,319,928,919	$ 55,439,699	$ 313,481,566	$ 40,000,000	$ 75,000,000	$ 2,172,000	$ 2,474,171,577
Status of Budgetary Resources:								
Obligations Incurred	$ 1,109,535,594	$ 880,536,888	$ 42,849,803	$ 83,230,412	$ 29,635,861	$ 71,110,630	$ 2,172,000	$ 420,449,393
Unobligated Balance Available:								
Apportioned	877,383,424	842,399,600	10,644,896	10,085,419	10,364,139	3,889,370	-	683,006,839
Unobligated Balance Not Available:	1,819,103,166	1,596,992,431	1,945,000	220,165,735	-	-	-	1,370,715,345
Total Status of Budgetary Resources	$ 3,806,022,184	$ 3,319,928,919	$ 55,439,699	$ 313,481,566	$ 40,000,000	$ 75,000,000	$ 2,172,000	$ 2,474,171,577
Relationship of Obligations to Outlays:								
Obligated Balance, Net - as of October 1, 2005	$ 384,862,005	$ 322,272,076	$ 6,298,834	$ 34,699,991	$ 7,370,311	$ 13,538,935	$ 681,859	$ 3,645,002
Obligations Incurred	1,109,535,594	$ 880,536,888	$ 42,849,803	$ 83,230,412	$ 29,635,861	$ 71,110,630	$ 2,172,000	$ 420,449,393
Recoveries of Prior Years Obligations	-							
Adjustments								
Obligated Balance, Net - End of Period								
Accounts Payable	(8,881,212)	0	(774,246)	0	(1,670,526)	(6,436,440)	0	(5,335,899)
Obligations	(1,376,397,315)	(1,171,279,742)	(42,587,517)	(112,225,132)	(21,566,882)	(26,954,705)	(1,783,336)	(379,526,106)
Total Outlays	$ 109,119,072	$ 31,529,222	$ 5,786,873	$ 5,705,271	$ 13,768,764	$ 51,258,420	$ 1,070,523	$ 39,232,390
Outlays:								
Disbursements	109,119,072	31,529,222	5,786,873	5,705,271	13,768,764	51,258,420	1,070,523	39,232,390
Collections / Refunds	-							-
Net Outlays	$ 109,119,072	$ 31,529,222	$ 5,786,873	$ 5,705,271	$ 13,768,764	$ 51,258,420	$ 1,070,523	$ 39,232,390

The footnotes are an integral part of these financial statements

Notes to Financial Statements
(As of September 30, 2006)

Note 1—Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, results of operations, cash flows, and budgetary resources for MCC (the Corporation), as required by Section 613 of the Millennium Challenge Act of 2003 and the Government Corporation Control Act (31 U.S.C. §9106). These financial statements have been prepared from the books and records of the Corporation and are presented in accordance with the applicable requirements of OMB, the Secretary of the Treasury, and the Government Management and Reform Act of 1994.

The Corporation's accounting policies conform to and are consistent with generally accepted accounting principles for the Federal government, as promulgated by OMB and prescribed by the Federal Accounting Standards Advisory Board (FASAB).

The Corporation's principal financial statements are:

- Statement of Financial Position;
- Statement of Operations and Changes in Net Position;
- Statement of Functional Expenses;
- Statement of Cash Flows; and
- Statement of Budgetary Resources.

MCC has presented comprehensive statements for fiscal year 2006, with summary totals for 2005 for comparative purposes. These notes are considered an integral part of the financial statements.

B. Reporting Entity

The Corporation was formed in January 2004 pursuant to the Millennium Challenge Act of 2003 (Public Law 108-199). The Corporation's mission is to provide United States assistance to eligible countries for global development. The assistance is intended to provide economic growth and the elimination of extreme poverty, strengthen good governance, encourage economic freedom, and promote investments in people.

C. Budgets and Budgetary Accounting

The Corporation's programs and activities are funded through no-year appropriations. Such funds are available for obligation without fiscal year limitation and remain available until expended. MCC was provided total appropriations of almost $1.8 billion and $1.5 billion in FY 2006 and FY 2005, respectively. OMB apportions MCC administrative funds on an annual basis pursuant to statutory limitations in the appropriations bill. In addition, MCC receives from OMB a separate apportionment for due diligence funds, which MCC uses for compact evaluations and support, compact programs, 609(g) funds, the Threshold Program, and audit funds. Because of the no-year status of MCC appropriations, unobligated administrative, audit and due diligence funds (apportioned on annual bases) are not returned to Treasury. MCC's policy is to transfer any unobligated balances as of September 30, for these three categories of funds to compact funds at the beginning of the subsequent fiscal year.

D. Basis of Accounting

Financial transactions are recorded on accrual and budgetary bases in accordance with pertinent Federal accounting and financial reporting requirements. Under the accrual method of accounting, financing sources are recognized when used and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates the Corporation's compliance with legal constraints and controls over the use of Federal funds.

The accompanying Statements of Financial Position, Operations and Changes in Net Position, Cash Flows, and Functional Expenses have been prepared on the accrual basis. The Statement of Budgetary Resources has been prepared in accordance with budgetary accounting rules. The Statement of Cash Flows has been prepared to reconcile budgetary to financial (proprietary) accounting information.

E. Fund Balance with Treasury

The Corporation does not maintain cash in commercial bank accounts. Rather, the Corporation's funds are maintained in Treasury accounts. The Department of the Treasury processes all cash receipts and disbursements for the Corporation. The Fund Balances with Treasury represent no-year funds, which are maintained in appropriated funds that are available to pay current and future commitments.

F. Advances to Others

The Corporation advances funds in response to compact countries and Federal agency drawdown requests in order to implement compact projects in an MCA country or inter-agency agreements. Funds advanced to compact countries are used to pay legitimate costs and expenses incurred per the formal compacts entered into by MCC and the countries.

G. Property and Equipment

The Corporation's accounting policies require that property and equipment with original cost of $25,000 or more and an estimated useful life of two or more years to be capitalized. Such assets include leasehold improvements, telephone equipment, computer systems equipment, copiers, computer software, furniture, and assets under capital leases. The assets are to be depreciated (or amortized) over their estimated useful lives.

H. Compacts and Pre-Compact (609(g))Funding Payable

Compact funding, including 609(g) funds, are made to eligible countries with approved Compact or pre-Compact funding agreements. Upon formally entering into a compact with a country, the Corporation records a commitment of funds (i.e., administrative reservation) in its financial records for the total value of the compact. Once a compact enters into force, the value of the compact is obligated on MCC's financial books (and the related commitment reduced/liquidated). At the end of the fiscal year, the Corporation records the total estimated amount of compact expenses incurred for work performed but not paid as liquidations of the advances. The estimated amount of such expenses at September 30, 2006 and September 30, 2005, were $1.956 million and $0, respectively.

I. Accounts Payable

The Corporation records as liabilities all amounts to others as a direct result of transactions or events that have occurred. Accounts payable represent amounts due to both Federal and non-federal entities for goods and services received by the Corporation, but not paid at the end of the fiscal year.

J. Actuarial FECA Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose deaths are attributable to a job-related injury or occupational disease.

Claims incurred for benefits for Corporation employees under FECA are administered by the Department of Labor (DOL) and later billed to the Corporation. The Corporation's actuarial liability for workers' compensation includes any costs incurred but unbilled as of year-end, as calculated by DOL, and is not funded by current appropriations.

The Corporation incurred no FECA liabilities during fiscal years 2006 and 2005.

K. Other Liabilities

Other liabilities include amounts owed, but not paid, at the end of the fiscal year for employee payroll and benefits and Federal Employees' Compensation Act charges (see Exhibit 13).

L. Accrued Annual Leave

The value of employees' unused annual leave at the end of the fiscal year is accrued as a liability. At the end of each fiscal year, the balance in the accrued annual leave account is adjusted to reflect current year pay rates and leave balances. Annual leave is funded from current appropriations. Sick leave and other types of non-vested leave are expensed when used and, in accordance with Federal requirements, no accruals are recorded for unused leave.

M. Net Position

Net position is composed of unexpended appropriations and cumulative results of operations. Unexpended appropriations are funds appropriated by the Congress to the Corporation that are still available for expenditure at the end of the fiscal year. Cumulative results of operations represent the net differences between financing sources and expenses from the Corporation inception.

N. Financing Sources

Per note 1.C, the Corporation funds its program and operating expenses through no-year appropriations. Appropriations are recognized as an accrual-based financing source at the time they are used to pay program or administrative expenses, except for expenses to be funded by future appropriations.

O. Retirement Benefits

The Corporation's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS was established by Public Law 99-335. Pursuant to this law, most employees hired after December 31, 1983 are covered by FERS and Social Security. Employees hired prior to January 1, 1984, were allowed to elect whether they desired to participate in FERS (with Social Security coverage) or remain in CSRS.

For employees covered by CSRS, the Corporation contributes seven percent of their gross pay towards their retirement benefits. For those employees covered by FERS, the Corporation contributes 11 percent of their gross pay towards retirement. Employees are also allowed to participate in the Federal Thrift Savings Plan (TSP). For employees under FERS, the Corporation contributes an automatic one percent of basic pay to TSP and matches employee contributions up to an additional four percent of pay, for a maximum Corporation contribution amounting to five percent of pay. Employees under CSRS may participate in the TSP, but will not receive either the Corporation's automatic or matching contributions.

During FY 2006, the Corporation made retirement contributions of $761,000 to CSRS; $1.977 million to FERS; and $620,700 to TSP. In FY 2005 the Corporation made contributions of $30,000 to CSRS, $876,000 to FERS and $226,000 to TSP.

P. Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of financing sources and expenses during the reporting period. Actual results could differ from such estimates.

Q. Contingencies

The Corporation can be a party to various routine administrative proceedings, legal actions, and claims brought by or against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the Corporation. In the opinion of the Corporation's management and legal counsel, there are no proceedings, actions or claims outstanding or threatened, which would materially impact the Corporation's financial statements.

R. Judgment Fund

Certain legal matters to which the Corporation can be named as a party may be administered and, in some instances, litigated and paid by other Federal agencies. In general, amounts paid in excess of $2,500 for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation administered by the Department of Treasury, called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management does not expect any liability or expense that might ensue would be material to the Corporation's financial statements.

S. Custodial Receivables and Liabilities

Under current policy and procedures, the Corporation funds all Compacts with other countries by advancing funds to cover projected needs, generally for a forthcoming three-month period. Such funds provided to the countries are required to be deposited in interest-bearing accounts, if legally feasible, until disbursed. The interest earned on these accounts is remitted to the Corporation and deposited into an account at the

U.S. Treasury. Such interest may not be retained or used by the Corporation, but periodically is returned to the Treasury's general funds. As of September 30, 2006, receivables for amounts of interest to be remitted by the countries and the related liabilities are not reflected in these financial statements. As of September 30, 2006, the Corporation had outstanding advances related to compact financing of approximately $16.6 million. During FY 2006 the Corporation received and deposited $304,000 in interest remittances. At the end of FY 2006, approximately $174,000 of interest earned on compact advances to the MCAs was due to be remitted to MCC. At the end of FY 2005, the Corporation had advances of $1.8 million and received interest remittances of approximately $17,000 during the year.

Note 2—Fund Balance with Treasury

The U.S. Treasury accounts for all U.S. Government funds on an overall consolidated basis. The Fund Balance with Treasury line items on the Statements of Financial Position for FY 2006 and FY 2005 consisted of amounts presented in the following table.

Fund Balances with Treasury
(in thousands)

Unobligated	$ 2,546,127	$ 1,973,685
Obligated	1,385,278	384,862
Total	**$ 3,931,405**	**$ 2,358,547**

Note 3—Advances/Accounts Receivable

Advances reflect amounts provided to MCA compact countries and other Federal agencies, in accordance with formal compacts or inter-agency agreements, respectively. Accounts receivable reflect overpayments of payroll and travel expenses to current employees of the Corporation. As such, no allowance for doubtful accounts is necessary. As of September 30, 2006, the Corporation reported $18.9 million in advances and receivables, of which $18.8 million related to advances for compact implementation and approximately $62,000 for receivables.

Note 4—Fixed Assets

The Corporation's fixed (capital) assets are predominantly comprised of leasehold improvements related to the MCC headquarters offices located in Washington, DC. As of September 30, 2006, the Corporation reported $5.1 million of which $4.8 million represented leasehold improvements and $280,000 represented capitalized equipment. At the end of the fiscal year, $483,000 of amortization and depreciation had been recorded for the two categories of assets.

Note 5—Other Liabilities

The Corporation is liable for amounts owed to other parties, including employees and other Federal groups. The following table presents the amounts of such liabilities as of September 30, 2006 and 2005.

Other Liabilities
(in dollars)

Evaluation and Support	$ (461,744)*	$ 997,921
Travel	300,000	747,143
Office of the Inspector General	0	450,809
Miscellaneous	1,566,695	326,935
Payroll	1,111,865	0
Total	**$ 2,516,786**	**$ 2,522,808**

** This amount represents the difference in funds drawn from MCC's accounts by other Federal parties per inter-agency agreements (through the Department of the Treasury's Intra-governmental Payment and Collection System (IPAC)) and the liability amounts recorded by MCC. In short, as of September 30, 2006, other Federal entities had drawn approximately $1.401 million from MCC's accounts with Treasury. MCC had recorded liabilities of $.939 million for the pertinent charges—$.462 million less than the amounts "drawn" by the entities. At the end of the fiscal year, MCC and its financial services provider (the Department of Interior's National Business Center) were researching the differences and reconciling supporting records.*

Note 6—Net Position

The reported net position consists of unexpended appropriations and cumulative results of operations, which reflects the difference between financing sources and expenses since the Corporation's inception.

The following table presents total obligated and unobligated compact and 609(g) funds as of September 30, 2006 and 2005.

Total Obligated and Unobligated Compact and 609(g) Funds (in dollars)

Armenia	$ 235,646,17	$ 235,150,00	$ 49	
Benin	1,062,985		1,062,985	
CapeVerde	106,077,520	106,014,782	62,738	$
Georgia	296,178,084	292,802,057	3,376,027	4,111,000
Ghana	13,584,891		13,584,891	48,688
Honduras	213,166,147	213,166,147		215,000,000
Lesotho	902,934		902,934	600,000
Madagascar	103,290,130	101,990,130	1,300,000	110,378,000
Mali	4,421,534		4,421,534	
Mozambique	12,956,078		12,956,078	
Nicaragua	173,583,320	173,529,975	53,345	
Senegal	4,882,237		4,882,237	
Vanuatu	65,214,603	65,214,603		
Benin	$ 305,781,62	$ 305,761,55	$	
CapeVerde	–			$ 110,078,48
Georgia	–			295,300,000
Ghana	536,638,050	536,638,050		2,870,502
Mali	4,606,861		4,606,861	
Mozambique	–			6,000,000
Nicaragua	–			175,000,000
Senegal	425,658		425,658	6,528,299

Note 7—Permanent Rescission

In FY 2006 and FY 2005, respectively, $17.7 million and $ 12 million of amounts previously appropriated under the FY 2006 and FY 2005 Foreign Operations, Export Financing, and Related Programs Appropriations Acts (Public Law 109-148 and Public Law 108-447, respectively), were rescinded. The rescissions were part of the Across-the-Board Rescissions enacted for FY 2006 and FY 2005, respectively.

Note 8—Inter-Agency Agreements

MCC is party to various inter-agency agreements (IAA) with other Federal agencies for services to be provided by those entities. Such services include financial, travel management and other administrative functions; technical and engineering services, personnel background records checks; and information technology services. During FY 2006, MCC executed 20 IAAs with other Federal agencies totaling almost $9.1 million. At the end of the year, approximately $6.8 million remained available for paying future services to be provided under the subject IAAs. The following table provides a summary of the IAAs by Federal entity.

Fiscal Year 2006 Inter-agency Agreements

NBC, Dept. of Interior	6	$1,216,313	$ 0
State Dept.	4	437,668	242,160
U.S. Agency for International Development	1	140,000	140,000
Dept. of Agriculture	1	228,478	44,820
U.S. Army Corps of Engineers	3	5,441,379	5,004,390
Dept. of Transportation	1	109,083	83,794
Dept. of Health and Human Services	1	1,500,000	1,241,422
Dept. of Labor	1	2,912	0
Government Printing Office	1	3,000	3,000
Office of Personnel Management	1	5,000	220
Total	20	$9,083,833	$6,759,806

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