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FROM THE AMERICAN PEOPLE

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, 2008 AND 2007**

AUDIT REPORT NO. M-000-09-001-C
November 17, 2008

WASHINGTON, DC



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*Office of Inspector General
for the
Millennium Challenge Corporation*

November 17, 2008

Ambassador John J. Danilovich
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, N.W.
Washington, DC 20005-2203

Subject: Audit of the Millennium Challenge Corporation's Financial Statements,
Internal Controls, and Compliance for the Period Ending September 30,
2008 and 2007
Report No. M-000-09-001-C

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 Cotton & Company LLP to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2008. The contract required that the audit be performed in accordance with United States Generally Accepted Government Auditing Standards, Office of Management and Budget (OMB) Bulletin 07-04, *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, 2008 the auditors found:

- that the financial statements were fairly presented in conformity with U.S. Generally Accepted Accounting Principles.
- four significant deficiencies in the internal controls over financial reporting and its operation, one of which is considered a material weakness.
- no instances of material noncompliance with laws and regulations.

Significant deficiencies increase the risk of improper recording, unauthorized transactions, omissions, potential funds control violations and noncompliance with laws, regulations, contracts and grant agreements. Cotton & Company LLP reported the following internal control significant deficiencies:

1. Absence of quality controls over financial reporting (material weakness)
2. Authorization for personnel actions inconsistent with stated policies and procedures.
3. Transactions not recorded in the period they occurred, and
4. Lack of adequate review for accuracy and duplication prior to processing and recording transactions in General Ledger.

In carrying out its oversight responsibilities, the OIG reviewed Cotton & Company, LLP's report and related audit documentation. This review, as differentiated from an audit in accordance with U.S. Generally Accepted Government Auditing Standards, was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements, or internal control; or on MCC's compliance with applicable laws and regulations. Cotton & Company, LLP is responsible for the attached auditor's report, dated November 14, 2008, and the conclusions expressed in the report. However, our review disclosed no instances that Cotton & Company, LLP did not comply, in all material respects, with applicable standards.

To address the internal control deficiencies reported by Cotton & Company, LLP, we are making the following recommendations to MCC's management:

Recommendation No. 1: We recommend that the Millennium Challenge Corporation management:

1.1. Perform detailed quality control reviews to ensure compliance with accounting standards and reporting guidance.

1.2. Review and revise written policies and procedures regarding the preparation of the financial statements and related footnote disclosures to ensure that all financial statement line items are reported accurately and properly supported, and that any adjustments are reviewed and approved before recording in the GL by NBC. Document the above processes to ensure that an audit trail is available for all line items and amounts reported.

1.3. Effectively coordinate with its service providers (USAID and NBC) to ensure timely and accurate receipt of final trial balance information sufficient to prepare complete financial statements in accordance with OMB Circular A-136.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation's management review and revise its process for requesting, authorizing, and certifying its personnel actions to ensure all actions are properly authorized, documented, and retained prior to the action being processed into the personnel database.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation management develop and adhere to all policies and procedures related to quarterly and yearend reporting to ensure that all appropriate transactions are reviewed and a determination is made as to the amounts to accrue for the current period; and the accrual amount is properly prepared, clearly documented, and supported and that it is reviewed by both the service provider, NBC, and MCC for completeness and accuracy prior to and subsequently after posting to the GL.

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

4.1. Ensure that procedures for reviewing accruals and adjustments recorded by NBC are effectively performed to ensure each is valid and has been properly recorded.

4.2. Require documentation to support the entry of a JV to avoid duplication of the transactions. In addition, use of a consistent naming convention when entering JVs should be required to avoid duplication.

4.3. Ensure that PP&E reconciliations are effectively performed each quarter and that amortization schedules are accurate and complete.

In finalizing the report, we received and considered MCC's response to the draft audit report and the recommendations included therein. In its comments, MCC concurred with all of the recommendations. We acknowledge that management decisions have occurred for the audit recommendations. Please inform us when final action has been taken.

The OIG appreciates the cooperation and courtesies extended to our staff and to the staff of Cotton & Company, LLP during the audit. Please contact me or Richard J. Taylor, Director, Financial Audits Division, at (202) 216-6963, if you have any questions concerning this report.

Sincerely,

Alvin A. Brown /s/
Assistant Inspector General
Millennium Challenge Corporation

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Cotton & Company LLP
635 Slaters Lane
4th Floor
Alexandria, VA 22314

P: 703.836.6701
F: 703.836.0941
www.cottoncpa.com

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

INDEPENDENT AUDITOR'S REPORT

We have audited the Balance Sheet of the Millennium Challenge Corporation (MCC) as of September 30, 2008, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the year then ended. These financial statements are the responsibility of MCC management. Our responsibility is to express an opinion on the financial statements based on our audit. The financial statements of MCC as of September 30, 2007, were audited by other auditors whose report dated October 23, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements. An audit also includes assessing accounting principles used and significant estimates made by management, as well as evaluating 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 position of MCC as of September 30, 2008, and its net costs, changes in net position, and budgetary resources for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis (MD&A) and other accompanying information are not required as part of MCC's basic financial statements. For MD&A, which is required by OMB Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 15, *Management's Discussion and Analysis*, we made certain inquiries of management and compared information for consistency with MCC's audited financial statements and against other knowledge we obtained during our audit. For other accompanying information, we compared information with the financial statements. On the basis of this limited work, we found no material inconsistencies

with the financial statements, U.S. generally accepted accounting principles, or OMB guidance. We did not audit the MD&A or other accompanying information and therefore express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued separate reports dated November 4, 2008, on our consideration of MCC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations. The purpose of these reports is to describe the scope of our testing of internal control over financial reporting and compliance and results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing results of our audit.

COTTON & COMPANY LLP

Colette Y. Wilson, CPA
Partner /s/

November 14, 2008
Alexandria, Virginia



Cotton & Company LLP
635 Slaters Lane
4th Floor
Alexandria, VA 22314

P: 703.836.6701
F: 703.836.0941
www.cottoncpa.com

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the Balance Sheet of the Millennium Challenge Corporation (MCC) as of September 30, 2008, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the year then ended. We have issued our report thereon dated November 4, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered MCC's internal control over financial reporting as a basis for designing audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the MCC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MCC's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements in a timely manner. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements, that is more than inconsequential, will not be prevented or detected by the entity's internal control.

We noted four matters involving internal control and its operation that we consider to be significant deficiencies. These matters are listed below and are detailed in the report.

- Quality Control over Financial Reporting
- Authorization for Personnel Actions
- Proper Reporting Period
- Postings to the General Ledger

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we consider the significant deficiency related to Quality Control over Financial Reporting to be a material weakness as defined above.

QUALITY CONTROL OVER FINANCIAL REPORTING

MCC's quality control over quarterly and yearend financial reporting is not sufficient to enable the agency to detect errors and misstatements and to make corrections in a timely manner. During our interim test work and review of quarterly statements and trial balances, we identified several control deficiencies in financial reporting that contributed to a significant deficiency. We brought these deficiencies to the attention of management.

At the conclusion of yearend test work and after having received final statements and notes, we noted that deficiencies previously brought to management's attention remained uncorrected. It is the combination and continuous nature of identified significant deficiencies that raised this finding to the level of a material weakness. Specifically we found that:

- Despite frequent communications and early coordination with the United States Agency for International Development (USAID), MCC was unable to ensure timely submission of complete and accurate trial balance information and adjustments for reporting Threshold Program balances in its final financial statements, and lacked adequate cooperation from USAID. We noted the following:
 - MCC prepared final FY 2007 statements with preliminary trial balance information from USAID. USAID's FY 2007 Federal Agencies' Centralized Trial Balance System II (FACTS II) transmission was not completed in a timely manner sufficient for MCC reporting. Subsequent adjustments for FACTS II reporting were included in FY 2008 beginning balances, thus creating differences in beginning and ending balances.
 - MCC, in conjunction with its auditors, discussed the timing of final adjustments necessary for accurate and complete FY 2008 yearend reporting with USAID. Final trial balances were due by October 20, and USAID submitted the final trial balance when due. On November 6, however, USAID informed MCC that an additional budgetary adjustment of \$5.2 million was being posted during the FACTS II revision period. MCC had submitted final statements for audit on November 5.
- MCC did not prepare comparable FYs 2008 and 2007 quarterly statements and FYs 2007 and 2006 audited statements. These statements contained prior-year ending balances that did not tie to beginning balances for the current year. We noted the following discrepancies:
 - FY 2006 ending balances did not agree to FY 2007 beginning balances for the following line items:
 - Unobligated Balance differed by \$25,114,174.

- Obligated Balance differed by \$135,345,240.
- Cumulative Results of Operations (CRO) differed by \$834.
- FY 2007 ending balances did not tie to beginning FY 2008 balances for the following line items:
 - Unobligated Balance differed by \$4,324 in the first- and second-quarter statements and by \$3,437,077 in the third-quarter statements due to formula errors.
 - Obligated Balances (Unpaid) differed by \$1,213,646 in the first- and second-quarter statements and by \$4,646,399 in the third-quarter statements due to formula errors.
 - Unexpended Appropriations differed by \$3,621,292.
- In addition, the following ending FY 2007 account balances did not tie to beginning FY 2008 balances.
 - FBWT differed by 3,969,761.
 - Advances differed by \$72,105.
 - Accounts Payable 420,574.

MCC restated FY 2006 ending balances, and audit adjustments were proposed to correct FY 2008 balances in the current year.

- MCC does not perform detailed quality control reviews over quarterly and yearend MCC trial balances and financial statements submitted for review and audit. We noted the following:
 - The Excel file prepared by MCC's service provider, the National Business Center (NBC), and used to prepare FY 2008 third-quarter financial statements, contained errors in formulas and cell references. According to MCC personnel, these errors were made when combining the MCC and USAID trial balances. These errors were not detected by NBC personnel and were not detected or corrected by MCC personnel prior to submission to the auditors. As a result of these errors, third-quarter statements contained incorrect and missing line item balances, and the trial balance showing the beginning balances did not net to zero. Specifically:
 - The Appropriations Used line items on the Statement of Changes in Net Position (SCNP) for CRO and Unexpended appropriations did not agree.
 - Rescissions of \$12,611,700 at third quarter were recorded in the general ledger (GL); however it was not reported on the SCNP as a part of Unexpended Appropriations.
 - MCC does not conduct a thorough review or analysis of USAID-prepared trial balances for MCC's Threshold Program before including these in the financial statements.
 - The trial balance for the financial statement package submitted for audit on November 10 did not balance to zero for all program funds. The balance of

all GL accounts for Due Diligence funds totaled \$156,399. The balance of GL accounts related to Program funds totaled \$(126,214). Even with these differences, which net to \$30,185, the total of all GL accounts for all funds was recorded as zero. Proposed audit adjustments were not fully posted. MCC did not post audit adjustments related to GL account 4610, *Allotments – Realized Resources*, and thus the trial balance did not balance.

- While the statements are prepared electronically using Excel, the preparation lacks edit checks to ensure proper relationships exist among line items. MCC and NBC do not perform sufficient reconciliations, analyses, and reviews to ensure that appropriate and/or reasonable relationships exist within GL accounts and financial statement line items, and that all footnote disclosures are complete and accurate per the financial statement line items. For example:
 - Reporting of UDOs in MCC’s footnotes only included amounts from GL account 4801, *UDO, Unpaid*, and thus was incomplete. Balances in GL accounts 4802, *UDO, Paid*, 4871, *Downward Adjustments*, and 4881, *Upward Adjustments*, were omitted, thus causing the footnote amount to be understated by more than \$42 million.
 - Testing related to the proper relationship existing between budgetary accounts payable and proprietary accounts payable at third quarter showed a difference of \$5,117,519. Testing related to the proper relationship existing between budgetary expended authority and proprietary expenses at third quarter showed a difference of \$149,836.
 - The Statement of Financing (SOF) footnote did not properly reconcile MCC’s Net Cost of Operations to its budgetary resources, because Gross Obligations did not agree with the amount reported on the Statement of Budgetary Resources.

OMB Circular A-136, *Form and Content of Performance and Accountability Report (PAR)*, states:

Reporting entities should ensure that information in the financial statements is presented in accordance with GAAP for Federal entities and the requirements of this Circular....

Preparation of the annual financial statement is the responsibility of agency management....

With an allocation transfer....All costs are then consolidated in the parent's financial statements in order to provide a complete cost of the parent’s program. Effective FY2007, the parent must report all budgetary and proprietary activity in its financial statements, whether material to the child, or not....Receiving agencies with transfer appropriation accounts must submit a full USSGL trial balance with attributes to the parent no later than 12 calendar days following the end of the reporting period or a date required by the parent to meet its reporting and auditing deadlines, whichever comes first....

By not reviewing components comprising the financial statement line items, MCC may present statements that are not comparative, accurate, or in compliance with applicable requirements. In

addition, by not performing such reviews, MCC is not taking full ownership and responsibility of its financial statements.

Recommendation

We recommend that MCC management:

- Perform detailed quality control reviews to ensure compliance with accounting standards and reporting guidance.
- Review and revise written policies and procedures regarding the preparation of the financial statements and related footnote disclosures to ensure that all financial statement line items are reported accurately and properly supported, and that any adjustments are reviewed and approved before recording in the GL by NBC. Document the above processes to ensure that an audit trail is available for all line items and amounts reported.
- Effectively coordinate with its service providers (USAID and NBC) to ensure timely and accurate receipt of final trial balance information sufficient to prepare complete financial statements in accordance with OMB Circular A-136.

Management Response

MCC concurs with the recommendations. MCC has published, in its FMPP Manual on Financial Reporting, Financial Audits, and Performance and Accountability Reports, FMPP 420, procedures regarding the preparation of financial statements and footnote disclosures to ensure that financial statement items are reported accurately and are properly supported. MCC will revise/expand its written procedures to include procedures to perform detailed quality control reviews to include reviewing adjustments recorded by NBC to ensure each is valid and has been properly recorded. Further, MCC will develop and implement procedures and documentation that provides an “audit trail” supporting management review and approval. Estimated completion date: No later than March 31, 2008.

MCC has made painstaking efforts to mitigate the reporting difficulties with USAID in its capacity as a service provider. During the last fiscal year MCC has met with USAID on four different occasions to discuss, among other things, the timing of delivery of its deliverables. Our meetings took place between September 2007 and October 23, 2008. Our most recent meeting, held in conjunction with the OIG, demonstrated that while USAID makes an effort to meet the requirements of OMB Circular A-136 and our Memorandum of Understanding, their system of controls prevents them from ensuring we receive final deliverables timely. MCC will continue its efforts to work with USAID to eliminate this major source of financial statement errors and misstatements.

MCC believes it has taken full ownership and responsibility for its financial statements. MCC converted its statements to comply with OMB Circular A-136 in advance of the OMB mandated date of September 30, 2007. In conjunction with this change MCC assumed responsibility for the preparation of all of its footnote disclosures and associated exhibits. As stated above, MCC will be implementing measures to improve quality control in accordance with the auditors’ recommendations.

AUTHORIZATION FOR PERSONNEL ACTIONS

MCC's process of documenting requests and authorizations for personnel actions (SF-52s) is inconsistent with stated policies and procedures. In lieu of authorizing signatures on the SF-52, MCC relies on emails for requests and approvals. MCC also relies on systematic notifications from its performance management and staffing system, Avue, for requests and approvals related to promotions or internal transfers of its employees.

During our testing of a sample of 45 employees, we noted:

- Twelve instances where SF-52s were not signed by the requesting official and/or the certifying official, nor was email documentation present in the Official Personnel File (OPF) or subsequently provided;
- Four instances where the OPF did not have either the SF-52 or email documentation authorizing the personnel action; and
- One instance where an employee was not systematically selected for hire in the Avue system at the time the SF-52 was created and processed.

During our testing of a sample of 10 newly hired employees, we noted:

- Two instances where SF-52s were not signed by the requesting, authorizing, and/or certifying officials, nor were email documentation or Avue screenshots documented in the OPF or subsequently provided; and
- Three instances where SF-52s were not signed by the certifying official nor was email documentation present in the OPF or subsequently provided.

Office of Personnel Management's (OPM), *The Guide to Processing Personnel Actions*, Chapter 4, *Requesting and Documenting Personnel Actions*, Section 4c, *Approval of Personnel Actions*, states:

Personnel actions must be approved by the appointing officer on or before their effective dates. An appointment officer is an individual in whom the power of appointment is vested by law or to whom it has been legally delegated. Only an appointment officer may sign and date the certification in Part C-2 of the Standard Form 52 ... the appointing officer is responsible for ensuring that each personnel action meets all legal and regulatory requirements.

For personnel action requests, we noted that the requesting officials, authorizing officials, and approving officials did not sign in their designated area to document as validation and approval of for the action. In cases where SF-52s are not signed or are not drafted, MCC's process is to rely on email authorizations from appropriate officials to serve as supporting documentation for actions to be processed. Per our interview conducted with Human Resources (HR) personnel, email authorizations are placed in the employees' OPF as supporting documentation for processed personnel actions. However, as noted above, email authorizations were not located in all OPFs nor were they maintained in a centralized location for subsequent access and retrieval.

By not properly completing and processing personnel action requests with appropriately documented authorizations, there is increased risk that personnel actions could be falsely created and processed, or that personnel actions could be processed with incorrect legal and regulatory actions.

Recommendation

We recommend that MCC review and revise its process for requesting, authorizing, and certifying its personnel actions to ensure all actions are properly authorized, documented, and retained prior to the action being processed into the personnel database.

Management Response

MCC concurs with this recommendation. The Human Resources Division (HRD) has recognized the deficiency in documentation/SF-52s in the OPF's. Since MCC's conversion to the competitive hiring process and as part of our Delegating Examining Authority, HRD's staffing specialists have established an electronic work flow/approval authorization process within Avue to include all personnel actions. All staffing actions will be electronically signed-off on and apparent on all SF-52s within the Avue system. Once an action is complete and signed-off on by the Vice President, Manager, Supervisor, HRD, and Finance and Budget Division, the hard copy (coded) SF-52 is now printed and filed in each employees' OPF. We have taken the formal approval process one step further to include the MCC Vice President, Administration and Finance, and the MCC Chief of Staff, to our current electronic process. This will be updated in the current Avue system by December 31, 2008.

- *The Recruit to Fill and Promotions/Reassignments/Retention Request Process outlines the Avue/Personnel Action Request (PAR) process that will record electronic approvals and lead to a hard coded SF-52 for filing in the employees' OPFs.*
- *Through the Avue system, HRD will be able to generate reports for the Delegated Examining Unit Audit requests. HRD has also established and will continue to update our internal standard operating procedures (SOPs) for staffing and SF-52s processing.*

PROPER REPORTING PERIOD

During our testing of expenses, we noted transactions that were reported in Fiscal Year (FY) 2008, for several expenses that were actually incurred in FY 2007. Out of a sample of 61 expense transactions, we noted the following:

- One vendor payment to USAID did not have an accrual recorded in FY 2007 before payment was made in November 2007 (FY 2008). This resulted in an understatement of FY 2007 expenses and an overstatement of FY 2008 expenses of \$1,176,360.
- Purchase card transactions for August 2007 were not posted to the general ledger until March 2008, and an accrual was not posted to the General Ledger (GL) in FY 2007. This resulted in an understatement of FY 2007 expenses and an overstatement of FY 2008 expenses of \$36,554.
- Miscellaneous expenses related to refunds for expenses incurred in FY 2007, were posted in October 2007 (FY 2008). An accrual was not posted in FY 2007 to match the expense resulting in an overstatement of FY 2007 and an understatement of FY 2008 expenses in the amount of \$18,214.

- An accrual for a compact country utilizing the Common Payment System (CPS) was not posted in FY 2007; instead expenses that were incurred in FY 2007 were reported in FY 2008. We estimate that \$383,332 of expenses recorded for Mali during the first two weeks of October 2007 (FY 2008) actually related to FY 2007 expenses.

In addition, during our testing of subsequent disbursements, we found 7 out of 24 sampled transactions that were paid in FY 2009, related to FY 2008 and did not have accruals posted. Expenses were therefore understated by \$1,597,587.

Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, (p. 22 and 23) requires that “a liability be recognized when one party receives goods or services in return for a promise to provide money or other resources in the future... The expense is recognized in the period that the exchange occurs.”

Office of Management and Budget (OMB) Circular A-136, *Form and Content of the Performance and Accountability Report (PAR), Balance Sheet*, Section III.4.3.4 *Liabilities*, states that “liabilities shall be recognized when they are incurred regardless of whether they are covered by available budgetary resources.”

Although MCC does have a process in place for recording accruals on a quarterly and yearend basis, it did not adequately perform this review at yearend for interagency agreements and vendor contracts. In addition, MCC did not have a process by which it reviewed amounts due from vendors for services already rendered in order to accrue for the refund and reduce the appropriate period’s expenses.

In FY 2007, MCC did not have a system in place to compute amounts owed, but not paid, for services rendered or goods accepted by MCC for countries utilizing CPS, as this was the first year of implementation and only one country (Mali) was using it.

FY 2008 expenses were overstated by \$1,578,032 due to lack of accruals in FY 2007 and understated by \$1,597,586 due to lack of FY 2008 accruals.

Recommendation

We recommend MCC management develop and adhere to policies and procedures related to quarterly and yearend reporting to ensure:

- All appropriate transactions are reviewed and a determination is made as to the amount to accrue for the current period; and
- The accrual amount is properly prepared, clearly documented, and supported and that it is reviewed by both the service provider, NBC, and MCC for completeness and accuracy prior to and subsequently after posting to the GL.

Management Response

MCC concurs with the recommendation. In both FY 2007 and 2008, MCC developed and utilized comprehensive Yearend Closing and Opening Policies and Procedures that, among other items, detailed MCC accrual procedures. These policies and procedures are published and disseminated each year. Incorporating these recommendations results in an expanded scope that includes updated procedures that ensure all appropriate transactions are reviewed, and a determination is made as to the amount to accrue for the current period. Additionally,

accruals will be reviewed and approved by MCC prior to posting and will be reviewed for accuracy and completeness after posting as well.

POSTING TO THE GENERAL LEDGER

Internal controls are not adequate to ensure that invoices, purchase orders, and journal vouchers (JV) are correct, accurate, and properly entered into MCC's GL. During our testing we noted the following:

- Two travel related accruals were posted twice in the GL. NBC Accounting Technicians posted two accruals (MCC-2008-045 and MCC-2008-046 in the amounts of \$302,384 and \$72,187, respectively) on April 7, 2008; these two accruals were posted again on April 12th. The first two entries were subsequently reversed in the next period. In addition, a JV related to accruing expenses for MCC's Threshold program was posted twice in the amount of \$739,817. NBC was unable to provide documentation or a reason as to why the JV accruals were posted twice. MCC surmised that NBC did not realize or verify that the entries had already been posted.
- Airfare for one trip was erroneously posted twice at different amounts. Documentation provided for airfare posted on the centrally billed account showed that an initial amount of \$13,640 was recorded but not reversed when the trip was changed to a subsequent day. New airfare in the amount of \$14,025 was charged when the trip was rebooked. Based on inquiries with the Travel Coordinator regarding the airfare, it was determined that the duplication was not known until brought to management's attention by the auditors. The erroneous amount was credited on a subsequent credit card statement.
- Property, Plant and Equipment (PP&E) transactions were incorrectly recorded in the GL and were not corrected in a timely manner, as follows:
 - Accountable equipment purchases in the amount of \$51,862 were recorded in BOCs for capitalized assets.
 - A \$7,875 invoice for capitalized leasehold improvements (LHI) was incorrectly recorded as an expense.
 - Accumulated amortization on LHI was understated by \$251,992 in the third-quarter financial statements. The transactions to record amortization expense and accumulated amortization were posted as accruals instead of expenses; thus the amortization expense was systematically reversed, reducing accumulated amortization at June 30, 2008.

- A \$1,033,429 invoice was recorded in the capitalized LHI account but was not recorded on the amortization schedule. This resulted in amortization expense and accumulated amortization not being accounted for during the first three quarters of FY 2008.

Government Accountability Office (GAO) Internal Control Standards for the Federal Government, GAO/AIMD-00-21.3.1 (11/90) states:

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Control activities may be applied in a computerized information system environment or through manual processes.

Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination...All documentation and records should be properly managed and maintained.

While some of the discrepancies in property were discovered and known by MCC management, corrections were not made timely. Transactions that are erroneously posted and not corrected in a timely manner increase the risk of financial misstatements. As a result of erroneous postings, expenses and equipment balances were overstated in the second and third quarter financial statements. All transactions were corrected by management in the 4th quarter.

Recommendation

We recommend MCC management:

- Ensure that procedures for reviewing accruals and adjustments recorded by NBC are effectively performed to ensure each is valid and has been properly recorded.
- Require documentation to support the entry of a JV to avoid duplication of the transaction. In addition, use of a consistent naming convention when entering JVs should be required to avoid duplication.
- Ensure that PP&E reconciliations are effectively performed each quarter and that amortization schedules are accurate and complete.

Management Response

MCC concurs with the recommendation. MCC has a section published in its Financial Management Policies and Procedures (FMPP) Manual on Expense Accruals, FMPP 220. Closer scrutiny of the existing policy and procedures indicated a need to “tighten” the controls surrounding these processes. MCC will adopt procedures to review accruals and adjustments recorded by NBC to ensure each is valid and has been properly recorded. Additionally, MCC and NBC will jointly develop procedures to eliminate the possibility of recording duplicate transactions. Lastly, MCC’s FMPP 350, Policies and Procedures on Property, Plant and Equipment (PP&E), clearly defines MCC’s policies on PP&E but is silent on specific control procedures. MCC will develop and implement detailed procedures by no later than March 31, 2009.

We noted certain matters involving internal control and its operation that we will report to MCC management in a separate letter.

This report is intended solely for the information and use of USAID, MCC management, others within MCC, OMB, and Congress. It is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

Colette Y. Wilson, CPA
Partner /s/

November 14, 2008
Alexandria, Virginia



Cotton & Company LLP
635 Slaters Lane
4th Floor
Alexandria, VA 22314

P: 703.836.6701
F: 703.836.0941
www.cottoncpa.com

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

We have audited the Balance Sheet of the Millennium Challenge Corporation (MCC) as of September 30, 2008, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the year then ended. We have issued our report thereon dated November 4, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*.

MCC management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether MCC's financial statements are free of material misstatement, 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 07-04. 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 of compliance disclosed no instances of noncompliance that we are required to report under *Government Auditing Standards* and OMB Bulletin 07-04.

This report is intended solely for the information and use of USAID, MCC management, others within MCC and USAID, OMB, and Congress. It is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

Colette Y. Wilson, CPA
Partner /s/

November 14, 2008
Alexandria, Virginia

Appendix A

Status of Prior Year Findings

Following is the disposition of prior year (2007) findings, recommendations, and MCC Management's action.

Finding:

MCC did not sufficiently execute its monitoring function related to advances.

Recommendations:

- 1.1 Implement a policy that reduces outstanding advances based on the FIFO method.
- 1.2 Implement the common payment system for all MCAs on a more aggressive timeline.
- 1.3 Make payments in accordance with the monthly schedule, and if a payment is held, consider the need for it to be disbursed at all.
- 1.4 Ensure that there is a more rigorous review of advance requests including an assessment of outstanding advances

Status:

During FY 2008, MCC began analyzing advances and re-disbursements to ensure that outstanding advances are based on the FIFO method. In addition, MCC implemented the Common Payment System (CPS) for all countries and programs, with the exception of Vanuatu, allowing it to disburse payments directly to vendors for Millennium Challenge Account (MCA) compact countries.

Result:

We consider this FY 2007 condition to be resolved as of September 30, 2008.

Finding:

MCC lacks written Policies and Procedures related to financial reporting accountability and document control.

Recommendations:

- 2.1 Formally document the MCC accountability for ensuring MCA compliance with the reporting provisions.
- 2.2 Implement document retention policies that include standards for version control and a central repository for documents that are used by multiple MCC units.
- 2.3. Continue with the planned implementation of the BIDS project and ensure that information is validated prior to inclusion in the new system

Status:

Prior to FY 2008, MCC did not have a master depository for maintaining MCA compact documents and clearance (or approval) documentation to support disbursement of advances to Compact countries. MCC could not provide sufficient documentation to support all approvals made in prior years for re-disbursements that occurred in the current period. During FY 2008, however, MCC instituted the SharePoint database where all clearances and approvals of quarterly reports are tracked and retained in a central location with each country having a dedicated site. We were able to verify this database and its effectiveness through testing of other disbursements without exception. The BIDS project has been postponed until FY 2009.

Result:

We consider this FY 2007 condition to be resolved as of September 30, 2008, with the exception of the BIDS project.

Management
Comments and Our
Evaluation

We received and evaluated MCC's management comments to the recommendations made in this report. Management comments have been included in its entirety in Appendix C.

Based on MCC's comments, we acknowledge that management decisions have been reached on all of the recommendations. MCC should report to the OIG when final action has been taken on the recommendations. The following is a brief summary of MCC's management comments on the four recommendations included in this report and our evaluation of those comments.

Recommendation No. 1

MCC concurs with the recommendations. MCC has published, in its FMPP Manual on Financial Reporting, Financial Audits, and Performance and Accountability Reports, FMPP 420, procedures regarding the preparation of financial statements and footnote disclosures to ensure that financial statement items are reported accurately and are properly supported. MCC will revise/expand its written procedures to include procedures to perform detailed quality control reviews to include reviewing adjustments recorded by NBC to ensure each is valid and has been properly recorded. Further, MCC will develop and implement procedures and documentation that provides an "audit trail" supporting management review and approval. Estimated completion date: No later than March 31, 2009.

Auditor Evaluation:

We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been taken.

Recommendation No. 2

MCC concurs with this recommendation. The Human Resources Division (HRD) has recognized the deficiency in documentation/SF-52s in the OPF's. Since MCC's conversion to the competitive hiring process and as part of our Delegating Examining Authority, HRD's staffing specialists have established

Appendix B

an electronic work flow/approval authorization process within Avue to include all personnel actions. All staffing actions will be electronically signed-off on and apparent on all SF-52s within the Avue system. Once an action is complete and signed-off on by the Vice President, Manager, Supervisor, HRD, and Finance and Budget Division, the hard copy (coded) SF-52 is now printed and filed in each employees' OPF. We have taken the formal approval process one step further to include the MCC Vice President, Administration and Finance, and the MCC Chief of Staff, to our current electronic process. This will be updated in the current Avue system by December 31, 2008.

Auditor Evaluation:

We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been taken.

Recommendation No. 3

MCC concurs with the recommendation. In both FY 2007 and 2008, MCC developed and utilized comprehensive Yearend Closing and Opening Policies and Procedures that, among other items, detailed MCC accrual procedures. These policies and procedures are published and disseminated each year. Incorporating these recommendations results in an expanded scope that includes updated procedures that ensure all appropriate transactions are reviewed, and a determination is made as to the amount to accrue for the current period. Additionally, accruals will be reviewed and approved by MCC prior to posting and will be reviewed for accuracy and completeness after posting as well.

Auditor Evaluation:

We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been taken.

Recommendation No. 4

MCC concurs with the recommendation. MCC has a section published in its Financial Management Policies and Procedures (FMPP) Manual on Expense Accruals, FMPP 220. Closer scrutiny of the existing policy and procedures indicated a need to "tighten" the controls surrounding these processes. MCC will adopt procedures to review accruals and adjustments recorded by NBC to ensure each is valid and have been properly recorded. Additionally, MCC and NBC will jointly develop procedures to eliminate the possibility of recording duplicate transactions. Lastly, MCC's FMPP 350, Policies and Procedures on Property, Plant and Equipment (PP&E), clearly defines MCC's policies



Memorandum

TO: Alvin A. Brown
Assistant Inspector General

FROM: Michael Casella /s/
Acting Vice President, Administration and Finance

DATE: November 17, 2008

SUBJECT: Management Response to Draft Independent Auditor's
Report on MCC's Financial Statements for Fiscal Years
Ended September 30, 2008 and 2007, Respectively

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

Financial Position;
Net Costs;
Changes in Financial Position; and
Budgetary Resources.

The Millennium Challenge Corporation's (MCC) management recognizes the importance of accountability, effective stewardship and public disclosures 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 Cotton & Company for working closely with us during the audit process. Any questions may be addressed to Mr. Dennis Nolan, Deputy Chief Financial Officer, or to me.

Following are our management decisions and responses to Cotton & Company's audit recommendations.

Material Weakness

Quality Control over Financial Reporting

MCC's quality control over quarterly and yearend financial reporting is not sufficient to enable the agency to detect errors and misstatements and to make corrections in a timely manner.

Recommendation No. 1

We recommend that MCC management:

1.1 Perform detailed quality control reviews to ensure compliance with accounting standards and reporting guidance.

1.2 Review and revise written policies and procedures regarding the preparation of the financial statements and related footnote disclosures to ensure that all financial statement line items are reported accurately and properly supported, and that any adjustments are reviewed and approved before recording in the GL by NBC. Document the above processes to ensure that an audit trail is available for all line items and amounts reported.

1.3 Effectively coordinate with its service providers (USAID and NBC) to ensure timely and accurate receipt of final trial balance information sufficient to prepare complete financial statements in accordance with OMB Circular A-136.

Management Response

MCC concurs with the recommendations. MCC has published, in its FMPP Manual on Financial Reporting, Financial Audits, and Performance and Accountability Reports, FMPP 420, procedures regarding the preparation of financial statements and footnote disclosures to ensure that financial statement items are reported accurately and are properly supported. MCC will revise/expand its written procedures to include procedures to perform detailed quality control reviews to include reviewing adjustments recorded by NBC to ensure each is valid and has been properly recorded. Further, MCC will develop and implement procedures and documentation that provides an "audit trail" supporting management review and approval. Estimated completion date: No later than March 31, 2008.

MCC has made painstaking efforts to mitigate the reporting difficulties with USAID in its capacity as a service provider. During the last fiscal year MCC has met with USAID on four different occasions to discuss, among other things, the timing of delivery of its deliverables. Our meetings took place between September 2007 and October 23, 2008. Our most recent meeting, held in conjunction with the OIG, demonstrated that while USAID makes an effort to meet the requirements of OMB Circular A-136 and our Memorandum of Understanding, their system of controls prevents them from ensuring we receive final deliverables timely. MCC will continue its efforts to work with USAID to eliminate this major source of financial statement errors and misstatements.

MCC believes it has taken full ownership and responsibility for its financial statements. MCC converted its statements to comply with OMB Circular A-136 in advance of the OMB mandated date of September 30, 2007. In conjunction with this change MCC assumed responsibility for the preparation of all of its footnote disclosures and associated exhibits. As stated above, MCC will be implementing measures to improve quality control in accordance with the auditors' recommendations.

Significant Deficiency 1: Authorization for Personnel Actions

MCC's process of documenting requests and authorizations for personnel actions (SF-52s) is inconsistent with stated policies and procedures.

Recommendation No. 2

We recommend that MCC review and revise its process for requesting, authorizing, and certifying its personnel actions to ensure all actions are properly authorized, documented, and retained prior to the action being processed into the personnel database.

Management Response

MCC concurs with this recommendation. The Human Resources Division (HRD) has recognized the deficiency in documentation/SF-52s in the OPF's. Since MCC's conversion to the competitive hiring process and as part of our Delegating Examining Authority, HRD's staffing specialists have established an electronic work flow/approval authorization process within Avue to include all personnel actions. All staffing actions will be electronically signed-off on and apparent on all SF-52s within the Avue system. Once an action is complete and signed-off on by the Vice President, Manager, Supervisor, HRD, and Finance and Budget Division, the hard copy (coded) SF-52 is now printed and filed in each employees' OPF. We have taken the formal approval process one step further to include the MCC Vice President, Administration and Finance, and the MCC Chief of Staff, to our current electronic process. This will be updated in the current Avue system by December 31, 2008.

- *The Recruit to Fill and Promotions/Reassignments/Retention Request Process outlines the Avue/Personnel Action Request (PAR) process that will record electronic approvals and lead to a hard coded SF-52 for filing in the employees' OPFs.*
- *Through the Avue system, HRD will be able to generate reports for the Delegated Examining Unit Audit requests. HRD has also established and will continue to update our internal standard operating procedures (SOPs) for staffing and SF-52s processing.*

Significant Deficiency 2: Proper Reporting Period

During our testing of expenses, we noted transactions that were reported in Fiscal Year (FY) 2008, for several expenses that were actually incurred in FY 2007.

Recommendation No. 3

We recommend MCC management develop and adhere to policies and procedures related to quarterly and yearend reporting to ensure:

- 3.1 All appropriate transactions are reviewed and a determination is made as to the amount to accrue for the current period; and
- 3.2 The accrual amount is properly prepared, clearly documented, and supported and that it is reviewed by both the service provider, NBC, and MCC for completeness and accuracy prior to and subsequently after posting to the GL.

Management Response

MCC concurs with the recommendation. In both FY 2007 and 2008, MCC developed and utilized comprehensive Yearend Closing and Opening Policies and Procedures that, among other items, detailed MCC accrual procedures. These policies and procedures are published and disseminated each year. Incorporating these recommendations results in an expanded scope that includes updated procedures that ensure all appropriate transactions are reviewed, and a determination is made as to the amount to accrue for the current period. Additionally, accruals will be reviewed and approved by MCC prior to posting and will be reviewed for accuracy and completeness after posting as well.

Significant Deficiency 3: Posting to the General Ledger

MCC's internal controls are not adequate to ensure that invoices, purchase orders, and journal vouchers (JV) are correct, accurate, and properly entered into MCC's GL.

Recommendation No. 4

We recommend MCC management:

- 4.1 Ensure that procedures for reviewing accruals and adjustments recorded by NBC are effectively performed to ensure each is valid and has been properly recorded.
- 4.2 Require documentation to support the entry of a JV to avoid duplication of the transaction. In addition, use of a consistent naming convention when entering JVs should be required to avoid duplication.
- 4.3 Ensure that PP&E reconciliations are effectively performed each quarter and that amortization schedules are accurate and complete.

Management Response

MCC concurs with the recommendation. MCC has a section published in its Financial Management Policies and Procedures (FMPP) Manual on Expense Accruals, FMPP 220. Closer scrutiny of the existing policy and procedures indicated a need to "tighten" the controls

Appendix C

surrounding these processes. MCC will adopt procedures to review accruals and adjustments recorded by NBC to ensure each is valid and has been properly recorded. Additionally, MCC and NBC will jointly develop procedures to eliminate the possibility of recording duplicate transactions. Lastly, MCC's FMPP 350, Policies and Procedures on Property, Plant and Equipment (PP&E), clearly defines MCC's policies on PP&E but is silent on specific control procedures. MCC will develop and implement detailed procedures by no later than March 31, 2009.

FINANCIAL SECTION

In accordance with the OMB Circular A-136, Financial Reporting Requirements, MCC is presenting its financial statements in the appropriate form and content for FY 2008. The tables below outline the following financial statements:

- ▶ Balance Sheets
- ▶ Statement of Budgetary Resources
- ▶ Statement of Net Cost
- ▶ Statement of Changes in Net Position
- ▶ Notes to Financial Statements

BALANCE SHEET

	FY 2008 (in dollars)	FY 2007 (in dollars)
Assets		
Intra-Governmental		
Fund Balance with Treasury (Note 2)	\$6,546,857,481	\$5,549,289,597
Total Intra-Governmental	6,546,857,481	5,549,289,597
Accounts Receivable (Note 3)	54,672	67,798
General Property, Plant, and Equipment (Note 4)	8,127,205	7,115,606
Other/Advances (Note 10, Note 5)	42,578,652	32,243,157
Total Assets	\$6,597,618,010	\$5,588,716,158
Liabilities		
Intra-Governmental		
Other (Note 1R)	\$383,270	(\$588,235)
Total Intra-Governmental	383,270	(588,235)
Accounts Payable (Note 1F)	35,341,439	39,176,698
Other/Accrued Funded Liabilities (Note 1R)	6,444,041	6,017,983
Total Liabilities	\$42,168,750	\$44,606,446
Net Position		
Unexpended Appropriations – Other Funds	\$6,548,610,190	\$5,536,714,361
Cumulative Results of Operations – Other Funds	6,839,070	7,395,351
Total Net Position	\$6,555,449,260	\$5,544,109,712
Total Liabilities and Net Position	\$6,597,618,010	\$5,588,716,158

The notes are an integral part of these financial statements.

STATEMENT OF BUDGETARY RESOURCES

	FY 2008 (in dollars)	FY 2007 (in dollars)
Budgetary Resources		
Unobligated Balance – Beginning of Period	\$2,256,142,503	\$2,671,372,416
Recoveries of Prior Years Obligations	504,898	15,930,609
Budget Authority:		
Appropriations	1,557,000,000	1,752,300,000
Nonexpenditure Transfers, Net, Anticipated and Actual	(10,810,404)	(9,415,980)
Permanently Not Available (<i>Note 8</i>)	(70,611,700)	
Total Budgetary Resources	\$3,732,225,297	\$4,430,187,045
Status of Budgetary Resources		
Obligations Incurred		
Direct	\$2,769,921,274	\$2,174,044,542
Unobligated Balance Available	780,796,905	1,516,900,216
Unobligated Balance Not Available	181,507,118	739,242,287
Total Status of Budgetary Resources	\$3,732,225,297	\$4,430,187,045
Change in Obligated Balance		
Obligated Balance, Net – as of October 1, 2008		
Unpaid Obligations, Brought Forward, October 1	\$3,287,907,145	\$1,408,398,635
Obligations Incurred	\$2,769,921,274	2,174,044,542
Gross Outlays	(\$473,979,346)	(278,605,423)
Recoveries of Prior Year Unpaid Obligations, Actual	(\$504,898)	(15,930,609)
Obligated Balance, Net – End of Period		
Unpaid obligations	\$5,583,344,175	\$3,287,907,145
Net Outlays		
Gross Outlays	\$473,979,346	\$278,605,423

The notes are an integral part of these financial statements.

STATEMENT OF NET COSTS

Program	2008 Total (in dollars)	2007 Total (in dollars)
Program Costs		
Compact		
Gross Costs <i>(Note 7)</i>	\$226,498,265	\$81,079,458
Less: Earned Revenue		
Net Program Costs	226,498,265	81,079,458
609 (g) Programs		
Gross Costs	9,768,972	17,172,113
Less: Earned Revenue		
Net Program Costs	9,768,972	17,172,113
Threshold Programs		
Gross Costs	118,903,902	75,766,215
Less: Earned Revenue		
Net Program Costs	118,903,902	75,766,215
Due Diligence Programs		
Gross Costs	17,338,771	32,789,662
Less: Earned Revenue		
Net Program Costs	17,338,771	32,789,662
Audit		
Gross Costs	2,304,181	2,865,820
Less: Earned Revenue		
Net Program Costs	2,304,181	2,865,820
Administrative		
Gross Costs	85,782,157	77,922,458
Less: Earned Revenue		
Net Program Costs	85,782,157	77,922,458
Program Costs – Net of All Programs	\$460,596,248	\$287,595,725
Net Costs of Operations	\$460,596,248	\$287,595,725

The notes are an integral part of these financial statements.

STATEMENT OF CHANGES IN NET POSITION

	FY 2008 (in dollars)	FY 2007 (in dollars)
Cumulative Results of Operations		
Beginning Balances	\$7,395,351	\$4,694,987
Adjustments <i>(Note 11)</i>	(1,671,357)	0
Beginning Balance, as Adjusted	\$5,723,994	\$4,694,987
Budgetary Financing Sources		
Appropriations Used	\$460,060,774	\$288,359,297
Other Financing Sources		
Donations and Forfeitures of Property	0	\$123,750
Imputed Financing	1,650,550	1,813,042
Total Financing Sources	461,711,324	290,296,089
Net Cost of Operations	(460,596,248)	(287,595,725)
Net Change	1,115,076	2,700,364
Cumulative Results of Operations	\$6,839,070	\$7,395,351
Unexpended Appropriations		
Beginning Balance	\$5,536,714,361	\$4,082,189,638
Adjustments <i>(Note 8)</i>	(3,621,292)	
Beginning Balance, as Adjusted	\$5,533,093,069	\$4,082,189,638
Budgetary Financing Sources		
Appropriations Received	\$1,557,000,000	\$1,752,300,000
Appropriations Transferred In/Out	(10,810,404)	(9,415,980)
Other adjustments <i>(Note 8)</i>	(70,611,700)	0
Appropriations Used	(460,060,774)	(288,359,297)
Total Budgetary Financing Sources	1,015,517,122	1,454,524,723
Total Unexpended Appropriations	\$6,548,610,190	\$5,536,714,361
Net Position	\$6,555,449,260	\$5,544,109,712

The notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS (AS OF SEPTEMBER 30, 2008)

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 and budgetary resources for MCC, as required by OMB Circular A-136, *Financial Reporting Requirements* for form and content and in accordance with 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 MCC's books and records 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.

MCC'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).

MCC's principle financial statements are:

- ▶ Balance Sheet
- ▶ Statement of Net Cost
- ▶ Statement of Budgetary Resources
- ▶ Statement of Changes in Net Position

Financial statement footnotes are also included and are considered an integral part of the financial statements.

B. Reporting Entity

MCC was formed in January 2004 pursuant to the Millennium Challenge Act of 2003 (Public Law 108-199). MCC's mission is to reduce poverty by supporting sustainable, transformative economic growth in developing countries which create and maintain sound policy environments. The assistance is intended to provide economic growth and the alleviation of extreme poverty, strengthen good governance, encourage economic freedom, and promote investments in people.

C. Budgets and Budgetary Accounting

MCC'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 \$1.557 billion and \$1.752 billion in FY 2008 and FY 2007, 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 of funds for administrative (SAE) and audit oversight, compact programs, due diligence programs, 609(g) programs and

threshold programs. Because of the no-year status of MCC appropriations, unobligated administrative, audit, and due diligence funds (apportioned on annual bases) are not returned to the Treasury; however, unobligated balances as of September 30 for these three categories of funds are transferred to the compact fund category 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 MCC's compliance with legal constraints and controls over the use of federal funds.

The accompanying Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position are prepared on the accrual basis. The Statement of Budgetary Resources is prepared in accordance with budgetary accounting rules.

E. Fund Balance with Treasury

MCC does not maintain cash in commercial bank accounts. Rather, MCC's funds are maintained in Treasury accounts. The Department of the Treasury processes all cash receipts and disbursements for MCC. 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. Accounts Payable

MCC records as liabilities all amounts due to others as a direct result of transactions or events that have occurred. Accounts payable represent amounts due to federal and non-federal entities for goods and services received by MCC, but not paid at the end of the accounting period. Accounts payable reported at the end of FY 2008 and FY 2007 were \$35.3 million and \$39.2 million, respectively. A significant portion of accounts payable reported (\$24.4 million) for FY 2008 was from the USAID reported balances for Threshold programs.

G. 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 MCC. MCC'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.

MCC incurred no FECA liabilities during FY 2008 and FY 2007.

H. Accrued Annual Leave

The value of employees' unused annual leave at the end of each fiscal quarter is accrued as a liability. At the end of each fiscal quarter, the balance in the accrued annual leave account is adjusted to reflect current 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.

I. Net Position

Net position is composed of unexpended appropriations and cumulative results of operations. Unexpended appropriations are funds appropriated by Congress to MCC 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 since MCC's inception.

MCC made an adjustment to the FY 2008 beginning balance for cumulative results of operations to account for FY 2007 prior period adjustments. These adjustments were identified as expense accruals for payments that were not properly accrued in FY 2007.

J. Financing Sources

Per note 1.C, MCC 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.

K. Retirement Benefits

MCC'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 U.S. Government employees hired after December 31, 1983, are covered by FERS and Social Security. Federal 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, MCC contributes 7 percent of their gross pay toward their retirement benefits. For those employees covered by FERS, MCC contributes 11 percent of their

gross pay toward retirement. Employees are also allowed to participate in the federal Thrift Savings Plan (TSP). For employees under FERS, MCC contributes an automatic 1 percent of basic pay to TSP and matches employee contributions up to an additional 4 percent of pay, for a maximum Corporation contribution amounting to 5 percent of pay. Employees under CSRS may participate in the TSP, but will not receive either MCC's automatic or matching contributions.

At the end of FY 2008, MCC made retirement contributions of \$142,000 to CSRS, \$2.66 million to FERS, and \$998,130 to TSP.

L. 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.

M. Contingencies

MCC 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 MCC. In the opinion of MCC's management and legal counsel, there are no proceedings, actions, or claims outstanding or threatened that would materially impact MCC's financial statements.

N. Judgment Fund

Certain legal matters to which MCC 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 the Treasury, called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management expects that any liability or expense that might ensue would not be material to MCC's financial statements.

O. Custodial Receivables and Liabilities

Under current policy and procedures, MCC funds all compacts with other countries by advancing funds on a monthly basis to cover projected needs. 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 MCC and deposited into an account at the U.S. Treasury. Such interest may not be retained or used by MCC, but periodically, is returned to the Treasury's general funds. MCC had

outstanding advances related to compact financing (Compact, Due Diligence and 609(g) funding) of approximately \$32.6 million and \$30.8 million on September 30, 2008 and 2007, respectively. MCC received and deposited \$1.61 million and \$1.93 million in interest remittances on September 30, 2008 and 2007, respectively.

P. Donated Services

MCC may on occasion utilize donated services from other Federal agencies and private firms in the course of business operations. MCC did not utilize donated services for FY 2008. The approximate fair market value of donated services for September 30, 2007 was \$123,750.

Q. Transfers with Other Federal Agencies

MCC is a party to allocation transfers with another federal agency as a transferring entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays that are incurred by the child entity are charged to this allocation account, as they execute the delegated activity on behalf of the parent entity.

Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, budget appointments are derived. MCC allocates funds, as the parent, to the United States Agency for International Development (USAID). In FY 2008 and 2007, MCC transferred budgetary authority of \$110 million and \$201 million, respectively to USAID for Threshold programs.

R. Liabilities

MCC reclassified FY 2007 balances (\$2.046 million) from Intragovernmental Liabilities to non-Intragovernmental liabilities in the column titled “Other/Accrued Funded Liabilities” for proper reporting with FY 2008 balances. MCC noted that expense accruals reported in FY 2007 should not have been displayed as “Intragovernmental” and should have been denoted as liabilities from the “Public.” In order to ensure the FY 2007 expense accruals were properly reported in comparison with FY 2008 expense accruals, MCC reclassified this portion of the FY 2007 balance.

Note 2—Fund Balance with Treasury

The U.S. Treasury accounts for all U.S. Government cash on an overall consolidated basis. MCC is appropriated “general” funds only and maintains these balances in the Fund Balance with Treasury. The general fund line items on the Balance Sheet for September 30, 2008 and 2007 consisted of the amounts presented in Exhibit 53. The

status of the general fund balances is summarized by obligated and unobligated balances in Exhibit 54.

Exhibit 53: Fund Balance with Treasury as of September 30

	September 30, 2008 (in thousands)	September 30, 2007 (in thousands)
Fund Balances		
General Funds	\$6,546,857	\$5,549,290
Total	\$6,546,857	\$5,549,290

Exhibit 54: Status of Fund Balance with Treasury as of September 30

	September 30, 2008 (in thousands)	September 30, 2007 (in thousands)
Status of Fund Balances with Treasury		
Unobligated Balance Available	\$782,006	\$1,520,927
Unobligated Balance Unavailable	181,507	739,242
Obligated Balance	\$5,583,344	\$3,289,121
Total	\$6,546,857	\$5,549,290

Note 3—Accounts Receivable, Net

Accounts receivable reflects overpayments of payroll, travel and other MCC current and former employee expenses. MCC does not record an allowance for doubtful accounts as these expenses are deemed wholly collectible. Total receivables at the end of FY 2008 and 2007 were approximately \$55,000 and \$68,000, respectively.

MCC reclassified its FY 2007 balances for Accounts Receivable from Intragovernmental Assets to non-Intragovernmental Assets for proper reporting with the FY 2008 balances. MCC, in its previous A-136 financial statement reporting, has incorrectly classified its Accounts Receivable balances as “Intragovernmental.” These balances were reviewed during FY 2008 and determined to be Accounts Receivable due from the “Public.”

Note 4—General Property, Plant and Equipment (PP&E), Net

MCC’s PP&E costs are the associated leasehold improvements made to its leased office space. MCC has made significant leasehold improvements to its office space and amortizes the improvements based on the in-service (invoice) date of the

improvement. Amortization on that in-service improvement is calculated on a quarterly basis. The cost of these improvements at September 30, 2008 and 2007 was \$10.9 million and \$8.7 million, respectively. Accumulated depreciation was \$2.8 million and \$1.5 million, respectively. The current book value is valued at \$8.1 million and \$7.1 million for the periods ending September 30, 2008 and 2007, respectively. The useful life of the improvements is based on the lease terms; 10 years for the Bowen building lease and 8 years for the City Center building lease.

MCC's capitalization threshold for all other general property, plant and equipment must have an original cost of \$50,000 or more and an estimated useful life of 5 or more years. MCC's software capitalization threshold defines a capitalized asset that has an original cost of \$200,000 or more and an estimated useful life of 5 years or more and the information technology infrastructure capitalization threshold defines a capitalized asset as having an original cost of \$200,000 or more and an estimated useful life of 3 years or more. These thresholds reduce MCC's administrative costs associated with accounting for PP&E, and result in increased operational efficiency.

Note 5—Other Assets

Advances reflect amounts provided to MCA compact countries and other federal agencies in accordance with formal compacts or inter-agency agreements. MCC reported \$42.6 million and \$32.2 million in advances as of September 30, 2008 and 2007, respectively.

Note 6—Leases

MCC leases office space in two adjacent locations in Washington, D.C. These leases are on 10 year (Bowen) and 8 year (City Center) lease terms that terminate on May 25 and May 26, 2015, respectively. The Bowen building lease increases approximately 1 percent each year of the lease term. The City Center building lease increases every three years through the lease term. The increases for both buildings are depicted in Exhibit 55 below.

Exhibit 55: Operating Leases

Future Lease Payments Due			
Fiscal Year	Bowen	City Center	Total
FY 2009	5,502,517	1,889,524	7,392,041
FY 2010	5,557,542	1,889,524	7,447,006
FY 2011	5,613,117	1,942,376	7,555,493
FY 2012	5,669,249	1,942,376	7,611,625
FY 2013	5,725,941	1,942,376	7,668,317
After 5 Years	11,624,232	3,990,458	15,614,690
Total Future Lease Payments (in dollars)	\$39,692,598	\$13,596,634	\$53,289,232

Note 7—Intragovernmental Costs and Exchange Revenue

The Statement of Net Cost reports the MCC’s gross cost less earned revenues to arrive at net cost of operations. Costs have been illustrated by MCC specific programs. Exhibit 56 shows the value of exchange transactions between the Corporation and other Federal entities, as well as non-Federal entities. Intra-governmental costs relate to transactions between the MCC and other Federal entities. Public costs, on the other hand, relate to transactions between the MCC and non-Federal entities. MCC does not have any exchange revenues.

Exhibit 56: Intra-governmental Costs and Exchange Revenue

	Compact	609(g)	Threshold	Due Diligence	Audit	Administrative	FY 2008 Total (in thousands)	FY 2007 Total (in thousands)
Intra-Governmental	-	-	3,006	2,680	2,118	11,285	19,089	14,156
Public	226,498	9,769	115,898	14,659	186	74,497	441,507	273,439
Total - Program	\$226,498	\$9,769	\$118,904	\$17,339	\$2,304	\$85,782	\$460,596	\$287,595

Note 8—Adjustments to Beginning Balance of Budgetary Resources

At the beginning of FY 2008, \$12.6 million of amounts appropriated under the Foreign Operations, Export Financing and Related Programs Appropriations Act were rescinded. The rescission was part of the Across-the-Board rescission enacted for FY 2008. MCC was also subject to a mid fiscal year 2008 rescission of \$58 million.

MCC also made adjustments to its Unexpended Appropriations beginning balance to reflect the ending balance from FY 2007. This adjustment was due to untimely reporting of final FY 2007 ending balances from USAID for the Threshold program. At the end of FY 2007, USAID made an additional adjustment to its account balances that was never reported and incorporated into MCC’s consolidated financial statements. This oversight was identified in FY 2008 and recorded as an adjustment to ensure that FY 2007 ending balances for Unexpended Appropriations equaled FY 2008 beginning balances for Unexpended Appropriations.

Note 9—Explanation of Differences between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

MCC ensures that the information reported in its books is reflected within the Budget of the U.S. Government. Since MCC's financial statements are published before the President's Budget, this reconciliation is based on the Statement of Budgetary Resources (SBR) for FY 2007 and the 2007 actual data reported in the President's 2009 budget submission. Fiscal year 2008 actual data will be published in February 2009 within the 2010 Budget of the United States. Material differences reported in the budgetary resources column (\$2,679) represent unobligated balances reported on MCC's SBR and SF133, but not in the Budget of the U.S. Government. See Exhibit 57.

Exhibit 57: Material Differences Between the SBR and the President's Budget

	Budgetary Resources (in millions)	Obligations Incurred (in millions)	Distributed Offsetting Receipts (in millions)	Total Outlays (in millions)
Statement of Budgetary Resources	4,430	2,174		277
Unobligated Balance Carry forward from FY 2006	(2,679)			
Budget of the U.S. Government	1,751		(3)	277

Note 10—Undelivered Orders at the End of the Period

The reported net position consists of unexpended appropriations and cumulative results of operations, which reflects the difference between financing sources and expenses since MCC's inception. Exhibit 58 presents Undelivered Orders as of September 30, 2008 and 2007.

Exhibit 58: Undelivered Orders

Undelivered Orders	2008	2007
Administrative	27,302,437	27,939,653
Audit	2,180,340	1,466,325
609(g)	25,349,832	25,781,640
Due Diligence	49,203,177	33,829,978
Compact/CIF	5,242,750,204	2,956,809,299
Threshold	238,174,754	234,952,661
Total	\$5,584,960,744	\$3,280,779,556

Note 11—Reconciliation of Net Cost of Operations to Budget

Exhibit 59 reconciles the resources available to MCC to finance operations with the net cost of operating MCC’s programs. Some operating costs, such as depreciation, do not require direct financing sources. This exhibit illustrates the reconciliation of Net Cost of Operations to Budget.

Exhibit 59: Reconciliation of Net Cost of Operations to Budget

Resources Used to Finance Activities	Program Costs		
Budgetary Resources Obligated			
Gross obligations	2,769,921,274	Gross Costs	460,596,248
Recoveries of prior year unpaid obligations	(504,898)		
Other financing resources	1,650,550		
Total resources used to finance activities	2,771,066,926		
Total resources used to finance items not part of the net cost of operations	(2,306,454,323)	Less: Earned Revenue	-
Total components of net cost of operations that will not require or generate resources	1,147,968		
Other expenses not requiring budgetary resources	(5,164,323)		
Net Cost of Operations	460,596,248	Net Cost of Operations	460,596,248

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig